



\$500,000,000
STANFORD HEALTH CARE
Taxable Bonds
Series 2018

Dated: Date of Issuance

Due: November 15, 2048

This Offering Memorandum has been prepared to provide information in connection with the issuance of the Stanford Health Care Taxable Bonds, Series 2018 (the “Series 2018 Taxable Bonds”). The Series 2018 Taxable Bonds are general obligations of Stanford Health Care (“SHC”), and are payable from payments made by SHC under the Indenture described herein, from payments to be made by the Obligated Group on Obligation No. 40 to be issued under the Master Indenture, described herein, and from certain funds held under the Indenture.

The Series 2018 Taxable Bonds are subject to optional redemption and mandatory purchase in lieu of redemption prior to maturity, as described herein.

Interest on and gain, if any, on the sale of the Series 2018 Taxable Bonds are not excludable from gross income for federal, state or local income tax purposes. See “CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS” herein.

The Series 2018 Taxable Bonds are issuable as fully registered bonds and, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company (“DTC”), New York, New York. Individual purchases of the Series 2018 Taxable Bonds will be made in book-entry form only. Principal, Redemption Price and Make-Whole Redemption Price of and interest on the Series 2018 Taxable Bonds will be payable by the Trustee for the Series 2018 Taxable Bonds to the registered owners, which will be Cede & Co. as long as DTC is the Securities Depository. Subsequent disbursements of principal, Redemption Price, Make-Whole Redemption Price and interest will be made by Participants in DTC to the Beneficial Owners of the Series 2018 Taxable Bonds.

The Series 2018 Taxable Bonds will be issued in the denomination of \$1,000 or any integral multiple thereof.

Interest on the Series 2018 Taxable Bonds will be payable semiannually on May 15 and November 15 in each year, commencing on May 15, 2018.

This cover page contains information for general reference only. It is not intended as a summary of this transaction. Investors are advised to read the entire Offering Memorandum to obtain information essential to making an informed investment decision.

**MATURITY DATE, PRINCIPAL AMOUNT,
 INTEREST RATE AND YIELD**

\$500,000,000 3.795% Series 2018 Taxable Bonds due November 15, 2048 Price: 100%
Yield: 3.795% CUSIP †† 85434VAA6

The Series 2018 Taxable Bonds are offered when, as and if received by the Underwriters, subject to prior sale and to the approval of certain legal matters for SHC by Ropes & Gray LLP, San Francisco, California, and for the Underwriters by their counsel, Norton Rose Fulbright US LLP, San Francisco, California. It is expected that the Series 2018 Taxable Bonds in definitive form will be available for delivery through the facilities of DTC in New York, New York, on or about January 17, 2018.

MORGAN STANLEY

GOLDMAN SACHS & CO. LLC

BARCLAYS

January 9, 2018

† For an explanation of the ratings, see “RATINGS” herein.

†† A registered trademark of The American Bankers Association. CUSIP data herein is provided by CUSIP Global Services (“CGS”), managed by S&P Global Market Intelligence on behalf of The American Bankers Association. This data is not intended to create a database and does not serve in any way as a substitute for the CGS database. CUSIP numbers are provided for convenience of reference only. Neither SHC nor the Underwriters assume any responsibility for the accuracy of such numbers.

This Offering Memorandum does not constitute an offer to sell the Series 2018 Taxable Bonds or the solicitation of an offer to buy, nor shall there be any sale of the Series 2018 Taxable Bonds by any person in any state or other jurisdiction to any person to whom it is unlawful to make an offer, solicitation or sale in that state or jurisdiction. No dealer, salesman or any other person has been authorized to give any information or to make any representation other than those contained in this Offering Memorandum in connection with the offering of the Series 2018 Taxable Bonds and, if given or made, that information or representation must not be relied upon.

The information set forth in APPENDIX D has been furnished by DTC. All other information herein has been obtained by the Underwriters from SHC and other sources deemed by the Underwriters to be reliable, but is not to be construed as a representation by the Underwriters. The information herein is subject to change without notice, and neither the delivery of this Offering Memorandum nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of DTC or SHC.

The Underwriters have provided the following sentence for inclusion in this Offering Memorandum. The Underwriters have reviewed the information in this Offering Memorandum in accordance with, and as part of, their respective responsibilities to investors under federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of this information.

The CUSIP number of the Series 2018 Taxable Bonds is included in this Offering Memorandum for the convenience of the Holders and potential Holders. No assurance can be given that the CUSIP number for the Series 2018 Taxable Bonds will remain the same after the date of issuance and delivery of the Series 2018 Taxable Bonds.

IN CONNECTION WITH THE OFFERING OF THE SERIES 2018 TAXABLE BONDS, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES 2018 TAXABLE BONDS OFFERED HEREBY AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

CAUTIONARY STATEMENTS REGARDING PROJECTIONS, ESTIMATES AND OTHER
FORWARD-LOOKING STATEMENTS IN THIS OFFERING MEMORANDUM

Certain statements included or incorporated by reference in this Offering Memorandum constitute projections or estimates of future events, generally known as forward-looking statements. These statements are generally identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget” or other similar words. Such forward-looking statements include but are not limited to certain statements under the captions “PLAN OF FINANCE” and “BONDHOLDERS’ RISKS” in the forepart of this Offering Memorandum and under the caption “SUMMARY OF FINANCIAL INFORMATION—Management’s Discussion and Analysis of Recent Financial Performance” in APPENDIX A to this Offering Memorandum.

The achievement of certain results or other expectations contained in these forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause actual results, performances or achievements described to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. SHC does not plan to issue any updates or revisions to those forward-looking statements if or when changes in their expectations, or events, conditions or circumstances on which these statements are based occur.

The Series 2018 Taxable Bonds and Obligation No. 40 have not been registered with the Securities Exchange Commission under the Securities Act of 1933, as amended (the “Securities Act”), and are being issued in reliance on an exemption contained in Section 3(a)(4) of the Securities Act. The Series 2018 Taxable Bonds are not exempt from registration in every jurisdiction in the United States; some jurisdictions’ securities laws (the “blue sky laws”) may require a filing and a fee to secure the Series 2018 Taxable Bonds’ exemption from registration. Neither the Indenture nor the Master Indenture has been qualified under the Trust Indenture Act of 1939, as amended (the “Trust Indenture Act”), in reliance upon an exemption contained in the Trust Indenture Act.

**INFORMATION CONCERNING OFFERING RESTRICTIONS
IN CERTAIN JURISDICTIONS OUTSIDE THE UNITED STATES**

REFERENCES IN THIS SECTION TO THE “ISSUER” MEAN STANFORD HEALTH CARE AND REFERENCES TO “BONDS” OR “SECURITIES” MEAN THE SERIES 2018 TAXABLE BONDS OFFERED HEREBY.

MINIMUM UNIT SALES

THE SERIES 2018 TAXABLE BONDS WILL TRADE AND SETTLE ON A UNIT BASIS (ONE UNIT EQUALING ONE BOND OF \$1,000 PRINCIPAL AMOUNT). FOR ANY SALES MADE OUTSIDE THE UNITED STATES, THE MINIMUM PURCHASE AND TRADING AMOUNT IS 150 UNITS (BEING 150 BONDS IN AN AGGREGATE PRINCIPAL AMOUNT OF \$150,000).

NOTICE TO CANADIAN INVESTORS

The Series 2018 Taxable Bonds may be sold only to purchasers purchasing, or deemed to be purchasing, as principal that are accredited investors, as defined in National Instrument 45-106 *Prospectus Exemptions* or subsection 73.3(1) of the *Securities Act* (Ontario), and are permitted clients, as defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and by purchasing the Series 2018 Taxable Bonds, the Canadian investor is deemed to have represented and warranted such to the Underwriters. Any resale of the Series 2018 Taxable Bonds must be made in accordance with an exemption from, or in a transaction not subject to, the prospectus requirements of applicable securities laws. The Series 2018 Taxable Bonds will be subject to the following legend restriction: “Unless permitted under securities legislation, the holder of the Series 2018 Taxable Bonds must not trade the security before the date that is 4 months and a day after the later of (i) the date of distribution of the Series 2018 Taxable Bonds, and (ii) the date the issuer became a reporting issuer in any province or territory.” In the event that no physical certificates representing the Series 2018 Taxable Bonds are provided to the purchaser (including if the Series 2018 Taxable Bonds are entered into direct registration or other electronic book-entry system), the above constitutes written notice pursuant to, and as required by, Section 2.5(2)(3.1) of National Instrument NI 45-102 *Resale of Securities* (“NI 45-102”) of the legend requirement set out in section 2.5 of NI 45-102.

Securities legislation in certain provinces or territories of Canada may provide a purchaser with remedies for rescission or damages if this Offering Memorandum (including any amendment hereto) contains a misrepresentation (as defined under applicable Canadian securities laws), provided that the remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser’s province or territory. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser’s province or territory for particulars of these rights or consult with a legal advisor.

Canadian investors are advised that, pursuant to section 3A.3 (or, in the case of securities issued or guaranteed by the government of a non-Canadian jurisdiction, section 3A.4) of National Instrument 33-105 *Underwriting Conflicts* (“NI 33-105”), the Underwriters and SHC are, in connection with this offering, relying on the exemption from the requirement to provide Canadian investors with certain disclosure required by NI 33-105 regarding underwriter conflicts of interest pertaining to “connected issuer” and/or “related issuer” relationships.

NOTICE TO PROSPECTIVE INVESTORS IN THE EUROPEAN ECONOMIC AREA

THIS OFFERING MEMORANDUM HAS BEEN PREPARED ON THE BASIS THAT ANY OFFER OF THE SECURITIES IN ANY MEMBER STATE OF THE EUROPEAN ECONOMIC AREA (“EEA”) WHICH HAS IMPLEMENTED THE PROSPECTUS DIRECTIVE (EACH, A “RELEVANT MEMBER STATE”) WILL BE MADE PURSUANT TO AN EXEMPTION UNDER THE PROSPECTUS DIRECTIVE FROM THE REQUIREMENT TO PUBLISH A PROSPECTUS FOR OFFERS OF THE SECURITIES. ACCORDINGLY, ANY PERSON MAKING OR INTENDING TO MAKE AN OFFER IN THAT RELEVANT MEMBER STATE OF THE SECURITIES MAY ONLY DO SO IN CIRCUMSTANCES IN WHICH NO OBLIGATION ARISES FOR THE ISSUER OR ANY OF THE INITIAL PURCHASERS TO PUBLISH A PROSPECTUS PURSUANT TO ARTICLE 3 OF THE PROSPECTUS DIRECTIVE OR SUPPLEMENT A PROSPECTUS PURSUANT TO ARTICLE 16 OF THE PROSPECTUS DIRECTIVE, IN EACH CASE, IN RELATION TO SUCH OFFER. NEITHER THE ISSUER NOR THE INITIAL PURCHASERS HAVE AUTHORIZED, NOR DO THEY AUTHORIZE, THE MAKING OF ANY OFFER OF SECURITIES IN CIRCUMSTANCES IN WHICH AN OBLIGATION ARISES FOR THE

ISSUER OR THE INITIAL PURCHASERS TO PUBLISH OR SUPPLEMENT A PROSPECTUS FOR SUCH OFFER.

IN RELATION TO EACH RELEVANT MEMBER STATE, WITH EFFECT FROM AND INCLUDING THE DATE ON WHICH THE PROSPECTUS DIRECTIVE IS IMPLEMENTED IN THAT RELEVANT MEMBER STATE, NO OFFER OF ANY SECURITIES WHICH ARE THE SUBJECT OF THE OFFERING CONTEMPLATED BY THIS OFFERING MEMORANDUM HAS BEEN MADE OR WILL BE MADE TO THE PUBLIC IN THAT RELEVANT MEMBER STATE, OTHER THAN: (A) TO ANY LEGAL ENTITY WHICH IS A QUALIFIED INVESTOR AS DEFINED IN THE PROSPECTUS DIRECTIVE; (B) TO FEWER THAN 150 NATURAL OR LEGAL PERSONS (OTHER THAN QUALIFIED INVESTORS AS DEFINED IN THE PROSPECTUS DIRECTIVE), SUBJECT TO OBTAINING THE PRIOR CONSENT OF THE RELEVANT INITIAL PURCHASER OR INITIAL PURCHASERS NOMINATED BY THE ISSUER FOR ANY SUCH OFFER; OR (C) IN ANY OTHER CIRCUMSTANCES FALLING WITHIN ARTICLE 3(2) OF THE PROSPECTUS DIRECTIVE, PROVIDED THAT NO SUCH OFFER OF THE SECURITIES SHALL REQUIRE THE ISSUER OR ANY INITIAL PURCHASER TO PUBLISH A PROSPECTUS PURSUANT TO ARTICLE 3 OF THE PROSPECTUS DIRECTIVE OR A SUPPLEMENT TO A PROSPECTUS PURSUANT TO ARTICLE 16 OF THE PROSPECTUS DIRECTIVE.

FOR THE PURPOSES OF THIS PROVISION, THE EXPRESSION AN “OFFER OF SECURITIES TO THE PUBLIC” IN RELATION TO ANY SECURITIES IN ANY RELEVANT MEMBER STATE MEANS THE COMMUNICATION IN ANY FORM AND BY ANY MEANS OF SUFFICIENT INFORMATION ON THE TERMS OF THE OFFER AND THE SECURITIES TO BE OFFERED SO AS TO ENABLE AN INVESTOR TO DECIDE TO PURCHASE OR SUBSCRIBE THE SECURITIES, AS THE SAME MAY BE VARIED IN THAT RELEVANT MEMBER STATE BY ANY MEASURE IMPLEMENTING THE PROSPECTUS DIRECTIVE IN THAT RELEVANT MEMBER STATE.

THE EXPRESSION “PROSPECTUS DIRECTIVE” MEANS DIRECTIVE 2003/71/EC (AS AMENDED, INCLUDING BY DIRECTIVE 2010/73/EU) AND INCLUDES ANY RELEVANT IMPLEMENTING MEASURE IN THE RELEVANT MEMBER STATE.

ANY PERSON OFFERING, SELLING OR RECOMMENDING THE CERTIFICATES (A “DISTRIBUTOR”) SUBJECT TO DIRECTIVE 2014/65/EU (AS AMENDED, “MIFID II”) IS RESPONSIBLE FOR UNDERTAKING ITS OWN TARGET MARKET ASSESSMENT IN RESPECT OF THE CERTIFICATES AND DETERMINING APPROPRIATE DISTRIBUTION CHANNELS.

NOTICE TO PROSPECTIVE INVESTORS IN THE UNITED KINGDOM

THIS OFFERING MEMORANDUM HAS NOT BEEN APPROVED FOR THE PURPOSES OF SECTION 21 OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 (“FSMA”) AND DOES NOT CONSTITUTE AN OFFER TO THE PUBLIC IN ACCORDANCE WITH THE PROVISIONS OF SECTION 85 OF THE FSMA. IT IS FOR DISTRIBUTION ONLY TO, AND IS DIRECTED SOLELY AT, PERSONS WHO (I) ARE OUTSIDE THE UNITED KINGDOM, (II) ARE INVESTMENT PROFESSIONALS, AS SUCH TERM IS DEFINED IN ARTICLE 19(5) OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL PROMOTION) ORDER 2005, AS AMENDED (THE “FINANCIAL PROMOTION ORDER”), (III) ARE PERSONS FALLING WITHIN ARTICLE 49(2)(A) TO (D) OF THE FINANCIAL PROMOTION ORDER, OR (IV) ARE PERSONS TO WHOM AN INVITATION OR INDUCEMENT TO ENGAGE IN INVESTMENT ACTIVITY (WITHIN THE MEANING OF SECTION 21 OF THE FSMA) IN CONNECTION WITH THE ISSUE OR SALE OF ANY BONDS MAY OTHERWISE BE LAWFULLY COMMUNICATED OR CAUSED TO BE COMMUNICATED (ALL SUCH PERSONS TOGETHER BEING REFERRED TO AS “RELEVANT PERSONS”). THIS OFFERING MEMORANDUM IS DIRECTED ONLY AT RELEVANT PERSONS AND MUST NOT BE ACTED ON OR RELIED ON BY PERSONS WHO ARE NOT RELEVANT PERSONS. ANY INVESTMENT OR INVESTMENT ACTIVITY TO WHICH THIS OFFERING MEMORANDUM RELATES IS AVAILABLE ONLY TO RELEVANT PERSONS AND WILL BE ENGAGED IN ONLY WITH RELEVANT PERSONS. ANY PERSON WHO IS NOT A RELEVANT PERSON SHOULD NOT ACT OR RELY ON THIS OFFERING MEMORANDUM OR ANY OF ITS CONTENTS.

NOTICE TO INVESTORS IN KOREA

THE SERIES 2018 TAXABLE BONDS HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE FINANCIAL SERVICES COMMISSION OF KOREA FOR PUBLIC OFFERING IN KOREA UNDER THE FINANCIAL INVESTMENT SERVICES AND CAPITAL MARKETS ACT AND ITS SUBORDINATE DECREES AND REGULATIONS (THE “FSCMA”). NONE OF THE SERIES 2018 TAXABLE BONDS MAY BE OFFERED, SOLD OR DELIVERED, DIRECTLY OR INDIRECTLY, OR OFFERED OR SOLD TO ANY PERSON FOR RE-OFFERING OR RESALE, DIRECTLY OR INDIRECTLY, IN KOREA OR TO ANY RESIDENT OF KOREA EXCEPT AS OTHERWISE PERMITTED UNDER THE APPLICABLE LAWS AND REGULATIONS OF KOREA, INCLUDING THE FSCMA AND THE FOREIGN EXCHANGE TRANSACTION LAW OF KOREA AND ITS SUBORDINATE DECREES AND REGULATIONS (COLLECTIVELY, THE “FETL”). FURTHERMORE, THE SERIES 2018 TAXABLE BONDS MAY NOT BE RESOLD TO KOREAN RESIDENTS UNLESS THE PURCHASE OF THE SERIES 2018 TAXABLE BONDS COMPLIES WITH ALL APPLICABLE REGULATORY REQUIREMENTS (INCLUDING BUT NOT LIMITED TO GOVERNMENT REPORTING REQUIREMENTS UNDER THE FETL) IN CONNECTION WITH THE PURCHASE OF THE SERIES 2018 TAXABLE BONDS.

NOTICE TO PROSPECTIVE INVESTORS IN TAIWAN

THE OFFER OF THE SERIES 2018 TAXABLE BONDS HAS NOT BEEN AND WILL NOT BE REGISTERED WITH THE FINANCIAL SUPERVISORY COMMISSION OF TAIWAN PURSUANT TO RELEVANT SECURITIES LAWS AND REGULATIONS, AND THE SERIES 2018 TAXABLE BONDS MAY NOT BE OFFERED, ISSUED OR SOLD WITHIN TAIWAN THROUGH A PUBLIC OFFERING OR IN CIRCUMSTANCES WHICH CONSTITUTE AN OFFER WITHIN THE MEANING OF THE SECURITIES AND EXCHANGE ACT OF TAIWAN THAT REQUIRES A REGISTRATION OR FILING WITH OR APPROVAL OF THE FINANCIAL SUPERVISORY COMMISSION OF TAIWAN. NO PERSON OR ENTITY IN TAIWAN HAS BEEN AUTHORIZED TO OFFER, SELL, GIVE ADVICE REGARDING OR OTHERWISE INTERMEDIATE THE OFFERING AND SALE OF THE BONDS IN TAIWAN.

NOTICE TO RESIDENTS OF HONG KONG

THE SERIES 2018 TAXABLE BONDS MAY NOT BE OFFERED OR SOLD IN HONG KONG BY MEANS OF ANY DOCUMENT, OTHER THAN (I) IN CIRCUMSTANCES WHICH DO NOT CONSTITUTE AN OFFER TO THE PUBLIC WITHIN THE MEANING OF THE COMPANIES (WINDING UP AND MISCELLANEOUS PROVISIONS) ORDINANCE (CAP. 32 OF THE LAWS OF HONG KONG) (“COMPANIES (WINDING UP AND MISCELLANEOUS PROVISIONS) ORDINANCE”) OR WHICH DO NOT CONSTITUTE AN INVITATION TO THE PUBLIC WITHIN THE MEANING OF THE SFO, OR (II) TO ‘PROFESSIONAL INVESTORS’ AS DEFINED IN THE SFO AND ANY RULES MADE THEREUNDER, OR (III) IN OTHER CIRCUMSTANCES WHICH DO NOT RESULT IN THE DOCUMENT BEING A “PROSPECTUS” AS DEFINED IN THE COMPANIES (WINDING UP AND MISCELLANEOUS PROVISIONS) ORDINANCE. IN ADDITION, NO PERSON MAY ISSUE OR HAVE IN ITS POSSESSION FOR THE PURPOSES OF ISSUE, WHETHER IN HONG KONG OR ELSEWHERE, ANY ADVERTISEMENT, INVITATION OR DOCUMENT RELATING TO THE SERIES 2018 TAXABLE BONDS, WHICH IS DIRECTED AT, OR THE CONTENTS OF WHICH ARE LIKELY TO BE ACCESSED OR READ BY, THE PUBLIC OF HONG KONG (EXCEPT IF PERMITTED TO DO SO UNDER THE SECURITIES LAWS OF HONG KONG) OTHER THAN WITH RESPECT TO BONDS WHICH ARE OR ARE INTENDED TO BE DISPOSED OF ONLY (A) TO PERSONS OUTSIDE HONG KONG, OR (B) TO ‘PROFESSIONAL INVESTORS’ IN HONG KONG AS DEFINED IN THE SFO AND ANY RULES MADE THEREUNDER.

NOTICE TO PROSPECTIVE INVESTORS IN SWITZERLAND

THIS OFFERING MEMORANDUM IS NOT INTENDED TO CONSTITUTE AN OFFER OR A SOLICITATION TO PURCHASE OR INVEST IN THE SERIES 2018 TAXABLE BONDS. THE SERIES 2018 TAXABLE BONDS MAY NOT BE PUBLICLY OFFERED, SOLD OR ADVERTISED, DIRECTLY OR INDIRECTLY, IN, INTO OR FROM SWITZERLAND AND WILL NOT BE LISTED ON THE SIX SWISS EXCHANGE OR ON ANY OTHER EXCHANGE OR REGULATED TRADING FACILITY IN SWITZERLAND. NEITHER THIS OFFERING MEMORANDUM NOR ANY OTHER OFFERING OR MARKETING MATERIAL RELATING TO THE SERIES 2018 TAXABLE BONDS CONSTITUTES A PROSPECTUS AS SUCH TERM IS

UNDERSTOOD PURSUANT TO ART. 652A OR ART. 1156 OF THE SWISS CODE OF OBLIGATIONS OR A LISTING PROSPECTUS WITHIN THE MEANING OF THE LISTING RULES OF THE SIX SWISS EXCHANGE LTD OR ANY OTHER REGULATED TRADING FACILITY IN SWITZERLAND AND THE SERIES 2018 TAXABLE BONDS DO NOT CLAIM TO COMPLY WITH THE DISCLOSURE STANDARDS OF THE SWISS CODE OF OBLIGATIONS AND THE LISTING RULES OF SIX SWISS EXCHANGE LTD AND CORRESPONDING PROSPECTUS SCHEMES ANNEXED TO THE LISTING RULES OF THE SIX SWISS EXCHANGE LTD OR THE LISTING RULES OF ANY OTHER SWISS STOCK EXCHANGE OR REGULATED TRADING FACILITY AND MAY NOT COMPLY WITH THE DIRECTIVE FOR NOTES OF FOREIGN BORROWERS OF THE SWISS BANKERS ASSOCIATION. NEITHER THIS OFFERING MEMORANDUM NOR ANY OTHER OFFERING OR MARKETING MATERIAL RELATING TO THE SERIES 2018 TAXABLE BONDS MAY BE PUBLICLY DISTRIBUTED OR OTHERWISE MADE PUBLICLY AVAILABLE IN, INTO AND OUT OF SWITZERLAND. NEITHER THIS OFFERING MEMORANDUM NOR ANY OTHER OFFERING OR MARKETING MATERIAL RELATING TO THE OFFERING, NOR THE ISSUER, NOR THE SERIES 2018 TAXABLE BONDS HAVE BEEN OR WILL BE FILED WITH OR APPROVED BY ANY SWISS REGULATORY AUTHORITY. THE SERIES 2018 TAXABLE BONDS ARE NOT SUBJECT TO SUPERVISION BY ANY SWISS REGULATORY AUTHORITY, E.G., THE SWISS FINANCIAL MARKET SUPERVISORY AUTHORITY FINMA, AND INVESTORS IN THE SERIES 2018 TAXABLE BONDS WILL NOT BENEFIT FROM PROTECTION OR SUPERVISION BY SUCH AUTHORITY.

THE SERIES 2018 TAXABLE BONDS ARE BEING OFFERED IN SWITZERLAND BY WAY OF A PRIVATE PLACEMENT (I.E., TO A SMALL, LIMITED NUMBER OF SELECTED INVESTORS ONLY), WITHOUT ANY PUBLIC ADVERTISEMENT AND ONLY TO INVESTORS WHO DO NOT PURCHASE THE SERIES 2018 TAXABLE BONDS WITH THE INTENTION TO DISTRIBUTE THEM TO THE PUBLIC. THE INVESTORS WILL BE INDIVIDUALLY APPROACHED DIRECTLY FROM TIME TO TIME. THIS OFFERING MEMORANDUM, AS WELL AS ANY OTHER MATERIAL RELATING TO THE SERIES 2018 TAXABLE BONDS, MAY ONLY BE USED BY THOSE INVESTORS TO WHOM IT HAS BEEN HANDED OUT IN CONNECTION WITH THE OFFERING DESCRIBED HEREIN AND MAY NEITHER DIRECTLY OR INDIRECTLY BE DISTRIBUTED OR MADE AVAILABLE TO OTHER PERSONS WITHOUT THE ISSUER'S EXPRESS CONSENT.

SELLING RESTRICTIONS FOR OFFER OF SECURITIES IN SINGAPORE

THIS OFFERING MEMORANDUM HAS NOT BEEN AND WILL NOT BE REGISTERED AS A PROSPECTUS WITH THE MONETARY AUTHORITY OF SINGAPORE. ACCORDINGLY, THIS OFFERING MEMORANDUM AND ANY OTHER DOCUMENT OR MATERIAL IN CONNECTION WITH THE OFFER OR SALE, OR INVITATION FOR SUBSCRIPTION OR PURCHASE, OF THE SERIES 2018 TAXABLE BONDS MAY NOT BE CIRCULATED OR DISTRIBUTED, NOR MAY THE SERIES 2018 TAXABLE BONDS BE OFFERED OR SOLD, OR BE MADE THE SUBJECT OF AN INVITATION FOR SUBSCRIPTION OR PURCHASE, WHETHER DIRECTLY OR INDIRECTLY, TO ANY PERSON IN SINGAPORE OTHER THAN (I) TO AN INSTITUTIONAL INVESTOR (AS DEFINED IN SECTION 4A OF THE SECURITIES AND FUTURES ACT, CHAPTER 289 OF SINGAPORE (THE "SFA"), (II) TO A RELEVANT PERSON (AS DEFINED IN SECTION 275(2) OF THE SFA) PURSUANT TO SECTION 275(1) OF THE SFA, OR TO ANY PERSON PURSUANT TO SECTION 275(1A) OF THE SFA, AND IN ACCORDANCE WITH THE CONDITIONS SPECIFIED IN SECTION 275 OF THE SFA, OR (III) OTHERWISE PURSUANT TO, AND IN ACCORDANCE WITH THE CONDITIONS OF, ANY OTHER APPLICABLE PROVISION OF THE SFA.

WHERE THE SERIES 2018 TAXABLE BONDS ARE SUBSCRIBED OR PURCHASED UNDER SECTION 275 OF THE SFA BY A RELEVANT PERSON WHICH IS:

(A) A CORPORATION (WHICH IS NOT AN ACCREDITED INVESTOR (AS DEFINED IN SECTION 4A OF THE SFA)) THE SOLE BUSINESS OF WHICH IS TO HOLD INVESTMENTS AND THE ENTIRE SHARE CAPITAL OF WHICH IS OWNED BY ONE OR MORE INDIVIDUALS, EACH OF WHOM IS AN ACCREDITED INVESTOR; OR

(B) A TRUST (WHERE THE TRUSTEE IS NOT AN ACCREDITED INVESTOR) WHOSE SOLE PURPOSE IS TO HOLD INVESTMENTS AND EACH BENEFICIARY OF THE TRUST IS AN INDIVIDUAL WHO IS AN ACCREDITED INVESTOR,

SECURITIES (AS DEFINED IN SECTION 239(1) OF THE SFA) OF THAT CORPORATION OR THE BENEFICIARIES' RIGHTS AND INTEREST (HOWSOEVER DESCRIBED) IN THAT TRUST SHALL NOT BE TRANSFERRED WITHIN SIX MONTHS AFTER THAT CORPORATION OR THAT TRUST HAS ACQUIRED SUCH BONDS PURSUANT TO AN OFFER MADE UNDER SECTION 275 OF THE SFA, EXCEPT:

- (1) TO AN INSTITUTIONAL INVESTOR (AS DEFINED IN SECTION 4A OF THE SFA) OR TO A RELEVANT PERSON (AS DEFINED IN SECTION 275(2) OF THE SFA), OR TO ANY PERSON ARISING FROM AN OFFER REFERRED TO IN SECTION 275(1A) OR SECTION 276(4)(i)(B) OF THE SFA;
- (2) WHERE NO CONSIDERATION IS OR WILL BE GIVEN FOR THE TRANSFER;
- (3) WHERE THE TRANSFER IS BY OPERATION OF LAW;
- (4) AS SPECIFIED IN SECTION 276(7) OF THE SFA; OR
- (5) AS SPECIFIED IN REGULATION 32 OF THE SECURITIES AND FUTURES (OFFERS OF INVESTMENTS) (SHARES AND DEBENTURES) REGULATIONS 2005 OF SINGAPORE.

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SUMMARY OF THE OFFERING

Issuer	Stanford Health Care
Securities Offered	\$500,000,000 3.795% Stanford Health Care Taxable Bonds, Series 2018, due November 15, 2048
Interest Payment Dates	May 15 and November 15 of each year, commencing May 15, 2018
Redemption	The Series 2018 Taxable Bonds are subject to optional redemption prior to maturity, in whole or in part (i) prior to the Par Call Date, at the Make-Whole Redemption Price, and (ii) on or after the Par Call Date, at the Redemption Price, as further described herein. See “THE SERIES 2018 TAXABLE BONDS—Redemption” herein.
Settlement Date	January 17, 2018
Authorized Denominations	\$1,000 and any integral multiple thereof
Form and Depository	The Series 2018 Taxable Bonds will be delivered solely in book-entry form through the facilities of DTC. See “BOOK-ENTRY ONLY SYSTEM.”
Use of Proceeds	SHC will use proceeds of the Series 2018 Taxable Bonds as described in “PLAN OF FINANCE” herein.
Ratings	Fitch: AA S&P: AA- Moody’s: Aa3

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OFFERING MEMORANDUM

\$500,000,000
Stanford Health Care
Taxable Bonds
Series 2018

INTRODUCTION

The following introductory statement is subject in all respects to the more complete information set forth in this Offering Memorandum, including the cover page and the Appendices hereto (the “Offering Memorandum”). The descriptions and summaries of various documents hereinafter set forth do not purport to be comprehensive or definitive and are qualified in their entirety by reference to each document. All capitalized terms used in this Offering Memorandum and not otherwise defined herein or in APPENDIX C have the same meaning as in the Senior Master Indenture (as defined herein) or the Indenture (as defined herein). See APPENDIX C – “SUMMARY OF PRINCIPAL DOCUMENTS—DEFINITIONS OF CERTAIN TERMS.”

Purpose of this Offering Memorandum

The purpose of this Offering Memorandum is to set forth information in connection with the offering of \$500,000,000 total aggregate principal amount of Stanford Health Care Taxable Bonds, Series 2018 (the “Series 2018 Taxable Bonds”) to be issued by Stanford Health Care (“SHC”), a California nonprofit public benefit corporation.

Stanford Health Care

SHC operates Stanford Hospital, a tertiary, quaternary and specialty teaching hospital (the “Hospital”), and the Stanford University clinics (the “Clinics”), which include primary, specialty and sub-specialty clinics, in which the medical faculty of the Stanford University School of Medicine provide clinical services. SHC serves as the principal teaching affiliate of the Stanford University School of Medicine with respect to providing primary and specialty health services to adults and operates its facilities to provide the clinical settings through which the Stanford University School of Medicine educates medical and graduate students, trains residents and clinical fellows, supports faculty clinicians and conducts medical and biological sciences research. The principal facilities of the Hospital and the Clinics are located on the campus of Stanford University adjacent to its School of Medicine and elsewhere in Palo Alto, California and in other communities in the San Francisco Bay Area.

For additional information concerning SHC, its facilities and operations, including certain financial and statistical data, see APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE.”

SHC is solely responsible for the payment of principal of and interest on the Series 2018 Taxable Bonds. Neither Stanford University nor any legal entity other than SHC is obligated to make any such payments. Stanford University and SHC are not co-guarantors of the debt of each other, and each is separately rated by the rating agencies.

The Series 2018 Taxable Bonds

The Series 2018 Taxable Bonds will be issued pursuant to an Indenture of Trust, dated as of January 1, 2018 (the “Indenture”), between SHC and The Bank of New York Mellon Trust Company, N.A., as trustee (the “Trustee”). The Series 2018 Taxable Bonds will be payable from payments required to be made by SHC under the Indenture, by payments required to be made pursuant to Obligation No. 40 (as defined herein) issued by SHC pursuant to the Master Indenture (as defined herein) and payable from amounts held in the funds and accounts under the Indenture.

Recent Financing

As part of SHC's plan of finance, in December 2017 the California Health Facilities Financing Authority (the "Authority") issued its \$454,200,000 Refunding Revenue Bonds (Stanford Health Care), 2017 Series A (the "Series 2017 Bonds"), for the benefit of SHC. The proceeds of the Series 2017 Bonds were used to advance refund certain outstanding tax-exempt bonds previously issued by the Authority for the benefit of SHC. Certain information relating to the Series 2017 Bonds is included in APPENDIX A – "INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION."

Defined Terms

All capitalized terms used in this Offering Memorandum and not otherwise defined herein shall have the same meanings included in APPENDIX C – "SUMMARY OF PRINCIPAL DOCUMENTS—DEFINITIONS OF CERTAIN TERMS."

Security for the Series 2018 Taxable Bonds

The Series 2018 Taxable Bonds are general obligations of SHC, payable from payments made by SHC under the Indenture and from payments made by SHC on Obligation No. 40 (hereinafter defined), and are secured by a pledge and assignment of amounts held in the funds and accounts by the Trustee under the Indenture.

The obligation of SHC under the Indenture with respect to the Series 2018 Taxable Bonds will be further evidenced and secured by an obligation ("Obligation No. 40") to be issued under the Amended and Restated Master Indenture of Trust, dated as of June 1, 2011 and effective as of June 16, 2011 (the "Amended and Restated Master Indenture of Trust"), between SHC, formerly known as Stanford Hospital and Clinics, and The Bank of New York Mellon Trust Company, N.A., as master trustee (the "Master Trustee"), as supplemented by the Supplemental Master Indenture for Obligation No. 40, dated as of January 1, 2018 ("Supplement No. 40"), between SHC and the Master Trustee. The Amended and Restated Master Indenture of Trust amended and restated the Master Indenture of Trust, dated as of December 1, 1990 (the "Original Master Indenture"), between SHC, then known as Stanford University Hospital, and First Interstate Bank, LTD., predecessor trustee to BNY Western Trust Company predecessor-in-interest to The Bank of New York Mellon Trust Company, N.A. formerly known as The Bank of New York Trust Company, N.A. as Master Trustee. The Amended and Restated Master Indenture of Trust, as supplemented and amended from time to time pursuant to its terms, including as supplemented by Supplement No. 40, is herein referred to as the "Master Indenture."

The obligations of SHC with respect to the Series 2017 Bonds were evidenced by an Obligation issued by SHC under the Master Indenture which ranks on a parity with all Obligations issued under the Master Indenture, including Obligation No. 40. Obligation No. 40, the outstanding Obligations relating to other indebtedness and obligations of SHC (as described below) and any other Obligations issued in the future under the Master Indenture (each an "Obligation" and collectively, the "Obligations"), will be secured by security interests in (i) the Gross Revenues of each Member of the Obligated Group and (ii) the moneys on deposit from time to time in the Gross Revenue Fund established under the Master Indenture. Currently, SHC is the only Member of the Obligated Group created pursuant to the Master Indenture. See "SECURITY FOR THE SERIES 2018 TAXABLE BONDS" herein.

Notwithstanding the effectiveness of the Amended and Restated Master Indenture of Trust, provisions therein providing for certain actions to be taken upon the direction of the Holders of a majority in aggregate principal amount of Outstanding Obligations, rather than upon the direction of the Holders of twenty-five percent (25%) of Outstanding Obligations as provided in the Original Master Indenture, will not go into effect until SHC secures the consent of the Holders of 100% in aggregate principal amount of Obligations Outstanding. See APPENDIX C – "SUMMARY OF PRINCIPAL DOCUMENTS—MASTER INDENTURE—Defaults and Remedies—Events of Default, "—Acceleration; Annulment of Acceleration" and "—Additional Remedies and Enforcement of Remedies" for a summary of such provisions. By purchasing the Series 2018 Taxable Bonds offered hereunder, the purchasers and Beneficial Owners will be deemed to have consented to amendment of each such direction of holder provision set forth in the Amended and Restated Master Indenture of Trust.

No reserve fund is being established in connection with the Series 2018 Taxable Bonds.

Additional Indebtedness

As described below under “SECURITY FOR THE SERIES 2018 TAXABLE BONDS,” SHC is permitted to incur additional indebtedness under the Master Indenture, subject to the financial tests and limitations set forth therein and described in APPENDIX C attached hereto. See APPENDIX C – “SUMMARY OF PRINCIPAL DOCUMENTS—MASTER INDENTURE—Covenants—Limitations on Indebtedness.”

For a description of certain events that are expected to require the incurrence of additional indebtedness of SHC, see “SERVICES, FACILITIES AND OPERATIONS—SHC’s Long-Range Master Plan and Additional Capital Needs” in APPENDIX A attached hereto.

Additional Bonds

The Indenture provides that SHC may issue Additional Bonds thereunder, subject to the terms and conditions set forth in the Indenture. All such Additional Bonds shall mature on the maturity date for the Series 2018 Taxable Bonds and shall bear interest at the rate per annum for the Series 2018 Taxable Bonds, and shall be subject to redemption at the same times and at the same redemption prices as the Series 2018 Taxable Bonds. Additional Bonds may be consolidated with the Series 2018 Taxable Bonds upon compliance with certain requirements of the Indenture. Each Additional Bond to be so consolidated shall constitute part of the Series 2018 Taxable Bonds. See APPENDIX C – “SUMMARY OF PRINCIPAL DOCUMENTS—INDENTURE—Additional Bonds.”

THE SERIES 2018 TAXABLE BONDS

The following is a summary of certain provisions of the Series 2018 Taxable Bonds. Reference is made to the Series 2018 Taxable Bonds for the complete text thereof and to the Indenture for a more detailed description of these provisions. The discussion herein is qualified by such reference. See also APPENDIX C – “SUMMARY OF PRINCIPAL DOCUMENTS.”

General

The Series 2018 Taxable Bonds are being issued pursuant to the Indenture in the aggregate principal amount described on the cover page of this Offering Memorandum. The Series 2018 Taxable Bonds will be delivered in fully registered form without coupons. The Series 2018 Taxable Bonds will be dated the date of issuance and will be payable as to principal, subject to the redemption provisions set forth herein, on the date and in the amount as set forth on the cover hereof. The Series 2018 Taxable Bonds shall be in denominations of \$1,000 and integral multiples in excess thereof. Interest on the Series 2018 Taxable Bonds shall be computed upon the basis of a 360-day year consisting of twelve 30-day months.

The Series 2018 Taxable Bonds will be transferable and exchangeable as set forth in the Indenture and, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository for the Series 2018 Taxable Bonds. Ownership interests in the Series 2018 Taxable Bonds may be purchased in book-entry form only, in denominations of \$1,000 or any integral multiple thereof. See “BOOK-ENTRY ONLY SYSTEM” herein. So long as Cede & Co. is the registered owner of the Series 2018 Taxable Bonds, principal, Redemption Price and Make-Whole Redemption Price of and interest on the Series 2018 Taxable Bonds are payable by wire transfer by the Trustee to Cede & Co., as nominee for DTC, which, in turn, will remit such amounts to DTC Participants (as defined in APPENDIX D) for subsequent disbursement to the Beneficial Owners. See APPENDIX D – “INFORMATION REGARDING BOOK-ENTRY ONLY SYSTEM.”

If the book-entry system for the Series 2018 Taxable Bonds is ever discontinued, payment of interest on the Series 2018 Taxable Bonds will be made by check mailed on each Interest Payment Date to each Holder thereof as of the close of business on the Record Date at its address as it appears on the bond registration books maintained by the Trustee or, upon the written request of any Holder of Bonds in an aggregate principal amount of at least \$1,000,000 as shown in the registration books of the Trustee, who, at least one Business Day prior to the Record Date next

preceding any Interest Payment Date, shall have provided the Trustee with written wire instructions for an account within the United States, by wire transfer in accordance with the wire transfer instructions provided by the Holder. Payment of the principal, Redemption Price or Make-Whole Redemption Price of the Series 2018 Taxable Bonds will then be payable upon surrender thereof at the corporate trust office of the Trustee.

Summary of Certain Provisions of the Series 2018 Taxable Bonds

The Series 2018 Taxable Bonds will bear interest at the rate set forth on the cover page of this Offering Memorandum. Payment of the interest on any Series 2018 Taxable Bond shall be made on May 15 and November 15 of each year, commencing May 15, 2018 (each, an “Interest Payment Date”) to the Holder thereof as of the Record Date (which will be the first day of the calendar month during which such Interest Payment Date occurs, whether or not a Business Day) for each Interest Payment Date (except with respect to interest in default, for which a special record date and special interest payment date shall be established). See APPENDIX C – “SUMMARY OF PRINCIPAL DOCUMENTS—INDENTURE” for a description of the terms of the Series 2018 Taxable Bonds.

Redemption

Optional Redemption of the Series 2018 Taxable Bonds at Par. On or after the Par Call Date, the Series 2018 Taxable Bonds are subject to optional redemption prior to maturity, in whole or in part, at the written direction of SHC to the Trustee. Such redemption shall be in accordance with the terms of the Series 2018 Taxable Bonds as directed by SHC, at the Redemption Price, which is equal to 100% of the principal amount of Series 2018 Taxable Bonds to be redeemed plus accrued and unpaid interest thereon to, but excluding, the redemption date. “Par Call Date” means May 15, 2048.

Optional Redemption of the Series 2018 Taxable Bonds at Make-Whole Redemption Price. Prior to the Par Call Date, the Series 2018 Taxable Bonds are subject to optional redemption prior to maturity, in whole or in part, at the written direction of SHC to the Trustee. Such redemption shall be in accordance with the terms of the Series 2018 Taxable Bonds as directed by SHC, at the Make-Whole Redemption Price. SHC shall retain an independent accounting firm or an independent financial advisor to determine the Make-Whole Redemption Price of the Series 2018 Taxable Bonds to be redeemed and perform all actions and make all calculations required to determine such Make-Whole Redemption Price. The Trustee and SHC may conclusively rely on such accounting firm’s or financial advisor’s calculations in connection with, and its determination of, the Make-Whole Redemption Price, and neither the Trustee nor SHC shall have any liability for such reliance. The determination of the Make-Whole Redemption Price by such accounting firm or financial advisor shall be conclusive and binding on the Trustee, SHC and the Holders of the Series 2018 Taxable Bonds. “Make-Whole Redemption Price” means the greater of (1) 100% of the principal amount of the Series 2018 Taxable Bonds to be redeemed; or (2) the sum of the present values of the remaining scheduled payments of principal and interest to the maturity date of the Series 2018 Taxable Bonds to be redeemed (not including any portion of those payments of interest accrued and unpaid as of the redemption date), discounted to the redemption date on a semi-annual basis assuming a 360-day year consisting of twelve 30-day months at the Treasury Rate plus 15 basis points, plus, in each case, accrued and unpaid interest on such Series 2018 Taxable Bonds to, but excluding, the redemption date. For purposes of this paragraph, the following definitions apply:

“Comparable Treasury Issue” means the United States Treasury security or securities selected by a Designated Investment Banker as having an actual or interpolated maturity comparable to the remaining term of the Series 2018 Taxable Bonds to be redeemed that would be used, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of a comparable maturity to the remaining term of such Series 2018 Taxable Bonds.

“Comparable Treasury Price” means, with respect to any redemption date, the average of the Primary Treasury Dealer Quotations for such redemption date, or, if the Designated Investment Banker obtains only one Primary Treasury Dealer Quotation, such Primary Treasury Dealer Quotation.

“Designated Investment Banker” means a Primary Treasury Dealer appointed by SHC.

“Primary Treasury Dealer” means one or more entities appointed by SHC, which, in each case, is a primary United States government securities dealer in the city of New York, New York, and its or their respective successors.

“Primary Treasury Dealer Quotations” means, with respect to each Primary Treasury Dealer and any redemption date, the average, as determined by the Designated Investment Banker, of the bid and ask prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Designated Investment Banker by such Primary Treasury Dealer at 3:30 p.m. New York time on the third Business Day preceding such redemption date.

“Treasury Rate” means, with respect to any redemption date, the rate per annum equal to (i) the semiannual equivalent yield to maturity or (ii) if no such semiannual equivalent yield to maturity is available, the interpolated yield to maturity (on a day count basis) of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such redemption date.

Notice of Redemption. Notice of redemption shall be sent by SHC to the Trustee by first class mail or using Electronic Means not less than five Business Days nor more than sixty days prior to the date that notice of redemption is due to be given by the Trustee in accordance with the following sentence. Notice of redemption shall be sent by the Trustee by first class mail or using Electronic Means, not less than seven days (or, if longer, the minimum number of days necessary to comply with the operational requirements of the Securities Depository then in effect), nor more than sixty days prior to the redemption date, to the respective Holders of any Series 2018 Taxable Bonds designated for redemption at their addresses appearing on the registration books of the Trustee. If the Series 2018 Taxable Bonds are no longer held by the Securities Depository or its successor or substitute, the Trustee shall also give notice of redemption by overnight mail to such securities depositories and/or securities information services as shall be designated in a Certificate of SHC. Each notice of redemption shall state the date of such notice, the date of issue of the Series 2018 Taxable Bonds, the redemption date, the Redemption Price or the method for determining the Make-Whole Redemption Price, the place or places of redemption (including the name and appropriate address or addresses of the Trustee), the maturity, the CUSIP number (if any), the conditions, if any, to the redemption, and, in the case of Series 2018 Taxable Bonds to be redeemed in part only, the portion of the principal amount thereof to be redeemed. Each such notice shall also state that, on such date, there will become due and payable on each such Series 2018 Taxable Bond the Redemption Price or Make-Whole Redemption Price (as applicable) thereof, or such specified portion of the principal amount thereof, in the case of a Series 2018 Taxable Bond to be redeemed in part only, and that from and after such redemption date interest thereon shall cease to accrue, and shall require that such Series 2018 Taxable Bonds be then surrendered.

Failure by the Trustee to give notice in accordance with the Indenture to any one or more of the securities information services or depositories designated by SHC, or the insufficiency of any such notice, shall not affect the sufficiency of the proceedings for redemption. Failure by the Trustee to send notice of redemption in accordance with the Indenture to any one or more of the respective Holders of any Series 2018 Taxable Bonds designated for redemption shall not affect the sufficiency of the proceedings for redemption with respect to the Holders to whom such notice was mailed.

SHC may instruct the Trustee to provide conditional notice of redemption, which may be conditioned upon the receipt of moneys or any other event.

Rescission of Notice of Redemption. Any notice of optional redemption may be rescinded by written notice given to the Trustee by SHC no later than five Business Days prior to the date specified for redemption. The Trustee shall give notice of such rescission as soon thereafter as practicable to the same parties and in the same manner as notice of such redemption was given.

Selection of Bonds for Redemption. If the Series 2018 Taxable Bonds are registered in book-entry only form and so long as the Securities Depository or its nominee is the sole registered owner of the Series 2018 Taxable Bonds, if less than all of the Series 2018 Taxable Bonds are called for redemption, the particular Series 2018 Taxable Bonds or portions thereof to be redeemed shall be selected on a pro rata pass-through distribution of principal basis in accordance with the customary procedures and the operational arrangements of the Securities Depository then in effect, but, if such operational arrangements do not allow for redemption on a pro rata pass-through distribution of

principal basis, the Series 2018 Taxable Bonds shall be selected for redemption, in accordance with the customary procedures of the Securities Depository, or by lot.

If the Securities Depository or its nominee is no longer the sole registered owner of the Series 2018 Taxable Bonds, and if less than all of the Series 2018 Taxable Bonds are called for redemption, the Trustee shall select the Series 2018 Taxable Bonds to be redeemed on a pro rata basis.

Effect of Redemption. Moneys for payment of the Redemption Price or Make-Whole Redemption Price of the Series 2018 Taxable Bonds (or portion thereof called for redemption in accordance with the Indenture) shall be held by the Trustee, and, if any conditions specified in the notice of redemption have been satisfied, paid by the Trustee, on the date fixed for redemption designated in such notice. The Series 2018 Taxable Bonds (or portion thereof) so called for redemption shall become due and payable at the Redemption Price or Make-Whole Redemption Price specified in (or pursuant to the method of calculating the Make-Whole Redemption Price specified in) such notice, interest on the Series 2018 Taxable Bonds so called for redemption shall cease to accrue and such Series 2018 Taxable Bonds (or portion thereof) shall cease to be entitled to any benefit or security under this Indenture, and the Holders of such Series 2018 Taxable Bonds shall have no rights in respect thereof except to receive the payment of such Redemption Price or Make-Whole Redemption Price from funds held by the Trustee for such payment.

Mandatory Purchase in Lieu of Redemption. Each Holder or Beneficial Owner, by purchase and acceptance of any Series 2018 Taxable Bond, irrevocably grants to SHC the option to purchase such Series 2018 Taxable Bond, in whole or in part, at any time such Series 2018 Taxable Bond is subject to optional redemption pursuant to the Indenture. Such Series 2018 Taxable Bond is to be purchased at a purchase price equal to the then applicable redemption price of such Series 2018 Taxable Bond. SHC shall direct the Trustee to provide notice of mandatory purchase, such notice to be provided, as and to the extent applicable, in accordance with the notice of redemption provisions of the Indenture and to select Series 2018 Taxable Bonds subject to mandatory purchase in the same manner as Series 2018 Taxable Bonds called for redemption pursuant to the Indenture. On the date fixed for purchase of any Series 2018 Taxable Bond in lieu of redemption, SHC shall pay the purchase price of such Series 2018 Taxable Bond to the Trustee in immediately available funds, and the Trustee shall pay the same to the Holders of the Series 2018 Taxable Bonds being purchased against delivery thereof. No purchase of any Series 2018 Taxable Bond in lieu of redemption shall operate to extinguish the indebtedness evidenced by such Series 2018 Taxable Bond. No Holder or Beneficial Owner may elect to retain a Series 2018 Taxable Bond subject to mandatory purchase in lieu of redemption. SHC may exercise its option to purchase Series 2018 Taxable Bonds, in whole or in part, in accordance with the purchase in lieu of redemption provisions of the Indenture.

BOOK-ENTRY ONLY SYSTEM

General

The Series 2018 Taxable Bonds will be issued in book-entry form. DTC will act as securities depository for the Series 2018 Taxable Bonds. The Series 2018 Taxable Bonds will be issued as fully registered securities registered in the name of Cede & Co., as nominee of DTC, or such other name as may be requested by an authorized representative of DTC. One fully registered Bond certificate will be issued for the Series 2018 Taxable Bonds set forth on the cover page of this Offering Memorandum, in the aggregate principal amount of the Series 2018 Taxable Bonds, and will be deposited with DTC. For additional information regarding DTC and its book-entry only system, see APPENDIX D hereto.

Limitations

For so long as the Series 2018 Taxable Bonds are registered in the name of DTC or its nominee, Cede & Co., SHC and the Trustee will recognize only DTC or its nominee, Cede & Co., as the registered owner of the Series 2018 Taxable Bonds for all purposes, including payments, notices and voting.

Because DTC is treated as the registered owner of the Series 2018 Taxable Bonds for substantially all purposes under the Indenture, Beneficial Owners may have a restricted ability to influence in a timely fashion remedial action or the giving or withholding of requested consents or other directions. In addition, because the

identity of Beneficial Owners is unknown to SHC, to DTC or to the Trustee, it may be difficult to transmit information of potential interest to Beneficial Owners in an effective and timely manner. Beneficial Owners should make appropriate arrangements with their broker or dealer regarding distribution of information regarding the Series 2018 Taxable Bonds that may be transmitted by or through DTC.

Under the Indenture, payments made by the Trustee to DTC or its nominee shall satisfy SHC's obligations under the Indenture and SHC's obligations under Obligation No. 40 to the extent of the payments so made.

SHC cannot and does not give any assurances that DTC will distribute to DTC Participants or that DTC Participants or others will distribute to the Beneficial Owners payments of principal, Redemption Price and Make-Whole Redemption Price of and interest, on the Series 2018 Taxable Bonds or any redemption or other notices or that they will do so on a timely basis or will serve and act in the manner described in this Offering Memorandum. SHC is not responsible or liable for the failure of DTC or any DTC Participant or DTC Indirect Participant (as defined in APPENDIX D) to make any payments or give any notice to a Beneficial Owner with respect to the Series 2018 Taxable Bonds or any error or delay relating thereto.

Neither SHC or the Trustee shall have any responsibility or obligation with respect to: (i) the accuracy of the records of DTC, its nominee or any DTC Participant or Indirect Participant with respect to any beneficial ownership interest in any Series 2018 Taxable Bond; (ii) the delivery to any DTC Participant or Indirect Participant or any other Person, other than a registered owner, as shown in the bond register, of any notice with respect to any Series 2018 Taxable Bond including, without limitation, any notice of redemption or purchase with respect to any Series 2018 Taxable Bond; (iii) the payment to any DTC Participant or Indirect Participant or any other Person, other than a registered owner, as shown in the bond register, of any amount with respect to the interest on, or Redemption Price, Make-Whole Redemption Price or principal of, any Series 2018 Taxable Bond; and (iv) the selection of the Beneficial Owners to receive payment in the event of any partial redemption of the Series 2018 Taxable Bonds.

Prior to any discontinuation of the book-entry only system with respect to the Series 2018 Taxable Bonds as hereinabove described, SHC and the Trustee may treat DTC as, and deem DTC to be, the absolute owner of the Series 2018 Taxable Bonds for all purposes whatsoever, including, without limitation: (i) the payment of interest on the Series 2018 Taxable Bonds or the Redemption Price, Make-Whole Redemption Price or principal of a Series 2018 Taxable Bond; (ii) giving notices of redemption and other matters with respect to the Series 2018 Taxable Bonds; (iii) registering transfers of the Series 2018 Taxable Bonds; and (iv) the selection of Series 2018 Taxable Bonds for redemption.

SECURITY FOR THE SERIES 2018 TAXABLE BONDS

General

The Series 2018 Taxable Bonds are general obligations of SHC, payable from payments made by SHC under the Indenture and from payments made by SHC on Obligation No. 40, and are secured by a pledge of amounts held in certain funds and accounts by the Trustee under the Indenture. See “—The Master Indenture” below.

No reserve fund is being established under the Indenture.

The Master Indenture

Joint and Several Obligations. Currently, SHC is the sole Member of the Obligated Group. Under the Master Indenture, SHC, as Obligated Group Representative, may incur, for itself and on behalf of the other Members of the Obligated Group, Indebtedness, which may be evidenced and secured by Obligations issued under the Master Indenture. All Members of the Obligated Group are jointly and severally liable with respect to the payment of each Obligation issued under the Master Indenture.

Obligation No. 40 is being issued by SHC under and pursuant to the Master Indenture on a parity with all other Obligations issued or to be issued thereunder. See “Outstanding Obligations Under the Master Indenture” below. All Members of the Obligated Group are required to make payments on Obligation No. 40 in amounts sufficient to

pay the principal of and interest on the Series 2018 Taxable Bonds when due. For a discussion of entry into or withdrawal from the Obligated Group, see APPENDIX C – “SUMMARY OF PRINCIPAL DOCUMENTS—MASTER INDENTURE—Membership in Obligated Group” and “—Withdrawal from Obligated Group.”

Outstanding Obligations Under the Master Indenture. Upon the issuance of the Series 2018 Taxable Bonds, Obligations outstanding under the Master Indenture will secure (i) \$1,863,915,000 in aggregate principal amount of indebtedness related to tax-exempt revenue and taxable bonds issued for the benefit of SHC, (ii) SHC’s obligations to make regularly scheduled payments and, in limited circumstances, settlement payments, under certain existing interest rate swap agreements and (iii) SHC’s obligations to make payments, under certain circumstances, to the financial institution which have purchased certain revenue bonds issued for the benefit of SHC in prior direct placement transactions. For a discussion of the interest rate swap agreements that SHC has entered into, see APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION—Interest Rate Swap Arrangements.”

Security for Obligations. All Obligations issued and outstanding under the Master Indenture, including Obligation No. 40, which evidences and secures SHC’s obligations under the Indenture, are secured by security interests in (i) the Gross Revenues of each Member of the Obligated Group and (ii) the moneys and investments on deposit from time to time in the Gross Revenue Fund created under the Master Indenture and held by the Master Trustee. For a description of the limitations on the enforceability of the Master Indenture, see “SECURITY FOR THE SERIES 2018 TAXABLE BONDS—Security and Enforceability—Risks Related to Master Indenture Financings, Fraudulent Transfer or Conveyance Statutes” herein.

Security Interest in Gross Revenues. Pursuant to the Master Indenture, SHC and each of the other Members of the Obligated Group, if any, grants a security interest in its Gross Revenues. The security interest in Gross Revenues has been perfected to the extent the same may be perfected by filing under the California Commercial Code. The California Commercial Code does not permit perfection by filing with respect to certain items included in Gross Revenues. Under certain circumstances, the security interest in Gross Revenues may be subordinated to the interests of creditors other than the Holders of Obligations.

The Gross Revenue Fund; Security Interest Therein. Under the Master Indenture, SHC and each of the other Members of the Obligated Group, if any, are required to deposit daily all of the cash proceeds of the Gross Revenues with a depository bank or banks (collectively, a “Depository Bank”). Subject to the provisions of the Master Indenture permitting the moneys in the Gross Revenue Fund to be used as provided therein, SHC and each of the other Members of the Obligated Group, if any, grants a security interest in the Gross Revenue Fund to the Master Trustee. With certain exceptions, a security interest in the moneys in the Gross Revenue Fund may be perfected only if the moneys are held by the Master Trustee or its agent. SHC, the Master Trustee and each Depository Bank are required to execute and have executed account control agreements (each, an “Account Control Agreement”) to create this agency relationship. See APPENDIX C – “SUMMARY OF PRINCIPAL DOCUMENTS—MASTER INDENTURE—Gross Revenue Fund.”

Additional Indebtedness. SHC and each of the other Members of the Obligated Group, if any, are permitted under the Master Indenture to incur additional Indebtedness, either unsecured or secured by Permitted Liens, subject to the financial tests and limitations contained in the Master Indenture. Additional Indebtedness need not be evidenced by Obligations issued under the Master Indenture. However, only Indebtedness represented by Obligations will be secured by the security interests in Gross Revenues and the Gross Revenue Fund on a parity with other Obligations. For a description of the financial tests and limits on additional indebtedness in the Master Indenture. See APPENDIX C – “SUMMARY OF PRINCIPAL DOCUMENTS—MASTER INDENTURE—Covenants—Limitations on Indebtedness.”

Other Master Indenture Covenants. In addition to the security and other provisions described above, the Master Indenture contains provisions, covenants and restrictions related to debt coverage, mergers, consolidations, sales and conveyances, dispositions of assets and other matters. See APPENDIX C – “SUMMARY OF PRINCIPAL DOCUMENTS—MASTER INDENTURE—Covenants.”

Limitations on Enforceability. There are circumstances under which it is possible that the Master Indenture would not be enforced by courts, especially as to future Members of the Obligated Group. Also there are a number

of circumstances under which the security interests, especially the security interest in Gross Revenues, may not be enforced or may be subordinated to the claims of others. See “Security and Enforceability —Risks Related to Master Indenture Financings; Fraudulent Transfer or Conveyance Statutes;” “Enforceability of the Indenture;” and “Enforceability of Security Interests” herein.

Replacement of Obligation No. 40. Obligation No. 40 shall be surrendered by the Trustee and delivered to the Master Trustee for cancellation upon the terms and conditions set forth in the Indenture, which include receipt by the Trustee of: (a) a Request of SHC requesting such surrender and delivery and stating that SHC has become a member of an obligated group (herein referred to as the “New Group”) under a master indenture (other than the Master Indenture) (herein referred to as the “Replacement Master Indenture”) and that an obligation is being issued to the Trustee under the Replacement Master Indenture; (b) a properly executed obligation (the “Replacement Obligation”) issued under the Replacement Master Indenture and registered in the name of the Trustee with the same tenor and effect as Obligation No. 40 (in a principal amount equal to the then-Outstanding principal amount of 2018 Series Taxable Bonds), authenticated by the master trustee under the Replacement Master Indenture; (c) an Opinion of Counsel to SHC to the effect that the Replacement Obligation has been validly issued under the Replacement Master Indenture and constitutes a valid and binding obligation of SHC and each of the other members of the New Group; (d) a copy of the Replacement Master Indenture, certified as a true and accurate copy by the master trustee under the Replacement Master Indenture; (e) written confirmation from each Rating Agency then rating the 2018 Series Taxable Bonds that the replacement of Obligation No. 40 will not, by itself, result in a reduction in the then-current ratings on the 2018 Series Taxable Bonds; and (f) a certificate of the Master Trustee to the effect that Obligation No. 40 has been cancelled.

Security and Enforceability

Bankruptcy. In the event of bankruptcy of SHC, the rights and remedies of the Bondholders are subject to various provisions of the federal Bankruptcy Code. If SHC were to file a petition in bankruptcy, payments made by SHC during the 90 day (or perhaps one-year) period immediately preceding the filing of such petition may be avoidable as preferential transfers to the extent such payments allow the recipients thereof to receive more than they would have received in the event of such entity’s liquidation. Security interests and other liens granted to a trustee, including the Trustee and the Master Trustee, and perfected during such preference period also may be avoided as preferential transfers to the extent such security interest or other lien secures obligations that arose prior to the date of such perfection. Such a bankruptcy filing would operate as an automatic stay of the commencement or continuation of any judicial or other proceeding against SHC and its property and as an automatic stay of any act or proceeding to enforce a lien upon or to otherwise exercise control over such property, as well as various other actions to enforce, maintain or enhance the rights of a trustee. If the bankruptcy court so ordered, the property of SHC, including accounts receivable and proceeds thereof, could be used for the financial rehabilitation of SHC despite any security interest of a trustee therein. The rights of the Trustee to enforce its security interests and other liens could be delayed during the pendency of the rehabilitation proceeding.

SHC could file a plan for the adjustment of its debts in any such proceeding, which could include provisions modifying or altering the rights of creditors generally or any class of them, secured or unsecured. The plan, when confirmed by a court, binds all creditors who had notice or knowledge of the plan and, with certain exceptions, discharges all claims against the debtor to the extent provided for in the plan. No plan may be confirmed unless certain conditions are met, among which are conditions that the plan be feasible and that it shall have been accepted by each class of claims impaired thereunder. Each class of claims has accepted the plan if at least two-thirds in dollar amount and more than one-half in number of the class cast votes in its favor. Even if the plan is not so accepted, it may be confirmed if the court finds that the plan is fair and equitable with respect to each class of non-accepting creditors impaired thereunder and does not discriminate unfairly.

In addition, the obligations of SHC under the Indenture are not secured by a lien on or security interest in any assets or revenues of SHC, other than the lien on Gross Revenues and in the funds on deposit in the Gross Revenue Fund as described herein under “SECURITY FOR THE SERIES 2018 TAXABLE BONDS” securing all Obligations issued under the Master Indenture. Except with respect to such lien on Gross Revenues, in the event of a bankruptcy of SHC, Bondholders would be unsecured creditors and would be in an inferior position to any secured creditors and on a parity with all other unsecured creditors.

In the event of bankruptcy of SHC, there is no assurance that certain covenants contained in the Indenture would survive.

Risks Related to Master Indenture Financings; Fraudulent Transfer or Conveyance Statutes. On the date of issuance of the Series 2018 Taxable Bonds, SHC will be the only Member of the Obligated Group, and, consequently, the risks described below in this section would not apply. However, should other institutions join the Obligated Group in the future, the risks described below would be relevant.

The state of insolvency, fraudulent transfer or conveyance and bankruptcy laws relating to the enforceability of obligations of one corporation in favor of the creditors of another, or the obligation of one member of an obligated group to make debt service payments on behalf of another member or the ability of a corporate parent to compel its affiliates or subsidiaries to make such payments is unsettled. The ability of the Master Trustee or SHC to compel one Member of the Obligated Group to make payment on behalf of another Member could be subject to challenge if such Member would, by make such payment, be rendered insolvent. In particular, such efforts by the Master Trustee or SHC may not be enforced under the Federal Bankruptcy Code or applicable state fraudulent transfer or conveyance statutes if the obligation to pay is incurred without “fair consideration” or “reasonably equivalent value” to the obligor-Member and if the incurrence of the obligation renders the Member insolvent. The standards for determining the fairness of consideration and the manner of determining insolvency are matters of judicial discretion based upon subjective standards and may vary under the Federal Bankruptcy Code and other statutes that may be applicable.

In addition a court could determine, in the event of a bankruptcy of a Member, that payments made on Obligation No. 40 by a bankrupt Member could constitute payments to or for the benefit of an insider, within the meaning of Section 547(b) of the Federal Bankruptcy Code, which payments, if made within one year of the filing of the bankruptcy petition, might be recoverable by the bankruptcy court from the owners of the Series 2018 Taxable Bonds.

If a court were to find that a Member did not receive fair consideration or reasonably equivalent value for the incurrence of the indebtedness evidenced by Obligation No. 40 and such Member: (i) was insolvent; (ii) was rendered insolvent by such incurrence; (iii) was engaged in a business activity for which its remaining assets were unreasonably small; or (iv) intended (or believed) to incur, assume or issue, debt beyond its ability to pay, a court could determine to invalidate, the indebtedness represented by Obligation No. 40.

Enforceability of the Indenture. The legal right and practical ability of the Trustee to enforce rights and remedies under the Indenture may be limited by laws relating to bankruptcy, insolvency, reorganization, fraudulent conveyance or moratorium and by other similar laws affecting creditors’ rights. In addition, enforcement of such rights and remedies will depend upon the exercise of various remedies specified by such document, which, in many instances, may require judicial actions that are subject to discretion and delay, that otherwise may not be readily available or that may be limited by certain legal principles.

There exists common law authority and authority under certain statutes for the ability of the courts to terminate the existence of a nonprofit corporation or undertake supervision of its affairs on various grounds, including a finding that such corporation has insufficient assets to carry out its stated charitable purposes. Such court action may arise on the court’s own motion or pursuant to a petition of the State or such other persons who have interests different from those of the general public, pursuant to the common law and statutory power to enforce charitable trusts and to see to the application of their funds to their intended charitable uses.

The various legal opinions delivered concurrently with the issuance of the Series 2018 Taxable Bonds are qualified as to the enforceability of the various legal instruments by limitations imposed by state and federal laws, rulings, policy and decisions affecting remedies and by bankruptcy, reorganization or other laws of general application affecting the enforcement of creditors’ rights or the enforceability of certain remedies or document provisions.

Enforceability of Security Interests. The security interest in Gross Revenues will be perfected to the extent, and only to the extent, that such security interest may be perfected under the California Commercial Code. The foregoing grant of a security interest may be subordinated to the interest and claims of others in several instances. Some examples of cases of subordination of prior interests and claims are (i) statutory liens, (ii) rights arising in favor of the United States of America or any agency thereof, (iii) present or future prohibitions against assignment in any

federal statutes or regulations, (iv) constructive trusts, equitable liens or other rights impressed or conferred by any state or federal court in the exercise of its equitable jurisdiction, and (v) federal or state bankruptcy laws that may affect the enforceability of the Master Indenture or grant of a security interest in Gross Revenues. In addition, it may not be possible to perfect a security interest in any manner whatsoever in certain types of Gross Revenues (e.g., gifts, donations, certain insurance proceeds, Medicare and Medi-Cal payments) prior to actual receipt by SHC for deposit in the Gross Revenue Fund. To the extent that funds of the Obligated Group are not on deposit in the Gross Revenue Fund, the owners of Obligations, including Obligation No. 40, have no security interest in such funds.

PLAN OF FINANCE

SHC plans to use the proceeds of the Series 2018 Taxable Bonds for its general corporate purposes.

ESTIMATED SOURCES AND USES OF FUNDS

The following table sets forth the estimated sources and uses of funds related to the Series 2018 Taxable Bonds (with all amounts rounded to the nearest whole dollar).

	Series 2018 Taxable Bonds
<u>Estimated Sources</u>	
Par amount	\$500,000,000
Equity Contribution for Costs of Issuance ⁽¹⁾	3,385,285
Total	\$503,385,285
<u>Estimated Uses</u>	
General Corporate Purposes	\$500,000,000
Costs of Issuance ⁽¹⁾	3,385,285
Total	\$503,385,285

⁽¹⁾ SHC will pay the costs of issuance, including underwriters' compensation, from an equity contribution.

CONTINUING DISCLOSURE

SHC has entered into continuing disclosure undertakings (the "Continuing Disclosure Undertakings") in connection with the tax-exempt bonds previously issued for the benefit of SHC (the "Tax-Exempt Bonds"). Holders and prospective purchasers of the Series 2018 Taxable Bonds may obtain copies of the information provided by SHC under the Continuing Disclosure Undertakings on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access system ("EMMA"). Each Continuing Disclosure Undertaking terminates when the related Tax-Exempt Bonds are paid or deemed paid in full.

SHC covenants in the Indenture that, unless otherwise available on EMMA, or any successor thereto or to the functions thereof, copies of SHC's annual audited consolidated financial statements and certain quarterly unaudited consolidated financial information will be posted on SHC's website or with Digital Assurance Certification, LLC, or filed with the Trustee. A breach of this Indenture covenant does not constitute an Event of Default under the Indenture. The sole and exclusive remedy for a breach of this covenant is specific performance, and no person, including any Holder or Beneficial Owner of the 2018 Series Taxable Bonds, may recover monetary damages thereunder under any circumstances.

BONDHOLDERS' RISKS

The purchase of the Series 2018 Taxable Bonds involves investment risks that are discussed throughout this Offering Memorandum. Prospective purchasers of the Series 2018 Taxable Bonds should evaluate all of the information presented in this Offering Memorandum. This section on Bondholders' Risks focuses primarily on the general risks associated with hospital or health system operations, whereas Appendix A describes SHC specifically. These should be read together.

General

Except as noted under "SECURITY FOR THE SERIES 2018 TAXABLE BONDS," the Series 2018 Taxable Bonds are payable from payments made pursuant to the Indenture and from funds provided under Obligation No. 40 and the Indenture. **No representation or assurance can be made that revenues will be realized by SHC in amounts sufficient to make such payments and hence the debt service on the Series 2018 Taxable Bonds.**

SHC is subject to a wide variety of federal and state regulatory actions and legislative and policy changes by those governmental and private agencies that administer Medicare, Medicaid and other payors and is subject to actions by, among others, the National Labor Relations Board, The Joint Commission, the Centers for Medicare and Medicaid Services ("CMS") of the U.S. Department of Health and Human Services ("DHHS"), the Attorney General of the State of California (the "State"), and other federal, state and local government agencies. The future financial condition of the Obligated Group could be adversely affected by, among other things, changes in the method, timing and amount of payments to the Obligated Group by governmental and nongovernmental payors, the financial viability of these payors, increased competition from other health care entities, the costs associated with responding to governmental audits, inquiries and investigations, demand for health care, other forms of care or treatment, changes in the methods by which employers purchase health care for employees, capability of management, changes in the structure of how health care is delivered and paid for (e.g., accountable care organizations ("ACOs"), value based purchasing, bundled payments and other health reform payment mechanisms, including a "single-payor" system), future changes in the economy, demographic changes, availability of physicians, nurses and other health care professionals, and malpractice claims and other litigation. These factors and others may adversely affect payment by SHC and any future Member of the Obligated Group under the Indenture and Obligation No. 40 and, consequently, on the Series 2018 Taxable Bonds. In addition, the tax-exempt status of SHC and any future Obligated Group Member could be adversely affected by, among other things, an adverse determination by a governmental entity, noncompliance with governmental regulations or legislative changes, including changes resulting from current health care reform legislation or initiatives. See "—Health Care Reform" and "—Tax-Exempt Status and Other Tax Matters" below.

Significant Risk Areas Summarized

Certain of the primary risks associated with the operations of hospitals and health systems similar to those operated by SHC are briefly summarized in general terms below and are explained in greater detail in subsequent sections. The occurrence of one or more of these risks could have a material adverse effect on the financial condition and results of operations of SHC or any future Member of the Obligated Group and, in turn, the ability of the Obligated Group to make payments under the Indenture and Obligation No. 40.

Federal Health Care Reform and Deficit Reduction. The Patient Protection and Affordable Care Act, as enacted in March 2010 and as subsequently amended (the "ACA"), impacts almost all aspects of hospital and provider operations and health care delivery, and has changed and is changing how health care services are covered, delivered, and reimbursed. These changes have resulted in new payment models with the risk of lower hospital reimbursement from Medicare, utilization changes, increased government enforcement and the necessity for health care providers to assess, and potentially alter, their business strategy and practices, among other consequences. It is unclear how efforts to repeal the legislation and lawsuits to challenge its provisions will be resolved. Uncertainties regarding implementation of the ACA create unpredictability for the strategic and business planning efforts of health care providers, which in itself creates risk. Requirements for state "health information exchanges" could fundamentally alter the health insurance market by giving the health information exchanges a rate-setting role, negatively impacting hospital providers.

In recent years, federal policymakers have undertaken various efforts to reduce the federal deficit, principally by reducing federal spending on entitlement programs, including Medicare and Medicaid. Additional attempts to curb federal entitlement program spending are likely, and federal deficit reduction efforts would likely curb federal Medicare and Medicaid spending further to the detriment of hospitals, physicians and other health care providers. From time to time, there may be legislative or judicial efforts to repeal or substantially modify provisions of the ACA. See “—Health Care Reform” below.

Tax Reform. Tax legislation, administrative actions taken by tax authorities, or court decisions, whether at the federal or state level, may adversely affect the tax-exempt status of interest on SHC’s outstanding tax-exempt bonds under federal or state law. In addition, such legislation or actions (whether currently proposed, proposed in the future, or enacted) and such decisions could affect the market price or marketability of SHC’s outstanding tax-exempt bonds. In particular, federal tax reform legislation that was signed into law on December 22, 2017 significantly changes the income tax rates for individuals and corporations, repeals the alternative minimum tax for corporations, and significantly modifies the alternative minimum tax for individuals for tax years beginning after December 31, 2017.

Rate Pressure from Insurers and Purchasers. Certain health care markets, including many communities in California, are strongly impacted by large health insurers and, in some cases, by major purchasers of health services. In those areas, health insurers may have significant influence over the rates, utilization and competition of hospitals and other health care providers. Rate pressure imposed by health insurers or other major purchasers, including managed care payers, may have a material adverse impact on health care providers, particularly if major purchasers put increasing pressure on payers to restrain rate increases. Business failures by health insurers also could have a material adverse impact on contracted hospitals and other health care providers in the form of payment shortfalls or delay, and/or continuing obligations to care for managed care patients without receiving payment. In addition, disputes with non-contracted payers may result in an inability to collect billed charges from these payers.

Medicare. Inpatient hospitals rely to a high degree on payment from the federal Medicare program, and future payment changes are predicted. Recent, as well as future, changes in the underlying law and regulations, as well as in payment policy and timing, create uncertainty and could have a material adverse impact on hospitals’ payment streams from Medicare. With health care and hospital spending reported to be increasing faster than the rate of general inflation, Congress and CMS may take action in the future to decrease or change Medicare outlays for hospitals and physicians.

General Economic Conditions, Bad Debt, Indigent Care and Investment Performance. Health care providers are economically influenced by the environment in which they operate. Any national economic difficulties may constrain corporate and personal spending, limit the availability of credit and increase the national debt and federal and certain state government deficits. To the extent that unemployment rates are high, employers reduce their workforces and their budgets for employee health care coverage, or private and public insurers seek to reduce payments to health care providers or curb utilization of health care services, health care providers may experience decreases in insured patient volume and reductions in payments for services. In addition, to the extent that state, county or city governments are unable to provide a safety net of medical services, pressure is applied to local health care providers to increase free care. Economic downturns and lower funding of federal Medicare and state Medicaid and other state health care programs may increase the number of patients who are unable to pay for some or all of their medical and hospital services. These conditions may give rise to increases in health care providers’ uncollectible accounts, or “bad debt,” uninsured discount and charity care and, consequently, to reductions in operating income. Declines in investment portfolio values may reduce or eliminate non-operating revenues. Investment losses (even if unrealized) may trigger debt covenant violations and may jeopardize hospitals’ economic security. Losses in pension and other postretirement benefit funds may result in increased funding requirements for hospitals and health systems. Potential failure of lenders, insurers or vendors may negatively impact the results of operations and the overall financial condition of health care providers. Philanthropic support may also decrease or be delayed. These factors may have a material adverse impact on hospitals and health care providers. For a discussion of these risks with regard to SHC, in particular SHC’s recent results of operations and statement of financial position and performance of SHC’s investments, see APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION.”

Interest Rate Swaps and Hedge Risk. Interest rate swaps have experienced, from time to time, negative trading patterns, causing many to cease to function effectively to hedge interest rate exposure. Some swap counterparties have ceased to exist and others have suffered repeated downgrading and negative market perception. Further, certain swap arrangements may not be terminable except upon the payment of termination fees by the borrowing party, which may be substantial in amount. In the interim, negative mark-to-market valuation of certain swap arrangements must be recorded on a borrower's balance sheet. These factors may have a material adverse impact on hospitals and health systems involved in such financial arrangements. For a discussion of the interest rate swap agreements that SHC has entered into, see APPENDIX A – "INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION—Interest Rate Swap Arrangements."

Debt Limit Increase. Through legislation, the federal government has created a debt "ceiling" or limit on the amount of debt that may be issued by the United States Treasury. In the past several years, political disputes have arisen within the federal government in connection with discussions concerning the authorization for an increase in the federal debt ceiling. Any failure by Congress to increase the federal debt limit may impact the federal government's ability to incur additional debt, pay its existing debt instruments and to satisfy its obligations relating to the Medicare and Medicaid programs.

Management of SHC is unable to determine at this time what impact any future failure to increase the federal debt limit may have on the operations and financial condition of SHC, although such impact may be material. Additionally, the market price or marketability of the Series 2018 Taxable Bonds in the secondary market may be materially adversely impacted by any failure to increase the federal debt limit.

Nonprofit Health Care Environment. The significant tax benefits received by nonprofit, tax-exempt hospitals have increasingly caused the business practices of such hospitals to be subject to scrutiny by public officials and the press, and to political and legal challenges of the ongoing qualification of such organizations for tax-exempt status. Multiple governmental authorities, including Congress, the Internal Revenue Service (the "IRS"), state attorneys general, and state legislatures have held hearings and carried out audits regarding the conduct of tax-exempt organizations, including tax-exempt hospitals. Citizen organizations, such as labor unions and patient advocates, have also focused public attention on the activities of tax-exempt hospitals and health systems and raised questions about their practices. The IRS imposes certain reporting requirements on hospitals and health systems, including through Schedule H, Schedule J and Schedule K of the IRS Form 990 ("Form 990"). Proposals to stiffen the regulatory requirements for nonprofit hospitals' retention of tax-exempt status, such as by establishing a minimum level of charity care, have also been introduced repeatedly in Congress. These challenges and examinations, and any resulting legislation, regulations, judgments or penalties, could materially change the operating environment for nonprofit providers and have a material adverse effect on SHC. Significant changes in the obligations of nonprofit, tax-exempt hospitals and challenges to or loss of the tax-exempt status of nonprofit hospitals generally, or SHC in particular, could have a material adverse effect on SHC. See "—Tax-Exempt Status and Other Tax Matters" below.

Capital Needs vs. Capital Capacity. Hospital and other health care operations are capital intensive. Regulation, technology and expectations of physicians and patients require constant and often significant capital investment. In California, seismic safety standards mandated by the State may require that many hospital facilities be substantially modified, replaced or closed. Nearly all hospitals in California are affected. Estimated construction costs are substantial and actual costs of compliance may exceed estimates. Total capital needs may exceed capital capacity. Furthermore, capital capacity of hospitals and health systems may be reduced as a result of any credit market dislocations.

Construction Risks. Construction projects are subject to a variety of risks, including but not limited to delays in issuance of required building permits or other necessary approvals or permits, including environmental approvals, strikes, shortages of materials and labor, and adverse weather conditions. Such events could delay occupancy. Cost overruns may occur due to change orders, delays in the construction schedule, scarcity of building materials and labor and other factors. Cost overruns could cause the costs to exceed available funds. See APPENDIX A – "INFORMATION CONCERNING STANFORD HEALTH CARE—SERVICES, FACILITIES AND OPERATIONS—SHC's Long-Range Master Plan and Additional Capital Needs."

Government "Fraud" Enforcement. "Fraud" in government funded health care programs is of significant concern to the federal government and state regulatory agencies overseeing health care programs, and is one of the

federal government's prime law enforcement priorities. The federal government and, to a lesser degree, state governments impose a wide variety of extraordinarily complex and technical requirements intended to prevent over-utilization based on economic inducements, misallocation of expenses, overcharging and other forms of "fraud" in the Medicare and Medicaid programs, as well as other state and federally-funded health care programs. This body of regulation impacts a broad spectrum of hospital and other health care provider commercial activity, including licensing, billing, accounting, recordkeeping, medical staff oversight, medical necessity determinations, quality assurance, physician contracting and recruiting, cost allocation, clinical trials, discounts and other functions and transactions.

Violations and alleged violations may be deliberate, but also frequently occur in circumstances where management is unaware of the conduct in question, as a result of mistake, or where the individual participants do not know that their conduct is in violation of law. Violations may occur and be prosecuted in circumstances that do not have the traditional elements of fraud, and enforcement actions may extend to conduct that occurred in the past. Violations may carry significant sanctions. The government periodically conducts widespread investigations covering categories of services or certain accounting, coding or billing practices.

Violations and Sanctions. The government and/or private "whistleblowers" often pursue aggressive investigative and enforcement actions. The government has a wide array of civil, criminal, monetary and other penalties, including suspending essential hospital and other health care provider payments from the Medicare or Medicaid programs, or exclusion from those programs. Aggressive investigation tactics, negative publicity and threatened penalties can be, and often are, used to force settlements, payment of fines and compliance with prospective restrictions that may have a materially adverse impact on hospital and other health care provider operations, financial condition, results of operations and reputation. Multi-million dollar fines and settlements for alleged intentional misconduct, fraud or false claims are not uncommon in the health care industry. These risks are generally uninsured. Government enforcement and private whistleblower suits may continue to increase in the hospital and health care sector. Many large hospital and other health care provider systems are likely to be adversely impacted by actions or claims of this kind.

Personnel Shortage. From time to time, shortages of physicians and nursing and other technical personnel occur, which may impact hospitals and health care systems. Various studies have predicted that physician and nurse shortages will become more acute over time, as practitioners retire and patient volume exceeds the growth in new professionals. As reimbursement amounts are reduced to health care facilities and organizations that employ or contract with physicians, nurses and other health care professionals, pressure to control and possibly reduce wage and benefit costs may further strain the supply of those professionals. In California, regulation of nurse staff ratios can intensify the potential shortage of nursing personnel. In addition, shortages of other professional and technical staff such as pharmacists, therapists, laboratory technicians, billing coders and others may occur or worsen. Hospital operations, patient and physician satisfaction, financial condition and future growth could be negatively affected by physician and nursing and other technical personnel shortages, resulting in material adverse impact to hospitals and health care systems.

Technical and Clinical Developments. New clinical techniques and technology, as well as new pharmaceutical and genetic developments and products, may alter the course of medical diagnosis and treatment in ways that are currently unanticipated, and that may dramatically change medical and hospital care. These developments could result in higher health care costs, significant capital investments, reductions in patient populations, lower utilization of hospital service and/or new sources of competition for hospitals.

Costs and Restrictions from Governmental Regulation. Nearly every aspect of hospital operations and health care delivery is regulated, in some cases by multiple agencies of government. The level and complexity of regulation and compliance audits appear to be increasing, imposing greater operational limitations, higher staffing and training requirements, enforcement and liability risks, and significant and sometimes unanticipated costs.

Proliferation of Competition. Hospitals increasingly face competition from specialty providers of care and ambulatory care facilities. This competition may cause hospitals to lose essential inpatient or outpatient market share. Competition may be focused on services or payor classifications where hospitals realize their highest margins, thus negatively affecting programs that are economically important to hospitals. Specialty hospitals may treat only profitable classifications of patients, leaving full-service hospitals with higher acuity and/or lower paying patient

populations. These new sources of competition may have a material adverse impact on hospitals, particularly where a group of a hospital's principal physician admitters may curtail their use of a hospital service in favor of a competitor's facilities.

Increasing Consumer Choice. Hospitals and other health care providers face increased pressure to be transparent and provide information about cost and quality of services, which may lead to a loss of business as consumers and others make choices about where to receive health care services based upon publicly available information.

Labor Costs and Disruption. The delivery of health care services is labor intensive. Labor costs, including salary, benefits and other liabilities associated with the workforce, have significant impact on hospital and health care provider operations and financial condition. Hospital and health care employees are increasingly organized in collective bargaining units and may be involved in work actions of various kinds, including work stoppages and strikes. Overall costs of the hospital workforce are high, and turnover is high. Pressure to recruit, train and retain qualified employees is expected to accelerate. These factors may materially increase hospital costs of operation. At the same time, health care organizations will be under increasing pressure to reduce the cost of delivering care to patients, including the cost of salary and benefits, in order to compete in a transparent price market. Workforce disruption may negatively impact hospital revenues and reputation. See APPENDIX A – "INFORMATION CONCERNING STANFORD HEALTH CARE—EMPLOYEES."

Pension and Benefit Funding. As large employers, hospitals and health care providers may incur significant expenses to fund pension and benefit plans for employees and former employees, and to fund required workers' compensation benefits. Plans are often underfunded or may become underfunded, and funding obligations, in some cases, may be erratic or unanticipated and may require significant commitments of available cash needed for other purposes.

Organizations that are controlled by or under common control with other entities may be jointly and severally liable for the defined benefit pension plan obligations of these entities, by virtue of the "controlled group" rules under the Internal Revenue Code of 1986, as amended (the "Code") and the Employee Retirement Income Security Act of 1974, as amended. To the extent that a plan sponsor is unable to or does not meet the plan's minimum funding standards or if there are unfunded liabilities upon plan termination, members of the controlled group are jointly and severally liable, and any excise tax applicable to the unpaid required minimum funding contributions can be levied against the controlled group. The rules permit the Pension Benefit Guaranty Corporation ("PBGC"), the federal agency charged with insuring and monitoring defined benefit plans, to impose a lien on the controlled group if required minimum funding contributions and unpaid amounts total more than \$1 million. The PBGC also has the authority to recover from the members of the plan sponsor's controlled group amounts that the PBGC pays, or assumes the obligation to pay, to plan participants and beneficiaries in connection with a termination of an underfunded plan. The PBGC may also attach a lien to the assets of the plan sponsor's controlled group members to secure its claims for recovery.

SHC sponsors a defined benefit pension plan, which is frozen to new participants, and has other pension-related obligations with respect to its workforce. SHC is also a member of a controlled group that sponsors two additional defined benefit plans. See APPENDIX A – "INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION—Management's Discussion and Analysis of Recent Financial Performance—Pension Funding Requirements."

Medical Liability Litigation and Insurance. Medical liability litigation is subject to public policy determinations and legal and procedural rules that may be altered from time to time, with the result that the frequency and cost of such litigation, and resultant liabilities or insurance costs, may increase in the future. Hospitals and health care providers may be affected by negative financial and liability impacts on physicians. Costs of insurance, including self-insurance, may increase dramatically.

Facility Damage. Hospitals and health care providers are highly dependent on the condition and functionality of their physical facilities. Damage from earthquakes, floods, fires, other natural causes, deliberate acts of destruction, or various facilities system failures may have a material adverse impact on operations, financial conditions and results of operations.

Nonprofit Health Care Environment

The tax-exempt status afforded nonprofit health care organizations is the subject of increasing regulatory and legislative threats. As a nonprofit tax-exempt organization, SHC is subject to federal, state and local laws, regulations, rulings and court decisions relating to its organization and operation, including its operation for charitable purposes. At the same time, SHC conducts large-scale complex business transactions and is a major employer in its geographic area. There can often be a tension between the rules designed to regulate a wide range of charitable organizations and the day-to-day operations of a complex health care organization. Hospitals or other health care providers may be forced to forgo otherwise favorable opportunities for certain joint ventures, recruitment and other arrangements in order to maintain their tax-exempt status.

The operations and practices of nonprofit, tax-exempt hospitals are routinely challenged or criticized for inconsistency or inadequate compliance with the regulatory requirements for, and societal expectations of, nonprofit tax-exempt organizations. These challenges, in some cases, are broader than concerns about compliance with federal and state statutes and regulations, such as Medicare and Medicaid compliance, and instead in many cases are examinations of core business practices of the health care organizations. A common theme of these challenges is whether nonprofit hospitals may not confer community benefits that exceed or equal the benefit received from their tax-exempt status. Areas that have come under examination have included pricing practices, billing and collection practices, charitable care, methods of providing and reporting community benefit, executive compensation, exemption of property from real property taxation, private use of facilities financed with tax-exempt bonds and others. These challenges and questions have come from a variety of sources, including state attorneys general, the IRS, local and state tax authorities, labor unions, Congress, state legislatures and patients, and in a variety of forums, including hearings, audits and litigation. The challenges and examinations, and any resulting legislation, regulations, judgments or penalties, could have a material adverse effect on SHC.

Congressional Hearings. A number of House and Senate Committees, including the House Committee on Energy and Commerce, the House Committee on Ways and Means and the Senate Committee on Finance, have conducted hearings and/or investigations into issues related to nonprofit tax-exempt health care organizations. These hearings and investigations have included a nationwide investigation of hospital billing and collection practices, charity care and community benefit and prices charged to uninsured patients and possible reforms to the nonprofit sector. These hearings and investigations may result in new legislation.

Nonprofit Legislation. Legislative proposals that could have an adverse effect on SHC include: (i) any changes in the taxation of nonprofit corporations or in the scope of their exemption from income or property taxes; (ii) limitations on the amount or availability of tax-exempt financing for corporations recognized as tax-exempt under Section 501(c)(3) of the Code; (iii) regulatory limitations affecting SHC's ability to undertake capital projects or develop new services; (iv) a requirement that nonprofit health care institutions pay real property tax and sales tax on the same basis as for-profit entities; (v) mandates to provide certain levels of free or substantially reduced care that must be provided to low income uninsured and underinsured populations; and (vi) placing ceilings on executive compensation.

Tax-Exempt Bond Examinations. IRS officials have indicated that resources will be invested in audits of tax-exempt bonds in the charitable organization sector with specific review of private use. Bonds issued for the benefit of SHC have been audited in the past. Schedule K of Form 990 requires tax-exempt organizations to report on the investment and use of tax-exempt bond proceeds to address IRS concerns regarding compliance with arbitrage rebate requirements and the private use of bond-financed facilities.

IRS Examination of Compensation Practices and Community Benefit. The IRS has been historically concerned about executive compensation practices of tax-exempt hospitals. In 2004, the IRS began a compliance program to measure compliance by tax-exempt organizations with requirements that they not pay excessive compensation and benefits to their officers and other insiders. In February 2009, the IRS issued its Hospital Compliance Project Final Report (the "IRS Final Report") that examined tax-exempt organizations' practices and procedures with regard to compensation and benefits paid to their officers and other defined "insiders." The IRS Final Report indicated that the IRS will continue to heavily scrutinize executive compensation arrangements, practices and procedures of tax-exempt hospitals and other tax-

exempt organizations and, in certain circumstances, may conduct further investigations or impose fines on tax-exempt organizations.

The IRS has also undertaken a community benefit initiative directed at hospitals. The IRS Final Report determined that the reporting of community benefit by nonprofit hospitals varied widely, both as to types of programs and expenditures classified as community benefit and the measurement of community benefits. Form 990 requires detailed disclosure of compensation practices, corporate governance, loans to management and others, joint ventures and other types of transactions, political campaign activities, and other areas the IRS deems to be a compliance risk. The Form 990 also requires the disclosure of information on community benefit as well as reporting of information related to tax-exempt bonds, including compliance with the arbitrage rules and rules limiting private-use of bond-financed facilities, including compliance with the safe harbor guidance in connection with management contracts and research contracts. The Form 990 is intended to provide enhanced transparency as to the operations of exempt organizations. See “—Tax-Exempt Status and Other Tax Matters” below.

Revisions to Form 990, Schedule H. As described below in “—Tax-Exempt Status and Other Tax Matters” the ACA contains new requirements for tax-exempt hospitals through Section 501(r) of the Code. Schedule H of Form 990, which hospitals must use to report their community benefit activities, has been revised to require details on how a hospital determines eligibility for free or discounted care (if the federal poverty guidelines are not used). Consistent with Section 501(r) of the Code, Schedule H now requires hospitals to describe billing and collection practices permitted under the hospital facility’s policies, as well as information about the hospital’s emergency medical care policy, financial assistance policy, and community health needs assessments. Hospitals must complete all of Schedule H, including lines that relate to community health needs assessments.

Litigation Relating to Billing and Collection Practices. Lawsuits have been filed in both federal and state courts alleging, among other things, that hospitals have failed to fulfill their obligations to provide charity care to uninsured patients and have overcharged uninsured patients. Some of these cases have since been dismissed by the courts and some hospitals and health systems have entered into substantial settlements. Cases are pending in various courts around the country and others could be filed.

California Attorney General. California nonprofit public benefit corporations, including SHC, are subject to oversight and examination by the State Attorney General to ensure that their charitable purposes are being carried out, that their fundraising and investment activities comply with State law and that the terms of charitable gifts are followed.

California Auditor Investigation of Exempt Status of Nonprofit Hospitals. In August 2011, California’s Joint Legislative Audit Committee directed the California Bureau of State Audits to investigate whether the State’s nonprofit hospitals are providing enough charity care and community benefit to justify their tax-exempt status. A report was issued in August 2012 that summarized the findings and recommended that the California Legislature (i) amend state law to include requirements with respect to the amount of community benefits a hospital provides, (ii) define a standard methodology for calculating the community benefits a hospital delivers, and (iii) amend state law to allow assessment of a penalty against hospitals that are not in compliance with submitting community benefit plans to the Office of Statewide Health Planning and Development (“OSHPD”). See “—Tax-Exempt Status and Other Tax Matters” below.

Financial Assistance and Charity Care. California law requires hospitals to maintain written policies about discount payment and charity care and provide copies of such policies to patients and OSHPD. California law also requires hospitals to follow specific billing and debt collection procedures and communicate proactively through the entire cycle of care to patients on the options available to them within the policies. SHC has adopted and maintains such policies.

Indigent Care. Tax-exempt health care providers often treat large numbers of indigent patients who are unable to pay in full for their medical care. Typically, urban, inner-city hospitals and other health care providers may treat significant numbers of indigents. These hospitals and health care providers may be susceptible to economic and political changes that could increase the number of indigents or their

responsibility for caring for this population. General economic conditions may affect the number of employed individuals who have health coverage and the ability of those individuals to pay for their health care. Similarly, changes in governmental policy, which may result in coverage exclusions under local, county, state and federal health care programs (including Medicare and Medicaid) may increase the frequency and severity of indigent treatment by such hospitals and other providers. It also is possible that future legislation could require that tax-exempt hospitals and other providers maintain minimum levels of indigent care as a condition to federal tax exemption or exemption from certain state or local taxes.

Challenges to Real Property Tax Exemptions. The real property tax exemptions afforded to certain nonprofit health care providers by state and local taxing authorities have been challenged in certain circumstances on the assertion that the health care providers were not engaged in sufficient charitable activities. These challenges have been based on a variety of grounds, including allegations of aggressive billing and collection practices, excessive financial margins and operations that closely resemble for-profit businesses.

The foregoing are some examples of the challenges and examinations facing nonprofit health care organizations. They are indicative of a greater scrutiny of the billing, collection and other business practices of these organizations and may indicate an increasingly difficult operating environment for health care organizations, including SHC. The challenges and examinations, and any resulting legislation, regulations, judgments, or penalties, could have a material adverse effect on hospitals and health care providers, including SHC, and, in turn, its ability to make payments under the Indenture and Obligation No. 40.

Federal Budget Cuts

The Budget Control Act of 2011 mandates significant reductions and spending caps on the federal budget for fiscal years 2012–2021, including a reduction of 2% on all Medicare payments during this period. Subsequent legislation enacted by Congress extended these reductions through 2025. There is a substantial risk that Congress will act to extend or increase these across-the-board reductions.

Because Congress may make changes to the budget in the future, it is impossible to predict the impact any spending cuts may have upon SHC. Similarly, it is impossible to predict whether any automatic reductions to Medicare may be triggered in lieu of other spending cuts that may be proposed by Congress. If and to the extent Medicare and/or Medicaid spending is reduced under either scenario, this may have a material adverse effect upon the financial condition of SHC. Ultimately, these reductions or alternatives could have a disproportionate impact on hospital providers and could have a material adverse effect on the financial condition of SHC.

Health Care Reform

The discussion herein describes risks associated with certain existing federal and State laws, regulations, rules, and governmental administrative policies and determinations to which SHC and the health care industry are subject. While these are regularly subject to change, many of the existing provisions were enacted by or promulgated pursuant to the ACA, to which opposition has been expressed by President Trump and the Secretary of DHHS, as well as the majority leaders of each chamber of Congress and members of their caucuses. It is not possible to predict with any certainty whether or when the ACA or any specific provision or implementing measure will be repealed, withdrawn or modified in any significant respect, but a unified administration and majority in both chambers of Congress could enact legislation, withdraw, modify or promulgate rules, regulations and policies, or make determinations affecting SHC, any of which individually or collectively could have a material adverse effect on the operations, financial condition and financial performance of SHC.

President Trump and certain Congressional leaders have included a repeal of all or a portion of the ACA in statements concerning their respective legislative agendas, and Congress has taken steps to repeal and replace parts of the ACA. The repeal effort, to date, has focused on individual and employer mandates, exchanges, insurance industry regulations, Medicaid expansion, and the taxes to pay for these elements of the ACA. If a repeal in whole or in part were to occur, it is unclear when or if a replacement plan would be implemented. A repeal could result in additional pressure on Medicaid and Medicare funding and could have the effect of reducing the availability of health insurance to individuals who were previously insured, resulting in greater numbers of uninsured individuals, and could otherwise

materially adversely affect SHC. Tax reform legislation signed into law on December 22, 2017 reduces to zero dollars the penalty for failure to obtain minimum essential coverage beginning in 2019, essentially repealing the individual mandate of the ACA.

There can be no assurances that any existing health care laws and regulations will remain in their current form. Further, there can be no assurances that any potential changes to the laws and regulations governing health care would not have a material adverse financial or operational impact on SHC.

Therefore, the following discussion should be read with the understanding that significant changes could occur in 2018 and beyond in many of the statutory and regulatory matters discussed.

Federal Health Care Reform. As a result of the ACA, substantial changes have occurred and are anticipated to occur in the United States health care system. The ACA is impacting the delivery of health care services, the financing of health care costs, reimbursement of health care providers and the legal obligations of health insurers, providers, employers and consumers. Because of the complexity of the ACA generally, additional legislation may be considered and enacted over time. The ACA has also required, and will continue to require, the promulgation of substantial regulations with significant effects on the health care industry. Thus, the health care industry is the subject of significant new statutory and regulatory requirements and consequently to structural and operational changes and challenges for a substantial period of time. The full ramifications of the ACA may also become apparent only over time and through later regulatory and judicial interpretations. Portions of the ACA have already been limited and nullified as a result of legislative amendments and judicial interpretations and future actions may further change its impact. The uncertainties regarding the implementation of the ACA create unpredictability for the strategic and business planning efforts of health care providers, which in itself constitutes a risk.

The changes in the health care industry brought about by the ACA may have both positive and negative effects, directly and indirectly, on the nation's hospitals and other health care providers, including SHC. For example, the increase in the numbers of individuals with health care insurance occurring as a consequence of Medicaid expansion, creation of health insurance exchanges, subsidies for insurance purchase and the penalty on certain individuals who do not purchase insurance could result in lower levels of bad debt and increased utilization or profitable shifts in utilization patterns for hospitals. Further, the ACA establishes the criteria for the new Qualified Health Plans ("QHPs") that may participate in the state run exchanges. A QHP must meet certain minimum essential coverage requirements. However, the extent to which Medicaid expansion, which is now optional on a state by state basis, is either not pursued or results in a shifting of significant numbers of commercially-insured individuals to Medicaid, or health insurance options on exchanges are limited or unaffordable, and/or the cost containment measures and pilot programs that the ACA requires, may offset these benefits. A negative impact to the hospital industry overall will likely result from scheduled cumulative reductions in Medicare payments; such reductions are substantial. The ACA's cost-cutting provisions to the Medicare program include reduction in Medicare market basket updates to hospital reimbursement rates under the inpatient prospective payment system, additional reductions to or elimination of Medicare reimbursement for certain patient readmissions and hospital-acquired conditions, as well as anticipated reductions in rates paid to Medicare managed care plans that may ultimately be passed on to providers. Industry experts also expect that government cost reduction actions may be followed by private insurers and other third-party payors.

Health care providers could be further subjected to decreased reimbursement as a result of implementation of recommendations of the Independent Payment Advisory Board ("IPAB"). In the event that the projected Medicare per capita growth rate exceeds a target growth rate in any year, IPAB is directed to make recommendations for cost reduction, and those recommended reductions will be automatically implemented unless Congress adopts alternative legislation that meets equivalent savings targets. While hospitals are largely exempted from recommendations from the IPAB, industry experts also expect that government cost reduction actions may be followed by private insurers and payors. To date, IPAB members have not been appointed by the President.

Beginning in 2014, the ACA created state "health insurance exchanges" in which health insurance can be purchased by certain groups and segments of the population, expanded the availability of subsidies and tax credits for premium payments by some consumers and employers, and required that certain terms and conditions be included by commercial insurers in contracts with providers. In addition, the ACA imposed many new obligations on states related to health insurance. It is unclear how the increased federal oversight of state health care may affect future state

oversight or affect SHC. The health insurance exchanges may have a positive impact for hospitals by increasing the availability of health insurance to individuals who were previously uninsured. Conversely, employers or individuals may shift their purchase of health insurance to new plans offered through the exchanges, which may or may not reimburse providers at rates equivalent to rates the providers currently receive. The exchanges could alter the health insurance markets in ways that cannot be predicted, and exchanges might, directly or indirectly, take on a rate-setting function that could negatively impact providers. Because the exchanges are still relatively new, the effects of these changes upon the financial condition of any third party payor that offers health insurance, rates paid by third-party payors to providers and, thus, the revenues of SHC, and upon the operations, results of operations and financial condition of SHC, taken as a whole, cannot be predicted.

The ACA will likely affect some health care organizations differently from others, depending, in part, on how each organization adapts to the legislation's emphasis on directing more federal health care dollars to integrated provider organizations and providers with demonstrable achievements in quality care. The ACA has created a value-based purchasing system for hospitals under which a percentage of payments will be contingent on satisfaction of specified performance measures related to common and high-cost medical conditions, such as cardiac, surgical and pneumonia care. The ACA also funds various demonstration programs and pilot projects and other voluntary programs to evaluate and encourage new provider delivery models and payment structures, including "accountable care organizations" and bundled provider payments. The outcomes of these projects and programs, including the likelihood of being made permanent or expanded or their effect on health care organizations' revenues or financial performance cannot be predicted.

The ACA has expanded access to Medicaid and the scope of services covered thereunder. With respect to access, Medicaid may be available to all individuals with incomes of less than 138% of the federal poverty level, depending on whether a state opts to expand such coverage. The ACA allows states, beginning in 2014, to expand Medicaid eligibility to non-elderly, non-pregnant individuals who are not otherwise eligible for Medicare, if they have incomes of less than 138% of the federal poverty level. To assist states with the cost of covering such newly eligible individuals, the federal government has paid 100% of the new cost for a limited number of years. Thereafter, the cost share is expected to decrease to 90%. However, the U.S. Supreme Court's decision in *National Federation of Independent Business v. Sebelius* (2012) made expansion of Medicaid an option for each state. In the event a state chooses not to participate in the expanded Medicaid program, the net effect of the reforms in the ACA could be significantly reduced. Additionally, Medicaid reimbursement rates differ by state and the effect of expanded Medicaid enrollment must be determined on a state-by-state basis.

The ACA contains amendments to existing criminal, civil and administrative anti-fraud statutes and increases in funding for enforcement and efforts to recoup prior federal health care payments to providers. Under the ACA, a broad range of providers, suppliers and physicians are required to adopt a compliance and ethics program. While the government has already increased its enforcement efforts, failure to implement certain core compliance program features provides new opportunities for regulatory and enforcement scrutiny, as well as potential liability if an organization fails to prevent or identify improper federal health care program claims and payments. See also "—Regulatory Environment" below.

With respect to charity care, the ACA contains many features from previous tax exempt reform proposals, including a set of sweeping changes applicable to charitable hospitals exempt under Section 501(c)(3) of the Code. The ACA: (i) imposes new eligibility requirements for 501(c)(3) hospitals, coupled with an excise tax for failures to meet certain of those requirements; (ii) requires mandatory IRS review of the hospitals' entitlement to exemption; (iii) sets forth new reporting requirements, including information related to community health needs assessments and audited financial statements; (iv) requires hospitals to adopt and publicize a financial assistance policy, limit charges to patients who qualify for financial assistance to the amounts generally billed to insured patients and prohibits the use of gross charges, and control the billing and collection processes; and (v) imposes further reporting requirements on the Secretary of the Treasury regarding charity care levels. Failure to satisfy these conditions may result in the imposition of fines and the loss of tax exempt status.

Efforts to repeal or substantially modify provisions of the ACA are from time to time pending in Congress. In June 2012, the Supreme Court upheld most provisions of the ACA, while limiting the power of the federal government to penalize states for refusing to expand Medicaid, and in June 2015, the Supreme Court issued a decision in *King v. Burwell*, ruling that health insurance subsidies under the ACA would be available in all states, including

those with a federally-facilitated health insurance exchange. In November 2015, the BBA repealed a provision of the ACA which would require employers that offer one or more health benefits plans and have more than 200 full-time employees to automatically enroll new full-time employees in a health plan.

On January 30, 2017, President Trump issued an executive order requiring federal agencies to remove two previously implemented regulations for every new regulation added. President Trump also issued an executive order directing each federal agency to set up a “regulatory reform task force” to review existing regulations and eliminate those which are costly or unnecessary. Based on these executive orders and the present political climate, there can be no assurances that any existing health care laws and regulations will remain in their current form. Further, there can be no assurances that any potential changes to the laws and regulations governing health care would not have a material adverse financial or operational impact on SHC.

In May 2017 the U.S. House of Representatives voted to adopt the American Health Care Act (the “AHCA”), which would replace portions of the ACA, including eliminating the individual and large employer mandate to obtain or provide health insurance coverage, respectively, imposing a per capita cap on federal funding of Medicaid programs, or permitting the transition of federal funding to block grants, and permitting states to seek waivers of certain federal essential health benefit and pre-existing condition requirements. In June 2017, the U.S. Senate proposed a corresponding bill containing substantially similar provisions as described above with respect to the AHCA but with other slight variations from the bill approved by the House of Representatives.

In addition to legislative changes, ACA implementation and the ACA insurance exchange markets can be significantly impacted by executive branch actions. On January 20, 2017, President Trump issued an executive order requiring all federal agencies with authorities and responsibilities under the ACA to “exercise all authority and discretion available to them to waive, defer, grant exemptions from, or delay” parts of the ACA that place “a fiscal burden ... or a cost, fee, tax, penalty, or regulatory burden” on states, individuals or health care providers.

On October 12, 2017 the President signed an executive order directing the Department of Labor to consider proposing regulations or revising guidance enabling the formation of association health plans so that they would be exempt from certain ACA requirements such as the essential health benefits mandate. The executive order also: (i) provides for the Secretaries of the Treasury, Labor and DHHS to consider proposing regulations or revising guidance to expand access to short-term health plans that are limited under the ACA; (ii) provides for the Secretaries of the Treasury, Labor and DHHS to consider proposing regulations or revising guidance to expand how workers use employer-funded accounts to purchase their own policies; and (iii) sets a priority of limiting consolidation throughout the health care system.

Additionally, on October 12, 2017, the Trump Administration announced that cost-sharing reduction payments will no longer be made to insurers, which are still required to offer cost-sharing to certain low-income plan members under the ACA. Cost sharing reduction payments help offset deductibles and other out-of-pocket expenses for exchange health insurance coverage for approximately seven million individuals earning up to 250 percent of the federal poverty level. The Congressional Budget Office previously reported that if cost-sharing reduction payments were to end, premiums for silver-level plans would increase by 20 percent, before premium tax credits are accounted for, in 2018. On October 13, 2017, eighteen states and the District of Columbia filed suit in the U.S. District Court for the Northern District of California challenging the Trump Administration’s action and asking the court to issue a preliminary injunction mandating the continuance of cost-sharing reduction payments, which request was denied. On October 17, 2017 the chairman and ranking member of the Senate Committee on Health, Education, Labor, and Pensions announced a bipartisan proposal intended to continue cost-sharing reduction payments, but no such legislation has been passed to date.

These recent actions have the potential to significantly impact the insurance exchange market by reducing the number of plans available on exchanges and/or increasing insurance premiums. SHC cannot predict the effect of any such executive actions on its business or financial condition, though such effects could be material.

There can be no assurances that any current health care laws and regulations, in addition to the ACA, will remain in their current form. There can be no assurances that any potential changes to the laws and regulations governing health care would not have a material adverse financial or operational impact on SHC. Therefore, the

preceding discussion should be read with the understanding that significant changes could occur in 2017 and beyond in many of the statutory and regulatory matters discussed.

California Health Care Reform. The State has enacted several laws intended to implement the ACA within the required federal timeframes. Among the steps taken to date to implement or advance the ACA, the State established a state health insurance exchange which operates under a brand name, “Covered California”; the State approved expansion of Medi-Cal coverage, effective January 1, 2014, to include adults with incomes up to 138% of the federal poverty level who are under age 65, not pregnant and not otherwise currently eligible for Medi-Cal; and legislation was enacted prohibiting insurers from denying health coverage based on preexisting conditions. In addition, the State is also running a dual-eligibles pilot program with federal funding. The implementation of health care reform has extended coverage under Medi-Cal to approximately four million more Californians in three years and added new services such as treatment for substance abuse and mental health.

Patient Service Revenues

Net patient service revenues realized by SHC are derived from a variety of sources. A substantial portion of the net patient service revenues of SHC is derived from third-party payors which pay for the services provided to covered patients. These third-party payors include the federal Medicare program, the Medi-Cal program and private health plans and insurers, including health maintenance organizations and preferred provider organizations. Many of those programs make payments to SHC in amounts that may not reflect SHC’s direct and indirect costs of providing services to patients.

The financial performance of SHC has been and could be in the future adversely affected by the financial position, the insolvency of, the bankruptcy of or other delays in receipt of payments from third-party payors that provide coverage for services to its patients.

Health care providers have been and continue to be affected significantly by changes made in the last several years in federal and state health care laws and regulations, particularly those pertaining to Medicare and Medicaid. The purpose of much of this statutory and regulatory activity has been to reduce the rate of increase in health care costs, particularly costs paid under the Medicare and Medicaid programs.

The Medicare Program. Medicare is the federal health insurance system under which hospitals and other providers are paid for services provided to eligible elderly and disabled persons. Medicare provides certain health care benefits to beneficiaries who are 65 years of age or older, blind, disabled or qualify for the End Stage Renal Disease Program. Medicare Part A covers inpatient hospital services, skilled nursing care, hospice and some home health care, and Medicare Part B covers physician services, outpatient hospital services, diagnostic tests, outpatient therapy and some supplies. Medicare is administered by CMS, which delegates to the states the process for certifying hospitals to which CMS will make payment. In order to achieve and maintain Medicare certification, hospitals must meet CMS’s “conditions of participation” on an ongoing basis, as determined by each state in which they operate and The Joint Commission or other officially sanctioned accrediting organization. The requirements for Medicare certification are subject to change, and, therefore, it may be necessary for hospitals to effect changes from time to time in their facilities, equipment, operations, personnel, billing, policies and services.

As the U.S. population ages, more people will become eligible for the Medicare program. Current projections indicate that demographic changes and continuation of current cost trends will exert significant and negative forces on the overall federal budget. The Medicare program reimburses hospitals based on a fixed schedule of rates based on categories of treatments or conditions. These rates change over time and there is no assurance that these rates will cover the actual costs of providing services to Medicare patients. Further, it is anticipated there will be reductions in rates paid to Medicare managed care plans that may ultimately be passed on to providers.

The ACA institutes multiple mechanisms for reducing costs to the Medicare program and thus reimbursement to hospitals, while also promoting new and innovative health care delivery models, including the following:

Value-Based Purchasing Program. Since federal fiscal year 2013, Medicare inpatient payments to hospitals are determined, in part, based on a program under which value-based incentive payments are

made in a fiscal year to hospitals that meet certain performance standards during that fiscal year. The program is funded through the reduction of hospital inpatient care payment by 2% for federal fiscal year 2017 and subsequent federal fiscal years. This reduction may be offset by incentive payments for hospitals that meet or exceed quality standards. In each federal fiscal year, the total amount collected from these reductions will be pooled and used to fund payments to reward hospitals that meet certain quality performance standards established by DHHS.

Market Basket Reductions. Commencing upon enactment of the ACA and through September 30, 2019, the annual Medicare market basket updates for hospitals have been, and will be, reduced. The market basket adjustments for inpatient hospital care have averaged approximately 2% to 4% annually in recent years. The ACA calls for reductions in the annual market basket updates ranging from 0.10% to 0.75% each year through federal fiscal year 2019. The market basket reduction for federal fiscal year 2018 is -0.75%. In addition, the market basket updates are subject to productivity adjustment. The productivity adjustment for fiscal year 2018 is -0.6%. The reductions in market basket updates and the productivity adjustments will have a disproportionately negative effect upon those providers that are relatively more dependent upon Medicare. The combination of reductions to the market basket updates and the imposition of the productivity adjustments may, in some cases and in some years, result in reductions in Medicare payments per discharge on a year-to-year basis.

Hospital Acquired Conditions Penalty. Effective October 1, 2014, CMS began reducing Medicare payments by 1% for all Diagnosis-Related Groups (“DRGs”) to hospitals that are in the top quartile nationally for their rate of hospital-acquired conditions. Effective July 1, 2011, federal payments to states for Medicaid services related to preventable health conditions were prohibited.

Readmission Rate Penalty. Beginning in federal fiscal year 2013, Medicare inpatient payments to those hospitals with excess readmissions compared to the national average for three patient conditions (acute myocardial infarction, pneumonia and heart failure) are reduced based on a risk-adjusted measure of the hospital’s readmissions performance. The maximum penalty of 3% has applied since fiscal year 2015. In fiscal year 2015, CMS expanded the patient conditions assessed for this penalty to include acute exacerbation of chronic obstructive pulmonary disease, elective total hip arthroplasty, and total knee arthroplasty. Effective fiscal year 2017, CMS expanded the program to include patients admitted for coronary artery bypass graft surgery.

Medicare and Medicaid Disproportionate Share Payments. The ACA provided that, beginning in federal fiscal year 2014, hospitals receiving supplemental Disproportionate Share (“DSH”) payments from Medicare (i.e., those hospitals that care for a disproportionate share of low-income Medicare beneficiaries and Medicaid enrollees) will see their DSH payments reduced significantly. This reduction potentially will be offset by new, additional payments based on the volume of uninsured and uncompensated care provided by each such hospital, and is anticipated to be offset by a higher proportion of covered patients as other provisions of the ACA go into effect. The extent to which these reductions are offset depends considerably on whether the state in which the hospital is located expanded Medicaid eligibility. Medicare DSH payments will continue to decrease as the number of uninsured also decreases.

On September 13, 2013, CMS issued a final rule confirming its methodology, which accounted for statewide reductions in uninsured and uncompensated care, and reduced Medicaid DSH allotments to each state. Under this final rule, the federal share of Medicaid DSH payments was reduced by \$500 million in fiscal year 2014 and \$600 million in fiscal year 2015. Such reductions have been delayed several times, most recently under the Medicare Access and CHIP Reauthorization Act of 2015 (“MACRA”), but are scheduled to take effect October 1, 2018, which extended cuts through fiscal year 2025.

Medicare Advantage. Hospitals also receive payments from health plans under the Medicare Advantage program. The ACA includes significant changes to federal payments to Medicare Advantage plans resulting in a transition to benchmark payments tied to the level of fee-for-service spending in the applicable county. Decreased federal payments to the Medicare Advantage plans whether through adjustments to benchmark payments or other federal policy changes could in turn affect the scope of coverage of these plans or cause plan sponsors to negotiate lower payments to providers.

Quality Improvement Covenants. Health care insurers are required to include quality improvement covenants in their contracts with hospital providers, and are required to report their progress on such actions to the Secretary of the DHHS. Commencing January 1, 2015, health care insurers participating in the health insurance exchanges are allowed to contract only with hospitals with more than 50 beds that have implemented programs designed to ensure patient safety and enhance quality of care. The effect of these provisions upon the process of negotiating contracts with insurers or the costs of implementing such programs cannot be predicted.

Center for Medicare and Medicaid Innovation. The ACA creates a Center for Medicare and Medicaid Innovation (“CMMI”) to test innovative payment and service delivery models and to implement various demonstration programs and pilot projects to test, evaluate, encourage and expand new payment structures and methodologies to reduce health care expenditures while maintaining or improving quality of care. Demonstration efforts include, bundled payments under Medicare and Medicaid. Other provisions encourage the creation of new health care delivery models, such as accountable care organizations (described below) or combinations of provider organizations, that voluntarily meet quality thresholds to share in the cost savings they achieve for the Medicare program. CMMI has begun testing new payment and service delivery models by instituting mandatory pilot programs. For example, the Comprehensive Care for Joint Replacement (“CJR”) Model is currently in effect. Other proposed mandatory models include extending the CJR model to include hip fracture and cardiac episode payment models for acute myocardial infarction hospitalization and coronary artery bypass graft surgery, although these proposals have been delayed and it is not possible to predict whether they will be further delayed, amended or retracted. The outcomes of these projects and programs, including their effect on payments to providers and financial performance, cannot be predicted.

For information concerning the Medicare payments received by SHC for the fiscal years ended August 31, 2015, 2016 and 2017, see APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION—Sources of Revenue.”

Hospital Inpatient Reimbursement. Hospitals generally are paid for inpatient services rendered to Medicare beneficiaries under the inpatient prospective payment system (the “IPPS”). Under the IPPS, for each covered hospitalization, Medicare pays a predetermined base operating payment and a separate predetermined base payment for capital-related costs. Each hospitalization of a Medicare beneficiary is classified into one of several hundred diagnosis-related groups, or DRGs. The IPPS payment rate is not linked directly to the hospital’s actual cost of treating a particular patient. It is a fixed sum, generally based on national DRG rates and a Hospital Wage Index intended to reflect geographic differences in the cost of labor. Several hospital characteristics are reflected in payment adjustments, including an indirect medical education adjustment, the disproportionate share adjustment to pay certain hospitals for a portion of the higher costs of treating a large proportion of poor patients and for indirect costs of operating in areas accessible to poor patients and outlier case adjustments (an additional payment for selected cases of unusually long stays or high costs). Therefore, the actual cost of care, including capital costs, may be more or less than the DRG rate. In addition, DRG rates are subject to adjustment by CMS, including reductions mandated by the ACA, and are further subject to federal budget considerations. There is no guarantee that DRG rates, as they change from time to time, will cover actual costs of providing services to Medicare patients. For information regarding the impact of the ACA on payments to hospitals for inpatient services, see “—The Medicare Program” above.

Effective October 1, 2013, CMS adopted a policy known as the Inpatient Hospital Prepayment Review “Probe & Educate” review process or the “Two-Midnight” rule. The “Two-Midnight” rule specifies that hospital stays spanning two or more midnights after the beneficiary is properly and formally admitted as an inpatient will be presumed to be “reasonable and necessary” for purposes of inpatient reimbursement. With some exceptions, beneficiaries whose stays are not expected to extend past two midnights should not be admitted and should instead be billed as outpatient. Enforcement of the “Two-Midnight” rule was ultimately delayed until 2015. Effective October 1, 2015, responsibility for initial review of inpatient admissions shifted from Medicare administrative contractors to quality improvement organizations (“QIO”), and recovery audit contractors will conduct reviews for providers referred by the related QIO. Effective January 1, 2016, the “Two-Midnight” rule was revised to allow an exception for Medicare Part A payment on a case-by-case basis for inpatient admissions that do not satisfy the two-midnight benchmark if documentation in the medical records supports that the patient required inpatient care. CMS has announced that it will not continue to impose an inpatient payment cut to hospitals under the “Two-Midnight” rule

starting in 2017, following ongoing industry criticism and a legal challenge. In the 2017 Medicare IPPS final rule released on August 2, 2016, CMS removed the inpatient payment cuts under the “Two Midnight” rule for fiscal year 2017 and onward. The “Two-Midnight” rule has had, and will likely continue to have, an adverse financial impact for hospitals.

Hospital Outpatient Reimbursement. Hospitals are generally paid for outpatient services provided to Medicare beneficiaries under the Outpatient Prospective Payment System (“Outpatient PPS”), which is based on established categories of treatments or conditions known as ambulatory payment classifications (“APC”). The actual cost of care, including capital costs, may be more or less than the reimbursements. Generally, the Outpatient PPS rates are adjusted annually based on estimated cost increases and other factors, including productivity and budget neutrality adjustments. These adjustments are typically positive, and often range from 0.5% to 2.5%. However, occasionally, because of statutory formulas and other legislative and administrative actions, these adjustments can be negative, and Medicare payments to hospitals can be reduced as a result. Moreover, Congress often takes action to specify payment update reductions, which can have the effect of constraining or reducing hospital payments. There is no guarantee that APC rates, as they change from time to time, will cover actual costs of providing services to Medicare patients.

Medicare Physician Payment. The sustainable growth rate (“SGR”) formula, a limit on the growth of Medicare payments for physician services, was enacted in 1997 and linked to changes in the U.S. Gross Domestic Product over a ten-year period. From 2003 to 2015, Congress provided temporary relief from scheduled “negative” updates that would have reduced physician payments. In April of 2015, Congress enacted MACRA, which eliminated the cut to physician payments required by the SGR formula, and substituted annual 0.5% payment increases through 2019. Payment rates will be frozen at 2019 levels through 2025. While the immediate payment cuts associated with the SGR formula have been eliminated, it is possible that future legislative action will be taken that would once again trigger physician payment reductions.

Furthermore, MACRA moved Medicare physician reimbursement from a fee-for-service to a pay-for-performance model that will continue to control the growth of physician payments based on clinical outcomes and quality reporting. In addition to the base payment methodology, physicians can earn merit-based payments based on factors including compliance with meaningful use of certified electronic health records technology and demonstration of quality-based medicine.

Beginning January 1, 2019, and carrying through 2025, physician payment adjustments will occur through the Quality Payment Program’s two reimbursement tracks – the Merit-based Incentive Payment System (“MIPS”) or an Advanced Alternative Payment Model (“APM”). In calculating physician payment adjustments, MIPS streamlines existing quality and value programs, accounting for physician performance under the meaningful use of electronic health records incentive program, the value-based modifier, and physician quality reporting system. Payments to physicians participating in APMs similarly accounts for performance under such programs. Beginning January 1, 2026, and effective January 1 of each subsequent calendar year, physician payments will be increased 0.75% for physicians who adequately participate in APMs, and 0.25% for those in MIPS. The outcomes of these programs, including the likelihood of being revised or expanded or their effect on health care organizations revenues or financial performance cannot be predicted, and it remains unclear what effect this legislation will have on SHC. For example, these programs may encourage more physicians to retire, not accept Medicare (or only accept Medicare Advantage). Alternatively, or in addition to other externalities of the implementation of these programs, increased focus and performance scoring on resource use may impact utilization of health care resources. Furthermore, implementation of a quality payment system will likely require regular reporting to CMS and greater internal resources to monitor performance and prevent payment reductions.

Off-Campus Provider-Based Departments. Some health care providers bill for services as “provider-based entities” and, as such, are subject to CMS’s provider-based regulations. Beginning January 1, 2017, off-campus hospital outpatient departments that were not billing Medicare as provider based as of November 2, 2015 generally will not be eligible for payment under the Outpatient PPS with the exception of certain emergency services. To date, CMS has determined that such non-emergency services performed at these facilities will be paid under the physician fee schedule, but it is not known what payment system may be designated in the future. The new payment methodology for these locations and services has resulted in lower payments to hospitals than in previous years for providing the same services. A hospital outpatient department is considered to be “off-campus” if it is located more

than 250 yards from a main provider hospital or a remote location of a hospital. Administrative and judicial review are unavailable for determinations relating to applicable payment systems or determinations whether a provider department is considered an off-campus hospital outpatient department.

Other Medicare Service Payments. Medicare payment for skilled nursing services, psychiatric services, inpatient rehabilitation services, general outpatient services and home health services are based on regulatory formulas or pre-determined rates. There is no guarantee that these rates, as they may change from time to time, will be adequate to cover the actual cost of providing these services to Medicare patients.

Reimbursement of Hospital Capital Costs. Hospital capital costs apportioned to Medicare patient use (including depreciation and interest) are paid by Medicare on the basis of a standard federal rate (based upon average national costs of capital), subject to limited adjustments specific to the hospital. There can be no assurance that future capital-related payments will be sufficient to cover the actual capital-related costs of SHC's facilities applicable to Medicare patient stays or will provide flexibility for hospitals to meet changing capital needs.

Medical Education Payments. SHC, as the operator of a teaching hospital, has historically received direct and indirect medical education reimbursement through the Medicare program. Medicare currently pays for a portion of both direct and indirect graduate medical education ("GME") costs. These forms of additional payments are also vulnerable to reduction, modification or elimination. For example, the fiscal year 2017 federal budget proposed to reduce Medicare indirect GME payments by 10%.

Medicare Bad Debt Reimbursement. Under Medicare, the costs attributable to the deductible and coinsurance amounts which remain unpaid by the Medicare beneficiary can be added to the Medicare share of allowable costs as cost reports are filed. Hospitals generally receive interim pass-through payments during the cost report year which were determined by the Medicare Administrative Contractor ("MAC") from the prior cost report filing. Bad debts must meet the following criteria to be allowable:

- the debt must be related to covered services and derived from deductible and coinsurance amounts;
- the provider must be able to establish that reasonable collection efforts were made;
- the debt was actually uncollectible when claimed as worthless; and
- sound business judgment established that there was no likelihood of recovery at any time in the future.

The amounts uncollectible from specific beneficiaries are to be charged off as bad debts in the accounting period in which the accounts are deemed to be uncollectible. In some cases, an amount previously written off as a bad debt and allocated to the program may be recovered in a subsequent accounting period. In these cases, the recoveries must be used to reduce the cost of beneficiary services for the period in which the collection is made. In determining reasonable costs for hospitals, the amount of bad debts otherwise treated as allowable costs is reduced by 35% of the total amount. Amounts incurred by a hospital as reimbursement for bad debts are subject to audit and recoupment by the MAC. Bad debt reimbursement has been a focus of MAC audit/recoupment efforts in the past.

Recovery Audit Contractor Program. CMS has implemented a Recovery Audit Contractor ("RAC") program on a nationwide basis pursuant to which CMS contracts with private contractors to conduct pre- and post-payment reviews to detect and correct improper payments in the fee-for-service Medicare program. The ACA expands the RAC program's scope to include managed Medicare plans and Medicaid claims. CMS also contracts with Medicaid Integrity Contractors ("MICs") to perform post-payment audits of Medicaid claims and identify improper payments. These programs tend to result in retroactively reduced payment and higher administration costs to hospitals.

Medicaid Program. Medicaid is a program of medical assistance, funded jointly by the federal government and the states, for certain low income individuals and their dependents. Under Medicaid, the federal government provides limited funding to states that have medical assistance programs that meet federal standards. The ACA provides significantly enhanced federal funding for states to expand their Medicaid program to virtually all non-elderly, non-disabled adults with incomes up to 138% of the federal poverty level. Attempts to balance or reduce the

federal and state budgets, including the balanced budget requirements in California, may negatively impact spending for Medicaid and other state health care programs spending.

California Medi-Cal. Medi-Cal is the California Medicaid program.

Prior to July 2013, the State selectively contracted with general acute care hospitals to provide inpatient services to Medi-Cal patients through the Selective Provider Contracting Program (“SPCP”). Legislation enacted in 2010 directed the State Department of Health Care Services (“DHCS”) to replace the SPCP, which provided for per-diem payments, with reimbursement according to DRGs. Effective July 1, 2013, the SPCP was replaced by the DRG-based payment methodology, which was phased in over a three-year period. The DRG payment method is based on All-Patient Refined Diagnosis Related Groups (“APR-DRGs”), which is a proprietary classification system for clinical conditions that is currently licensed and in use by many other state Medicaid programs. Under the APR-DRG payment methodology, DHCS reimburses hospitals a fixed amount for each inpatient admission based on the APR-DRG for that admission, which DHCS will assign based on the diagnoses, procedures, patient age and discharge status submitted on the hospital claim form. As DHCS and hospitals gain experience with the APR-DRG payment methodology, DHCS intends to make adjustments in certain circumstances. It is anticipated that some California hospitals will see decreases in Medi-Cal payments while other hospitals will receive increases. Management does not believe that these changes have had any material impact on the financial condition of SHC.

At this time, a significant amount of legislation regarding Medi-Cal has been proposed. However, management is unable to determine the impact that any current or future proposed legislation may have on the financial condition of SHC.

Impact of Medicaid Payment Reductions. The ACA makes changes to Medicaid funding and substantially increases the potential number of Medicaid beneficiaries. To fund this expansion, the ACA provides that the federal government will fund 100% of the costs of this expansion from fiscal years 2014–2016, decreasing to 90% of the costs of this expansion in fiscal year 2020 and thereafter. In June 2012, the U.S. Supreme Court held that the federal government cannot withhold existing federal funds for states that refuse to expand Medicaid as required by the ACA. The State expanded Medi-Cal under the ACA, and it is uncertain to what extent the risk of lower reimbursement rates under Medi-Cal may be mitigated if the increased Medi-Cal utilization replaces previously uncompensated patients. Furthermore, there can be no assurance that legislation will not be adopted that would materially alter federal financing to the states in support of the Medicaid program, and there can be no assurance that any such legislation will not materially adversely affect SHC. See also “Health Care Reform” above.

For information concerning the Medi-Cal payments received by SHC, for the fiscal years ended August 31, 2015, 2016 and 2017, see APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION—Sources of Revenue.”

California Hospital Fee Program. In 2009, the California legislature enacted the Medi-Cal Hospital Provider Rate Stabilization Act and the Quality Assurance Fee Act, which imposed a “quality assurance fee” on California’s general acute care hospitals, except for public hospitals and certain exempt hospitals. The Medi-Cal hospital provider fee is essentially a tax on hospitals to raise funds for provider payments. The proceeds are used to earn federal matching funds for Medi-Cal, and to increase Medi-Cal payments to hospitals. Under this program, some California hospitals receive more funding in increased Medi-Cal reimbursement than the quality assurance fees paid, while other California hospitals receive less money in Medi-Cal payments than the fees paid. The California Medi-Cal Hospital Reimbursement Initiative, or Proposition 52, which passed in November 2016, extends the hospital fee program indefinitely and puts projections in place to prevent diversion of funds from the program. See APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION—Management’s Discussion and Analysis of Recent Financial Performance.”

Medicare and Medicaid Audits. Hospitals that participate in the Medicare and Medicaid programs are subject from time to time to audits and other investigations relating to various aspects of their operations and billing practices, as well as to retroactive audit adjustments to reimbursements claimed under these programs. Medicare and Medicaid regulations also provide for withholding reimbursement payments in certain circumstances. New billing rules and reporting requirements for which there is no clear guidance from CMS or state Medicaid agencies could result in claims submissions being considered inaccurate. The penalties for violations may include an obligation to

refund money to the Medicare or Medicaid program, payment of criminal or civil fines and, for serious or repeated violations, exclusion from participation in federal health programs.

Disproportionate Share Payments. The federal Medicare and the State Medi-Cal programs each provide additional payment for hospitals that serve a disproportionate share of certain low-income patients. SHC does not qualify as a disproportionate share hospital under the Medi-Cal program. The ACA substantially reduces Medicare and Medicaid payments to disproportionate share hospitals. There can be no assurance that payments to disproportionate share hospitals will not be further decreased or eliminated in the future.

California State Budget. The State enacted a balanced fiscal year 2017-18 budget, which took effect on July 1, 2017. However, it is impossible to predict the impact of future financial challenges to the California economy, including threat of future recessions, changes in federal spending policy and other events that could result in budget deficits. It is also impossible to predict actions that the Governor, the State legislature or voters—via ballot initiative—may take in the future. It is reasonable to expect, however, that cost containment measures, including aggressive management of the State’s health care spending, will be pursued to keep the State’s budget in balance, which may have an adverse effect on the financial condition of SHC. Examples of past such actions are set forth below:

- Aggressive health care cost-containment efforts by the Governor and the State legislature to help eliminate prior years’ budget deficits, including the State’s substantial cuts to health care provider reimbursement, including Medi-Cal payments to hospitals. For example, California enacted legislation to reduce its Medicaid expenditures through eligibility restrictions, (causing a greater number of indigent, uninsured or underinsured patients) and reductions in Medicaid payment rates. In October 2011, CMS approved the State’s request for 10% reductions in Medi-Cal payments for certain outpatient services and for long-term care. In May 2013, the Ninth Circuit Court of Appeals upheld the reductions, and in January 2014, the U.S. Supreme Court declined to review the Ninth Circuit Court of Appeals ruling.
- The significant expansions to Medicaid programs—Medi-Cal in California—under the ACA. This expansion will require additional program funding. Federal funding is available for some of this expansion, but it is conditioned on states maintaining specified beneficiary eligibility criteria and California has sought to limit program eligibility in recent years to reduce program costs. In May 2016, individuals 19 years of age and younger became eligible for full scope Medi-Cal benefits regardless of immigration status. This population was previously only eligible for restricted scope Medi-Cal, which only covers emergency medical conditions. This expansion will require additional program funding, and will be funded with State funds if federal participation is not available.
- While federal funding is available to facilitate Medicaid program expansion, this funding is expected to be temporary. The Medicaid program expansion and the expected longer-term loss of federal financial support to offset longer-term expansion-related costs may require the State to reduce provider reimbursement rates further.

Health Plans and Managed Care. Most private health insurance coverage is provided by various types of “managed care” plans, including health maintenance organizations (“HMOs”) and preferred provider organizations (“PPOs”) that generally use discounts and other economic incentives to reduce or limit the utilization of or payment for health care services. Medicare and Medicaid also purchase health care using managed care options. Payments to health care organizations from managed care plans typically are lower than those received from traditional indemnity or commercial insurers.

In California, managed care plans have replaced indemnity insurance as the primary source of non-governmental payment for health care services, and health care organizations must be capable of attracting and maintaining managed care business, often on a regional basis. Regional coverage and aggressive pricing may be required. However, it is also essential that contracting health care organizations be able to provide the contracted services without significant operating losses, which may require multiple forms of cost containment.

Many HMOs and PPOs currently pay providers on a negotiated fee-for-service basis or, for institutional care, on a fixed rate per day of care, or a fixed rate per hospital stay, which, in each case, usually is discounted from the usual and customary charges for the care provided. As a result, the discounts offered to HMOs and PPOs could, in some cases, result in payment to a provider that is less than its actual cost. Additionally, the volume of patients directed to a provider may vary significantly from projections, and changes in the utilization may be dramatic and unexpected, thus jeopardizing the provider's ability to manage this component of revenue and cost.

Some HMOs employ a "capitation" payment method under which health care organizations are paid a predetermined periodic rate for each enrollee in the HMO who is "assigned" or otherwise directed to receive care from a particular health care organization. The health care organization may assume financial risk for the cost and scope of institutional care given. If payment is insufficient to meet the health care organization's actual costs of care, or if utilization by such enrollees materially exceeds projections, the financial condition of the health care organization could erode rapidly and significantly. In addition to this standard managed care risk sharing approach, private health insurance companies are increasingly adopting various additional risk sharing/cost containing measures, sometimes similar to those introduced by government payors. Commercial insurers are also adopting total cost of care and pay for performance strategies with providers. Providers may expect health care cost containment and its associated risk sharing to continue to increase in the coming years amongst all payors.

Often, managed care contracts are enforceable for a stated term, regardless of health care organization losses, and may require health care organizations to care for enrollees for a certain time period, regardless of whether the payor is able to pay the health care organization. Disputes with HMOs, PPOs and other managed care payors may result in mediation, arbitration or litigation. Health care organizations from time to time have disputes with HMOs, PPOs and other managed care payors concerning payment and contract interpretation issues.

There is no assurance that SHC will maintain particular insurance contracts, existing rates or obtain contracts from other third party payors in the future. Failure to maintain contracts could have the effect of reducing a health care organization's net patient services revenues. Conversely, participation may result in lower net income if participating health care organizations are unable to adequately contain their costs. In part to reduce costs, health plans are increasingly implementing, and offering to purchasing employers, tiered provider networks, which involve classification of a plan's network providers into different tiers based on care quality and cost. With tiered benefit designs, plan enrollees are generally encouraged, through incentives or reductions in copayments or deductibles, to seek care from providers in the top tier. Classification of a hospital in a non-preferred or lower tier by a significant payor may result in a material loss of volume.

In addition to tiered provider networks, managed care plans are also implementing narrow provider networks in which only a select group of providers participate as in-network providers. Managed care plans often look at quality performance and cost in selecting providers to participate in their narrow networks. A provider's exclusion from a narrow network may result in a material loss of volume. Managed care plans may offer lower reimbursement for providers in their narrow network(s) in exchange for additional volume expected from being one of a select group of network providers. The reimbursement may be insufficient to cover a network provider's cost in providing the services. The new demands of dominant health plans and other shifts in the managed care industry may also reduce patient volume and revenue. Thus, managed care poses one of the most significant business risks (and opportunities) that health care organizations face.

In addition, the current trend of consolidation in the health insurance industry is likely to increase the leverage of commercial insurers when negotiating rates with health care providers. Large health insurers that assume dominant positions in local markets threaten to increase health insurer concentration, reduce competition and decrease choice. If SHC were to terminate its agreement with any of the major managed care payors or not agree to terms proposed by such payors, it could have a significant material adverse impact on the financial condition of SHC.

With implementation of the ACA, substantial numbers of individuals are choosing health insurance under the health insurance exchanges, increasing the number of individuals covered in the individual market. Individuals choosing their own coverage may become highly price sensitive, which could increase the number of enrollees in HMO plans and increase the use of capitation, making price negotiations with HMO and other insurance plans more difficult.

For information concerning the managed care payments received by the Obligated Group for the fiscal years ended August 31, 2015, 2016 and 2017, see APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION—Sources of Revenue.”

International Classification of Diseases, 10th Revision Coding System. In 2009, CMS published the final rule adopting the International Classification of Diseases, 10th Revision coding system (“ICD-10”), which became effective in October 2015. ICD-10 provides a common approach to the classification of diseases and other health problems, allowing the United States to align with other nations to better share medical information, diagnosis, and treatment codes. ICD-10 is not without risk as staff had to be retrained, processes redesigned, and computer applications modified as the current available codes and digit size dramatically increased. Additionally, there is a potential for temporary coding and payment backlog, as well as potential increases in claims errors. In September 2015, CMS approved a “crosswalk” approach to coding conversion for Medicaid agencies in California, Louisiana, Maryland and Montana. Rather than full conversion to the new ICD-10 system, those states instead will be allowed to convert ICD-10 claims into ICD-9 codes for calculating payments under Medicaid fee-for-service programs. While this crosswalk approach creates risk of payment delays and potential errors, most Medicaid claims, particularly in California, are covered under capitated Medicaid managed care plans which do not bill for specific services under the coding system. At this time, however, it is not possible to predict the effects of full, or crosswalk, ICD-10 implementation.

Negative Rankings Based on Clinical Outcomes, Cost, Quality, Patient Satisfaction and Other Performance Measures. Health plans, Medicare, Medicaid, Medi-Cal, employers, trade groups and other purchasers of health services, private standard-setting organizations and accrediting agencies increasingly are using statistical and other measures in efforts to characterize, publicize, compare, rank and change the quality, safety and cost of health care services provided by hospitals and providers. The ACA shifts payments from paying for volume to paying for value, based on various health outcome measures. Published rankings such as “score cards,” “pay for performance” and other financial and non-financial incentive programs are being introduced to affect the reputation and revenue of hospitals, the members of their medical staffs and other providers and to influence the behavior of consumers and providers such as SHC. Currently prevalent are measures of quality based on clinical outcomes of patient care, reduction in costs, patient satisfaction and investment in health information technology. Measures of performance set by others that characterize a hospital or a provider negatively may adversely affect its reputation and financial condition.

Enforcement Affecting Clinical Research. In addition to increasing enforcement of laws governing payment and reimbursement, the federal government has also stepped up enforcement of laws and regulations governing the conduct of clinical trials at hospitals. DHHS elevated and strengthened its Office for Human Research Protections, one of the agencies responsible for monitoring federally funded research. In addition, the National Institutes of Health (“NIH”) significantly increased the number of facility inspections that these agencies perform. The Food and Drug Administration (“FDA”) also has authority over the conduct of clinical trials performed in hospitals when these trials are conducted on behalf of sponsors seeking FDA approval to market the drug or device that is the subject of the research. Moreover, the Office of Inspector General (“OIG”) in its recent “Work Plans” has included several enforcement initiatives related to reimbursement for experimental drugs and devices (including kickback concerns) and has issued compliance program guidance directed at recipients of extramural research awards from the NIH and other agencies of the U.S. Public Health Service. Although SHC is not the direct recipient of such awards (instead, Stanford University School of Medicine is the recipient of research awards), SHC receives payments for health care items and services under many of these grants as a subcontractor. As such, SHC is subject to complex and ambiguous coverage principles and rules governing billing for items or services it provides to patients participating in clinical trials funded by governmental agencies and private sponsors.

The enforcement powers of agencies with oversight of clinical research range from substantial fines and penalties to exclusion of researchers and suspension or termination of entire research programs. Billing of the Medicare program for experimental care provided to patients that is not eligible for Medicare reimbursement can subject SHC to sanctions as well as repayment obligations.

Regulatory Environment

“Fraud” and “False Claims.” Health care “fraud and abuse” laws have been enacted at the federal and state levels to broadly regulate the provision of services to government program beneficiaries and the methods and requirements for submitting claims for services rendered to the beneficiaries. Under these laws, hospitals and others can be penalized for a wide variety of conduct, including submitting claims for services that are not provided, billing in a manner that does not comply with government requirements or submitting inaccurate billing information, billing for services deemed to be medically unnecessary, or billings accompanied by an illegal inducement to utilize or refrain from utilizing a service or product.

Federal and state governments have a broad range of criminal, civil and administrative sanctions available to penalize and remediate health care fraud, including the exclusion of a hospital from participation in the Medicare/Medicaid programs, civil monetary penalties, requiring execution of corrective action plans, and suspension of Medicare/Medicaid payments. Fraud and abuse cases may be prosecuted by one or more government entities and/or private individuals, and more than one of the available sanctions may be, and often are, imposed for each violation. The ACA also authorizes the Secretary of DHHS to suspend payments to a provider pending an investigation or prosecution of a credible allegation of fraud against the provider.

Laws governing fraud and abuse may apply to a hospital and to nearly all individuals and entities with which a hospital does business. Fraud investigations, settlements, prosecutions and related publicity can have a material adverse effect on hospitals. See “Enforcement Activity,” below. Major elements of these often highly technical laws and regulations are generally summarized below.

False Claims Act. The federal False Claims Act (“FCA”) makes it illegal to knowingly submit or present a false, fictitious or fraudulent claim for payment or approval for payment for which the federal government provides, or reimburses at least some portion of the requested money or property. Because the term “knowingly” is defined broadly under the law to include not only actual knowledge but also deliberate ignorance or reckless disregard of the facts, the FCA can be used to punish a wide range of conduct. The ACA amends the FCA by expanding the number of activities that are subject to civil monetary penalties to include, among other things, failure to report and return known overpayments within statutory limits. FCA investigations and cases have become common in the health care field and may cover a range of activity from submission of intentionally inflated billings, to highly technical billing infractions, to allegations of inadequate care. Penalties under the FCA are severe and may include damages equal to three times the amount of the alleged false claims, as well as substantial civil monetary penalties. As a result, violation or alleged violation of the FCA frequently results in settlements that require multi-million dollar payments and compliance agreements. The FCA provides for potentially severe penalties: treble damages, attorneys’ fees and civil fines of \$5,000 to \$11,000 per claim. In June 2016, the Department of Justice (“DOJ”) issued a rule that more than doubles civil monetary penalties under the FCA. These increases took effect on August 1, 2016 and apply to FCA violations after November 2, 2015. The new penalties significantly increase the potential financial exposure resulting from an FCA violation.

The FCA also permits individuals to initiate civil actions on behalf of the government in lawsuits called “qui tam” actions. Qui tam plaintiffs, or “whistleblowers,” can share in the damages recovered by the federal government or recover independently if the government does not participate. The FCA has become one of the federal government’s primary weapons against health care fraud and suspected fraud. FCA violations or alleged violations could lead to settlements, fines, exclusion or reputation damage that could have a material adverse impact on a hospital and other health care providers. Some regulators and whistleblowers have asserted that claims submitted to governmental payers that do not comply fully with regulations or guidelines come within the scope of the FCA. Recently, the U.S. Supreme Court in *Universal Health Services, Inc. v. United States ex rel. Escobar* held that the theory of “implied false certification” can be used as a basis for FCA liability when (1) a claim does more than merely request payment and makes specific representations about the nature of the goods or services provided and (2) the failure to disclose noncompliance with material statutory, regulatory or contractual provisions makes the representations “misleading half-truths.” The application of this new standard is evolving and could lead to an increase in FCA claims in the health care industry based on this theory of liability.

Under the ACA, the FCA has been expanded to include overpayments that are discovered by a health care provider and are not promptly refunded to the applicable federal health care program, even if the claims relating to

the overpayment were initially submitted without any knowledge that they were false. The ACA requires that providers return identified overpayments within the later of 60 days of identification or the date any corresponding cost report is due or the overpayment becomes an “obligation” under the FCA. There was initially great uncertainty in the industry as to when an overpayment is technically “identified” and the ability of a provider to determine the total amount of an overpayment and satisfy its repayment obligation within the required time period. A March 14, 2016 CMS final rule clarified that an overpayment is considered to have been identified when either reasonable diligence is completed (including determination of the overpayment amount) or on the day the person received credible information of a potential overpayment (if the person failed to conduct reasonable diligence and the person in fact received an overpayment). That same final rule also established a six-year lookback period, meaning overpayments must be reported and returned only if a person identifies the overpayment within six years of the date the overpayment was received. This expansion of the FCA exposes hospitals and other health care providers to liability under the FCA for a considerably broader range of claims than in the past.

Anti-Kickback Law. The federal “Anti-Kickback Law” is a criminal statute that prohibits anyone from soliciting, receiving, offering or paying any remuneration, directly or indirectly, overtly or covertly, in cash or in kind, in return for a referral (or to induce a referral) for any item or service that is paid by any federal or state health care program. The Anti-Kickback Law potentially applies to many common health care transactions between persons and entities with which a hospital does business, including hospital-physician joint ventures, medical director agreements, physician recruitment agreements, physician office leases and other transactions. The ACA amended the Anti-Kickback Law to provide explicitly that a claim that includes items or services resulting from a violation of the Anti-Kickback Law constitutes a false or fraudulent claim for purposes of the FCA. Another amendment provides that an Anti-Kickback Law violation may be established without showing that an individual knew of the statute’s proscriptions or acted with specific intent to violate the Anti-Kickback Law, but only that the conduct was generally wrongful.

Violations or alleged violations of the Anti-Kickback Law may result in settlements that require multi-million dollar payments and onerous corporate integrity agreements. The Anti-Kickback Law can be prosecuted either criminally or civilly. A criminal violation may be prosecuted as a felony, subject to a fine of up to \$25,000 for each act (which may be each item or each bill sent to a federal program), imprisonment and exclusion from the Medicare and Medicaid programs, any of which could have a significant detrimental effect on the financial stability of most hospitals. In addition, civil monetary penalties of \$74,792 per item or service in noncompliance (which may be each item or each bill sent to a federal program) or an “assessment” of three times the amount claimed may be imposed. Increasingly, the federal government and qui tam relators are prosecuting violations of the Anti-Kickback Law under the FCA, based on the argument that claims resulting from an illegal kickback arrangement are also false claims for FCA purposes. See the discussion under the subheading “False Claims Act” above. The IRS has taken the position that hospitals that are in violation of the Anti-Kickback Law may also be subject to revocation of their tax-exempt status. See “—Tax-Exempt Status and Other Tax Matters” below.

Stark Referral Law. The federal “Stark” statute (“Stark” or the “Stark Law”) prohibits the referral of Medicare patients for certain designated health services (including inpatient and outpatient hospital services, clinical laboratory services, and radiation and other imaging services) to entities with which the referring physician, or immediate family member, has a financial relationship unless that relationship fits within a Stark exception. It also prohibits a hospital furnishing the designated services from billing Medicare, or any other payor or individual for services performed pursuant to a prohibited referral. The government does not need to prove that the entity knew that the referral was prohibited to establish a Stark violation. If certain substantive and technical requirements of an applicable exception are not satisfied, many ordinary business practices and economically desirable arrangements between hospitals and physicians, which constitute “financial relationships” would fall within the meaning of the Stark statute, thus triggering the prohibition on referrals and billing. Most providers of designated health services with physician relationships have some exposure to liability under the Stark statute.

Medicare may deny payment for all services performed based on a prohibited referral and a hospital that has billed for prohibited services may be obligated to notify and refund the amounts collected from the Medicare program. For example, if an office lease between a hospital and a large group of heart surgeons is found to violate Stark, the hospital could be obligated to repay CMS for the payments received from Medicare for all of the heart surgeries performed by all of the physicians in the group for the duration of the lease; a potentially significant amount. The government may also seek substantial civil monetary penalties, and in some cases, a hospital may be excluded from

the Medicare and Medicaid programs. Potential repayments to CMS, settlements, fines or exclusion for a Stark Law violation or alleged violation could have a material adverse impact on a hospital and other health care providers. Increasingly, the federal government is prosecuting violations of the Stark Law under the FCA, based on the argument that claims resulting from an illegal referral arrangement are also false claims for FCA purposes. See the discussion under the subheading “False Claims Act” above. The federal government has attempted to recover the federal portion of Medicaid claims referred to hospitals by physicians with whom they have a prohibited financial relationship.

CMS has established a voluntary self-disclosure program under which hospitals and other entities may report Stark Law violations and seek a reduction in potential refund obligations. The limited publicly available information with respect to the self-disclosure program suggests that most voluntary self-disclosure submissions remain under consideration by CMS for an extended period of time, and that it is difficult to predict how CMS will react to any specific voluntary self-disclosure. SHC may make self-disclosures under this program as appropriate from time to time. Any submission pursuant to the self-disclosure program does not waive or limit the ability of the OIG or DOJ to seek or prosecute violations of the Anti-Kickback Law or impose civil monetary penalties.

State “Fraud” and “False Claims” Laws. Hospital providers in California also are subject to a variety of State laws related to false claims (similar to the FCA or that are generally applicable false claims laws), anti-kickback (similar to the federal Anti-Kickback Law or that are generally applicable anti-kickback or fraud laws), and physician referral (similar to Stark). These prohibitions while similar in public policy and scope to the federal laws have not in all instances been avidly enforced to date. However, in the future they could pose the possibility of material adverse impact for the same reasons as the federal statutes. See discussion under the subheadings “False Claims Act,” “Anti-Kickback Law” and “Stark Referral Law” above. California also has an FCA-type law that applies to fraudulent claims presented to an insurance company, which thus goes beyond the scope of the FCA and California’s directly analogous statute, which are limited to fraudulent claims for which the federal government is required to pay or reimburse a portion or all of the claim. Under the California law, codified in Section 1871.7 of the California Insurance Code, a person who submits a fraudulent claim to an insurance company is subject to civil fines ranging from \$5,000 to \$10,000 per fraudulent claim, plus an additional assessment of no more than three times the amount of each claim, and may be subject to criminal penalties under the California Penal Code as well. Similar to the FCA, actions under this Insurance Code section may be initiated by private parties.

Antitrust. Antitrust liability may arise in a wide variety of circumstances, including medical staff privilege disputes, payor contracting, physician relations, joint ventures, merger, affiliation and acquisition activities, certain pricing or salary setting activities, as well as other areas of activity. Consolidation transactions among health care providers are an area in which investigation and enforcement activity by federal and state antitrust agencies is particularly frequent and vigorous. The application of the federal and state antitrust laws to health care is evolving (especially as the ACA is implemented), and therefore not always clear. Currently, the most common areas of potential liability are joint action among providers with respect to payor contracting and medical staff credentialing disputes, and hospital mergers and acquisitions.

Violation of the antitrust laws could result in criminal and/or civil enforcement proceedings by federal and state agencies, as well as actions by private litigants. In certain actions, private litigants may be entitled to treble damages, and in others, governmental entities may be able to assess substantial monetary fines. Investigations and proceedings arising from the application of federal and state antitrust laws can require the dedication of substantial resources by affected providers and can delay or impede proposed transactions even if ultimately it is determined that no violation of applicable law would occur as a result of the proposed transaction.

HIPAA, HITECH, and Other Privacy and Security Requirements. HIPAA, along with other federal and various state statutes, addresses the confidentiality of individuals’ health information. HIPAA’s detailed privacy standards extend not only to patient medical records, but also to a variety of demographic, clinical and financial information held by “covered entities,” *i.e.*, hospitals and other entities governed by HIPAA. HIPAA’s privacy standards prohibit the use and disclosure of, and access to, “Protected Health Information” (“PHI”), a broadly defined term, unless expressly permitted under the provisions of the HIPAA statute and regulations or authorized by the patient. The HIPAA privacy standards also give individuals the rights to know how their PHI is being used or disclosed, to access and amend their PHI, and obtain information about certain disclosures of their PHI. They also obligate covered entities to provide Notices of Privacy Practices to individuals, which detail how the entities use and disclose PHI and how individuals can exercise their rights in respect of their PHI. These requirements often impose

communication, operational, and accounting obligations that add costs and create potentially unanticipated sources of liability.

HIPAA contains security standards that require covered entities to implement certain administrative, physical, and technical security standards to protect the integrity, confidentiality and availability of electronic PHI. HIPAA also implemented transaction standards that dictate the use of standard transaction formats, code sets and standard identifiers in connection with certain electronic health care transactions between health plans and health care providers, including activities associated with the billing and collection of health care claims.

HIPAA imposes civil monetary penalties for violations and criminal penalties for violations of its privacy and security standards, and these civil penalties have now been increased through provisions in the Health Information Technology for Economic and Clinical Health Act (the "HITECH Act"), which was enacted as part of the economic stimulus legislation. The revised civil monetary penalty provisions of HITECH establish a tiered system of minimum penalties, ranging from a minimum of \$110 per violation for an unknowing violation to a minimum of \$55,010 for an uncorrected violation due to willful neglect. Maximum penalties may reach \$1,650,300 for identical violations.

The HITECH Act also (i) granted enforcement authority of HIPAA to state attorneys general, (ii) extended the reach of HIPAA beyond "covered entities," (iii) imposed a breach notification requirement on HIPAA covered entities, (iv) limited certain uses and disclosures of PHI, and (v) restricted covered entities' permissible marketing communications.

The breach notification obligation, in particular, may expose covered entities such as hospitals to heightened liability. Under HITECH, in the event of a privacy breach, covered entities are required to notify affected individuals and the federal government. If more than 500 individuals are affected by the breach, (1) the covered entity must also notify the media and (2) the federal government posts a description of the breach on its website and investigates the incident through the DHHS Office for Civil Rights ("OCR"), the administrative office that is tasked with enforcing HIPAA. The OCR may also investigate breaches involving fewer than 500 affected individuals.

Recent settlements of HIPAA breaches have reached the millions of dollars. Any breach of HIPAA, regardless of intent or scope, may result in penalties or settlement amounts that are material to a covered health care provider or health plan. In addition to the costs associated with any such penalties and settlements, covered entities may incur significant costs associated with investigating and handling potential privacy and security breaches.

Enforcement activity is expected to increase in future years in other respects as well. Criminal penalties may be enforced against persons who obtain or disclose personal health information without authorization. DHHS is also beginning to perform periodic audits of health care providers and group health plans to ensure that required policies under the HITECH Act are in place.

On January 25, 2013, DHHS issued comprehensive modifications to the existing HIPAA regulations to implement the requirements of the HITECH Act, commonly known as the "HIPAA Omnibus Rule." The HIPAA Omnibus Rule became effective on March 26, 2013, and covered entities were required to be in compliance by September 23, 2013, although certain requirements have a longer timeframe. Key aspects of the HIPAA Omnibus Rule, some of which are discussed above in the paragraphs discussing the HITECH Act, include, but are not limited to: (i) a new standard for what constitutes a breach of PHI, (ii) four levels of culpability with respect to civil monetary penalties assessed for HIPAA violations, (iii) direct liability of business associates for certain violations of HIPAA, (iv) modifications to the rules governing research, (v) stricter requirements regarding non-exempt marketing practices, (vi) modification and re-distribution of notices of privacy practices, (vii) expanded rights of individuals to receive electronic copies of their PHI, and (viii) stricter requirements regarding the protection of genetic information. While the effects of the HIPAA Omnibus Rule cannot be predicted at this time, the obligations imposed thereunder could have a material adverse effect on the financial condition of SHC.

Under HIPAA, covered entities must include certain required provisions in their contractual relationships with their business associates. Business associates are organizations that perform functions on behalf of covered entities, and receive PHI from the covered entities in order to carry out those functions. Business associates are indirectly regulated by HIPAA through those contractual obligations. The HITECH Act and the final rules promulgated thereunder provide that all of the HIPAA security administrative, physical, and technical safeguards, as

well as security policy, procedure and documentation requirements, now apply directly to all business associates. In addition, the HITECH Act makes certain privacy provisions directly applicable to business associates. These changes are significant because business associates will now be directly regulated by DHHS for those requirements, and as a result, will be subject to penalties imposed by DHHS and/or state attorneys general. Likewise, a covered entity may in certain circumstances be held liable for a breach by its business associate. Covered entities have had to review and amend their business associate agreements in recent years in order to comply with these changing rules, which can be costly and administratively burdensome.

In addition to HIPAA and HITECH, a number of other laws address the confidentiality of individual health information. These other laws may impose more stringent privacy requirements than HIPAA does. For instance, federal laws place additional confidentiality requirements on records pertaining to alcohol and substance abuse treatment at certain facilities. California and other states have adopted laws that afford greater protection to certain types of particularly sensitive health information, such as behavioral health records. California and many other states have also adopted broad data breach notification laws that extend to compromised medical and health insurance information. Together, all of these laws and regulations add compliance costs and create potentially unanticipated sources of legal liability for SHC.

Electronic Health Record Requirements. The HITECH Act also established programs under Medicare and Medicaid to provide incentive payments for the “meaningful use” of certified electronic health record (“EHR”) technology. In 2011, the Medicare and Medicaid EHR incentive programs began providing incentive payments to eligible professionals and eligible hospitals for demonstrating meaningful use of certified EHR technology. Health care providers demonstrate their meaningful use of EHR technology by meeting objectives specified by CMS for using health information technology and by reporting on specified clinical quality measures. Beginning in 2015, hospitals and physicians that have not satisfied the performance and reporting criteria for demonstrating meaningful use will have their Medicare payments significantly reduced. Additionally, beginning in 2014, the federal government began auditing hospitals’ and providers’ records related to their attestation of being “meaningful users” in order to obtain the incentive payments. A hospital or provider that fails the audit will have an opportunity to appeal. Ultimately, hospitals or providers that fail on appeal will have to repay any incentive payments they received through these programs.

Security Breaches and Unauthorized Releases of Personal Information. State and local authorities are increasingly focused on the importance of protecting the confidentiality of individuals’ personal information, including patient health information. Many states, including California, have enacted laws requiring businesses to notify individuals of security breaches that result in the unauthorized release of personal information. In some states, notification requirements may be triggered even where information has not been used or disclosed, but rather has been inappropriately accessed.

California medical privacy laws penalize the unlawful use or disclosure of, patients’ medical information, as well as unauthorized access to such information, which the laws define as the inappropriate access, review, or viewing of patient medical information without the direct need to do so for purposes of diagnosis, treatment or other lawful use. Administrative penalties under these medical privacy laws may reach \$250,000 per violation or for each reported event.

State consumer protection laws may also provide the basis for legal action for privacy and security breaches and frequently, unlike HIPAA, authorize a private right of action. In particular, the public nature of security incidents exposes health organizations to increased risk of individual or class action lawsuits from patients or other affected persons, in addition to government enforcement and negative media attention. Failure to comply with restrictions on patient privacy or to maintain robust information security safeguards, including taking steps to ensure that contractors who have access to sensitive patient information maintain the confidentiality of such information, could consequently damage a hospital’s reputation and materially adversely affect business operations.

In any hospital, there can be security incidents related to patient information, which stem from a variety of causes ranging from external or internal deliberate invasions by individuals or employees, to inadvertent loss or misdirection of paper or electronic records, to theft of hardware or software.

Exclusions from Medicare or Medicaid Participation. The government may exclude a hospital from Medicare/Medicaid program participation if it is convicted of a criminal offense relating to the delivery of any item or service reimbursed under Medicare or a state health care program, any criminal offense relating to patient neglect or abuse in connection with the delivery of health care, fraud against any federal, state or locally financed health care program or an offense relating to the illegal manufacture, distribution, prescription, or dispensing of a controlled substance. The government also may exclude individuals or entities under certain other circumstances, such as an unrelated conviction of fraud, or other financial misconduct relating either to the delivery of health care in general or to participation in a federal, state or local government program. Exclusion from the Medicare/Medicaid program means that a hospital would be decertified from program participation and no program payments can be made. Any hospital exclusion could be a materially adverse event. In addition, exclusion of hospital or independent contractors or their employees under Medicare or Medicaid may be another source of potential liability for hospitals or health systems based on services provided by those excluded employees.

Administrative Enforcement. Administrative regulations may require less proof of a violation than do criminal laws, and, thus, health care providers may have a higher risk of imposition of monetary penalties as a result of administrative enforcement actions.

Civil Monetary Penalty Law. The federal Civil Monetary Penalty Law (“CMPL”) provides for administrative sanctions against health care providers for a broad range of billing and other abuses. A health care provider is liable under the CMPL if it knowingly presents, or causes to be presented, improper claims for reimbursement under Medicare, Medicaid and other federal health care programs. A hospital that participates in arrangements known as “gainsharing” by paying a physician to limit or reduce services to Medicare fee-for-service beneficiaries also could be subject to CMPL penalties. A health care provider that provides benefits to Medicare or Medicaid beneficiaries that such provider knows or should know are likely to induce the beneficiaries to choose the provider for their care also could be subject to CMPL penalties. The CMPL authorizes imposition of a civil money penalty and treble damages. The ACA also amended the CMPL laws to establish various new grounds for exclusion and civil monetary penalties, as well as increased penalty thresholds for existing civil monetary penalties. The federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015 (the “Civil Penalties Inflation Adjustment Act”) required that federal agencies, including OIG, increase civil monetary penalty amounts annually to reflect adjustments for inflation; the Civil Penalties Inflation Adjustment Act additionally required that federal agencies “catch up” civil monetary penalty amounts to reflect prior years of inflation.

Health care providers may be found liable under the CMPL even when they did not have actual knowledge of the impropriety of their action. Knowingly undertaking the action is sufficient. Ignorance of the Medicare regulations is no defense. The imposition of civil money penalties on a health care provider could have a material adverse impact on the provider’s financial condition.

Compliance with Conditions of Participation. CMS, in its role of monitoring participating providers’ compliance with conditions of participation in the Medicare program, may determine that a provider is not in compliance with its conditions of participation. In that event, a notice of termination of participation may be issued or other sanctions, such as suspension or requiring execution of potentially burdensome corrective action plans, potentially could be imposed.

EMTALA. The Emergency Medical Treatment and Active Labor Act (“EMTALA”) is a federal civil statute that requires hospitals to treat or conduct a medical screening for emergency conditions and to stabilize a patient’s emergency medical condition before releasing, discharging or transferring the patient. A hospital that violates EMTALA is subject to civil penalties of up to \$103,139 per offense and exclusion from the Medicare and Medicaid programs. Over the last few years, the federal government has increased its enforcement of EMTALA. In addition, the hospital may be liable for any claim by an individual who has suffered harm as a result of a violation.

Licensing, Surveys, Investigations and Accreditations. Health facilities are subject to numerous legal, regulatory, professional and private licensing, certification and accreditation requirements. These include, but are not limited to, requirements of state licensing agencies and The Joint Commission. Renewal and continuation of certain of these licenses, certifications and accreditations are based on inspections or other reviews generally conducted in the normal course of business of health facilities. Loss of, or limitations imposed on, hospital licenses or accreditations could reduce hospital utilization or revenues, or a hospital’s ability to operate all or a portion of its facilities or to bill

various third party payors. Certain states, including California, can levy penalties against hospitals that experience certain significant patient care events, including those that are classified as posing “immediate jeopardy” to patient health and safety. In California, the administrative penalty for such incidents occurring on or after April 1, 2014 is up to a maximum of \$75,000 for the first incident, up to \$100,000 for the second, and up to \$125,000 for the third and every subsequent violation within three (3) years.

Environmental Laws and Regulations. Health facilities are subject to a wide variety of federal, state and local environmental and occupational health and safety laws and regulations. These include but are not limited to: air and water quality control requirements; waste management requirements; specific regulatory requirements applicable to asbestos and radioactive substances; requirements for providing notice to employees and members of the public about hazardous materials handled by or located at the health facilities; and requirements for training employees in the proper handling and management of hazardous materials and wastes.

Health facilities may be subject to requirements related to investigating and remedying hazardous substances located on their property, including such substances that may have migrated off the property. Typical hospital operations include the handling, use, storage, transportation, disposal and discharge of hazardous, infectious, toxic, radioactive, flammable and other hazardous materials, wastes, pollutants and contaminants. As such, hospital operations are particularly susceptible to the practical, financial and legal risks associated with the environmental laws and regulations. Such risks may result in damage to individuals, property or the environment; may interrupt operations and increase their cost; may result in legal liability, damages, injunctions or fines; and may result in investigations, administrative proceedings, civil litigation, criminal prosecution, penalties or other governmental agency actions; and may not be covered by insurance.

Enforcement Activity. Enforcement activity against health care providers has increased, and enforcement authorities have adopted aggressive approaches. In the current regulatory climate, it is anticipated that many hospitals and physician groups will be subject to an audit, investigation, or other enforcement action regarding the health care fraud laws mentioned above.

Enforcement authorities are often in a position to compel settlements by providers charged with or being investigated for false claims violations by withholding or threatening to withhold Medicare, Medicaid and similar payments or to recover higher damages, assessments or penalties by instituting criminal action. In addition, the cost of defending such an action, the time and management attention consumed, and the facts of a case may dictate settlement. Therefore, regardless of the merits of a particular case, a hospital could experience materially adverse settlement costs, as well as materially adverse costs associated with implementation of any settlement agreement. Prolonged and publicized investigations could be damaging to the reputation and business of a hospital, regardless of outcome.

Certain acts or transactions may result in violation or alleged violation of a number of the federal health care fraud laws described above, and therefore penalties or settlement amounts often are compounded. Generally these risks are not covered by insurance. Enforcement actions may involve multiple hospitals or other facilities in a health system, as the government often extends enforcement actions regarding health care fraud to other entities in the same organization. Therefore, Medicare fraud related risks identified as being materially adverse to a hospital could have materially adverse consequences to a health system taken as a whole.

Business Relationships and Other Business Matters

Integrated Delivery Systems. Hospitals and health care systems often own, control or have affiliations with physician groups and independent practice associations. Generally, the sponsoring health facility or health system is the primary capital and funding source for such alliances and may have an ongoing financial commitment to provide growth capital and support operating deficits. As separate operating units, integrated physician practices and medical foundations sometimes operate at a loss and require subsidies or other support from the related hospital or health system. In addition, integrated delivery systems present business challenges and risks. Inability to attract or retain participating physicians may negatively affect managed care, contracting and utilization. The technological and administrative infrastructure necessary both to develop and operate integrated delivery systems and to implement new payment arrangements in response to changes in Medicare and other payor reimbursement is costly. Hospitals may not achieve savings sufficient to offset the substantial costs of creating and maintaining this infrastructure.

These types of alliances are generally designed to respond to trends in the delivery of medicine to better integrate hospital and physician care, to increase physician availability to the community and/or to enhance the managed care capability of the affiliated hospitals and physicians. However, these goals may not be achieved, and an unsuccessful alliance may be costly and counterproductive to all of the above-stated goals.

These types of alliances are likely to become increasingly important to the success of hospitals in the future as a result of changes to the health care delivery and reimbursement systems that are intended to restrain the rate of increases of health care costs, encourage coordinated care, promote collective provider accountability and improve clinical outcomes. The ACA authorizes several alternative payment programs for Medicare that promote, reward or necessitate integration among hospitals, physicians and other providers.

Whether these programs will achieve their objectives and be expanded or mandated as conditions of Medicare participation cannot be predicted. However, Congress and CMS have clearly emphasized continuing the trend away from the fee-for-service reimbursement model, which began in the 1980s with the introduction of the prospective payment system for inpatient care, and toward an episode-based payment model that rewards use of evidence-based protocols, quality and satisfaction in patient outcomes, efficiency in using resources, and the ability to measure and report clinical performance. This shift is likely to favor integrated delivery systems, which may be better able than stand-alone providers to realize efficiencies, coordinate services across the continuum of patient care, track performance and monitor and control patient outcomes. Changes to the reimbursement methods and payment requirements of Medicare, which is the dominant purchaser of medical services, are likely to prompt equivalent changes in the commercial sector, because commercial payors frequently follow Medicare's lead in adopting payment policies.

While payment trends may stimulate the growth of integrated delivery systems, these systems carry with them the potential for legal or regulatory risks. Many of the risks discussed in “—Regulatory Environment” above, may be heightened in an integrated delivery system. The foregoing laws were not designed to accommodate coordinated action among hospitals, physicians and other health care providers to set standards, reduce costs and share savings, among other things. The ability of hospitals or health systems to conduct integrated physician operations may be altered or eliminated in the future by legal or regulatory interpretation or changes, or by health care fraud enforcement. In addition, participating physicians may seek their independence for a variety of reasons, thus putting the hospital or health system's investment at risk, and potentially reducing its managed care leverage and/or overall utilization. In October 2011, CMS, the Federal Trade Commission and DOJ jointly issued guidance regarding waivers and safe harbors to enable providers to participate in the Medicare Shared Savings Program (“MSSP”). There can be no assurance that such waivers or other regulations or guidance will sufficiently clarify the scope of permissible activity in all cases. State law prohibitions, such as the bar on the corporate practice of medicine, or state law requirements, such as insurance laws regarding licensure and minimum financial reserve holdings of risk-bearing organizations, may also introduce complexity, risk and additional costs in organizing and operating integrated delivery systems. Tax-exempt hospitals and health systems also face the risk in affiliating with for-profit entities that the IRS will determine that compensation practices or business arrangements result in private benefit or private use or generate unrelated business income for the hospitals and health systems.

Health care providers, responding to health care reform and other industry pressures, are increasingly moving toward integrated delivery systems, managing the health of populations of individuals, patient-centered medical homes, bundled payments, and capitated insurance plans. These trends will require new infrastructures, including the appropriate mix of physician specialties, new administrative skills, close relationships between physicians and hospitals, insurance risk management, and new relationships between patients and providers. Provider organizations may be unsuccessful in assembling successful integrated networks, may not achieve savings sufficient to offset the substantial costs of creating and maintaining the necessary infrastructures to support such developments, or otherwise could incur losses or damage reputations from assuming increased risk and could incur damage to reputations. Some health care organizations that traditionally operated hospitals may, directly or in partnership, take on actual insurance risk, market various health coverage products and access patients by way of unknown channels. Such new endeavors could adversely affect the financial and operating condition or reputation of an organization.

Physician Financial Relationships. In addition to the physician integration relationships referred to above, hospitals and health systems frequently have various additional business and financial relationships with physicians and physician groups. These are in addition to hospital physician contracts for individual services performed by

physicians in hospitals. They potentially include: joint ventures to provide a variety of outpatient services; recruiting arrangements with individual physicians and/or physician groups; loans to physicians; medical office leases; equipment leases from or to physicians; and various forms of physician practice support or assistance. These and other financial relationships with physicians (including hospital physician contracts for individual services) may involve financial and legal compliance risks for the hospitals and health systems involved. From a compliance standpoint, these types of financial relationships may raise federal and state “anti-kickback” and federal “Stark” issues (see “—Regulatory Environment,” above), tax exemption issues (see “—Tax-Exempt Status and Other Tax Matters,” below), as well as other legal and regulatory risks, and these could have a material adverse impact on hospitals.

Accountable Care Organizations. The ACA established the MSSP, which seeks to promote accountability and coordination of care through the creation of ACOs. The program allows hospitals, physicians and others to form ACOs and work together to invest in infrastructure and redesign integrated delivery processes to achieve high quality and efficient delivery of services. ACOs that achieve quality performance standards will be eligible to share in a portion of the amounts saved by the Medicare program. DHHS has significant discretion to determine key elements of the program, including what steps providers must take to be considered an ACO, how to decide if Medicare program savings have occurred, and what portion of such savings will be paid to ACOs.

To qualify as an ACO, organizations must agree to be accountable for the overall care of their Medicare beneficiaries, have adequate participation of primary care physicians, define processes to promote evidence-based medicine, report on quality and costs, and coordinate care. The ACO and MSSP final rules were published in November 2011 and June 2015; however, the regulations are complex and it remains unclear whether the qualification requirements will be a formidable barrier for providers. It is probable that hospital participants in ACOs will have to marshal a large upfront financial investment to form unique and untested ACO structures, which may or may not succeed in gaining qualification. For those ACOs that do qualify, it is not clear if the savings will be adequate to recoup the initial investment. In addition, although the regulation provides for waivers of certain federal laws, there may remain regulatory risks for participating hospitals, as well as financial and operational risks. The applicable regulating bodies have published guidance for ACOs to follow in order to comply with the law, but the published guidance is complex.

In particular, because the federal ACO regulation would not preempt state law, California providers participating as a federal ACO must be organized and operated in compliance with California’s existing statutes and regulations. Numerous organizations have formed ACOs and been selected by CMS to participate in the MSSP. CMS is also developing and implementing more advanced ACO payment models, such as the Next Generation ACO Model, which require ACOs to assume greater risk for attributed beneficiaries. Providers participating in MSSP and other ACO payment models developed by CMS may not be able to recoup their investments and may suffer further losses if they are not able to meet quality targets and sufficiently control the cost of care for their attributed beneficiaries. In addition, it is anticipated that private insurers may seek to establish similar incentives for providers, while requiring change in infrastructure and organization. The potential impacts of these initiatives and the regulation for ACOs are unknown and continually evolving, but introduce greater risk and complexity to health care finance and operations.

Hospital Pricing. Inflation in hospital prices may evoke action by legislatures, payors or consumers. It is possible that legislative action at the state or national level may be taken with regard to the pricing of health care services. California law requires every hospital to offer reduced rates to underinsured and uninsured patients that may have low to moderate income.

Hospital Medical Staff. The primary relationship between a hospital and physicians who practice in it is through the hospital’s organized medical staff. Medical staff bylaws, rules and policies establish the criteria and procedures by which a physician may have his or her privileges or membership curtailed, denied or revoked. Physicians who are denied medical staff membership or certain clinical privileges or who have such membership or privileges curtailed or revoked often file legal actions against hospitals and medical staffs. Such actions may include a wide variety of claims, some of which could result in substantial uninsured damages to a hospital. In addition, failure of the hospital governing body to adequately oversee the conduct of its medical staff may result in hospital liability to third parties.

Physician Supply. Sufficient community-based physician supply is important to hospitals and other health care facilities. CMS annually reviews overall physician reimbursement formulas for Medicare and Medicaid.

Changes to physician compensation under these programs could lead to physicians ceasing to accept Medicare and/or Medicaid patients. Regional differences in reimbursement by commercial and governmental payors, along with variations in the costs of living, may cause physicians to avoid locating their practices in communities with low reimbursement or high living costs. Hospitals and health systems may be required to invest additional resources in recruiting and retaining physicians, or may be compelled to affiliate with, and provide support to, physicians in order to continue serving the growing population base and maintain market share. The physician-to-population ratio in certain parts of the State is below the national average, and the shortage of physicians could become a significant issue for hospitals and health care systems in the State. Difficulties in recruiting or retaining physicians may reduce the volume or range of clinical services that a hospital is capable of providing and may, consequently, decrease patient service revenues.

Section 340B Drug Pricing Program. Hospitals that participate (as “covered entities”) in the prescription drug discount program established under Section 340B of the federal Public Health Service Act (the “340B Program”) are able to purchase certain outpatient prescription drugs for their patients at a reduced cost. On August 28, 2015 the Health Resources and Services Administration (“HRSA”) published proposed 340B Drug Pricing Program Omnibus Guidance in the Federal Register, which could have had a negative effect on hospitals participating as covered entities in the 340B program. This proposed guidance was withdrawn on January 30, 2017. Whether HRSA will adopt new guidance in the future and what effects such guidance may have on hospitals participating in the 340B Program are unknown.

In the 2018 outpatient prospective payment system final rule, CMS announced that it will reduce payments for separately payable drugs and biologicals (excluding drugs on pass-through payment status vaccines) purchased through the 340B Program from Average Sales Price (“ASP”) plus 6 percent to ASP minus 22.5 percent, which is a 28 percentage point reduction in payments for 340B Program drugs. CMS confirms in the preamble to the final rule that the 340B drug payment reduction will not apply to 340B-acquired drugs in non-excepted off-campus provider-based departments in 2018, but that CMS may consider extending the payment reduction to these facilities in 2019. A number of plaintiffs, including the American Hospital Association, have filed a lawsuit challenging the cut in 340B Program drug payments on the grounds that CMS’s action is arbitrary and capricious and has exceeded its statutory authority.

Competition Among Health Care Providers. Increased competition from a wide variety of sources, including specialty hospitals, other hospitals and health care systems, HMOs, inpatient and outpatient health care facilities, long-term care and skilled nursing services facilities, clinics, physicians and others, may adversely affect the utilization and/or revenues of hospitals. Existing and potential competitors may not be subject to various restrictions applicable to hospitals, and competition, in the future, may arise from new sources not currently anticipated or prevalent. The strong market position of Kaiser Permanente, a closed managed care system, presents additional challenges.

Freestanding ambulatory surgery centers may attract away significant commercial outpatient services traditionally performed at hospitals. Commercial outpatient services, currently among the most profitable services for hospitals, may be lost to competitors who can provide these services in an alternative, less costly setting. Full-service hospitals rely upon the revenues generated from commercial outpatient services to fund other less profitable services, and the decline of such business may result in the significant reduction of profitable income. Competing ambulatory surgery centers, more likely for-profit businesses, may not accept indigent patients or low paying programs and would leave these populations to receive services in the full-service hospital setting. Consequently, hospitals are vulnerable to competition from ambulatory surgery centers.

Additionally, scientific and technological advances, new procedures, drugs and appliances, preventive medicine and outpatient health care delivery may reduce utilization and revenues of the hospitals in the future or otherwise lead to new avenues of competition. In some cases, hospital investment in facilities and equipment for capital-intensive services may be lost as a result of rapid changes in diagnosis, treatment or clinical practice brought about by new technology or new pharmacology.

Action by Purchasers of Hospital Services and Consumers. Major purchasers of hospital services could take action to restrain hospital charges or charge increases. As a result of increased public scrutiny, it is also possible that the pricing strategies of hospitals may be perceived negatively by consumers, and hospitals may be forced to

reduce fees for their services. Decreased utilization could result, and hospitals' revenues may be negatively impacted. In addition, consumers and groups on behalf of consumers are increasing pressure for hospitals and other health care providers to be transparent and provide information about cost and quality of services that may affect future consumer choices about where to receive health care services.

Employer Status. Hospitals are major employers with mixed technical and nontechnical workforces. Labor costs, including salary, benefits and other liabilities associated with a workforce, have significant impacts on hospital operations and financial condition. Developments affecting hospitals as major employers include: (i) imposing higher minimum or living wages; (ii) enhancing occupational health and safety standards; (iii) imposing joint employer status on employers using contract, staffing agency or other temporary labor; (iv) penalizing employers of undocumented immigrants; and (v) complying with the employer requirements of the ACA. Legislation or regulation on any of the above or related topics could have a material adverse impact on SHC.

Labor Relations and Collective Bargaining. Hospitals are large employers with a wide diversity of employees. Increasingly, employees of hospitals are becoming unionized, and many hospitals have collective bargaining agreements with one or more labor organizations. Employees subject to collective bargaining agreements may include essential nursing and technical personnel, as well as food service, maintenance and other trade personnel. Renegotiation of such agreements upon expiration may result in significant cost increases to hospitals. Employee strikes or other adverse labor actions may have an adverse impact on operations, revenue and hospital reputation. Certain employees of SHC are currently covered by collective bargaining agreements. See APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE—EMPLOYEES.”

Class Actions. Nonprofit hospitals and health systems have long been subject to a wide variety of litigation risks, including liability for care outcomes, employer liability, property and premises liability, and peer review litigation with physicians, among others. In recent years, consumer class action litigation has emerged as a potentially significant source of litigation liability for nonprofit hospitals and health systems. These class action suits have most recently focused on hospital billing and collections practices, and they may be used for a variety of currently unanticipated causes of action. Since the subject matter of class action suits may involve uninsured risks, and since such actions often involve alleged large classes of plaintiffs, they may have material adverse consequences on nonprofit hospitals and health systems in the future.

Wage and Hour Class Actions and Litigation. Federal law and many states, including notably California, impose standards related to worker classification, eligibility and payment for overtime, liability for providing rest periods and similar requirements. Large employers with complex workforces, such as hospitals, are susceptible to actual and alleged violations of these standards. In recent years there has been a proliferation of lawsuits over these “wage and hour” issues, often in the form of large class actions. For large employers, such as hospitals and health systems, such class actions can involve multi-million dollar claims, judgments and settlements. A major class action decided or settled adversely to SHC could have a material adverse impact on the financial conditions and results of operations.

Health Care Worker Classification. Health care providers, like all businesses, are required to withhold income taxes from amounts paid to employees. If the employer fails to withhold the tax, the employer becomes liable for payment of the tax imposed on the employee. On the other hand, businesses are not required to withhold federal taxes from amounts paid to a worker classified as an independent contractor. The IRS has established criteria for determining whether a worker is an employee or an independent contractor for tax purposes. If the IRS were to reclassify a significant number of hospital independent contractors (*e.g.*, physician medical directors) as employees, back taxes and penalties could be material.

Staffing. From time to time, the health care industry suffers from a scarcity of nursing personnel, respiratory therapists, pharmacists and other trained health care and information system technicians. In addition, aging medical and nursing staffs and difficulties in recruiting individuals to these medical professions are predicted to result in shortages. A significant factor underlying this trend includes a decrease in the number of persons entering such professions. This is expected to intensify in the future, aggravating the general shortage and increasing the likelihood of hospital-specific shortages. Competition for physicians and other health care professionals, coupled with increased recruiting and retention costs, will increase hospital operating costs, possibly significantly, and growth may be constrained. This trend could have a material adverse impact on the financial conditions and results of operations of

hospitals and other health care facilities. This scarcity may further be intensified if utilization of health care services increases as a consequence of the ACA's expansion of the number of insured consumers. As reimbursement amounts are reduced to health care facilities and organizations that employ or contract with physicians, nurses and other health care professionals, pressure to control and possibly reduce wage and benefit costs may further strain the supply of those professionals.

California imposes mandatory nurse staffing ratios for all hospital patient care areas, which have been consistent since January 1, 2008. The impact on California hospitals will vary by facility, but the required staffing, in aggregate, is more costly than prior staffing patterns.

Professional Liability Claims and General Liability Insurance. In recent years, the number of professional and general liability suits and the dollar amounts of damage recoveries have increased in health care nationwide, resulting in substantial increases in malpractice insurance premiums, higher deductibles and generally less coverage. Professional liability and other actions alleging wrongful conduct and seeking punitive damages are often filed against health care providers. Insurance does not provide coverage for judgments of punitive damages.

Litigation also arises from the corporate and business activities of hospitals, from a hospital's status as an employer or as a result of medical staff or provider network peer review or the denial of medical staff or provider network privileges. As with professional liability, many of these risks are covered by insurance, but some are not. For example, some antitrust claims or business disputes are not covered by insurance or other sources and may, in whole or in part, be a liability of SHC if determined or settled adversely.

There is no assurance that hospitals will be able to maintain coverage amounts currently in place in the future, that the coverage will be sufficient to cover malpractice judgments rendered against a hospital or that such coverage will be available at a reasonable cost in the future.

Information Systems. The ability to adequately price and bill health care services and to accurately report financial results depends on the integrity of the data stored within information systems, as well as the operability of such systems. Information systems require an ongoing commitment of significant resources to maintain, protect and enhance existing systems and develop new systems to keep pace with continuing changes in information processing technology, evolving systems and regulatory standards. There can be no assurance that efforts to upgrade and expand information systems capabilities, protect and enhance these systems, and develop new systems to keep pace with continuing changes in information processing technology will be successful or that additional systems issues will not arise in the future.

Electronic media are also increasingly being used in clinical operations, including the conversion from paper to electronic medical records, computerization of order entry functions and the implementation of clinical decision-support software. The reliance on information technology for these purposes imposes new expectations on physicians and other workforce members to be adept in using and managing electronic systems. It also introduces risks related to patient safety, and to the privacy, accessibility and preservation of health information. See “—Regulatory Environment—HIPAA, HITECH, and Other Privacy and Security Requirements” above. Technology malfunctions or failure to understand and use information systems properly could result in the dissemination of or reliance on inaccurate information, as well as in disputes with patients, physicians and other health care professionals. Health information systems may also be subject to different or higher standards or greater regulation than other information technology or the paper-based systems previously used by health care providers, which may increase the cost, complexity and risks of operations. All of these risks may have adverse consequences on hospitals and health care providers.

Future government regulation and adherence to technological advances could result in an increased need of SHC to implement new technology. Such implementation could be costly and is subject to cost overruns and delays in application, which could negatively affect the financial condition of SHC.

Cybersecurity Risks. Health care providers are highly dependent upon integrated electronic medical record and other information technology systems to deliver high quality, coordinated and cost-effective health care. These systems necessarily hold large quantities of highly sensitive PHI or other sensitive information that is highly valued on the black market for such information. As a result, the electronic systems and networks of health care providers

are considered likely targets for cyberattacks and other potential breaches of their systems. Information technology systems are also vulnerable to random attacks, computer viruses, and physical or electronic break-ins. In addition to regulatory fines and penalties, the health care entities subject to the breaches may be liable for the costs of remediating the breaches, damages to individuals (or classes) whose information has been breached, reputational damage and business loss, and damage to the information technology infrastructure. SHC has taken, and continues to take measures to protect its information technology system against such cyberattacks and other events and issues that could result in breaches, but there can be no assurance that SHC will not experience a significant breach. If such a breach occurs, the financial consequences of such a breach could have a material adverse impact on SHC.

Affiliations, Merger, Acquisition and Divestiture

SHC evaluates and pursues potential acquisition, merger and affiliation candidates as part of the overall strategic planning and development process. As part of its ongoing planning and property management functions, SHC reviews the use, compatibility and business viability of many of the operations of SHC, and from time to time SHC may pursue changes in the use of, or disposition of, its facilities. Likewise, SHC occasionally receives offers from, or conducts discussions with, third parties about the potential acquisition of operations and properties that may become subsidiaries or affiliates of SHC in the future, or about the potential sale of some of the operations or property which are currently conducted or owned by SHC. Discussion with respect to affiliation, merger, acquisition, disposition or change of use of facilities, including those which may affect SHC, are held from time to time with other parties. These may be conducted with acute care hospital facilities and may be related to potential affiliation between SHC and another party, including potential affiliation with such other party's obligated group. As a result, it is possible that the current organization and assets of SHC may change from time to time. See "SECURITY FOR THE SERIES 2018 TAXABLE BONDS—The Master Indenture—Replacement of Obligation No. 40" herein.

In addition to relationships with other hospitals and physicians, SHC may consider investments, ventures, affiliations, development and acquisition of other health care-related entities. These may include home health care, long-term care entities or operations, infusion providers, pharmaceutical providers, and other health care enterprises that support the overall operations of SHC. In addition, SHC may pursue transactions with health insurers, HMOs, preferred provider organizations, third-party administrators and other health insurance-related businesses. Because of the integration occurring throughout the health care field, management will consider these arrangements if there is a perceived strategic or operational benefit for SHC. Any initiative may involve significant capital commitments and/or capital or operating risk (including, potentially, insurance risk) in a business in which SHC may have less expertise than in hospital operations. There can be no assurance that these projects, if pursued, will not lead to material adverse consequences to SHC.

Increasing Cost of Modern Technology. Technological advances in recent years have forced hospitals to acquire sophisticated and costly equipment to remain competitive. Moreover, the growth of e-commerce may also result in a shift in the way that health care is delivered, *i.e.*, from remote locations. For example, physicians will be able to provide certain services over the internet and pharmaceuticals and other health services may be purchased online. If, due to financial constraints, SHC were less able to acquire new technology required to remain competitive, SHC could lose market share, and the financial condition of SHC could be materially adversely affected.

Payment Card Industry Security Standards. Health care providers have seen significant changes in the method, amount of transactions and dollar amount of patient payments. Health care providers recognize that financial data security is a paramount concern as is continuing to protect and secure patient information. Chip cards used at Europay, MasterCard and Visa ("EMV") terminals protect against counterfeit transactions by replacing static data with dynamic data. Merchants are in the process of migrating to EMV chip card technology to improve the security of the card-present payments infrastructure. As a result, EMV is being introduced to health care providers.

Beginning October 1, 2015, the liability for card-present fraud shifts to whichever party is the least EMV-compliant in a fraudulent transaction. This means in practice that if a health care provider has not updated its system to accept chip cards and fraud occurs when a chip card is inserted into the terminal, the health care provider would be liable for the costs. It is not mandatory to begin using EMV compliant terminals on or after October 1, 2015 and there are no fines or other penalties currently in place, however, a health care provider that does not use EMV-compliant terminals may face much higher costs in the event of a large data breach. At this time, it is too early to predict the impact that this new technology will have on SHC.

Tax-Exempt Status and Other Tax Matters

Maintenance of the Tax-Exempt Status of SHC and any future Members of the Obligated Group. Loss of tax-exempt status of SHC or any future Member of the Obligated Group could result in the loss of tax exemption of tax-exempt debt issued for the benefit of SHC and the Obligated Group, and defaults in covenants regarding the tax-exempt debt could be triggered. Such an event could have material and adverse consequences on the financial condition of the Obligated Group. Management of SHC is not aware of any transactions or activities currently ongoing that are likely to result in the revocation of the tax-exempt status of SHC.

The maintenance of SHC's tax-exempt status, as an organization described in Section 501(c)(3) of the Code, is contingent on compliance with general rules promulgated in the Code and related regulations regarding the organization and operation of tax-exempt entities, including their operation for charitable and other permissible purposes and their avoidance of transactions that may cause their earnings or assets to inure to the benefit of private individuals. As these general principles were developed primarily for public charities that do not conduct large-scale technical operations and business activities, they often do not adequately address the myriad of operations and transactions entered into by a modern health care organization. Although traditional activities of health care providers, such as medical office building leases, have been the subject of interpretations by the IRS in the form of private letter rulings, many activities or categories of activities have not been fully addressed in any official opinion, interpretation or policy of the IRS.

The IRS has taken the position that hospitals which are in violation of the Anti-Kickback Law may also be subject to revocation of their tax-exempt status. See “—Regulatory Environment—Anti-Kickback Law” above. As a result, tax-exempt hospitals, such as SHC, which have, and will continue to have, extensive relationships with physicians are subject to an increased degree of scrutiny and perhaps enforcement by the IRS.

The ACA also contains requirements for tax-exempt hospitals through Section 501(r) of the Code. Under the ACA, each tax-exempt hospital facility is required to (i) conduct a community health needs assessment at least every three years and adopt an implementation strategy to meet the identified community needs, (ii) adopt, implement and widely publicize a written financial assistance policy and adopt a written policy to provide emergency medical treatment without discrimination, (iii) limit charges to individuals who qualify for financial assistance under such tax-exempt hospital's financial assistance policy to no more than the amounts generally billed to individuals who have insurance covering such care and refrain from using “gross charges” when billing such individuals, and (iv) refrain from taking extraordinary collection actions without first making reasonable efforts to determine whether the individual is eligible for assistance under such tax-exempt hospital's financial assistance policy.

On December 29, 2014, the Secretary of the Treasury issued final regulations under Section 501(r) of the Code that provide detailed and comprehensive guidance relating to requirements for community health needs assessments, financial assistance policies, emergency medical care policies, limitations on charges and billing and collection practices, and also provide guidance on consequences of failure to satisfy Section 501(r) requirements. These final regulations are complex and may be administratively burdensome to implement. Generally, the regulations apply to tax years beginning after December 29, 2015, and provide that a hospital organization may rely on a reasonable, good faith interpretation of the Section 501(r) requirements for tax years beginning on or before December 29, 2015, which may include compliance with certain prior proposed regulations under Section 501(r). A failure to comply with the provisions of Section 501(r) and the final regulations issued thereunder could result in a loss of tax-exempt status or otherwise subject revenues of a hospital facility to federal income tax.

In addition, the Treasury Department is required to review information about each tax-exempt hospital's community benefit activities at least once every three years, as well as to submit an annual report to Congress with information regarding the levels of charity care, bad debt expenses, unreimbursed costs of government programs, and costs incurred by tax-exempt hospitals for community benefit activities. The periodic reviews and reports to Congress regarding the community benefits provided by 501(c)(3) hospitals may increase the likelihood that Congress will require such hospitals to provide a minimum level of charity care in order to retain tax-exempt status and may increase IRS scrutiny of particular 501(c)(3) hospital organizations.

SHC participates in a variety of joint ventures and transactions with physicians either directly or indirectly. Management believes that the joint ventures and transactions to which SHC is a party are consistent with the requirements of the Code as to tax-exempt status, but, as noted above, there is uncertainty as to the state of the law.

The IRS has periodically conducted audit and other enforcement activity regarding tax-exempt health care organizations. Certain audits are conducted by teams of revenue agents, often take years to complete and require the expenditure of significant staff time by both the IRS and the audited organization. These audits examine a wide range of possible issues, including tax-exempt bond financings, partnerships and joint ventures, retirement plans and employee benefits, employment taxes, political contributions and other matters.

If the IRS were to find that SHC or any future Obligated Group Member has participated in activities in violation of certain regulations or rulings, the tax-exempt status of such entity could be in jeopardy. Although the IRS has not frequently revoked the 501(c)(3) tax-exempt status of nonprofit health care corporations, it could do so in the future. As described above, loss of tax-exempt status by SHC potentially could result in loss of tax exemption of the tax-exempt debt of SHC or any future Member of the Obligated Group, and defaults in covenants regarding the related tax-exempt debt and obligations likely would be triggered. Loss of tax-exempt status also could result in substantial tax liabilities on income of SHC or any future Obligated Group Member. For these reasons, loss of tax-exempt status of SHC could have a material adverse effect on the financial condition and results of operations of the Obligated Group.

In some cases, the IRS has imposed substantial monetary penalties on tax-exempt hospitals in lieu of revoking their tax-exempt status. In those cases, the IRS and exempt hospitals entered into settlement agreements requiring the hospital to make substantial payments to the IRS.

In addition, the IRS may impose a penalty in the form of excise taxes on certain “excess benefit transactions” involving 501(c)(3) organizations and “disqualified persons.” An excess benefit transaction is one in which a disqualified person or entity receives more than fair market value from the exempt organization or pays the exempt organization less than fair market value for property or services, or shares the net revenues of the tax-exempt entity. A disqualified person is a person (or an entity) who is in a position to exercise substantial influence over the affairs of the exempt organization during the five years preceding an excess benefit transaction. The statute imposes excise taxes on the disqualified person and any “organization manager” who knowingly participates in an excess benefit transaction. These rules do not currently penalize the exempt organization itself, so there would be no direct impact on an Obligated Group Member or the tax status of the Series 2018 Taxable Bonds if an excess benefit transaction were subject to IRS enforcement, pursuant to these “intermediate sanctions” rules. However, these intermediate sanctions do not replace other remedies available to the IRS, including revocation of tax-exempt status.

State and Local Tax Exemption. Until recently, California has not been as active as the IRS in scrutinizing the income tax exemption of health care organizations. With some overlap with the ACA’s mandates, California laws also require tax-exempt hospitals to conduct a community needs assessment, to adopt an implementation strategy, and to have a charity care policy. It is possible that legislation may be proposed to strengthen the role of the California Franchise Tax Board and the Attorney General in supervising nonprofit health systems. It is likely that the loss by SHC or any future Member of the Obligated Group of federal tax exemption would also trigger a challenge to its respective state tax exemption. Depending on the circumstances, such event could be material and adverse.

State, county and local taxing authorities undertake audits and reviews of the operations of tax-exempt health care providers with respect to their real property tax exemptions. In some cases, particularly where authorities are dissatisfied with the amount of services provided to indigents, the real property tax-exempt status of the health care providers has been questioned. For example, a court in New Jersey recently decided that a nonprofit hospital should pay property taxes on almost all of its property because it did not meet the legal test that it operated as a nonprofit, charitable organization during certain years. At this time, it is uncertain whether this state-specific case will have a negative impact on the broader nonprofit hospital community. Subjecting significant amounts of real property to taxation could adversely affect health care organizations. The majority of the real property of SHC is currently treated as exempt from real property taxation.

It is not possible to predict the scope or effect of future state and local legislative or regulatory actions with respect to taxation of nonprofit corporations. There can be no assurance that future changes in the laws and regulations

of state or local governments will not materially adversely affect the financial condition of the Obligated Group by requiring payment of income, local property or other taxes.

Limitations on Contractual and Other Arrangements Imposed by the Internal Revenue Code. As tax-exempt organizations, SHC and any future Obligated Group Member are limited with respect to their use of practice income guarantees, reduced rent on medical office space, low interest loans, joint venture programs and other means of recruiting and retaining physicians. Uncertainty in this area has been reduced somewhat by the issuance by the IRS of guidelines on permissible physician recruitment practices. The IRS scrutinizes a broad variety of contractual relationships commonly entered into by hospitals and has issued a detailed audit guide suggesting that field agents scrutinize numerous activities of the hospitals in an effort to determine whether any action should be taken with respect to limitations on or revocation of their tax-exempt status or assessment of additional tax. Any suspension, limitation, or revocation of SHC or any future Member's tax-exempt status or assessment of significant tax liability would have a materially adverse effect on the Obligated Group and might lead to loss of tax exemption of interest on tax-exempt debt of the Obligated Group.

Other Risk Factors

Earthquakes. Many hospitals in California are in close proximity to active earthquake faults. A significant earthquake in Northern California could have a material adverse effect on SHC and could result in material damage and temporary or permanent cessation of operations at SHC's facilities. SHC currently does not carry earthquake insurance coverage.

California law requires each acute care hospital in the State to evaluate and upgrade its patient care facilities to meet stated seismic standards by 2008 or, in certain cases, by 2030; ultimate deadlines depend on each acute hospital building's structural performance category. OSHPD has been directed to review previously established seismic performance categories for hospital buildings using new software technology known as "HAZUS." Reevaluation under HAZUS may result in buildings not being required to meet any new seismic standards until 2030. California law has been amended to allow various types of extensions of the 2008 deadline to 2013, 2015, 2016, 2018 or 2020, provided that the facility qualifies for such extension and certain requirements are met in enumerated time periods, including demonstrating to OSHPD reasonable progress towards meeting the ultimate deadlines.

Construction Risks. SHC has begun and will be completing substantial construction projects to replace and renew its patient care facilities. Construction projects are subject to a variety of risks, including but not limited to strikes, shortages of materials and labor, adverse weather conditions, and delays in issuance of required building permits or other necessary approvals or permits, including environmental approvals. Such events could delay occupancy. Cost overruns may occur due to change orders, delays in the construction schedule, scarcity of building materials and labor and other factors. Cost overruns could cause the costs to exceed available funds. Construction costs have historically inflated in California between 15% and 20% annually making some projects financially prohibitive.

See APPENDIX A – "INFORMATION CONCERNING STANFORD HEALTH CARE—SERVICES, FACILITIES AND OPERATIONS—SHC's Long-Range Master Plan and Additional Capital Needs."

Risks Related to Outstanding Variable Rate Obligations and Swaps. SHC has variable rate obligations outstanding, the interest rates on which could rise. Such interest rates vary on a periodic basis and may be converted to a fixed interest rate. This protection against rising interest rates is not unrestricted, however, because SHC would be required to continue to pay interest at the variable rate until it is permitted to convert the obligations to a fixed rate pursuant to the terms of the applicable transaction documents.

In addition, approximately \$84.1 million of outstanding variable rate bonds issued on behalf of SHC have a "put" feature which grants the holders of such bonds the right to tender these bonds for payment on seven, or fewer, days' notice. SHC also has \$60 million of outstanding variable rate bonds that could be "put" after a 30-day remarketing period plus a 6-month notification period. Such bonds are not supported by either a credit facility or a liquidity facility. If any variable rate bonds are tendered for purchase and not remarketed, SHC will be obligated to purchase such bonds.

Risks Related to Interest Rate Swaps. SHC has entered into interest rate swap agreements related to indebtedness of the Obligated Group (the “Swaps”). The Swaps are and will be subject to periodic “mark-to-market” valuations and at any time may have a negative value to SHC. The Swaps counterparty may terminate the Swaps upon the occurrence of certain “termination events” or “events of default.” SHC may terminate the Swaps at any time. If either the counterparty to the Swaps or SHC terminates any of the Swaps during a negative value situation, SHC may be required to make a termination payment to such Swaps counterparty, and such payment could be material.

Pursuant to the Swaps, the counterparty will be obligated to make payments to SHC, which payments may be more or less than the interest rates SHC is required to pay with respect to a comparable principal amount of the related indebtedness.

Regularly scheduled payments and, in limited circumstances, settlement amounts under the Swaps are secured under the Master Indenture. SHC or any future Member of the Obligated Group may in the future enter into additional Swaps and other financial product and hedge devices that also may be secured under the Master Indenture. See APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION—Interest Rate Swap Arrangements.”

Investments. SHC has significant holdings in a broad range of investments. Market fluctuations may affect the value of those investments and those fluctuations may be material. For a discussion of SHC’s investments, see APPENDIX A – “INFORMATION CONCERNING STANFORD HEALTH CARE—SUMMARY OF FINANCIAL INFORMATION—Cash and Investments.”

Contributions. A negative change in economic conditions, including a recurrence of a recession, or declines in the public equities market or private investment holdings of potential philanthropy sources, may have an adverse impact on SHC’s total receipt of charitable contributions. Failure to collect committed donations or to receive sufficient additional pledges of support may impair SHC’s ability to complete the construction projects or to develop programs or services that are dependent on charitable contributions. No assurances can be given that SHC will receive charitable contributions as anticipated or consistent with historical levels.

Epidemics, Pandemics and Disasters. An epidemic or pandemic, or a natural or man-made disaster could occur and result in an abnormally high demand for health care services, damage the facilities of SHC, interrupt utility service to the facilities, or otherwise impair SHC’s operations and the generation of revenues from SHC’s facilities. For example, if an outbreak of an infectious disease such as the Zika virus or Ebola virus were to occur nationally or in SHC’s service area, its business and financial results could be adversely affected. The treatment of a highly contagious disease at SHC’s hospital facilities may result in a temporary shutdown or diversion of patients. In addition, unaffected individuals may decide to defer elective procedures or otherwise avoid medical treatment, resulting in reduced patient volumes and operating revenues. SHC cannot predict any costs associated with the potential treatment of an infectious disease outbreak or preparation for such treatment.

Other Future Risks. In the future, the following factors, among others, may adversely affect the operations of health care providers, including SHC, or the market value of health care revenue bonds, including the Series 2018 Taxable Bonds, to an extent that cannot be determined at this time.

(a) Adoption of legislation or implementation of regulations that would establish a national or statewide single-payor health program or that would establish national, statewide or otherwise regulated rates applicable to hospitals and other health care providers.

(b) Reduced demand for the services of health facilities that might result from decreases in population or loss of market share.

(c) Bankruptcy of an indemnity/commercial insurer, managed care plan or other payor.

(d) Efforts by insurers and governmental agencies to limit the cost of hospital services, to reduce the number of hospital beds and to reduce the utilization of hospital facilities by such means as preventative medicine,

improved occupational health and safety and outpatient care, or comparable regulations or attempts by third-party payors to control or restrict the operations of certain health care facilities.

(e) Regulatory actions, which might limit the ability of hospitals to undertake capital improvements at its facilities or to develop new institutional health services.

(f) Cost and availability of any insurance, such as professional liability, fire, automobile and general comprehensive liability coverage, which health care facilities of a similar size and type generally carry.

(g) Increased unemployment or other adverse economic conditions in the service area of SHC, which would increase the proportion of patients who are unable to pay fully for the cost of their care.

(h) Competition from other hospitals and other competitive facilities now or hereafter located in SHC's service area, which could adversely affect revenues.

(i) Development of health maintenance and other alternative health delivery programs, which could result in decreased usage of inpatient hospital facilities.

(j) Limitations on the availability of, and increased compensation necessary to secure and retain, nursing, technical and other professional personnel.

INDEPENDENT ACCOUNTANTS

The consolidated financial statements of SHC as of August 31, 2017 and 2016 and for each of the two years then ended included in APPENDIX B to this Offering Memorandum, have been audited by PricewaterhouseCoopers LLP, independent accountants, as stated in their report appearing in APPENDIX B.

ABSENCE OF MATERIAL LITIGATION

There is no controversy or litigation of any nature, to the knowledge of its officers, now pending or threatened against SHC restraining or enjoining the issuance, sale, execution or delivery of the Series 2018 Taxable Bonds, or in any way contesting or affecting the validity of the Series 2018 Taxable Bonds.

As with most hospitals, SHC is subject to legal actions which, in whole or in part, are not or may not be covered by insurance or self-insurance because of the type of action (such as employee, contract or competition law claims) or remedies requested (such as punitive damages), because of a reservation of rights by an insurance carrier or self-insurance program, or because the action has not proceeded to a stage which permits full evaluation. Since these actions either claim punitive damages which could become a liability of SHC and/or state or threaten causes of action which may not be covered by insurance or self-insurance, insurers for SHC and the self-insurance program have not provided assurance of coverage, and to the extent any cases have not been served, counsel has not been retained to evaluate them.

CERTAIN UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

The following discussion summarizes certain U.S. federal tax considerations generally applicable to holders of the Series 2018 Taxable Bonds that acquired those Series 2018 Taxable Bonds in the initial offering. The discussion below is based upon laws, regulations, rulings, and decisions in effect and available on the date hereof, all of which are subject to change, possibly with retroactive effect. Prospective investors should note that no rulings have been or are expected to be sought from the IRS with respect to any of the U.S. federal tax considerations discussed below, and no assurance can be given that the IRS will not take contrary positions. Further, the following discussion does not deal with U.S. tax consequences applicable to any given investor, nor does it address the U.S. tax considerations applicable to all categories of investors, some of which may be subject to special taxing rules (regardless of whether or not such investors constitute U.S. Holders), such as certain U.S. expatriates, banks, REITs, RICs, insurance companies, tax-exempt organizations, dealers or traders in securities or currencies, partnerships, S corporations,

estates and trusts, investors that hold their Series 2018 Taxable Bonds as part of a hedge, straddle or an integrated or conversion transaction, or investors whose “functional currency” is not the U.S. dollar. Furthermore, it does not address (i) alternative minimum tax consequences, or (ii) the indirect effects on persons who hold equity interests in a holder. This summary also does not consider the taxation of the Series 2018 Taxable Bonds under state, local or non-U.S. tax laws. In addition, this summary generally is limited to U.S. tax considerations applicable to investors that acquire their Series 2018 Taxable Bonds pursuant to this offering for the issue price that is applicable to such Series 2018 Taxable Bonds (i.e., the price at which a substantial amount of the Series 2018 Taxable Bonds is sold to the public) and who will hold their Series 2018 Taxable Bonds as “capital assets” within the meaning of Section 1221 of the Code.

As used herein, “U.S. Holder” means a beneficial owner of a Series 2018 Taxable Bond that for U.S. federal income tax purposes is an individual citizen or resident of the United States, a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States or any state thereof (including the District of Columbia), an estate the income of which is subject to U.S. federal income taxation regardless of its source or a trust where a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons (as defined in the Code) have the authority to control all substantial decisions of the trust (or a trust that has made a valid election under U.S. Treasury Regulations to be treated as a domestic trust). As used herein, “Non-U.S. Holder” generally means a beneficial owner of a Series 2018 Taxable Bond (other than a partnership) that is not a U.S. Holder. If a partnership holds Series 2018 Taxable Bonds, the tax treatment of such partnership or a partner in such partnership generally will depend upon the status of the partner and upon the activities of the partnership. Partnerships holding Series 2018 Taxable Bonds, and partners in such partnerships, should consult their own tax advisors regarding the tax consequences of an investment in the Series 2018 Taxable Bonds (including their status as U.S. Holders or Non-U.S. Holders).

Prospective investors should consult their own tax advisors in determining the U.S. federal, state, local or non-U.S. tax consequences to them from the purchase, ownership and disposition of the Series 2018 Taxable Bonds in light of their particular circumstances.

U.S. Holders

Interest

Payments of interest on a Series 2018 Taxable Bond generally will be taxable to a U.S. Holder as ordinary interest income at the time such payments are accrued or are received (in accordance with the U.S. Holder’s regular method of tax accounting), provided such interest is “qualified stated interest” within the meaning of section 1272 of the Code. For purposes of this discussion, the term “qualified stated interest” on a Series 2018 Taxable Bond means all interest thereon based on a fixed rate, and payable unconditionally at fixed periodic intervals of one year or less during the entire term of the instrument.

Original Issue Discount

To the extent that the issue price of any bond of a maturity of the Series 2018 Taxable Bonds is less than the aggregate of the amounts (other than qualified stated interest) to be paid over the term of that bond by more than a *de minimis* amount, the difference may constitute original issue discount (“OID”) on that bond. U.S. Holders of Series 2018 Taxable Bonds will be required to include OID in income for U.S. federal income tax purposes as it accrues, in accordance with a constant yield method based on a compounding of interest (which may be before the receipt of cash payments attributable to such income). Under this method, U.S. Holders generally will be required to include in income increasingly greater amounts of OID in successive accrual periods.

Amortizable Bond Premium

A holder of a Series 2018 Taxable Bond that purchased that bond for an amount that was greater than its stated redemption price at maturity will be considered to have purchased the Series 2018 Taxable Bond with “amortizable bond premium” equal in amount to such excess. For purposes of this discussion, the “stated redemption price at maturity” of a Series 2018 Taxable Bond, as of any date, is an amount equal to the aggregate of the amounts

(other than qualified stated interest) to be paid on that bond over the remaining term. A U.S. Holder of a Series 2018 Taxable Bond purchased with amortizable bond premium may elect to amortize such premium using a constant yield method over the remaining term of the Series 2018 Taxable Bond and may offset interest otherwise required to be included in respect of the Series 2018 Taxable Bond during any taxable year by the amortized amount of such excess for the taxable year. Bond premium on a Series 2018 Taxable Bond held by a U.S. Holder that does not make such an election will decrease the amount of gain or increase the amount of loss otherwise recognized on the sale, exchange, redemption or retirement of a Series 2018 Taxable Bond. However, if the Series 2018 Taxable Bond may be optionally redeemed after the beneficial owner acquires it at a price in excess of its stated redemption price at maturity, special rules would apply under the Treasury Regulations that could result in a deferral of the amortization of some bond premium until later in the term of the Series 2018 Taxable Bond. Any election by a U.S. Holder to amortize bond premium applies to all taxable debt instruments beneficially owned by that person on or after the first day of the first taxable year to which such election applies and may be revoked only with the consent of the IRS. That a Series 2018 Taxable Bond was purchased by the holder with amortizable bond premium may affect the computation of includable original issue discount for that holder.

Sale or other Taxable Disposition of a Series 2018 Taxable Bond; Market Discount

Unless a nonrecognition provision of the Code applies, the sale, exchange, redemption, retirement (including pursuant to an offer by SHC) or other taxable disposition of a Series 2018 Taxable Bond will be a taxable event for U.S. federal income tax purposes. In such event, in general, a U.S. Holder of a Series 2018 Taxable Bond will recognize gain or loss equal to the difference between (i) the amount of cash plus the fair market value of property received (except to the extent attributable to accrued but unpaid qualified stated interest on the Series 2018 Taxable Bond, which will be taxed in the manner described above) and (ii) the U.S. Holder's adjusted U.S. federal income tax basis in the Series 2018 Taxable Bond (generally, the purchase price paid by the U.S. Holder for the Series 2018 Taxable Bond, decreased by any amortized premium, and increased by the amount of any OID previously included in income by such U.S. Holder with respect to such Series 2018 Taxable Bond). Any such gain or loss generally will be capital gain or loss. In the case of a non-corporate U.S. Holder of the Series 2018 Taxable Bonds, the maximum marginal U.S. federal income tax rate applicable to any such gain will be lower than the maximum marginal U.S. federal income tax rate applicable to ordinary income if such U.S. Holder's holding period for the Series 2018 Taxable Bonds exceeds one year. The deductibility of capital losses is subject to limitations.

Under current law, a U.S. Holder of a Series 2018 Taxable Bond that did not purchase that Series 2018 Taxable Bond at its issue price in the initial public offering (a "subsequent purchaser") generally will be required, on the disposition (or earlier partial principal payment) of such Series 2018 Taxable Bond, to recognize as ordinary income a portion of the gain (or partial principal payment), if any, to the extent of the accrued "market discount." In general, market discount is the amount by which the price paid for such Series 2018 Taxable Bond by such a subsequent purchaser is less than the stated redemption price at maturity of that Series 2018 Taxable Bond (or, in the case of a Series 2018 Taxable Bond bearing original issue discount, is less than the "revised issue price" of that Series 2018 Taxable Bond (as defined below) upon such purchase), except that market discount is considered to be zero if it is less than one quarter of one percent of the principal amount times the number of complete remaining years to maturity. The Code also limits the deductibility of interest incurred by a subsequent purchaser on funds borrowed to acquire Series 2018 Taxable Bonds with market discount. As an alternative to the inclusion of market discount in income upon disposition, a subsequent purchaser may elect to include market discount in income currently as it accrues on all market discount instruments acquired by the subsequent purchaser in that taxable year or thereafter, in which case the interest deferral rule will not apply. The recharacterization of gain as ordinary income on a subsequent disposition of such Series 2018 Taxable Bonds could have a material effect on the market value of such Series 2018 Taxable Bonds.

Medicare Tax

Certain non-corporate U.S. Holders of Series 2018 Taxable Bonds are subject to a 3.8% tax on the lesser of (1) the U.S. Holder's "net investment income" (in the case of individuals) or "undistributed net investment income" (in the case of estates and certain trusts) for the relevant taxable year and (2) the excess of the U.S. Holder's "modified adjusted gross income" (in the case of individuals) or "adjusted gross income" (in the case of estates and certain trusts) for the taxable year over a certain threshold (which in the case of individuals is between \$200,000 and \$250,000, depending on the individual's circumstances). A U.S. Holder's calculation of net investment income generally will

include its interest income on the Series 2018 Taxable Bonds and its net gains from the disposition of the Series 2018 Taxable Bonds, unless such interest income or net gains are derived in the ordinary course of the conduct of a trade or business (other than a trade or business that consists of certain passive or trading activities). If you are an individual, estate, or trust, you are urged to consult your tax advisors regarding the applicability of this tax to your income and gains in respect of your investment in the Series 2018 Taxable Bonds.

Information Reporting and Backup Withholding

Payments on the Series 2018 Taxable Bonds generally will be subject to U.S. information reporting and possibly to “backup withholding.” Under Section 3406 of the Code and applicable U.S. Treasury Regulations issued thereunder, a non-corporate U.S. Holder of the Series 2018 Taxable Bonds may be subject to backup withholding at the current rate of 28% with respect to “reportable payments,” which include interest paid on the Series 2018 Taxable Bonds and the gross proceeds of a sale, exchange, redemption, retirement or other disposition of the Series 2018 Taxable Bonds. The payor will be required to deduct and withhold the prescribed amounts if (i) the payee fails to furnish a U.S. taxpayer identification number (“TIN”) to the payor in the manner required, (ii) the IRS notifies the payor that the TIN furnished by the payee is incorrect, (iii) there has been a “notified payee underreporting” described in Section 3406(c) of the Code or (iv) the payee fails to certify under penalty of perjury that the payee is not subject to withholding under Section 3406(a)(1)(C) of the Code. Amounts withheld under the backup withholding rules may be refunded or credited against the U.S. Holder’s federal income tax liability, if any, provided that the required information is timely furnished to the IRS. Certain U.S. holders (including among others, corporations and certain tax-exempt organizations) are not subject to backup withholding. A holder’s failure to comply with the backup withholding rules may result in the imposition of penalties by the IRS.

Non-U.S. Holders

Under sections 1441 and 1442 of the Code, nonresident alien individuals and foreign corporations are generally subject to withholding at the current rate of 30% (or any lower rate specified in an income tax treaty) on periodic income items arising from sources within the United States, provided such income is not effectively connected with the conduct of a United States trade or business.

The foregoing notwithstanding, but subject to the discussions below under the headings “Information Reporting and Backup Withholding” and “Foreign Account Tax Compliance Act (“FATCA”)—U.S. Holders and Non-U.S. Holders,” and assuming the interest income of Non-US Holder on the Series 2018 Taxable Bonds is not treated as effectively connected income within the meaning of section 864 of the Code, such interest will not be subject to withholding under section 1441 or section 1442 of the Code to the extent that the interest income is treated as “portfolio interest”. Interest paid to a Non-U.S. Holder will be treated as portfolio interest as to that holder if: (i) the Non-U.S. Holder provides a statement to the payor certifying, under penalties of perjury, that the Non-U.S. Holder is not a United States person and providing the name and address of such Non-U.S. Holder; (ii) such interest is treated as not effectively connected with a United States trade or business of the Non-U.S. Holder; (iii) such interest payments are not made to a person within a foreign country that the Service has included on a list of countries having provisions inadequate to prevent United States tax evasion; (iv) such interest is not deemed “contingent interest” within the meaning of the portfolio debt provisions of the Code; (v) the Non-U.S. Holder is not a controlled foreign corporation, within the meaning of section 957 of the Code; and (vi) the Non-U.S. Holder is not a bank receiving interest on the Series 2018 Taxable Bonds pursuant to a loan agreement entered into in the ordinary course of the Non-U.S. Holder’s banking trade or business.

Subject to the discussions below under the headings “Information Reporting and Backup Withholding” and “Foreign Account Tax Compliance Act (“FATCA”)—U.S. Holders and Non-U.S. Holders,” any capital gain realized by a Non-U.S. Holder upon the sale, exchange, redemption, retirement (including pursuant to an offer by SHC) or other taxable disposition of a Series 2018 Taxable Bond generally will not be subject to U.S. federal income tax, unless (i) such gain is effectively connected with the conduct by such Non-U.S. Holder of a trade or business within the United States; or (ii) in the case of any gain realized by an individual Non-U.S. Holder, such holder is present in the United States for 183 days or more in the taxable year of such sale, exchange, redemption, retirement (including pursuant to an offer by SHC) or other disposition and certain other conditions are met.

Information Reporting and Backup Withholding

Subject to the discussion below under the heading “Foreign Account Tax Compliance Act (“FATCA”)—U.S. Holders and Non-U.S. Holders,” under current U.S. Treasury Regulations, payments of principal and interest on any Series 2018 Taxable Bonds to a Non-U.S. Holder will not be subject to any backup withholding tax requirements if the Non-U.S. Holder of the Series 2018 Taxable Bond or a financial institution holding the Series 2018 Taxable Bond on behalf of the Non-U.S. Holder in the ordinary course of its trade or business provides an appropriate certification to the payor and the payor does not have actual knowledge that the certification is false. If a Non-U.S. Holder provides the certification, the certification must give the name and address of such Non-U.S. Holder, state that such Non-U.S. Holder is not a United States person, or, in the case of an individual, that such Non-U.S. Holder is neither a citizen nor a resident of the United States, and the Non-U.S. Holder must sign the certificate under penalties of perjury. The current backup withholding tax rate is 28%.

Foreign Account Tax Compliance Act (“FATCA”)—U.S. Holders and Non-U.S. Holders

Sections 1471 through 1474 of the Code (commonly referred to as “FATCA”) impose a reporting regime and potentially a 30% withholding tax on certain payments made to or through (i) a “foreign financial institution” (as specifically defined in the Code) that does not enter into an agreement with the IRS to provide the IRS with certain information in respect of its account holders and investors or (ii) a “non-financial foreign entity” (as specifically defined in the Code) that does not provide sufficient information with respect to its substantial U.S. owners, if any. The United States has entered into, and continues to negotiate, intergovernmental agreements (each, an “IGA”) with a number of other jurisdictions to facilitate the implementation of FATCA. An IGA may significantly alter the application of FATCA and its information reporting and withholding requirements with respect to any particular investor.

Failure to comply with the additional certification, information reporting and other specified requirements imposed under FATCA could result in the 30% withholding tax being imposed on payments of interest and principal under the Series 2018 Taxable Bonds and sales proceeds of Series 2018 Taxable Bonds held by or through a foreign entity. In general, withholding under FATCA currently applies to payments of U.S. source interest (including OID) and, under current guidance, will apply to (i) gross proceeds from the sale, exchange or retirement of debt obligations paid after December 31, 2018 and (ii) certain “passthru” payments no earlier than January 1, 2019. Prospective investors should consult their own tax advisors regarding FATCA and its effect on them.

The foregoing summary is included herein for general information only and does not discuss all aspects of U.S. federal taxation that may be relevant to a particular holder of Series 2018 Taxable Bonds in light of the holder’s particular circumstances and income tax situation. Prospective investors are urged to consult their own tax advisors as to any tax consequences to them from the purchase, ownership and disposition of the Series 2018 Taxable Bonds, including the application and effect of state, local, non-U.S., and other tax laws.

Effect of Defeasance

Pursuant to the Indenture, the Series 2018 Taxable Bonds are subject to legal defeasance without the consent of the holders of the Series 2018 Taxable Bonds. Defeasance of any of the Series 2018 Taxable Bonds may be treated as a taxable constructive exchange of that Series 2018 Taxable Bond for the defeased Series 2018 Taxable Bond, in which event, the holder will recognize gain or loss for federal income tax purposes equal to the difference between the amount realized from the sale, exchange or retirement (less any accrued qualified stated interest, which will be taxable as described above) and the holder’s adjusted tax basis in the Series 2018 Taxable Bonds (described above).

ERISA CONSIDERATIONS

The Employee Retirement Income Security Act of 1974, as amended (“ERISA”), imposes certain restrictions on employee pension and welfare benefit plans subject to ERISA (“ERISA Plans”) regarding prohibited transactions, and also imposes certain obligations on those persons who are fiduciaries with respect to ERISA Plans. Section 4975 of the Code imposes similar prohibited transaction restrictions on (i) tax-qualified retirement plans described in Section 401(a) and 403(a) of the Code, which are exempt from tax under section 501(a) of the Code and which are

not governmental and church plans as defined herein (“Qualified Retirement Plans”), and (ii) Individual Retirement Accounts described in Section 408(b) of the Code (“Tax-Favored Plans”). Certain employee benefit plans, such as governmental plans (as defined in Section 3(32) of ERISA), and, if no election has been made under Section 410(d) of the Code, church plans (as defined in Section 3(33) of ERISA), are not subject to ERISA requirements. Additionally, such governmental and non-electing church plans are not subject to the requirements of Section 4975 of the Code. Although assets of such governmental or non-electing church plans may be invested in the Series 2018 Taxable Bonds without regard to the ERISA and Code considerations described below, any such investment may be subject to provisions of applicable federal and state law that are, to a material extent, similar to the requirements of ERISA and Section 4975 of the Code (“Similar Law”).

In addition to the imposition of general fiduciary obligations, including those of investment prudence and diversification and the requirement that a plan’s investment be made in accordance with the documents governing the plan, Section 406 of ERISA prohibits (as does Section 4975 of the Code) a broad range of transactions involving assets of ERISA Plans and Tax-Favored Plans and entities whose underlying assets include plan assets by reason of ERISA Plans or Tax-Favored Plans investing in such entities (collectively, “Benefit Plans”) and persons who have certain specified relationships to the Benefit Plans (such persons are referred to as “Parties in Interest” or “Disqualified Persons”), unless a statutory or administrative exemption is available. Parties in Interest (or Disqualified Persons) that participate in a prohibited transaction may be subject to an excise tax imposed pursuant to Section 4975 of the Code unless a statutory or administrative exemption is available.

Certain transactions involving a Benefit Plan’s purchase, holding or transfer of the Series 2018 Taxable Bonds might be deemed to constitute prohibited transactions under ERISA and the Code if SHC, the Underwriters, the Master Trustee or the Trustee, or any of their respective affiliates, is or becomes a Party in Interest or a Disqualified Person with respect to such Benefit Plan. The fiduciary of a Benefit Plan that proposes to purchase and hold any Series 2018 Taxable Bonds should consider, among other things, whether such purchase and holding may involve (i) the direct or indirect extension of credit to a Party in Interest, (ii) the sale or exchange of any property between a Benefit Plan and a Party in Interest, or (iii) the transfer to, or use by or for the benefit of, a Party in Interest, of any Benefit Plan assets.

Certain exemptions from the prohibited transaction rules could be applicable depending on the type and circumstances of the plan fiduciary making the decision to acquire a Series 2018 Taxable Bond. Included among these exemptions are: Prohibited Transaction Class Exemption (“PTCE”) 75-1, relating to certain broker-dealer transactions, PTCE 96-23, regarding transactions effected by “in-house asset managers”; PTCE 90-1, regarding investments by insurance company pooled separate accounts; PTCE 95-60, regarding transactions effected by “insurance company general accounts”; PTCE 91-38, regarding investments by bank collective investment funds; and PTCE 84-14, regarding transactions effected by “qualified professional asset managers.” In addition, Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code generally provide for a statutory exemption from the prohibitions of Section 406(a) of ERISA and Section 4975 of the Code for certain transactions between Benefit Plans and persons who are Parties in Interest solely by reason of providing services to such Benefit Plans or who are persons affiliated with such service providers, provided generally that such persons are not fiduciaries with respect to “plan assets” of any Benefit Plan involved in the transaction and that certain other conditions are satisfied.

By its acceptance of a Series 2018 Taxable Bond, each purchaser will be deemed to have represented and warranted that either (i) the purchase and holding of such Series 2018 Taxable Bond does not constitute a prohibited transaction under ERISA or Section 4975 of the Code, or (ii) the purchase and holding of such Series 2018 Taxable Bonds is exempt from the prohibited transaction restrictions of ERISA and Section 4975 of the Code pursuant to a statutory exemption or an administrative class exemption.

In addition, if Series 2018 Taxable Bonds (or any interest therein) are acquired by a Benefit Plan or are acquired with “plan assets” of any Benefit Plan, then the Benefit Plan, and the fiduciary of the Benefit Plan acquiring such Series 2018 Taxable Bonds (or interest therein) on behalf of the Benefit Plan or with such plan assets (the “Independent Plan Fiduciary”) will be deemed to represent and warrant by such acquisition of Series 2018 Taxable Bonds (or interest therein) that the decision to acquire the Series 2018 Taxable Bonds (or interest therein) has been made by the Independent Plan Fiduciary and the Independent Plan Fiduciary is an “independent fiduciary with financial expertise” as described in 29 C.F.R. Section 2510.3-21(c)(1) in a manner that complies with the requirements

of 29 C.F.R. Section 2510.3-21(c)(1). Specifically, this requires the Benefit Plan and Independent Plan Fiduciary to represent and warrant that:

(1) SHC, the Underwriters and their affiliates (collectively, the “Transaction Parties”) have not provided nor will provide advice with respect to the acquisition of the Series 2018 Taxable Bonds (or any interest therein) by the Benefit Plan, other than to the Independent Plan Fiduciary which is independent of the Transaction Parties, and the Independent Plan Fiduciary either:

(a) is a bank as defined in Section 202 of the U.S. Investment Advisers Act of 1940 (the “Advisers Act”), or similar institution that is regulated and supervised and subject to periodic examination by a U.S. state or U.S. federal agency;

(b) is an insurance carrier which is qualified under the laws of more than one U.S. state to perform the services of managing, acquiring or disposing of assets of a plan;

(c) is an investment adviser registered under the Advisers Act, or, if not registered as an investment adviser under the Advisers Act by reason of paragraph (1) of Section 203A of the Advisers Act, is registered as an investment adviser under the laws of the U.S. state in which it maintains its principal office and place of business;

(d) is a broker-dealer registered under the U.S. Securities Exchange Act of 1934, as amended;
or

(e) holds, or has under its management or control, total assets of at least U.S. \$50 million (provided that this clause (e) shall not be satisfied if the Independent Plan Fiduciary is an individual directing his or her own individual retirement account or plan account or a relative of such an individual);

(2) The Independent Plan Fiduciary is capable of evaluating investment risks independently, both in general and with respect to particular transactions and investment strategies, including the acquisition by the Benefit Plan of the Series 2018 Taxable Bonds (or interest therein);

(3) The Independent Plan Fiduciary is a “fiduciary” with respect to the Benefit Plan within the meaning of Section 3(21) of ERISA, Section 4975 of the Internal Revenue Code, or both, and is responsible for exercising independent judgment in evaluating the Benefit Plan’s acquisition of the Series 2018 Taxable Bonds (or interest therein);

(4) None of the Transaction Parties has exercised any authority to cause the Benefit Plan to invest in the Series 2018 Taxable Bonds or to negotiate the terms of the Benefit Plan’s investment in the Series 2018 Taxable Bonds (or interest therein); and

(5) The Independent Plan Fiduciary has been informed by the Transaction Parties:

(a) that none of the Transaction Parties are undertaking to provide impartial investment advice or to give advice in a fiduciary capacity in connection with the Benefit Plan’s acquisition of the Series 2018 Taxable Bonds (or interest therein); and

(b) of the existence and nature of the Transaction Parties’ financial interests in the Benefit Plan’s acquisition of the Series 2018 Taxable Bonds (or interest therein).

Any Benefit Plan fiduciary considering whether to purchase Series 2018 Taxable Bonds on behalf of an ERISA Plan should consult with its counsel regarding the applicability of the fiduciary responsibility and prohibited transaction provisions of ERISA and the Code to such investment and the availability of any of the exemptions referred to above. In addition, persons responsible for considering the purchase of Series 2018 Taxable Bonds by a governmental plan or non-electing church plan should consult with counsel regarding the applicability of any Similar Law to such an investment.

APPROVAL OF LEGALITY

Certain legal matters will be passed upon for SHC by Ropes & Gray LLP, San Francisco, California, and for the Underwriters by their counsel, Norton Rose Fulbright US LLP, San Francisco, California.

RATINGS

Fitch Ratings, Inc. (“Fitch”), S&P Global Ratings, a division of Standard & Poor’s Financial Services LLC (“S&P”), and Moody’s Investors Service, Inc. (“Moody’s”) have assigned their long-term municipal bond ratings of “AA,” “AA-” and “Aa3,” respectively, to the Series 2018 Taxable Bonds.

Any explanation of the significance of ratings may only be obtained from the rating agencies.

SHC has furnished to the rating agencies certain information and material concerning the Series 2018 Taxable Bonds and itself. Generally, rating agencies base their ratings on this information and materials and on investigations, studies and assumptions made by the rating agencies themselves. There is no assurance that the ratings mentioned above will remain in effect for any given period of time or that they might not be lowered or withdrawn entirely by the rating agency, if in its judgment circumstances so warrant. Any downward change in or withdrawal of any ratings might have an adverse effect on the market price or marketability of the Series 2018 Taxable Bonds.

UNDERWRITING

Morgan Stanley & Co. LLC, as representative of the Underwriters named on this Offering Memorandum (collectively, the “Underwriters”), has agreed to purchase the Series 2018 Taxable Bonds pursuant to a Bond Purchase Contract with SHC. The Series 2018 Taxable Bonds will be purchased at a purchase price of \$500,000,000.00. The Underwriters will receive a fee from SHC in the amount of \$2,650,000.00 in connection with the purchase of the Series 2018 Taxable Bonds. The Bond Purchase Contract for the Series 2018 Taxable Bonds provides that the Underwriters will purchase all of the Series 2018 Taxable Bonds, if any are purchased, and contains the agreements of SHC to indemnify the Underwriters against certain liabilities. The Bond Purchase Contract also provides that SHC will pay the fees of counsel to the Underwriters.

Morgan Stanley & Co. LLC, as an Underwriter of the Series 2018 Taxable Bonds, has entered into a retail distribution arrangement with its affiliate, Morgan Stanley Smith Barney LLC. As part of the distribution arrangement, Morgan Stanley & Co. LLC may distribute municipal securities to retail investors through the financial network of Morgan Stanley Smith Barney LLC. As part of this arrangement, Morgan Stanley & Co. LLC may compensate Morgan Stanley Smith Barney LLC for its underwriting efforts with respect to the Series 2018 Taxable Bonds.

The Underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include sales and trading, commercial and investment banking, advisory, investment management, investment research, principal investment, hedging, market making, brokerage and other financial and non-financial activities and services. Certain of the Underwriters and their respective affiliates have provided, and may in the future provide, a variety of these services to SHC and to persons and entities with relationships with SHC, for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the Underwriters and their respective affiliates, officers, directors and employees may purchase, sell or hold a broad array of investments and actively trade securities, derivatives, loans, commodities, currencies, credit default swaps and other financial instruments for their own account and for the accounts of their customers, and such investment and trading activities may involve or relate to assets, securities and/or instruments of SHC (directly, as collateral securing other obligations or otherwise) and/or persons and entities with relationships with SHC. The Underwriters and their respective affiliates may also communicate independent investment recommendations, market color or trading ideas and/or publish or express independent research views in respect of such assets, securities or instruments and may at any time hold, or recommend to clients that they should acquire, long and/or short positions in such assets, securities and instruments.

RELATIONSHIPS AMONG THE PARTIES

Certain of the parties acting with respect to the offering, sale, issuance and securing of the Series 2018 Taxable Bonds (this “Transaction”) act for parties related to SHC. Ropes & Gray LLP is acting as counsel to SHC in this Transaction. Ropes & Gray LLP also acts as outside counsel for Stanford University and Lucile Salter Packard Children’s Hospital at Stanford (“LPCH”). PricewaterhouseCoopers LLP is the independent auditors of the financial statements of SHC, Stanford University and LPCH. Morgan Stanley & Co. LLC, which is acting as an Underwriter in this Transaction, also acts as an underwriter for LPCH and Stanford University. Goldman Sachs & Co. LLC, which is acting as an Underwriter in this Transaction, also acts as an underwriter for Stanford University. Barclays Capital Inc., which is acting as an Underwriter in this Transaction, also acts as an underwriter for Stanford University.

MISCELLANEOUS

Any statements in this Offering Memorandum involving matters of opinion, whether or not expressly stated as such, are so intended and are not representations of fact.

The foregoing and subsequent summaries or description of provisions of the Series 2018 Taxable Bonds, the Indenture, the Master Indenture and Obligation No. 40 and all references to other materials not purporting to be quoted in full are only brief outlines of some of the provisions thereof and do not purport to summarize or describe all of the provisions thereof. Reference is made to said documents for full and complete statements of their provisions. The Appendices attached hereto are a part of this Offering Memorandum. Copies, in reasonable quantity, of the Indenture, the Master Indenture and Obligation No. 40 may be obtained during the offering period upon request directed to Morgan Stanley & Co. LLC, 555 California Street, Floor 21, San Francisco, California 94104.

OTHER MATTERS

This Offering Memorandum has been executed and delivered by SHC. This Offering Memorandum is not to be considered as a contract or agreement between SHC or the purchasers or Holders of any of the Series 2018 Taxable Bonds.

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STANFORD HEALTH CARE

By: _____ /s/ Linda Hoff
Linda Hoff
Chief Financial Officer

APPENDIX A

**INFORMATION CONCERNING
STANFORD HEALTH CARE**

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BACKGROUND AND ORGANIZATION

Introduction

Stanford Health Care (the “Corporation” or “SHC”), formerly known as Stanford Hospital and Clinics, is a principal teaching affiliate of the Stanford University School of Medicine (the “School of Medicine”) and provides primary and specialty health services to adults, including cardiac care, cancer treatment, solid organ transplantation services, orthopedics and neurosciences services. The Corporation, together with Lucile Salter Packard Children’s Hospital at Stanford (“LPCH”), operates the clinical settings through which the School of Medicine educates medical and graduate students, trains residents and clinical fellows, supports faculty and community clinicians and conducts medical and biological sciences research.

The principal clinical facilities of the Corporation are the Stanford Hospital, a 613-bed tertiary, quaternary and specialty hospital (the “Hospital”), and the primary, specialty and sub-specialty clinics (the “Clinics” and, together with the Hospital, the “Hospital and Clinics”) in which the medical faculty of the School of Medicine provide clinical services. The Hospital and the majority of the Clinics are located on the campus of Stanford University (“Stanford University”) adjacent to the School of Medicine in Palo Alto, California. Other Clinics are located elsewhere on campus and off campus in neighboring communities and in the San Francisco Bay Area (the “Bay Area”). The Corporation is currently in the process of renovating and expanding its existing Hospital and constructing an additional 1.1 million square feet of inpatient facilities (the “New Stanford Hospital”). See “SERVICES, FACILITIES AND OPERATIONS—SHC’s Long-Range Master Plan and Additional Capital Needs” herein. During the fiscal year ended August 31, 2017, the Corporation treated approximately 73,900 patients in its emergency department, admitted 25,942 inpatients and recorded 769,291 outpatient visits. From these patient care activities, the Corporation reported, on a consolidated basis, total operating revenues of \$4.5 billion and income from operations of \$234 million for the fiscal year ended August 31, 2017. At August 31, 2017, the Corporation’s consolidated total assets were \$6.2 billion, consolidated total liabilities were \$2.7 billion and consolidated net assets were \$3.5 billion.

The Corporation is solely responsible for the payment of principal of and interest on the Stanford Health Care Taxable Bonds, Series 2018 (the “Series 2018 Taxable Bonds”), as described in this Offering Memorandum. Neither Stanford University, LPCH nor any of their respective affiliates other than the Corporation are obligated to pay debt service on the Series 2018 Taxable Bonds. Stanford University, LPCH and the Corporation are not co-guarantors of the debt of each other, and the Corporation, Stanford University and LPCH receive separate credit ratings from rating agencies.

In December 2017, the California Health Facilities Financing Authority issued \$454,200,000 Refunding Revenue Bonds (Stanford Health Care) 2017 Series A (the “Series 2017 Bonds”) for the benefit of SHC to advance refund certain outstanding tax-exempt bond indebtedness of SHC consisting of (i) \$240,325,000 in aggregate principal amount of the California Health Facilities Financing Authority Refunding Revenue Bonds (Stanford Hospital and Clinics), Series 2008 Series A-1, A-2 and A-3 (the “2008 Series Bonds”) and (ii) \$240,860,000 in aggregate principal amount of the California Health Facilities Financing Authority Refunding Revenue Bonds (Stanford Hospital and Clinics), 2010 Series A and B (the “2010 Series Bonds”).

Capitalized terms used and not otherwise defined in this Appendix A have the meanings set forth in the forepart of this Offering Memorandum. Dollar amounts and percentages have been rounded in some cases to simplify the presentation of information in this Appendix A; in management’s view, such amounts are stated materially accurately. More precise dollar amounts are set forth in the audited consolidated financial statements of the Corporation included as Appendix B to this Offering Memorandum.

Corporate Organization and Related Entities

The Corporation is a California nonprofit public benefit corporation. It is exempt from federal income taxation as a charitable organization described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the “Code”) and is not a private foundation as defined in Section 509(a) of the Code.

Set forth below is a listing of other entities to which the Corporation is related, or in which it has interests, and a brief description of the nature of those relationships or interests. For additional information, including which of such entities are included in the Corporation’s audited consolidated financial statements, see Note 1 and Note 2 of such financial statements included as Appendix B to this Offering Memorandum, and “SUMMARY OF FINANCIAL INFORMATION” herein. None of the entities listed below is a member of the Obligated Group; the Corporation is the only current member of the Obligated Group.

Stanford University. Stanford University, of which the School of Medicine is a part, is a trust with corporate powers, a tax-exempt organization under Section 501(c)(3) of the Code and the sole member of the Corporation. As sole member of the Corporation, Stanford University elects all elected directors of the Corporation and has the power to amend the governing documents of the Corporation and to take certain other significant actions with respect to the Corporation.

Lucile Salter Packard Children’s Hospital at Stanford. LPCH, a California nonprofit public benefit corporation and a tax-exempt organization under Section 501(c)(3) of the Code, is the principal teaching affiliate of the School of Medicine that provides pediatric and obstetric services. LPCH operates a 302-bed pediatric and obstetric hospital and related outpatient clinics on Stanford University’s campus adjacent to the Hospital and provides pediatric care in the Bay Area, including through joint ventures and partnerships with other hospitals and physicians. LPCH purchases certain services from the Corporation and shares certain services with the Corporation. See “SERVICES, FACILITIES AND OPERATIONS—Operational Relationships Among the Corporation, Stanford University, LPCH and UHA” herein. Stanford University is also the sole member of LPCH.

University HealthCare Alliance (“UHA”). UHA is a California nonprofit public benefit corporation and a tax-exempt organization under Section 501(c)(3) of the Code that owns and operates multi-specialty clinics as a medical foundation in support of the charitable, education and research purposes of the Corporation and the School of Medicine. The Corporation and Stanford University are the corporate members of UHA. For further information about UHA, see “SERVICES, FACILITIES AND OPERATIONS—Operational Relationships Among the Corporation, Stanford University, LPCH and UHA” and “—Community Physician Network” herein.

The Hospital Committee for the Livermore-Pleasanton Areas, doing business as ValleyCare Health System (“ValleyCare”). ValleyCare, a California nonprofit public benefit corporation and a tax-exempt organization under Section 501(c)(3) of the Code, operates a 167-bed acute care hospital in Pleasanton and 75-bed acute care hospital in Livermore. ValleyCare provides health care services to the Tri-Valley region east of San Francisco, including the communities of Livermore, Pleasanton, Dublin and San Ramon. The Corporation is the sole member of ValleyCare. See “SERVICES, FACILITIES AND OPERATIONS—Market Strategy” herein.

The Stanford Blood Center, LLC (“SBC”). SBC is a limited liability company organized and licensed under the laws and jurisdiction of California. The Corporation is the sole member of SBC. SBC serves as a community blood center and provides blood products and testing services to hospitals, clinics, companies and other clients.

SUMIT Holding International, LLC (“SHI”). SHI is a limited liability company organized and licensed under the laws and jurisdiction of Delaware. The sole members of SHI are the Corporation and LPCH, which hold ownership interests of 80% and 20%, respectively. SHI is the sole owner of SUMIT Insurance Company Ltd. (“SUMIT”) (described below) and Stanford University Medical Network Risk Authority, LLC, which provides risk management services to SHI, the owners of SHI and other affiliated and unaffiliated parties.

SUMIT. SUMIT, a company organized and licensed under the laws and jurisdiction of Bermuda, provides claims-made liability coverage to the Corporation and LPCH for Health Care Professional, Comprehensive General, Miscellaneous Errors/Omissions and Employment Practices liability. See “PROFESSIONAL LIABILITY AND OTHER INSURANCE” herein for additional information. The governing body of SUMIT consists of eight voting directors of whom three are appointed by the Corporation, two by LPCH and the remainder by the appointees of the Corporation and LPCH.

Professional Exchange Assurance Company (“PEAC”). PEAC, a reciprocal risk retention group domiciled in Hawaii, provides insurance coverage to UHA and Packard Children’s Health Alliance (“PCHA”), a California nonprofit corporation that operates as a medical foundation in support of LPCH, and their respective affiliated parties. PCHA and UHA are owners of PEAC, and SHC is a corporate member of UHA.

Stanford Emanuel Radiation Oncology Center (“SEROC”). SEROC is a joint venture between the Corporation and Doctors Medical Center of Modesto, Inc. (“DMC”), a California corporation. SEROC operates an outpatient clinic that provides radiation oncology services to patients in Turlock, California and surrounding communities. The Corporation’s and DMC’s membership interests in SEROC are 60% and 40%, respectively.

Stanford Health Care Advantage (“SHCA”). SHCA, formerly known as University HealthCare Advantage, is a California nonprofit public benefit corporation and provides comprehensive health care coverage options to elderly and disabled individuals living in Santa Clara County. As a Medicare Advantage plan, SHCA promotes the health of the community by providing Medicare-eligible individuals with a broad range of health services. SHCA operates as an integral part of the broader charitable mission of the Corporation, its sole corporate member.

CareCounsel, LLC (“CareCounsel”). CareCounsel, a California limited liability company, was acquired by the Corporation in 2012. CareCounsel provides employer-sponsored consumer education, advocacy and access to expert health care resources and information to for-profit, nonprofit and governmental employers across the United States.

Stanford PET-CT, LLC (“PET-CT”). PET-CT, a California limited liability company, provides radiological services, including positron emission tomography and computerized axial tomography scan services. The Corporation and Stanford University each appoint half of the members of the governing board of PET-CT and are its members.

Stanford-StartX Fund, LLC (“StartX Fund”). StartX Fund, a California limited liability company, supports the continued experiential education of participants in a program that aims to accelerate the development of students, faculty and alumni of Stanford University identified as high potential entrepreneurs by StartX, a California nonprofit public benefit corporation. The Corporation’s membership interest in StartX Fund is 33%.

Pleasanton Physician Affiliates II, LLC (“PPA II”). PPA II, a California limited liability company, owns and operates a medical office building in Pleasanton. The Corporation is the sole member of ValleyCare, and ValleyCare’s membership interest in PPA II is 39%.

Corporate Partners Program

In 2011, the Corporation launched its Corporate Partners Program and recruited six leading Silicon Valley technology companies to join in providing philanthropic support for development of the Corporation’s facilities replacement project. Apple, eBay, HP, Intel, Intuit and Oracle are founding members of the Corporate Partners Program. Currently, there are 12 partners. Their contributions are projected to provide as much as \$250 million by 2022, of which over \$195 million has been received as of August 31, 2017 to help build the New Stanford Hospital and other replacement facilities and create a global model for patient-centered, technologically advanced health care. See “SERVICES, FACILITIES AND OPERATIONS—SHC’s Long-Range Master Plan and Additional Capital Needs” herein.

Governance

Board of Directors. Pursuant to the bylaws of the Corporation, the Board of Directors (the “Board”) is comprised of seven *ex officio* directors and between seven and twenty-six elected directors as determined by Stanford University. Currently, the Board consists of seven *ex officio* directors and twenty-two directors elected by the Board of Trustees of Stanford University. Each director has one vote. Elected directors, except for the community physician director, who serves for a one-year term, may serve for three-year terms commencing on the appointment effective date and ending three years after the appointment effective date, or when a director’s successor is duly elected and qualified. Each elected director may serve up to three consecutive terms, with the exception of a director who is a clinical department chair from the School of Medicine, who may not serve more than one term consecutively. A director who has served three consecutive terms is ineligible for reelection for one year thereafter; however, the term of a director who is the chair of the Board may be extended for one additional year (for a maximum term of 10 years) if needed for optimal Board operation. The Board has three classes of directors that are equally sized to the extent possible, and holds staggered elections such that the terms of the directors in only one class

expire each year. The current elected and *ex officio* directors, the year of each director's commencement of service on the Board, the year of expiration of each director's current term and each director's occupation are as follows:

Name	Service Commenced	Year of Expiration of Current Term	Occupation
Susan Bechtel	2015	2018	President of a non-profit foundation
William Brody, M.D.	2015	2018	Professor Emeritus
Mariann Byerwalter	2015	2018	Chairman of an advisory group
Jeff Chambers, <i>ex officio</i>	2017	N/A	Senior Advisor at a private equity firm
Bret Comolli	2012	2020	Chairman of a consumer technology protection services company
Ed Damrose, M.D., FACS, <i>ex officio</i>	2016	N/A	Chief of Medical Staff, SHC
Christopher Dawes, <i>ex officio</i>	2000	N/A	President and CEO, LPCH
David Entwistle, <i>ex officio</i>	2016	N/A	President and CEO, SHC
Chandler Evans	2014	2019	Community volunteer
Sanjiv Sam Gambhir, M.D. Ph.D.	2017	2019	Chair, Department of Radiology, the School of Medicine
Kaye Foster-Cheek	2017	2020	Independent consultant
John Goldman	2012	2020	Civic volunteer and President of an arts organization
Lori Goler	2013	2019	Executive of a social media company
John Gunn, Vice Chair	2011	2020	Senior executive of an investment firm
Fred Harman	2012	2018	Managing director of a venture capital firm
Robert Harrington, M.D.	2016	2018	Chair, Department of Medicine, the School of Medicine
Cecilia Herbert	2016	2019	Trustee of an investment firm
Joel Hyatt	2010	2018	Co-founder of a cable television channel
Charles Koob	2010	2019	Retired attorney
Chien Lee	2013	2018	Private investor
Mark Leslie	2015	2018	Retired entrepreneur
John Levin, Chair	2009	2018	Chairman of a law firm, Attorney
Randy Livingston, <i>ex officio</i>	2017	N/A	Stanford Medicine Liason, Chief Financial Officer, Stanford University
Linda Meier	2012	2018	Community volunteer
Lloyd Minor, M.D., <i>ex officio</i>	2013	N/A	Dean, the School of Medicine
Margaret Raffin	2014	2019	President of a non-profit foundation
Christopher Redlich	2009	2018	Former Chairman and owner of a contract stevedore and terminal operating company
Norman Rizk, M.D., <i>ex officio</i>	2001	N/A	Senior Associate Dean for Clinical Affairs, the School of Medicine
Caroline Schreiber, M.D.	2017	2018	Community physician

Board Committees. The bylaws of the Corporation provide for an Audit and Compliance Committee (auditor control, supervision and selection) and Quality and Service Committee (service quality and patient safety) and permit the Board to create other committees as it deems necessary for the effective governance of the Corporation. Pursuant to this power, the Board has created the following committees: Compensation, Credentials, Policies and Procedures, Development, Facilities, Finance, Information Technology, and Nominations and Governance. In addition, from time to time, the Board may create one or more *ad hoc* committees to deal with matters that the Board may delegate to such committees.

Management

The bylaws of the Corporation provide for the positions of President (Chief Executive Officer), Chief Financial Officer and Chief Operating Officer. The Board is authorized to appoint the President, in consultation with the President of Stanford University, from among candidates nominated by the President of Stanford University. The President of the Corporation is authorized to appoint the Chief Financial Officer and Chief Operating Officer and is also permitted to appoint and prescribe the duties of such additional officers as the President deems appropriate. Biographical information on the current executive management group is set forth below.

David Entwistle, President and Chief Executive Officer. David Entwistle was appointed President and Chief Executive Officer of the Corporation effective July 2016. Prior to his appointment, Mr. Entwistle served as the Chief Executive Officer at University of Utah Health (“UUH”). In that role, Mr. Entwistle led UUH since 2007. Prior to joining UUH, Mr. Entwistle served as Senior Vice President and Chief Operating Officer, as well as Senior Vice President of Operations, for the University of Wisconsin Hospital and Clinics. Previously, he was Vice President of Professional Services and Joint Venture Operations at City of Hope National Medical Center, where he also served as President and Chief Executive Officer for Oncology Management Services. Mr. Entwistle serves on the boards of the American Hospital Association, the AAMC Council of Teaching Hospitals, the Accreditation Council for Graduate Medical Education and Vizient (formerly University HealthSystem Consortium). He earned a B.S. in Health Sciences from Brigham Young University and an M.H.A. in Health Services Administration from Arizona State University. He also was awarded a postgraduate administrative fellowship at the University of Texas MD Anderson Cancer Center.

Quinn McKenna, Chief Operating Officer. Quinn McKenna joined the Corporation in January 2017. Mr. McKenna has more than 25 years of leadership experience in academic medical centers, health systems and management consulting. Prior to joining the Corporation, he served as Chief Operating Officer of UUH and as Executive Director of the University of Utah Hospital. Mr. McKenna previously held Chief Operating Officer roles at the University of Washington in Seattle and at Salt Lake Regional Medical Center. He earned an M.H.A. from the University of Washington and a B.S. in Business Finance from Utah State University.

Linda Hoff, Chief Financial Officer. Linda Hoff became the Chief Financial Officer of the Corporation in July 2017. Prior to joining the Corporation, Ms. Hoff was the Senior Vice President and Chief Financial Officer of Legacy Health in Portland, Oregon since 2014. Previously, she was Executive Vice President and Chief Financial Officer at Meriter Health Services in Madison, Wisconsin. She also served as President and Chief Executive Officer of Physicians Plus Insurance Corporation, with product lines including individual, small group, large

group, Medicare supplement and Medicaid. Ms. Hoff earned an M.B.A. in Health Care Financial Management from the University of Wisconsin, where she also received a B.S. in Economics, and is a CPA.

Eric Yablonka, Chief Information Officer. Eric Yablonka joined the Corporation in September 2017. Prior to his appointment, Mr. Yablonka served as Vice President and Chief Information Officer at University of Chicago Medicine for 16 years. Previously, Mr. Yablonka served as Vice President and Chief Information Officer at the Saint Raphael Healthcare System in New Haven, Connecticut for six years. He has also held IT leadership roles at The Joint Commission, Northwestern Memorial Hospital, University of Nebraska Medical Center and Beaumont Health. Mr. Yablonka earned an M.B.A. from the Advanced Management Program of the Eli Broad College of Business at Michigan State University and a B.S. in Business from the State University of New York – Buffalo State.

Dale Beatty, Chief Nursing Officer, Vice President Patient Care Services. Dale Beatty joined the Corporation in May 2017. Prior to his appointment, Mr. Beatty served as Chief Nursing Officer at the University of Illinois Hospital and Health Sciences System. Previously, Mr. Beatty served as Executive Vice President and Chief Nursing Officer at Northwest Community Healthcare, as well as Vice President and Chief Nursing Officer at Sharp HealthCare. Mr. Beatty holds a B.S. in Nursing from Ohio Wesleyan University, an M.S. in Nursing Administration from DePaul University, and a Doctor of Nursing Practice from the University of Illinois.

Norman Rizk, Chief Medical Officer. Dr. Norman Rizk was named Chief Medical Officer of the Corporation in 2011 and is also the Senior Associate Dean for Clinical Affairs at the School of Medicine and the Berthold and Belle N. Guggenhome Professor in Medicine. He is the Medical Director of the Intensive Care Unit at the Hospital and Program Director for Fellowships in Critical Care Medicine. Dr. Rizk graduated from Yale University School of Medicine and completed his residency and Fellowship at UCSF Medical Center. Dr. Rizk is board-certified in Critical Care Medicine, Internal Medicine, and Pulmonary Disease.

SERVICES, FACILITIES AND OPERATIONS

The Corporation operates the Hospital and Clinics on the campus of Stanford University, in neighboring communities, and in other communities in the Bay Area. In 2017, U.S. News and World Report named the Hospital and Clinics one of the nation's top ten on its Hospitals Honor Roll. The Hospitals Honor Roll is a distinction awarded to twenty hospitals that deliver exceptional treatment across multiple areas of care.

Principal Patient Services

The Corporation provides comprehensive primary and secondary care to residents of the Bay Area. In addition, the Corporation provides highly specialized referral services to patients residing in northern California and the surrounding regions. See “SERVICES, FACILITIES AND OPERATIONS—Service Area” herein.

Since 2001, the Corporation has concentrated its planning, development and marketing on five strategic clinical services (the “Strategic Clinical Services”): Cardiac Care, Cancer Treatment,

Solid Organ Transplantation (Abdominal), Orthopedics and Neurosciences. Historically, these services have been strengths of both the Hospital and Clinics and the School of Medicine. Such services are intensively focused on research and innovation, both strengths of the Corporation in management's view, and many procedures in these services lines are eligible for higher than average payments from third-party payors. Management planning, development and marketing efforts are directed toward sustaining the Hospital and Clinics as a leading center in the United States in each of these Strategic Clinical Services. Brief descriptions of the five Strategic Clinical Services follow. For additional information on utilization of the Strategic Clinical Services for the three years ended August 31, 2017, see "Utilization" herein.

Cardiac Care. The Hospital and Clinics are a referral center for the medical and surgical treatment of end-stage heart failure and aortic disease. Treatments available at the Hospital and Clinics include heart, heart/lung and lung transplants, aortic surgery, revascularization, implantation of mechanical pumps to replace heart muscle function as a temporary bridge to transplant and as a permanent therapy, stent placement, catheter ablation, internal cardioverter defibrillators and other electrophysiology treatments for heart rhythm problems, minimally invasive heart surgery and cardiac imaging. Breakthrough therapies, including new interventional devices to treat coronary artery disease and heart failure and to prolong the quality of heart muscle function, have also been developed as a part of this Strategic Clinical Service.

Cancer Treatment. The Corporation offers a multidisciplinary approach to the diagnosis and treatment of cancer, which brings together practitioners from a number of specialties, including medical and surgical specialties, radiation oncology, radiology and pathology. Specialty services include the treatment of cancers of the breast, gastrointestinal tract, head and neck, lung, and genitourinary tract, and gynecologic cancers, sarcoma and melanoma, as well as leukemia, lymphoma, and multiple myeloma. The bone marrow transplant program, specializing in the treatment of leukemia, Hodgkin's disease and lymphomas, is a significant part of the cancer treatment program. Many cancer treatments, particularly chemotherapy, are now performed in the Hospital's ambulatory infusion treatment area, which is open 365 days a year. Treatment of brain cancer is also provided and is described below under "Neurosciences." The cancer clinical trials office oversees more than 250 active cancer-related clinical trials providing patients access to experimental treatments. In July 2015, the Corporation began serving patients in the Stanford South Bay Cancer Center, an outpatient cancer center located in San Jose. The Stanford South Bay Cancer Center has expanded patient access to the latest advances in cancer care, including access to clinical trials, and treatments in complementary practices.

Solid Organ Transplantation (Abdominal). Services provided include kidney, simultaneous kidney/pancreas, pancreas, liver and intestinal transplantation. Such surgical transplantation services are in addition to heart, heart/lung and lung transplant services described above under "Cardiac Care." All transplant programs utilize multi-disciplinary teams comprised of experts in transplant surgery, immunology and infectious disease. Patients benefit from research protocols and receive care and education from specialty-trained bedside nurses, transplant coordinators, social workers and rehabilitation personnel.

Orthopedics. Services provided include total joint replacements, sports medicine, hand and upper extremities, foot and ankle, spine, trauma, tumor, and physiatry. The adult reconstructive team, also known as the total joint replacement team, develops and implements the protocols for recovery and return to productivity. The team also provides the latest in spine surgery

to enable high degrees of mobility for patients who are otherwise immobilized through injury or pain and works closely with the multi-disciplinary teams of rehabilitation services and pain management experts to serve the patient from pre-surgery through post-surgical recovery. The Outpatient Center, which opened in February 2009, supports continued growth and expansion in the scope of the Corporation's orthopedic services and gives the Corporation an opportunity to develop and implement additional innovations in orthopedic care.

Neurosciences. Development of treatments for diseases of the brain is emphasized at the Hospital and Clinics. Neurosurgeons, neurologists, radiologists and other specialists collaborate at the Hospital to design and develop these treatments. Brain tumor patients have access to chemotherapy, biologic agent therapy and gene therapy, as well as radiation therapy, including CyberKnife (developed by School of Medicine faculty at the Hospital) for deep-seated brain tumors and brain metastases. An extensive cerebro-vascular surgery program, including neuro-interventional radiology, treats patients with aneurysms, complex vascular malformations, and stroke. The Corporation also offers medical and neurosurgical treatments for intractable epilepsy, aggressive acute treatment of stroke, movement disorders such as Parkinson's disease, spine care, pain management, multiple sclerosis, amyotrophic lateral sclerosis and other neuromuscular disorders. In January 2016, the Corporation opened, adjacent to the Hospital campus, the Stanford Neuroscience Health Center, which brings together multidisciplinary teams of clinicians, integrated outpatient services, and advanced neuroscience technology in one patient-centered facility.

Other Clinical Services. The Corporation is, in the view of management, a recognized leader in providing a number of other services, including primary care and internal medicine, treatment of asthma, treatment of blood disorders, management of critical care patients, dermatologic care for complex skin disorders and vascular malformations, diagnostic radiology, endocrinology, endocrine surgery, gastrointestinal medicine and surgery, genetics, care for hearing disorders and cochlear implants, treatment of hepatobiliary disease, HIV care, treatment of immunological disorders, treatment of female and male infertility, laboratory medicine and pathology, laparoscopic surgery, major joint replacements, maxillo/craniofacial surgery, nephrology, ophthalmology, pain management, psychiatry, interventional and neurointerventional radiology, rehabilitation, rheumatology and treatment of bone malformation and disease, plastic surgery, pulmonary medicine and treatment for sleep disorders, surgery for scoliosis and other spinal disorders, sports medicine, urology, vascular medicine and surgery and women's health.

SHC's Long-Range Master Plan and Additional Capital Needs

The Master Plan. The Corporation's master plan for facilities replacement and renewal (the "Master Plan") is anticipated to be completed in multiple phases under a thirty-year development agreement among the City of Palo Alto, the Corporation, LPCH, and Stanford University that governs local entitlements. As part of the Master Plan, the Corporation is constructing the New Stanford Hospital, to consist of approximately 1.1 million square feet of inpatient facilities, including new surgical operating, diagnostic and treatment suites, a new emergency department and associated nursing and support space. Additional new construction includes approximately 429,000 square feet of clinics, medical offices, and administrative offices. Taken together, these new facilities will replace approximately 700,000 square feet of existing facilities, resulting in a net increase of approximately 824,000 square feet of facilities.

Construction activities have been planned to permit inpatient and outpatient services to continue during each phase of the Master Plan.

The New Stanford Hospital is a core element of the Master Plan. The goal of the New Stanford Hospital, endorsed by the Corporation's Board and embodied in the facilities design, is to create a place of healing that supports patient care, practitioner and staff productivity and environmental sustainability. The New Stanford Hospital is designed to create physical connections that foster inter-connectivity among the facility components, both expressing and enabling the translational medicine activities of the Corporation, the School of Medicine and LUCH. The New Stanford Hospital has also been designed to support growth of the Strategic Clinical Services and other tertiary services and to meet the standards of the Seismic Safety Act (defined below). Construction began in 2012 and is scheduled to be completed in late 2018 or early 2019, with transition to the New Stanford Hospital scheduled to occur during 2019. Upon completion, the New Stanford Hospital and the renovated portions of the existing Hospital will include approximately 600 patient beds.

Management currently estimates the cost of the New Stanford Hospital to be approximately \$2.1 billion, of which approximately \$1.5 billion has been spent as of August 31, 2017. Funding sources for the New Stanford Hospital include cash flows from operations, investment income, debt and philanthropy. Management currently estimates that total expenditures for on-campus capital improvements related to the Master Plan, including the approximately \$600 million of remaining expenditures on the New Stanford Hospital, will be approximately \$1.7 billion over the next four fiscal years. Management also estimates that an additional \$700 million will be spent on various off-campus capital projects and strategic initiatives over the next four fiscal years. Potential off-campus projects may include the expansion of existing and acquisition of new off-campus facilities, all of which are subject to approval by the Board. Capital plan expenditures remain subject to changes by management and are subject to the review and approval of the Board in light of the priorities, debt capacity and the strategic planning of the Corporation and the School of Medicine.

Seismic Safety Act Compliance. California's Hospital Seismic Safety Act (the "Seismic Safety Act") requires licensed acute care functions to be conducted only in facilities that meet specified seismic safety standards. Facilities classified by the State of California as non-compliant must be retrofitted, replaced or removed from acute care service by applicable deadlines, subject to extension if approved by the California Office of Statewide Health Planning and Development ("OSHPD"). OSHPD has classified a substantial portion of the Hospital as compliant with seismic safety structural standards until 2030 and beyond. Certain patient care activities are located in facilities that are structurally compliant until 2030. However, these facilities have utility and other connections to facilities that are only compliant until 2020 under prescribed circumstances. Certain non-inpatient buildings are only compliant until 2020. The Corporation received an OSHPD-approved extension through January 1, 2020 and management expects some non-inpatient facilities to be in compliance by such date. Additionally, certain nursing units and the perioperative suite in the Hospital cannot be completed until the New Stanford Hospital opens, and therefore will not be compliant by January 1, 2020. Management intends to seek, and expects to receive, from OSHPD an extension of the compliance date through January 1, 2023 for these facilities.

The School of Medicine

The School of Medicine was established in 1908 as a part of Stanford University and today is one of the preeminent schools of medicine in the United States. In 2017, U.S. News and World Report ranked the School of Medicine second nationally among research-oriented medical schools based upon peer assessment surveys. The School of Medicine offers an M.D. program, M.A. and Ph.D. programs in various areas of biosciences, intern and residency programs at the Hospital and Clinics and LPCH, and a Medical Scientist Program in which students earn both an M.D. and Ph.D.

The mission statement of the School of Medicine is in part "...to be a premier research-intensive medical school that improves health through leadership and a collaborative approach to discovery and innovation in patient care, education and research...." A specific strategic goal of the School of Medicine is to be a leader in the clinical application of knowledge acquired and scientific innovations achieved through research at the School of Medicine. The Hospital and Clinics provides the settings where these clinical applications are delivered to adult patients.

Joint Strategic Initiatives. The School of Medicine and the Corporation collaborate on strategies addressing areas of clinical excellence, patient satisfaction and business operations, and on a variety of initiatives in translational medicine.

Collaborations between the School of Medicine and the Corporation include:

- A Council of Clinical Chairs, co-chaired by the Senior Associate Dean for Clinical Affairs of the School of Medicine and the Corporation's Chief Executive Officer. The Council includes the chairs of the 18 clinical science departments of the School of Medicine as well as key officers of the Corporation.
- Joint planning involving the School of Medicine, other components of Stanford University and the Corporation to integrate the clinical services, business needs and information technology priorities.
- Coordination of development and philanthropy for the mutual benefit of the two institutions.
- Collaboration in protecting the privacy and security of patient health information.
- Clinical Services and outreach clinics with select community hospitals.
- Collaboration regarding health care reform and medical center strategy.

The School of Medicine has undertaken to improve the position of SHC in the Strategic Clinical Services and other tertiary and quaternary services. The School of Medicine has created five institutes that align research, education and clinical efforts, including the Stanford Cancer Institute; the Stanford Institute for Stem Cell Biology and Regenerative Medicine; the Stanford Cardiovascular Institute; the Stanford Neuroscience Institute; and the Stanford Institute for Immunity, Transplantation and Infection.

Operational Relationships Among the Corporation, Stanford University, LPCH and UHA

Purchased Services from the School of Medicine. Services provided at the Hospital and Clinics by the School of Medicine include emergency room physician coverage, medical direction and professional clinical services, which are delivered pursuant to a Professional Services Agreement (“PSA”) between the Corporation and the School of Medicine. The expenses for these services are included in purchased services in the consolidated statements of operations and changes in net assets of the Corporation, included as Appendix B to this Offering Memorandum, and were \$678.2 million for the year ended August 31, 2017.

The compensation methodology in the PSA is based on productivity and degree of complexity of the clinical procedures performed. Under the PSA, the payment to the School of Medicine is calculated using the volume of clinical work relative value units. As the School of Medicine achieves the strategic goal of seeing more patients, it is expected that the payment to the School of Medicine for services will increase.

Other Transactions with Stanford University. Services provided to the Corporation by Stanford University include telecommunications, transportation, utilities, and certain administrative services, which include legal and internal audit. The Corporation’s cost of such services for the fiscal year ended August 31, 2017 was \$99.6 million and is reflected in various expense categories in the consolidated statements of operations and changes in net assets.

The Corporation also received payment for services provided to Stanford University, including primarily building maintenance, housekeeping, and security. Costs incurred by the Corporation in providing these services are reflected in the respective categories in the consolidated statements of operations and changes in net assets. Reimbursement from Stanford University totaled \$38.1 million for the fiscal year ended August 31, 2017, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

The Corporation received certain grant monies for clinical trials from Stanford University that totaled \$6.8 million for the fiscal year ended August 31, 2017 and are reflected in the consolidated statements of operations and changes in net assets as net patient service revenue and recoveries. For the fiscal year ended August 31, 2017, the Corporation transferred \$69.4 million to Stanford University to support the academic mission of the School of Medicine and its initiatives, and to generally support the academic community and physical plant of Stanford University. The Corporation’s transfers to Stanford University are reflected in the consolidated statements of operations and changes in net assets as transfers to Stanford University.

Transactions with LPCH. The Corporation and LPCH share certain departments, including facilities design and construction, materials management, managed care contracting, compliance and general services. The costs for these shared services are allocated between the Corporation and LPCH based on negotiated rates. For the fiscal year ended August 31, 2017, the total cost of shared services departments was approximately \$410.2 million, of which \$31.4 million was reimbursed by LPCH. The reimbursement from LPCH is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

The Corporation also provides various services to LPCH, including operating room facilities and services, cardiac catheterization, interventional radiology, radiation oncology and

laboratory services. The Corporation charges LPCH for the services and products purchased by LPCH based on either (i) a percentage of charges intended to approximate actual cost or (ii) on the basis of actual cost per procedure. Reimbursement from LPCH for purchased services provided by the Corporation totaled \$44.8 million for the year ended August 31, 2017 and is reflected in the consolidated statements of operations and changes in net assets as net patient service revenue.

Other services provided by the Corporation to LPCH include services provided by interns and residents, certain billings and collections services, building maintenance and utilities. Reimbursement of these services totaled \$40.7 million for the year ended August 31, 2017, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

Transactions with UHA. The Corporation has agreed to sponsor UHA’s operating divisions comprised of multi-specialty clinics operated by UHA in 70 locations in San Mateo, Santa Clara and Alameda counties, and in connection with such sponsorship the Corporation has agreed to fund UHA’s general overhead costs and to supplement the operating division’s revenues if necessary to fund its operating and capital costs. The sponsorship continues from year to year at SHC’s discretion. In fiscal year 2017, the Corporation provided \$73.6 million to UHA in funding for operations and capital. Management of the Corporation estimates that transfers of such sponsorship amounts will not be material to the financial condition of the Corporation. See “SERVICES, FACILITIES AND OPERATIONS—Community Physician Network” below.

Additional Information Concerning Related Party Transactions. For additional information concerning related party transactions, see Note 13 of the audited consolidated financial statements of the Corporation included in Appendix B to this Offering Memorandum.

Bed Complement

As of August 31, 2017, the licensed and operational bed complement of the Corporation was allocated among the following services:

TABLE 1
Bed Complement by Service
as of August 31, 2017

<u>Service</u>	<u>Number of Beds</u>	
	<u>Licensed</u>	<u>Operational</u>
Medical/Surgical	491	381
Intensive Care	67	58
Rehabilitation	17	0 ⁽¹⁾
Coronary Care	8	8
Psychiatric	30	30
Totals	<u>613</u>	<u>477</u>

⁽¹⁾ Between August 31, 2008 and May 2009, the Corporation ceased operation of its rehabilitation service, including the 17 rehabilitation beds, to add 27 additional medical/surgical beds.

Source: Corporation Records.

Description of Admitting Medical Staff

As of August 31, 2017, the admitting medical staff of the Corporation was comprised of 2,480 physicians. Each member of the admitting medical staff is assigned to one of the medical staff departments and is granted hospital privileges to treat patients in accordance with experience, training and professional capabilities. Approximately 76% of the total medical staff (1,892 members of the admitting staff) are full-time members of the faculty of the School of Medicine and approximately 22% of the total medical staff (541 members of the admitting medical staff) are community physicians. Approximately 83% of the Corporation's admitting medical staff members are board certified in their respective specialties. The following table shows members of the admitting medical staff by specialty, average age and board certification.

TABLE 2
Medical Staff Composition
as of August 31, 2017

Specialty	Number of Staff	Average Age	Number of Board Certified Staff	Percentage of Board Certified Staff
Anesthesia	252	46	197	78.2%
Cardiothoracic Surgery	30	50	22	73.3%
Dermatology	46	43	45	97.8%
Medicine	705	48	646	91.6%
Neurology	88	48	86	97.7%
Neurosurgery	46	46	23	50.0%
Obstetrics & Gynecology	114	49	93	81.6%
Ophthalmology	63	50	51	81.0%
Orthopedic Surgery	88	47	71	80.7%
Otolaryngology/Head&Neck	63	48	49	77.8%
Pathology	74	47	65	87.8%
Pediatrics	238	46	209	87.8%
Psychiatry	223	49	143	64.1%
Radiation Oncology	26	49	21	80.8%
Radiology	178	45	135	75.8%
Surgery	136	49	108	79.4%
Urology	26	50	22	84.6%
Emergency Medicine	84	44	73	86.9%
Totals	2,480		2,059	
Average Age/Percentage		47		83.0%

Source: Corporation Records.

The following table shows the number of admitting medical staff physicians in each indicated age group, the percentage of the total admitting medical staff for each age group and the percentage of admissions for each age group for the fiscal year ended August 31, 2017.

TABLE 3

**Admissions by Physician Age Group
For the Fiscal Year Ended August 31, 2017**

<u>Age Group</u>	<u>Number of Physicians in Age Group</u>	<u>Percentage of Physicians in Age Group</u>	<u>Percentage of Total Admissions</u>
< 34	319	13	8
35-44	889	36	40.7
45-54	595	24	31.7
55-64	404	16	12.8
65+	273	11	6.8
Totals	2,480	100%	100.0%

Source: Corporation Records.

The following table shows the top ten admitters based on patient admissions and listed by specialty for the fiscal year ended August 31, 2017.

TABLE 4
Top Ten Admitting Physicians Based on Patient Volume For the Fiscal Year Ended August 31, 2017

<u>Rank</u>	<u>Physician Specialty</u>	<u>Admissions</u>	<u>Age</u>
1.	Neurosurgery	397	65
2.	Orthopedic Surgery	357	66
3.	General Surgery	306	45
4.	Oncology	290	39
5.	General Surgery	285	52
6.	General Medical Disciplines	281	35
7.	Cardiovascular Surgery	280	50
8.	Orthopedic Surgery	280	46
9.	General Medical Disciplines	274	38
10.	General Medical Disciplines	256	31
	Total Admissions	<u>3,006</u>	
	Average Age		47

Source: Corporation Records.

Service Area

The Corporation has classified its service area into the four geographical markets identified below. San Mateo and Santa Clara counties comprise the Local Market for the Corporation. This two-county area historically has been the predominant source of inpatient volume for the Hospital, accounting for approximately 50% of inpatient volume. In the Regional, California and National/International Markets, the Corporation provides primarily tertiary and quaternary care. The composition of these markets is described below:

Local Market—San Mateo and Santa Clara counties

Regional Markets

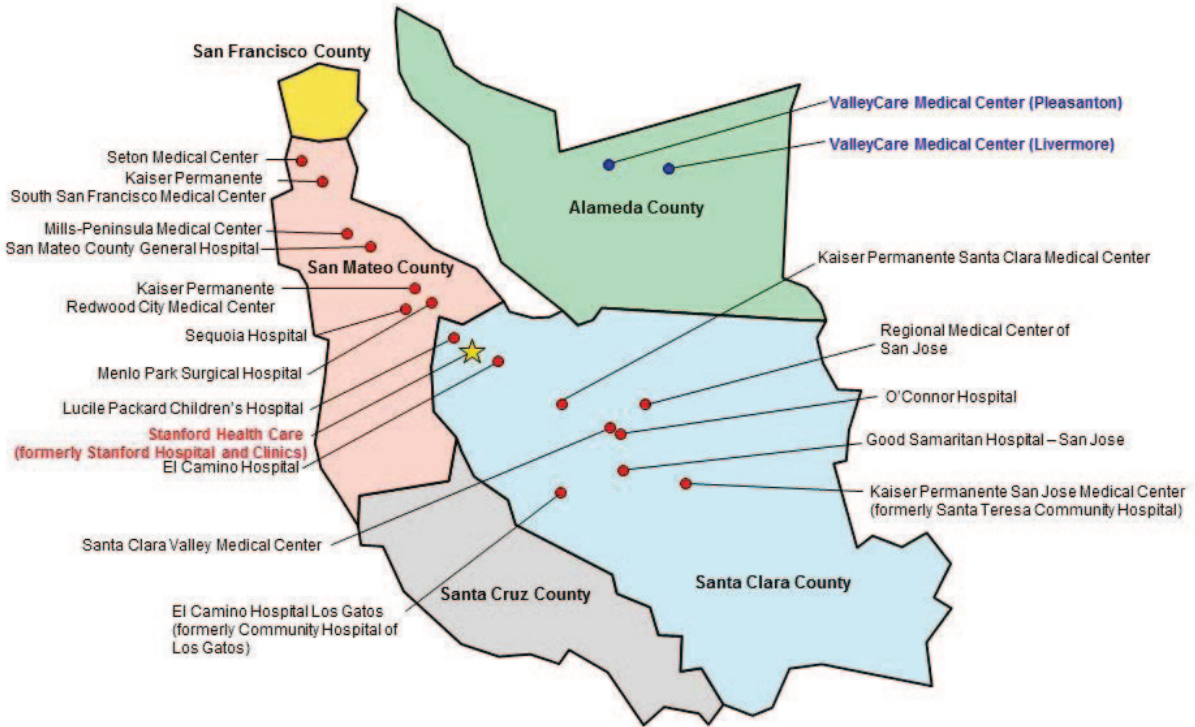
- East Bay—Alameda, Contra Costa, and Solano counties
- Central Coast—Monterey, San Benito, San Luis Obispo, Santa Cruz counties
- Central Valley—Madera, Fresno, Kings, Merced, Sacramento, San Joaquin, Stanislaus and Tulare counties
- North Bay—Sonoma, Marin, Napa and San Francisco counties

California Market—Counties north and south of the Regional Markets

National and International Markets—Nevada and the Pacific Northwest are the predominant sources of national cases; Asia Pacific countries are the predominant sources of international cases.

Service Area Map

Below is a map of the general service area of the Corporation that includes the Local Market area and a portion of the Regional Market area.



The table below provides, for the most recent years available, the following information by geographic region: (1) contribution to the Corporation's outpatient volume and a break-down of outpatient charges; (2) actual and projected population and projected population change; and (3) median age and average household income.

TABLE 5

**Clinics Outpatient Volume and Revenues and
Certain Demographic Information**

Local and Regional Markets	Fiscal Year ended August 31, 2016		Calendar Year				
	Percentage of Outpatient Volume	Percentage of Charges	Actual Population 2016	Projected Population 2021	Projected Percentage Population Change 2016 - 2021	Median Age 2015	Average Household Income 2015
Local Market	66.5%	60.4%	2,711,908	2,942,352	8.5%	38	\$130,273
Regional Market:							
East Bay	10.2	10.7	3,185,834	3,388,363	6.4	38	102,204
Central Coast	6.6	7.8	1,050,007	1,093,351	4.1	36	84,243
Central Valley	6.8	8.6	4,777,584	5,065,730	6.0	33	67,656
North Bay	3.4	3.7	1,820,836	1,958,504	7.6	40	113,446
Outside Local and Regional Markets	6.5	8.8	—	—	—	—	—
Totals	<u>100.0%</u>	<u>100.0%</u>					

Source: Corporation Records, Advisory Board, U.S. Census.

The following table provides the discharge data for calendar years 2013, 2014 and 2015 (the most recent years for which such data are available) for the Corporation and the hospitals in and near the Local Market that management has identified as competitors of the Corporation. Table 6 also provides case mix index data for each hospital's 2014 and 2015 fiscal years (the most recent years for which such data are available). The case mix index (the "Case Mix Index") is an indicator of the complexity and intensity of the services provided.

TABLE 6
Local Market and Selected Regional Market Competitors
Discharges and Case Mix Index Data

	Calendar Year 2013		Calendar Year 2014		Calendar Year 2015		FY 2014 Case Mix Index	FY 2015 Case Mix Index
	Discharges	% of total	Discharges	% of total	Discharges	% of total		
The Hospital	13,294	8.2%	12,884	8.0%	14,433	8.8%	2.2	2.3
California Pacific Medical Center - Pacific Campus ⁽¹⁾	1,544	0.9	1,532	1.0	1,433	0.9	1.3	1.4
California Pacific Medical Center - St. Luke's Campus ⁽¹⁾	380	0.2	336	0.2	378	0.2	1.1	1.2
California Pacific Medical Center - Davies Campus ⁽¹⁾	568	0.3	568	0.4	792	0.5	1.7	1.7
El Camino Hospital	16,141	9.9	16,518	10.3	16,442	10.0	1.2	1.2
Good Samaritan Hospital - San Jose	13,087	8.0	13,140	8.2	13,603	8.3	1.3	1.3
Kaiser Permanente - Redwood City	5,683	3.5	5,615	3.5	5,796	3.5	1.5	1.6
Kaiser Permanente - San Jose	9,903	6.1	9,529	5.9	9,670	5.9	1.3	1.3
Kaiser Permanente - Santa Clara	15,867	9.7	14,801	9.2	14,469	8.8	1.5	1.4
Kaiser Permanente - South San Francisco	3,839	2.4	3,795	2.4	4,061	2.5	1.6	1.6
Mills-Peninsula Medical Center	11,764	7.2	11,120	6.9	10,905	6.6	1.3	1.3
O'Connor Hospital	10,206	6.3	9,522	5.9	9,186	5.6	1.1	1.1
Regional Medical Center of San Jose	9,820	6.0	10,145	6.3	12,185	7.4	1.6	1.5
San Mateo Medical Center	3,508	2.2	3,476	2.2	3,214	2.0	1.2	1.2
Santa Clara Valley Medical Center	18,873	11.6	19,405	12.1	19,885	12.1	1.2	1.2
Sequoia Hospital	4,710	2.9	4,362	2.7	4,336	2.6	1.3	1.3
Seton Medical Center	5,325	3.3	5,052	3.2	4,725	2.9	1.6	1.6
UCSF Medical Center ⁽¹⁾	1,846	1.1	1,829	1.1	1,996	1.2	2.0	2.0
All Other Hospitals ⁽²⁾	16,755	10.3	16,657	10.4	16,837	10.2		
Total discharges	163,113		160,286		164,346			

⁽¹⁾ Although not actually within the Local Market boundaries, Corporation management identifies as a competitor comparable to other competitors within the local market.

⁽²⁾ The category "All Other Hospitals" includes all hospitals utilized by residents of San Mateo and Santa Clara counties. Discharge data include all 18+ Local Market and selected Regional Market patients; Case Mix Indices are based on inpatient discharges.

Source: Truven Analytics.

As indicated in the Case Mix Index data in Table 6, the Corporation has a higher Case Mix Index than each hospital identified as a competitor in the Local Market; such competitor hospitals tend to receive lower complexity and intensity cases, as reflected in the relatively lower Case Mix Index for those hospitals. While providing a significant amount of care at this level, the Corporation also provides care to patients whose cases are classified as high acuity and complex

cases in and near the Local Market, many of which are transferred to the Hospital from other local hospitals. In large part, the most acute and difficult cases come to the Hospital because the Hospital and UCSF Medical Center are the only two hospitals in the Bay Area to offer many of the treatments and procedures necessary for these patients. Management's strategic decision to concentrate on the five Strategic Clinical Services reflects its opinion that higher acuity services will produce higher operating margins than lower acuity services.

Market Strategy

The Corporation's strategic plan calls for near-term growth in its Strategic Clinical Services as well as other services in which the Corporation has demonstrated distinction. The Corporation focuses on aligning these specific services with relevant markets, based on an evaluation of various factors, including the type of services already available in such markets. This strategy is intended to promote growth in higher acuity inpatient and outpatient procedures. A principal focus of the strategic plan is the five Strategic Clinical Services: Cardiac Care, Cancer Treatment, Solid Organ Transplantation (Abdominal), Orthopedics and Neurosciences. The Corporation's goal is to grow inpatient and outpatient volume and expand national and international distinction in these services. The growth strategy is based on leveraging the Corporation's clinical innovations in these services. See "SERVICES, FACILITIES AND OPERATIONS—The School of Medicine" herein. The growth strategy also provides for more rapid translation of faculty research into clinical care. Leverage strategies are expected to be tailored to the opportunities in each market and are expected to include selective partnering with other institutions, management of subspecialty services for other institutions, development of outreach infrastructures that include both on-site and web-based delivery of care, and expanded contracting with payers for selected clinical services.

From time to time the Corporation evaluates and pursues potential acquisition, merger and affiliation candidates as part of the overall strategic planning and development process, which includes strengthening the Corporation's presence in Local and Regional Markets. Because of the integration occurring throughout the health care industry, the Corporation may consider such transactions if there is a perceived strategic or operational benefit for the Corporation.

In management's view, the Corporation's affiliation with ValleyCare plays a key role in its market positioning. The affiliation with ValleyCare has extended the Corporation's network of health care providers, clinical outreach and community services into the East Bay portion of the Corporation's Regional Market, supporting the Corporation's academic endeavors in population health sciences and clinical research and providing an outreach location for academic service lines.

The Corporation's strategic plan also envisions sustaining and increasing the share of the Corporation's patient care volume and revenue derived from higher-complexity tertiary and quaternary cases in the Regional, California, National and International markets, while strengthening the Corporation's presence in the Local Market through delivery of outpatient subspecialty services in selected local communities.

The following strategies of the Corporation and the School of Medicine are intended to increase higher-complexity tertiary and quaternary cases:

- Developing more complex treatments and therapies in both inpatient and outpatient settings.
- Focusing on the more complex and challenging treatment modalities within the Strategic Clinical Services.
- Focusing growth strategies on new services and more advanced treatments and methodologies.

Current actions being taken to implement these strategies include:

- In the Cardiac Care Strategic Clinical Service, concentrating on more complex and difficult revascularization procedures, such as coronary artery bypass graft and percutaneous transluminal coronary angioplasty procedures.
- In the Cancer Treatment Strategic Clinical Service, emphasizing the distinctive treatments provided by the Corporation, including bone marrow transplants, radiation therapy, and minimally invasive surgery techniques.
- In the Solid Organ Transplantation (Abdominal) Strategic Clinical Service, emphasizing living donor approaches in liver transplantation and new immunosuppressant therapies, as organ supply permits.
- In the Orthopedic Strategic Clinical Service, emphasizing total joint replacements, sports medicine, hand and upper extremities, foot and ankle, spine, trauma, tumor, and physiatry.
- In the Neurosciences Strategic Clinical Service, emphasizing chemo, biologic agent and gene and radiation therapies, including the CyberKnife, for spine care and neuro-oncology.

Community Physician Network

In 2011, the Corporation and Stanford University, acting on behalf of its School of Medicine, formed UHA to operate clinics staffed by a network of community-based physicians. These community-based clinics are staffed by community physicians, complementing the faculty practice clinics operated by the Corporation and staffed by members of the faculty of the School of Medicine. UHA's community-based clinic network began in 2011 with two clinics in Menlo Park, California, and as of August 2017 consists of over 70 clinic sites located in San Mateo, Santa Clara and Alameda counties. Clinic services are provided through long-term professional services agreements between UHA and community-based physicians, who are affiliated with UHA through operating divisions associated with the physicians' medical groups. The Corporation provides financial support for the operating divisions of UHA under sponsorship agreements. See "SERVICES, FACILITIES AND OPERATIONS—Operational Relationships Among the Corporation, Stanford University, LPCH and UHA" above. As new operating divisions are added, the Corporation may enter into additional sponsorship arrangements with UHA in support of expanding the network of community-based clinics operated by UHA. In a related effort, the Corporation is in discussions with other community-based physicians regarding extending the Corporation's electronic medical record system to community physician practices.

Utilization

A summary of historical utilization data for the Corporation for the three fiscal years ended August 31, 2015, 2016 and 2017 is presented in the following table.

TABLE 7
Historical Utilization

	Fiscal Years Ended August 31,		
	2015	2016	2017
Discharges			
Acute	25,438	25,075	25,142
Behavioral Health	608	688	800
Total	<u>26,046</u>	<u>25,763</u>	<u>25,942</u>
Patient Days			
Acute	140,125	144,428	145,957
Behavioral Health	10,201	10,110	9,541
Subtotal	<u>150,326</u>	<u>154,538</u>	<u>155,498</u>
Short Stay Outpatient	13,551	13,780	16,245
Total	<u>163,877</u>	<u>168,318</u>	<u>171,743</u>
Average Daily Census			
Acute	382.9	394.6	399.9
Behavioral Health	27.9	27.6	26.1
Total	<u>410.7</u>	<u>422.2</u>	<u>426.0</u>
Average Length of Stay			
Acute	5.51	5.76	5.81
Behavioral Health	16.78	14.69	11.93
Average	<u>5.77</u>	<u>6.00</u>	<u>5.99</u>
Case Mix Index	2.25	2.38	2.45
Emergency Room Visits ⁽¹⁾	68,643	71,500	73,900
Short Stay Outpatient Procedures	36,226	38,703	40,934
Other Outpatient Visits ⁽²⁾	<u>563,609</u>	<u>696,953</u>	<u>769,291</u>
Surgeries			
Inpatient	13,874	13,580	13,698
Outpatient ⁽²⁾	19,082	20,466	22,651
Totals	<u>32,956</u>	<u>34,046</u>	<u>36,349</u>

⁽¹⁾ Includes emergency room visits of admitted inpatients.

⁽²⁾ Excludes outpatient emergency room visits.

Source: Corporation Records.

SUMMARY OF FINANCIAL INFORMATION

All financial information presented in this section, “SUMMARY OF FINANCIAL INFORMATION,” is presented on a consolidated basis. The following consolidated statements of operations and changes in net assets of the Corporation for the fiscal years ended August 31, 2015, 2016 and 2017 have been derived by the Corporation’s management from the audited consolidated financial statements of the Corporation. All financial information presented in this section should be read in conjunction with the consolidated financial statements and related notes thereto for the fiscal years ended August 31, 2016 and 2017, included as Appendix B to this Offering Memorandum, which have been audited by PricewaterhouseCoopers LLP, independent public accountants.

The results of six of the Corporation’s related entities, UHA, SHI, SEROC, CareCounsel, PEAC, and SHCA are consolidated with those of the Corporation for all periods. The results of SBC are consolidated with those of the Corporation beginning with the fiscal year ended August 31, 2016. ValleyCare (together with UHA, SHI, SEROC, CareCounsel, PEAC, SHCA, and SBC (the “Related Entities”)) became affiliated with the Corporation in 2015, and results of ValleyCare are consolidated with those of the Corporation beginning May 18, 2015. The earnings of PET-CT are included in other revenue in the consolidated statements of operations and changes in net assets for all periods. The earnings of PPA II are included in the Corporation’s interest and investment income beginning May 18, 2015. The earnings and expenses of StartX Fund are included in the Corporation’s interest and investment income and other expenses for the fiscal years ended August 31, 2015 and August 31, 2016. The earnings of StartX Fund are included in earnings on equity method investments in the consolidated statements of operations and changes in net assets of the Corporation beginning with the fiscal year ended August 31, 2017.

Management calculates the Related Entities’ contribution to the Corporation’s total consolidated operating revenues as 16.3% for the fiscal year ended August 31, 2017, which is derived from the sum of the operating revenues of each of the Related Entities in proportion to the Corporation’s total consolidated operating revenues. The Corporation is currently the only member of the Obligated Group. The Related Entities are not Members of the Obligated Group or otherwise obligated with respect to the Series 2018 Taxable Bonds. (For additional information concerning the Related Entities and other entities to which the Corporation is related or in which it has interests included in the consolidated financial statements, see Note 1 and Note 2 of the audited consolidated financial statements of the Corporation included as Appendix B to this Offering Memorandum.)

TABLE 8
Stanford Health Care
Consolidated Statements of Operations and Changes in Net Assets
(In Thousands)

	Fiscal years ended August 31,		
	2015	2016	2017
Operating Revenues:			
Net patient service revenue	\$ 3,525,014	\$ 4,019,285	\$ 4,311,530
Provision for doubtful accounts	(131,601)	(126,280)	(77,004)
Net patient service revenue less provision for doubtful accounts	3,393,413	3,893,005	4,234,526
Premium revenue	62,893	72,292	80,647
Other revenue	98,718	122,996	129,324
Net assets released from restrictions used for operations	15,663	9,372	9,904
Total operating revenues	3,570,687	4,097,665	4,454,401
Operating Expenses:			
Salaries and benefits	1,428,100	1,850,124	1,986,360
Professional services	47,801	49,846	42,851
Supplies	484,036	531,130	586,056
Purchased services	912,886	1,058,182	1,136,020
Depreciation and amortization	109,735	136,442	154,686
Interest	40,485	39,661	43,643
Other	359,368	389,199	384,354
Expense recoveries from related parties	(93,640)	(104,965)	(113,451)
Total operating expenses	3,288,771	3,949,619	4,220,519
Income from operations	281,916	148,046	233,882
Interest and investment income	15,680	13,635	15,325
Earnings on equity method investments	-	-	5,114
Increase in value of Stanford University managed pools	54,309	24,181	144,829
Interest rate swaps mark-to-market adjustments	(59,392)	(115,958)	85,368
Loss on extinguishment of debt	(35)	-	-
Contribution income from SHC – ValleyCare affiliation	96,758	-	-
Excess of revenues over expenses	389,236	69,904	484,518
Other changes in unrestricted net assets:			
Transfer to Stanford University, net	(66,477)	(88,944)	(69,376)
Transfer from (to) LPCH	26,600	(3,300)	-
Change in net unrealized gains on investments	(2,445)	1,245	1,058
Net assets released from restrictions used for:			
Purchase of property and equipment	2,288	973	1,320
Change in pension and postretirement liability	(19,461)	(80)	6,182
Noncontrolling capital (distribution) contribution, net	(62)	(1,000)	301
Increase (decrease) in unrestricted net assets	329,679	(21,202)	424,003
Changes in temporarily restricted net assets:			
Transfer from Stanford University	4,062	2,645	2,748
Contributions and other	52,333	20,717	28,541
Contribution income from SHC – ValleyCare affiliation	62	-	-
Investment income	1,667	744	4,662
Gains on Stanford University managed pools	2,537	1,683	1,438
Net assets released from restrictions for:			
Operations	(15,663)	(9,372)	(9,904)
Purchase of property and equipment	(2,288)	(973)	(1,320)
Increase in temporarily restricted net assets	42,710	15,444	26,165
Changes in permanently restricted net assets:			
Contributions	2	200	250
Increase in permanently restricted net assets	2	200	250
Increase (decrease) in net assets	372,391	(5,558)	450,418
Net assets, beginning of year	2,687,317	3,059,708	3,054,150
Net assets, end of year	\$ 3,059,708	\$ 3,054,150	\$ 3,504,568

Management's Discussion and Analysis of Recent Financial Performance

Accounting Policies; Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Management evaluates its estimates on an ongoing basis and makes changes to the estimates as new information becomes available. Actual results could differ from those estimates.

The most significant estimates relate to patient accounts receivable allowances, amounts due to third party payors, retirement plan obligations, and self-insurance reserves. For additional information on the Corporation's use of estimates, see the notes to the audited consolidated financial statements of the Corporation included in Appendix B to this Offering Memorandum.

Recent Initiatives and Programs

Recent initiatives include: (i) continued construction of the New Stanford Hospital, which is scheduled to be completed by late 2018 or early 2019 with capital spending of \$1.5 billion as of August 31, 2017; and (ii) investments in new site openings and service expansions, including the Center for Academic Medicine on Stanford University's campus, which will provide offices for School of Medicine clinical faculty, researchers and administration, and SHC Emeryville, an outpatient center offering primary and specialty care in multiple medical specialties.

Three Year Historical Performance Overview

For the three years ended August 31, 2017, the Corporation's overall financial performance strengthened despite challenges, enhancing its ability to support investments in the facilities and systems required to remain at the forefront of medicine and to be the provider of choice for complex care in the communities it serves. Higher patient revenues and improved financial market conditions contributed to the Corporation's strengthened financial position. Cumulative operating revenues for the three years ended August 31, 2017 were \$12.1 billion, of which net patient service revenue less provision for doubtful accounts accounted for 95% of this total. Cumulative income from operations before investment income for the three years ended August 31, 2017 was \$664 million. Cumulative interest and investment income and change in the value of SHC's share of the Stanford University managed investment pools for the three years ended August 31, 2017 was \$268 million. Cumulative increase in net assets for the three years ended August 31, 2017 was \$817 million. Cumulative capital expenditures for the three years ended August 31, 2017 were approximately \$1.7 billion.

Financial Performance in Fiscal Year 2017 Compared to Fiscal Year 2016

The Corporation's net assets increased \$451 million, from \$3,054 million as of August 31, 2016, to \$3,505 million as of August 31, 2017. In fiscal year 2017, the Corporation generated a \$485 million excess of revenues over expenses compared to a \$70 million excess of revenues over

expenses in fiscal year 2016. Interest and investment income and change in value of SHC's share of the Stanford University managed investment pools increased by \$122 million in fiscal year 2017, resulting in a gain of \$160 million due to positive returns on these investments.

Net patient service revenue less provision for doubtful accounts (including the payments under UHA's capitated agreements with health maintenance organizations (the "Premium Revenue")) increased by 8.8%, from \$4.0 billion in fiscal year 2016, to \$4.3 billion in fiscal year 2017. Of this \$4.3 billion, inpatient revenues were 42% and grew by 3.7% on continuing increases in patient volume. Outpatient revenues increased by 12.8%, accounting for the remaining 58% of the \$4.3 billion. Operating expenses increased 6.9% in fiscal year 2017 to \$4.2 billion, from \$3.9 billion in fiscal year 2016. Salaries and benefits increased 7.4% to \$1,986 million in response to growth in patient volumes and to maintain SHC's position in the competitive market for health care professionals. All other operating expenses were up 6.4%, from \$2,099 million in fiscal year 2016, to \$2,234 million in fiscal year 2017 largely as a result of costs related to the increase in patient activity, payments to Stanford University under a funds flow agreement for clinical services provided by the School of Medicine, and inflation increases. Excluding revenues and expenses from the Hospital Fee Program, net patient service revenue less provision for doubtful accounts increased 9.1%, or \$351 million, while operating expenses increased 7%, or \$275 million in fiscal year 2017 compared to fiscal year 2016.

Financial Performance in Fiscal Year 2016 Compared to Fiscal Year 2015

The Corporation's net assets decreased \$6 million, from \$3,060 million as of August 31, 2015, to \$3,054 million as of August 31, 2016. In fiscal year 2016, the Corporation generated a \$70 million excess of revenues over expenses compared to \$389 million in fiscal year 2015. Although interest and investment income and change in value of SHC's share of Stanford University managed investment pools decreased by \$32 million in fiscal year 2016, the Corporation still had a gain of \$38 million due to positive returns on these investments.

Net patient service revenue less provision for doubtful accounts (including Premium Revenue) increased by 14.7%, from \$3.5 billion in fiscal year 2015, to \$4.0 billion in fiscal year 2016. Of this \$4.0 billion, inpatient revenues were 44% and grew by 6% on continuing increases in patient volume. Outpatient revenues increased by 22.5%, accounting for the remaining 56% of the \$4.0 billion. Operating expenses increased 20.1% in fiscal year 2016, from \$3.3 billion in fiscal year 2015, to \$3.9 billion. Salaries and benefits increased 29.6%, from \$1,428 million in fiscal year 2015, to \$1,850 million in fiscal year 2016 in response to growth in patient volumes. All other operating expenses combined increased 12.8%, from \$1,861 million in fiscal year 2015, to \$2,099 million in fiscal year 2016 largely as a result of costs related to increased patient activity, payments to Stanford University under a funds flow agreement for clinical services provided by the School of Medicine, and acquisition of the Stanford Blood Center. Excluding revenues and expenses from the Hospital Fee Program, net patient service revenue less provision for doubtful accounts increased 16.7%, or \$548 million, while operating expenses increased 21.4%, or \$689 million in fiscal year 2016 compared to fiscal year 2015.

Financial Performance in Fiscal Year 2015 Compared to Fiscal Year 2014

The Corporation's net assets increased \$373 million, from \$2,687 million as of August 31, 2014, to \$3,060 million as of August 31, 2015. In fiscal year 2015, the Corporation generated a \$389 million excess of revenues over expenses compared to \$432 million in fiscal year 2014. Although interest and investment income and change in value of SHC's share of Stanford University managed investment pools decreased by \$121 million from the fiscal year ended August 31, 2014, the Corporation still had a gain of \$70 million due to positive returns on these investments.

Net patient service revenue less provision for doubtful accounts (including Premium Revenue) increased by 19.2%, from \$2.9 billion in fiscal year 2014, to \$3.5 billion in fiscal year 2015. Of this \$3.5 billion, inpatient revenues were 47% and grew by 20.8% on continuing increases in patient volume. Outpatient revenues increased by 17.8%, accounting for the remaining 53% of the \$3.5 billion. Operating expenses increased 20.9% in fiscal year 2015, from \$2.7 billion in fiscal year 2014, to \$3.3 billion. Salaries and benefits increased 15.9% from \$1,232 million in fiscal year 2014 to \$1,428 million in fiscal year 2015 in response to growth in patient volumes and the competitive market for health care professionals. All other operating expenses combined increased 25.1%, from \$1,488 million in fiscal year 2014, to \$1,861 million in fiscal year 2015 largely as a result of costs related to the increase in patient activity and expanded clinical services. Excluding revenues and expenses from the Hospital Fee Program, net patient service revenue less provision for doubtful accounts increased 16.3%, or \$460 million, while operating expenses increased 18.5%, or \$503 million in fiscal year 2015 compared to fiscal year 2014.

Pension Funding Requirements

The majority of the Corporation's eligible employees are covered by the Corporation's 403(b) Retirement Plan, which is a defined contribution plan. Contributions are based on a percentage of an eligible employee's annual compensation.

In addition, certain employees are covered by a noncontributory defined benefit plan, the Staff Pension Plan (the "SPP"), that was closed to new participants in 1997. Benefits are based on years of service and an employee's compensation. Contributions to the plan are based on actuarially determined amounts sufficient to meet the benefits to be paid to plan participants. The financial performance of pension fund investments of the SPP can have a significant impact on the amount of pension expense and the recorded pension liability, as well as the amount and timing of pension contributions. Other factors can also have a significant impact on pension expense and contributions, such as interest rate levels and salary inflation. Taken together, these factors can have a material impact on both the results of operations and liquidity. As of August 31, 2017, the SPP had a net benefit liability recognized in the amount of \$52 million.

The Corporation contributed \$34.8 million in September 2017 to the SPP to eliminate Pension Benefit Guaranty Corporation variable rate premium fees. The Corporation's funded status with respect to the SPP is estimated at 93% as of September 30, 2017. The funded status assumes a discount rate of 3.56%. The Corporation's investment policy is dictated by a glide path that increases the plan's fixed income allocation as the plan's funded status increases. The

Corporation’s investment policy for the SPP assets targets a portfolio mix of 40% equity and 60% long-term debt.

The Corporation also provides post-retirement health insurance coverage through the Postretirement Medical Benefit Plan (the “PMBP”) for employees meeting specific criteria. As of August 31, 2017, the Corporation recognized a net benefit liability of \$66 million for the PMBP, recorded as a liability within self-insurance reserves and other on the Corporation’s consolidated balance sheets.

For additional information on the Corporation’s retirement plans and the PMBP, see Note 10 of the audited consolidated financial statements of the Corporation included as Appendix B to this Offering Memorandum.

Capitalization

The table below sets forth the actual consolidated capitalization of the Corporation as of August 31, 2017, and the consolidated capitalization of the Corporation, as of August 31, 2017, as adjusted to reflect the issuance of the Series 2017 Bonds, refunding of the 2008 Series Bonds and the 2010 Series Bonds, and issuance of the Series 2018 Taxable Bonds, as described under “PLAN OF FINANCE” in the forepart of this Offering Memorandum.

TABLE 9
Consolidated Capitalization
(Dollars in Thousands)

	As of August 31, 2017	As of August 31, 2017
	Actual	As Adjusted
Net Long-Term Debt ⁽¹⁾	\$1,566,064	\$1,904,079
Unrestricted Net Assets	2,893,173	2,893,173
Total Consolidated Capitalization	\$4,459,237	\$4,797,252
Net Long-Term Debt as a percentage of Total Consolidated Capitalization	35.1%	39.7%

⁽¹⁾ Actual net long-term debt includes debt subject to short-term remarketing arrangements classified as current liabilities in the audited consolidated financial statements of the Corporation included as Appendix B to this Offering Memorandum and the \$135,000,000 revolving credit agreement balance that was paid down September 1, 2017. “As Adjusted” net long-term debt assumes the issuance of the Series 2017 Bonds, refunding of the 2008 Series Bonds and the 2010 Series Bonds, and issuance of the Series 2018 Taxable Bonds. “As Adjusted” net long-term debt also excludes the \$135,000,000 revolving credit agreement balance paid down September 1, 2017.

Source: Corporation Records.

Cash and Investments

As of August 31, 2017, the Corporation’s funds were invested across three portfolios that included: a liquidity portfolio, consisting of cash and cash equivalents; a short-term portfolio, invested in a short-term fixed income mutual funds; and a long-term portfolio that invests in shares of the merged pool managed by Stanford University (the “Merged Pool”). The Merged Pool is invested in cash and cash equivalents, government and corporate debt securities, equity securities,

mutual funds, real estate, investments in partnerships and other investments. The Corporation's investments in the Merged Pool are carried on its financial statements based on a value per share in such funds. Gains and losses are realized only upon the sale of such shares. For additional information regarding the composition of the Corporation's investments at August 31, 2017, accounting for the Corporation's interest in pooled investment funds managed by Stanford University and earnings therefrom, see Note 2 and Note 6 of the audited consolidated financial statements of the Corporation included in Appendix B to this Offering Memorandum.

Liquidity

The following table sets forth the consolidated cash position and liquidity of the Corporation as of August 31, 2017.

TABLE 10
Consolidated Liquidity
(Dollars in Thousands)

	As of August 31, 2017
Cash and Cash Equivalents	\$ 710,109
Investments	411,452
Investments in Stanford University Managed Pools ⁽¹⁾	1,287,193
Less Temporarily and Permanently Restricted Cash and Investments included above	(90,559)
Total Liquid Assets	\$ 2,318,195
Days Cash on Hand ⁽²⁾	208.1

⁽¹⁾ See Note 2 and Note 6 of the audited consolidated financial statements of the Corporation included as Appendix B to this Offering Memorandum for a description of the managed pools of Stanford University in which the Corporation has invested.

⁽²⁾ Total liquid assets times 365 days divided by the total operating expenses net of depreciation and amortization. Source: Corporation Records.

Debt Service Coverage

The following table sets forth the actual maximum debt service coverage on a consolidated basis for the Corporation for fiscal years ended August 31, 2016 and 2017, and pro forma debt service coverage for the fiscal year ended August 31, 2017, taking into account the increase in maximum annual debt service resulting from the issuance of the Series 2017 Bonds, refunding of the 2008 Series Bonds and 2010 Series Bonds and issuance of the Series 2018 Taxable Bonds, as described under “PLAN OF FINANCE” in the forepart of this Offering Memorandum, in each case calculated based on the assumptions set forth in footnote 1 below.

TABLE 11
Maximum Annual Debt Service Coverage
(Dollars in Thousands)

	As of August 31,		
	2016	2017	2017
	Actual		Pro Forma ⁽³⁾
Excess of revenues over expenses	\$ 69,904	\$ 484,518	\$ 484,518
Depreciation and Amortization	136,442	154,686	154,686
Interest Expense	39,661	43,643	43,643
Change in value of Stanford University Managed Pools	30,272	(84,911)	(84,911)
Earnings on Equity Method Investments	-	(5,114)	(5,114)
Interest Rate Swap Mark-to-Market Adjustments	115,958	(85,368)	(85,368)
Funds Available for Debt Service	\$ 392,237	\$ 507,454	\$ 507,454
Maximum Annual Debt Service ⁽¹⁾	\$ 79,526	\$ 86,261	\$ 106,793
Coverage of Maximum Annual Debt Service ⁽²⁾	4.93x	5.88x	4.75x

⁽¹⁾ Excludes debt service on the 2008 Series Bonds and 2010 Series Bonds to be refunded with proceeds of the Series 2017 Bonds; assumes interest on the outstanding California Health Facilities Financing Authority Revenue Bonds (Stanford Hospital and Clinics), 2012 Series C is payable at the related interest rate swap rate of 3.365% until 2036, and 2.00% thereafter to maturity; assumes interest on the outstanding California Health Facilities Financing Authority Revenue Bonds (Stanford Hospital and Clinics), 2012 Series D is payable at the related interest rate swap rate of 4.314% to maturity; assumes interest on the outstanding California Health Facilities Financing Authority Revenue Bonds (Stanford Health Care), 2015 Series B is payable at the assumed rate of 2.52% to maturity; and assumes interest on all other currently outstanding variable rate bonds of the Corporation is payable at the related interest rate swap rate of 3.627% to maturity.

⁽²⁾ Ratio of Funds Available for Debt Service to the Maximum Annual Debt Service.

⁽³⁾ Pro Forma maximum annual debt service coverage assumes the issuance of the Series 2017 Bonds, refunding of the 2008 Series Bonds and 2010 Series Bonds, and issuance of the Series 2018 Taxable Bonds, with assumed level debt service over 30 years.

Source: Corporation Records.

Interest Rate Swap Arrangements

The Corporation enters into interest rate swap contracts (“Swaps”) from time to time to increase or decrease its variable rate debt exposure and to achieve a targeted mix of fixed and floating rate indebtedness. As of August 31, 2017, the Corporation had nine floating-to-fixed rate Swaps outstanding, representing a total notional amount of \$575.8 million, under which the Corporation pays a fixed rate and receives a variable rate from the swap counterparty. Each of the Swaps may be terminated by the Corporation at its option at any time. Swap counterparties may also terminate Swaps upon the occurrence of certain “termination events” or “events of default.” If either the Corporation or a counterparty terminates a Swap with a negative market value, the Corporation may be required to make a termination payment to such counterparty, and such payment could be material in amount. The estimated fair values of the Swaps are determined using available market information and valuation methodologies. The Corporation recognizes changes in the fair value of Swaps in excess (deficiency) of revenue over expenses. As of August 31, 2017, the Corporation’s mark-to-market liability on the Swaps totaled \$246.0 million. In addition, the Corporation is required to post collateral under two of its Swaps to secure its obligations to the Swap counterparty when the counterparty’s exposure exceeds certain stated thresholds. As of August 31, 2017 the Corporation had \$10.1 million in cash posted with one counterparty. See Note 2 and Note 9 of the audited consolidated financial statements of the Corporation included in Appendix B to this Offering Memorandum for more information related to the Corporation’s Swaps. The Corporation’s regularly scheduled payments with respect to the Swaps are secured on a parity with debt service payments with respect to the Series 2018 Taxable Bonds. See “SECURITY FOR THE SERIES 2018 TAXABLE BONDS—The Master Indenture” in the forepart to this Offering Memorandum.

Sources of Revenue

Payments are made to the Corporation on behalf of patients by the federal government under the Medicare program administered by the Centers for Medicare and Medicaid Services (“CMS”) of the United States Department of Health and Human Services, by the State of California under the Medi-Cal program, and by certain commercial insurance and managed care programs, as well as by patients on their own behalf.

The following table summarizes the percentage of gross patient revenues by source of payment to the Corporation for the fiscal years ended August 31, 2015, 2016 and 2017.

TABLE 12

Gross Patient Service Revenues

Source	Fiscal years ended August 31,		
	2015	2016	2017
Medicare	34%	34%	35%
Medi-Cal	4	4	3
Managed Care	55	55	55
Self-Pay and Other	7	7	7
Total	100%	100%	100%

Source: Corporation Records.

Gross patient service revenue is composed of usual and customary charges for services provided to all patients. Services provided to patients covered by Medicare, Medi-Cal and a number of managed care programs are typically paid at amounts that are less than usual and customary charges.

See “BONDHOLDERS’ RISKS” in the forepart of the Offering Memorandum for a more detailed discussion of the sources of revenue for the Corporation and certain other risks associated with certain sources of revenue.

Arrangements with Managed Care Plans

The Corporation maintains contracts with most managed care plans operating in Northern California. Management monitors the financial performance under these contracts on a regular basis and pursues renegotiation when appropriate and where feasible.

The largest volume commercial payers for the Corporation in fiscal year ended August 31, 2017 were Anthem Blue Cross, Blue Shield of California, and UnitedHealthcare. All commercial agreements are fee-for-service. Fee-for-service reimbursement employs the traditional methodologies including percentage of charges, per diems, case rates, surgical schedules and stop-loss.

Hospital Fee Program

State law imposes a fee on California’s general acute care hospitals, except for public hospitals and certain exempt hospitals (the “Hospital Fee Program”). Proceeds of the Hospital Fee Program are used to earn federal matching funds for Medi-Cal. The California Medi-Cal Hospital Reimbursement Initiative, or Proposition 52, passed in November 2016 and extends the Hospital Fee Program indefinitely. The program is subject to CMS approval. For more information about the Hospital Fee Program, see “BONDHOLDERS’ RISKS—Patient Service Revenues—California Hospital Fee Program” in the forepart to this Offering Memorandum.

SHC recognized \$45.6, \$55.2 and \$103.7 million in net patient service revenue and \$41.6, \$45.8 and \$73.6 million in other expense related to the Hospital Fee Program for the years ended August 31, 2017, 2016 and 2015, respectively.

See Note 3 of the audited consolidated financial statements of the Corporation included in Appendix B to this Offering Memorandum for more information related to the Hospital Fee Program.

ACCREDITATION, LICENSURE, MEDICARE AND MEDICAL CERTIFICATION

The California Department of Public Health (“CDPH”) licenses the Hospital as a general acute care facility. The Corporation is accredited by The Joint Commission (“TJC”), which conducted its last on-site survey in July 2016. TJC conducts unannounced on-site surveys within a predictable timeframe based on the accreditation cycle (for example, every three years for hospital accreditation).

In addition to recurring accreditation surveys by TJC, the Corporation is subject from time to time to incident-based surveys by CDPH, acting on behalf of CMS, to determine compliance with CMS Hospital Conditions of Participation (“CoP”). If such surveys, known as “validation surveys,” substantiate the provider’s noncompliance with CoP, CMS has authority to require the provider to be surveyed by CDPH and to take other enforcement action, including termination of the Medicare provider agreement. The Corporation remains a Medicare participating hospital, is fully licensed by CDPH and is fully accredited by TJC.

PROFESSIONAL LIABILITY AND OTHER INSURANCE

The Corporation maintains coverage for professional and comprehensive general liability and other coverages through programs of self-insurance and reinsurance. Primary layers of such liability are insured through SUMIT, an insurer controlled and owned by the Corporation and LPCH. SUMIT provides medical and hospital professional liability, general liability, employment practices liability, miscellaneous errors and omissions liability, and cyber liability to the Corporation and LPCH. SUMIT provides hospital professional and medical malpractice liability and cyber liability to the School of Medicine (including the clinical activities of its faculty and residents).

For the policy year September 1, 2016 to September 1, 2017, SUMIT retains 100% of the risk for the first \$15 million per claim for professional and general liability losses by the Corporation, LPCH and the School of Medicine, with an annual policy aggregate of \$25 million. SUMIT purchases \$165 million of excess reinsurance jointly covering the Corporation, LPCH and the School of Medicine from various reinsurance companies rated “A” or better by A.M. Best rating agency. In addition to excess reinsurance, SUMIT purchases a "buffer" that reduces SUMIT's liability for the first claim from \$15 million to \$10 million and reduces the annual policy aggregate from \$25 million to \$20 million.

SUMIT self-insures the first \$1.25 million per claim for cyber liability coverage in excess of \$1.25 million per claim. SUMIT purchases \$50 million of excess reinsurance jointly covering LPCH, SHC and the Stanford School of Medicine. For policy years prior to September 1, 2005,

SUMIT provided occurrence-based coverage for the risk related to the primary loss layer in amounts varying year to year since SUMIT was established in April 2000.

In addition to SUMIT, the Corporation obtains coverage for various risks under policies issued by commercial insurers. These policies typically cover LPCH as a named insured as well. As a result, claims brought against one named insured reduce the limits available to the other on each claim. The Corporation secures the following coverage jointly with LPCH:

- Workers' compensation in amounts in excess of a \$750,000 deductible, per claim for any fiscal year.
- Property in an aggregate blanket amount of \$500 million of coverage per claim with a \$100,000 deductible, subject to various sublimits, exclusions, and terms and conditions for property loss caused by risks such as flood, business interruption and certain acts of terrorism, among others. The Corporation does not purchase earthquake coverage.
- Directors and officers ("D&O") and employment practices liability ("EPL") in aggregate of \$50 million in limits subject to a self-insured D&O retention of \$250,000 per claim and a self-insured EPL retention of \$350,000 per claim, in the current fiscal year.
- Terrorism coverage with \$25 million in limits, subject to a \$1 million retention.

LITIGATION AND REGULATORY MATTERS

At any given time, the Corporation has lawsuits pending and threatened against it that may or may not be covered in whole or in part by insurance. There is not now pending or threatened any litigation restraining or enjoining the offering of the Series 2018 Taxable Bonds, if issued, or questioning or affecting the validity of the Series 2018 Taxable Bonds, if issued, or the proceedings and authority under which they were issued. Neither the creation, organization or existence of the Corporation nor the title of the present directors or officers of the Corporation to their respective offices is being contested. The Corporation is not now a party to any pending litigation, and is not aware of any circumstances that would likely result in such litigation that in any manner questions the right of the Corporation to use the proceeds of the Series 2018 Taxable Bonds, if issued, as described in this Offering Memorandum.

EMPLOYEES

As of August 31, 2017, the Corporation employed 8,925 full-time, 1,072 regular part time and 574 per diem/PRN (as needed) staff, equivalent to 10,571 full-time equivalent employees.

As of August 31, 2017, the Corporation employed 3,194 full and part-time registered nurses. Turnover rate for the registered nursing staff for the past twelve months was approximately 10.9%.

As of August 31, 2017, approximately 33% of the Corporation's employees were covered by collective bargaining arrangements with two bargaining units that are represented by Committee for Recognition of Nursing Achievement ("CRONA") and Service Employees

International Union–United Healthcare Workers (“SEIU–UHW”), respectively. The current CRONA contract is in effect through August 2020. The current contract with SEIU–UHW is also in effect through September 2020.

APPENDIX B

CONSOLIDATED FINANCIAL STATEMENTS OF SHC AND SUBSIDIARIES

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Stanford Health Care
Consolidated Financial Statements
and Accompanying Consolidating Information
August 31, 2017 and 2016

Stanford Health Care
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August 31, 2017 and 2016

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Report of Independent Auditors

To the Board of Directors
Stanford Health Care

We have audited the accompanying consolidated financial statements of Stanford Health Care (“SHC”), which comprise the consolidated balance sheets as of August 31, 2017 and 2016, and the related consolidated statements of operations and changes in net assets and of cash flows for the years then ended.

Management’s Responsibility for the Consolidated Financial Statements

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

Auditors’ Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to SHC'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 SHC'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 Stanford Health Care as of August 31, 2017 and 2016, and the results of its operations and changes in net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

December 5, 2017

Stanford Health Care
Consolidated Balance Sheets
August 31, 2017 and 2016
(in thousands of dollars)

	<u>2017</u>	<u>2016</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 710,109	\$ 690,460
Short term investments	233,533	103,627
Patient accounts receivable, net of allowance for doubtful accounts of \$191,000 and \$161,000 at August 31, 2017 and 2016, respectively	610,734	559,933
Other receivables	71,112	92,961
Inventories	56,559	50,016
Prepaid expenses and other	<u>42,528</u>	<u>36,273</u>
Total current assets	1,724,575	1,533,270
Investments	111,664	104,038
Investments at equity	66,255	41,609
Investments in University managed pools	1,287,193	1,316,489
Assets limited as to use, held by trustee	58,134	235,788
Property and equipment, net	2,869,346	2,401,880
Other assets	<u>112,445</u>	<u>124,263</u>
Total assets	<u>\$ 6,229,612</u>	<u>\$ 5,757,337</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 307,899	\$ 335,995
Accrued salaries and related benefits	255,759	236,819
Due to related parties	71,429	61,308
Third-party payor settlements	18,149	22,948
Current portion of long-term debt	13,335	13,756
Revolving line of credit	135,000	-
Debt subject to short-term remarketing arrangements	228,200	228,200
Self-insurance reserves and other	<u>45,854</u>	<u>43,232</u>
Total current liabilities	1,075,625	942,258
Self-insurance reserves and other, net of current portion	130,816	118,994
Other long-term liabilities	277,329	355,683
Pension liability	51,745	65,463
Long-term debt, net of current portion	<u>1,189,529</u>	<u>1,220,789</u>
Total liabilities	<u>2,725,044</u>	<u>2,703,187</u>
Net assets:		
Unrestricted:		
Stanford Health Care	2,871,113	2,449,037
Noncontrolling interests	<u>22,060</u>	<u>20,133</u>
Total unrestricted	2,893,173	2,469,170
Temporarily restricted	603,251	577,086
Permanently restricted	<u>8,144</u>	<u>7,894</u>
Total net assets	<u>3,504,568</u>	<u>3,054,150</u>
Total liabilities and net assets	<u>\$ 6,229,612</u>	<u>\$ 5,757,337</u>

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

Stanford Health Care
Consolidated Statements of Operations and Changes in Net Assets
Years Ended August 31, 2017 and 2016
(in thousands of dollars)

	<u>2017</u>	<u>2016</u>
Operating revenues:		
Net patient service revenue	\$ 4,311,530	\$ 4,019,285
Provision for doubtful accounts	<u>(77,004)</u>	<u>(126,280)</u>
Net patient service revenue less provision for doubtful accounts	4,234,526	3,893,005
Premium revenue	80,647	72,292
Other revenue	129,324	122,996
Net assets released from restrictions used for operations	<u>9,904</u>	<u>9,372</u>
Total operating revenues	<u>4,454,401</u>	<u>4,097,665</u>
Operating expenses:		
Salaries and benefits	1,986,360	1,850,124
Professional services	42,851	49,846
Supplies	586,056	531,130
Purchased services	1,136,020	1,058,182
Depreciation and amortization	154,686	136,442
Interest	43,643	39,661
Other	384,354	389,199
Expense recoveries from related parties	<u>(113,451)</u>	<u>(104,965)</u>
Total operating expenses	<u>4,220,519</u>	<u>3,949,619</u>
Income from operations	233,882	148,046
Interest and investment income	15,325	13,635
Earnings on equity method investments	5,114	-
Increase in value of University managed pools	144,829	24,181
Interest rate swaps mark to market adjustments	<u>85,368</u>	<u>(115,958)</u>
Excess of revenues over expenses	484,518	69,904
Other changes in unrestricted net assets:		
Transfer to Stanford University, net	(69,376)	(88,944)
Transfer to Lucile Salter Packard Children's Hospital	-	(3,300)
Change in net unrealized gains on investments	1,058	1,245
Net assets released from restrictions used for:		
Purchase of property and equipment	1,320	973
Change in pension and postretirement liability	6,182	(80)
Noncontrolling capital contributions (distributions)	<u>301</u>	<u>(1,000)</u>
Increase (decrease) in unrestricted net assets	<u>424,003</u>	<u>(21,202)</u>
Changes in temporarily restricted net assets:		
Transfer from Stanford University	2,748	2,645
Contributions and other	28,541	20,717
Investment income	4,662	744
Gains on University managed pools	1,438	1,683
Net assets released from restrictions used for:		
Operations	(9,904)	(9,372)
Purchase of property and equipment	<u>(1,320)</u>	<u>(973)</u>
Increase in temporarily restricted net assets	<u>26,165</u>	<u>15,444</u>
Changes in permanently restricted net assets:		
Contributions	<u>250</u>	<u>200</u>
Increase in permanently restricted net assets	<u>250</u>	<u>200</u>
Increase (decrease) in net assets	450,418	(5,558)
Net assets, beginning of year	<u>3,054,150</u>	<u>3,059,708</u>
Net assets, end of year	<u>\$ 3,504,568</u>	<u>\$ 3,054,150</u>

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

Stanford Health Care
Consolidated Statements of Cash Flows
Years Ended August 31, 2017 and 2016
(in thousands of dollars)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Change in Stanford Health Care net assets	\$ 448,491	\$ (2,712)
Change in noncontrolling interests	1,927	(2,846)
Total change in net assets	450,418	(5,558)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	152,840	134,502
Provision for doubtful accounts	77,004	126,280
Change in fair value of interest rate swaps	(85,368)	115,958
Increase in value of University managed pools	(144,829)	(24,181)
Unrealized gains on investments	(5,138)	(1,712)
Realized gains on investments	(22)	-
(Excess) deficit of income of equity method investees over distributions received	(12,154)	3,101
Contributions received for long lived assets or endowment and net equity transfers to/from related parties	44,639	79,767
Changes in operating assets and liabilities:		
Patient accounts receivable	(127,805)	(135,492)
Due to related parties	(24,877)	474
Other receivables, inventory, other assets, prepaid expenses and other	4,174	(34,759)
Accounts payable, accrued liabilities and pension liabilities	(22,131)	82,724
Accrued salaries and related benefits	18,940	33,960
Third-party payor settlements	(4,799)	13,930
Self-insurance reserves	14,444	6,944
Cash provided by operating activities	<u>335,336</u>	<u>395,938</u>
Cash flows from investing activities:		
Purchases of investments	(204,822)	(59,290)
Sales of investments	68,350	67,052
Purchases of investments at equity	(12,752)	(13,427)
Purchases of investments in University managed pools	(1,764)	(1,729)
Sales of investments in University managed pools	179,989	150,240
Decrease in assets limited as to use and other	177,654	344,913
Purchases of property and equipment	(635,550)	(619,570)
Cash used in investing activities	<u>(428,895)</u>	<u>(131,811)</u>
Cash flows from financing activities:		
Borrowing on revolver	135,000	-
Costs of issuance of debt	(71)	-
Payment of long-term debt and capital lease obligations	(18,708)	(15,951)
Contributions received for long lived assets or endowment and net equity transfers to/from related parties	(3,013)	(33,393)
Cash provided by (used in) financing activities	<u>113,208</u>	<u>(49,344)</u>
Net increase in cash and cash equivalents	19,649	214,783
Cash and cash equivalents, beginning of year	690,460	475,677
Cash and cash equivalents, end of year	<u>\$ 710,109</u>	<u>\$ 690,460</u>
Supplemental disclosures of cash flow information:		
Interest paid, net of amounts capitalized	\$ 45,439	\$ 41,427
Supplemental disclosures of non cash information:		
Decrease in payables for property and equipment	\$ (13,356)	\$ (8,128)
Equity transfers (to) from related parties, net	(7,690)	3,894
Assets and liabilities acquired under capital leases	1,191	1,632

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

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

1. Organization

Stanford Health Care (“SHC”) operates a licensed acute care hospital (“Stanford Hospital”) and a cancer center in Palo Alto, California, along with numerous outpatient physician clinics in the San Francisco Bay Area, in community settings, and in association with regional hospitals. Stanford Hospital is a principal teaching affiliate of the Stanford University School of Medicine (“SoM”) and provides primary and specialty health services to adults, including cardiac care, cancer treatment, solid organ transplantation services, neurosciences, and orthopedics services designated by management as SHC’s “Strategic Clinical Services”. SHC, together with Lucile Salter Packard Children’s Hospital at Stanford (“LPCH”), operates the clinical settings through which the SoM educates medical and graduate students, trains residents and clinical fellows, supports faculty and community clinicians and conducts medical and biological sciences research.

The Board of Trustees of Leland Stanford Junior University (the “University”) is the sole corporate member of SHC and LPCH. As part of their ongoing operations, SHC and LPCH engage in certain related party transactions as described further in Note 13.

The consolidated financial statements include SHC’s interest in University HealthCare Alliance (“UHA”), The Hospital Committee for the Livermore-Pleasanton Areas (dba Stanford Health Care - ValleyCare) (“SHC-VC”), Stanford Blood Center, LLC (“SBC LLC”), Stanford Emanuel Radiation Oncology Center, LLC (“SEROC”), CareCounsel, LLC (“CareCounsel”), SUMIT Holding International, LLC (“SHI”), Professional Exchange Assurance Company (“PEAC”), Stanford Health Care Advantage (“SHC Advantage”), Stanford International Medical Services RAK FZE (“SIMS RAK FZE”) and Stanford Medicine International (Hong Kong) Co., Limited (“SMI Hong Kong”) (collectively “SHC”).

UHA, a physician medical foundation, supports SHC’s mission of delivering quality care to the community and conducting research and education. In addition, UHA leads the development of a high quality clinical delivery network, built on collaboration with and sponsorship of community hospitals, on behalf of the SoM, SHC, and UHA physicians. The SoM and SHC are the members of UHA, and appoint directors to the governing board. The UHA bylaws afford control to SHC. Effective January 1, 2011, SHC entered into a sponsorship agreement with UHA whereby SHC agreed to certain funding for the development and operation of UHA and continued additional funding for future or alternative clinical sites of UHA. Additional funding by SHC to UHA for operations and capital was \$73,617 and \$60,118 for the years ended August 31, 2017 and 2016, respectively.

SHC-VC, a leading community hospital system located in the East Bay’s Tri-Valley region of Pleasanton, Livermore and Dublin, completed an affiliation agreement with SHC effective May 18, 2015. SHC is the sole corporate member of SHC-VC.

SBC LLC is a limited liability company organized effective July 31, 2015. SBC LLC serves as a community blood center and provides blood products and testing services to hospitals, clinics, companies and other clients. SHC is the sole member of SBC LLC. On September 30, 2015, SBC LLC completed the acquisition of the Stanford Blood Center from the University for \$36,000. SBC LLC paid consideration in excess of assets acquired in the amount of \$31,123, which is recorded in Transfer to Stanford University in the consolidated statements of operations and changes in net assets for the year ending August 31, 2016.

SEROC was originally formed as a joint venture between SHC and Emanuel Medical Center (“EMC”). On July 31, 2014, EMC transferred its membership interest to Doctors Medical Center of Modesto, Inc. (“DMC”). SEROC operates an outpatient clinic that provides radiation oncology services to patients in Turlock, California and surrounding communities. SHC’s interest in SEROC was 60% for the years ended August 31, 2017 and 2016. The remaining interest of 40% is recorded as a noncontrolling interest in unrestricted net assets on the consolidated balance sheets as of August 31, 2017 and 2016.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

1. Organization (Continued)

CareCounsel, a leading provider of employer-sponsored health advocacy and health care assistance services, was acquired by SHC effective July 18, 2012. The Bay Area company was founded in 1996 with a mission to help employees, retirees and their families navigate the complex health care environment through an employer-sponsored benefit that provides consumer education, advocacy and access to expert health care resources and information.

SHI is the sole owner of SUMIT Insurance Company Ltd. ("SUMIT") and Stanford University Medical Network Risk Authority, LLC (dba The Risk Authority) ("TRA"). SHC and LPCH are the owners of SHI.

SHC's share of net assets in SUMIT, a captive insurance carrier, was 79.7% and 78.4% for the years ended August 31, 2017 and 2016, respectively. LPCH's share of net assets in SUMIT was 20.3% and 21.6% for the years ended August 31, 2017 and 2016, respectively, and is recorded as a noncontrolling interest in unrestricted net assets on the consolidated balance sheets.

TRA was formed on September 19, 2012 and began operations on December 1, 2012. TRA provides risk management services to SHI, the owners of SHI and other affiliated and unaffiliated parties and serves as attorney-in-fact to PEAC. SHC's share of net assets in TRA was 82% for the years ended August 31, 2017 and 2016. The remaining interest of 18% is recorded as a noncontrolling interest in unrestricted net assets on the consolidated balance sheets as of August 31, 2017 and 2016.

PEAC, a captive insurance carrier, provides insurance coverage to UHA, Packard Children's Health Alliance and other affiliated parties. SHC's share of net assets in PEAC was 71.4% and 70.6% for the years ended August 31, 2017 and 2016, respectively. The remaining interest of 28.6% and 29.4% for the years ended August 31, 2017 and 2016, respectively, is recorded as a noncontrolling interest in unrestricted net assets on the consolidated balance sheets.

SHC Advantage, a non-profit public benefit corporation, provides comprehensive healthcare coverage options to elderly and disabled eligible Medicare populations of Santa Clara County through their Medicare Advantage Plan and is solely controlled by SHC. This service is offered to Medicare-eligible residents of Santa Clara County effective January 1, 2015.

SIMS RAK FZE was formed in January 2016 to provide consulting and project management services in the United Arab Emirates.

SMI Hong Kong was formed in May 2016, as a holding company for business activities in China.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of SHC and its subsidiaries, which are controlled and owned more than 50% by SHC. All significant inter-company accounts and transactions are eliminated in the consolidation.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

Basis of Presentation

The accompanying consolidated financial statements are prepared on the accrual basis of accounting. Net assets of SHC and changes therein have been classified and are reported as follows:

- **Unrestricted net assets** — Unrestricted net assets represent those resources of SHC that are not subject to donor-imposed stipulations. The only limits on unrestricted net assets are broad limits resulting from the nature of SHC and the purposes specified in its articles of incorporation or bylaws and, limits resulting from contractual agreements, if any.
- **Temporarily restricted net assets** — Temporarily restricted net assets represent contributions, which are subject to donor-imposed restrictions that can be fulfilled by actions of SHC pursuant to those stipulations or by the passage of time.
- **Permanently restricted net assets** — Permanently restricted net assets represent contributions that are subject to donor-imposed restrictions that they be maintained permanently by SHC. Generally, the donors of these assets permit SHC to use all or part of the investment return on these assets.

Expenses are generally reported as decreases in unrestricted net assets. A restriction expires when the stipulated time period has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. Temporarily restricted contributions are recorded as restricted revenue when received and when the restriction expires, the net assets are shown as released from restriction on the consolidated statements of operations and changes in net assets. Investment income on temporarily or permanently restricted assets that is restricted by donor or law is recorded within the respective net asset category, and when the restriction expires, the net assets are shown as released from restriction.

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less. Cash equivalents consist primarily of demand deposits and money market mutual funds.

Assets Limited as to Use, Held by Trustee

Assets limited as to use include various accounts held by a trustee in accordance with indenture requirements. The indenture terms require that the trustee control the expenditure of bond proceeds for capital projects. Assets limited as to use consist of cash and cash equivalents and short-term investments, recorded at cost, which approximates fair value. There are no amounts required to fund current liabilities of SHC, therefore the entire amount has been classified as long-term in the consolidated balance sheets at August 31, 2017 and 2016.

Inventories

Inventories, which consist primarily of hospital operating supplies and pharmaceuticals, are stated at the lower of cost or market value determined using the first-in, first-out method.

Investments

Investments held directly by SHC consist of cash and cash equivalents, mutual funds and investments in non-public entities and are stated at fair value. Fair value is determined in accordance with current accounting guidance as further described in Note 7. Investment earnings (including realized gains and losses on investments, interest, dividends and impairment loss on investment securities) are included in investment income unless the income or loss is restricted by donor or law. Income on investments of donor restricted funds is added to or deducted from the appropriate net asset category based on the donor's restriction. Unrestricted unrealized gains and losses on other than trading securities are separately reported below the excess of revenues over expenses.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

Investments at Equity

Investments at equity consist of investments in which SHC has ownership of 50% or less but is able to exercise significant influence over the investee. These investments include Stanford-StartX Fund, LLC ("StartX Fund"), Stanford PET-CT, LLC ("PET-CT") and Pleasanton Physician Affiliates II, LLC ("PPA II"). All earnings from StartX Fund and PPA II are included in earnings on equity method investments in the consolidated statements of operations and changes in net assets. Earnings from PET-CT are included in other revenue in the consolidated statements of operations and changes in net assets.

The mission of StartX, a California nonprofit public benefit corporation, is to accelerate the development of students, faculty and alumni of the University identified by StartX as high potential entrepreneurs through an experiential educational program. StartX Fund is a California limited liability company created to support the continued experiential education of participants in the StartX accelerator program. SHC's interest in StartX Fund was 33% for the years ended August 31, 2017 and 2016.

PET-CT is a California limited liability company which provides radiological services to patients of the community, including patients served by SHC and physicians affiliated with the SoM. SHC and the University each appoint one-half of the members of the governing board of PET-CT and are its only members. SHC's interest in PET-CT was 50% for the years ended August 31, 2017 and 2016.

PPA II is a California limited liability company which owns and operates a medical office building in Pleasanton. SHC-VC's interest in PPA II was 39% for the years ended August 31, 2017 and 2016.

Investments in University Managed Pools

Investments in University managed pools consist of funds invested in the University's Merged Pool ("MP") and Expendable Funds Pool ("EFP") (collectively the "Pools"). Under the terms of SHC's agreement with the University, the University has discretion to invest the funds in the Pools. SHC may deposit funds in the Pools at its discretion. Withdrawals from the MP and EFP require advance notice to the University. The value of its share of the Pools is determined by the University and is based on the fair value of the underlying assets in the Pools.

The University allocates investment earnings to SHC from the University managed pools based on SHC's share of the Pools. Earnings include interest, dividends, distributions, investment gains and losses, and the increases or decreases in the value of SHC's share of the pools. All investment gains and losses and increases and decreases in share value are treated as realized and included in the excess of revenues over expenses.

The increases or decreases in the value of SHC's share of the Pools are recorded as income and gains on University managed pools unless the income is restricted by donor or law. Income on investments of donor restricted funds invested in the University managed pools is added to or deducted from the appropriate net asset category based on the donor's restriction.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

Property and Equipment

Property and equipment are stated at cost except for donated assets, which are recorded at fair market value at the date of donation. Depreciation and amortization of property and equipment is determined using the straight-line method over the estimated useful lives of the assets, which are as follows:

Land improvements	10 to 25 years
Buildings and leasehold improvements	7 to 40 years
Equipment	3 to 20 years

Significant replacements and improvements are capitalized, while maintenance and repairs, which do not improve or extend the life of the respective assets, are charged to expense as incurred. Leasehold improvements are amortized over the shorter of the estimated useful life or term of the lease. Upon sale or disposal of property and equipment, the cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in the consolidated statements of operations and changes in net assets.

Equipment includes medical equipment, furniture and fixtures and computer software and hardware.

Equipment under capital leases is recorded at present value at the inception of the leases and is amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. The amortization of the assets recorded under capital leases is included in depreciation and amortization expense in the accompanying consolidated statements of operations and changes in net assets.

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized, net of any interest earned, as a component of the cost of acquiring those assets.

Asset Retirement Obligations

Asset retirement obligations (“ARO”) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value as other long-term liabilities and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently accreted over the useful lives of the related assets. SHC recorded current period accretion expense of \$397 and \$377 in the consolidated statements of operations and changes in net assets for the years ended August 31, 2017 and 2016, respectively. ARO liability of \$8,265 and \$7,868 is included in other long-term liabilities on the consolidated balance sheets as of August 31, 2017 and 2016, respectively.

Other Assets

Other assets include long-term portion of contributions receivable, intangible assets, and other long-term assets.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

Contributions Receivable

Unconditional promises to give (“contributions”) are recorded at fair value at the date the promise is received. Donations for specific purposes are reported as either temporarily or permanently restricted net assets. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved and applicable to the years in which the promises are received, and recorded in their respective net asset category. In accordance with current accounting guidance, the discount rates were determined using the risk free rate adjusted for the risk of donor default. Current and long-term portions of contributions receivable are included in other receivables and other assets in the consolidated balance sheets, respectively, and contribution revenue is included in the financial statements in the appropriate net asset category. Amortization of the discount is included in contributions and other in the consolidated statements of operations and changes in net assets. Conditional promises to give are recognized when the condition is substantially met.

Premiums, Discounts and Deferred Financing Costs on Long-Term Debt

Premiums and discounts arising from the original issuance of long-term debt are amortized on either the effective interest method or the straight-line basis, which approximates the effective interest method, over the life of the debt. The unamortized portion of these premiums and discounts are included in long-term debt on the consolidated balance sheets. Deferred financing costs represent costs incurred in conjunction with the issuance of SHC’s long-term debt. These costs are amortized on a straight-line basis, which approximates the effective interest method, over the life of the debt.

Interest Rate Swap Agreements

SHC has entered into several interest rate swap agreements to reduce the effect of interest rate fluctuation on its variable rate bonds. All swaps are recognized on the consolidated balance sheets at their fair value in accordance with current accounting guidance. Changes in the fair value of interest rate swaps are included in excess of revenues over expenses. The net cash payments or receipts under the interest rate swap agreements have been recorded as an increase (decrease) to interest expense.

Excess of Revenues over Expenses

The consolidated statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, include transfers of assets to and from affiliates for other than goods and services, change in unrealized gains and losses on marketable investments, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), changes in pension and postretirement liability and other changes related to noncontrolling interests.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers including Medicare and Medi-Cal, and others for services rendered, including estimated retroactive audit adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. Contracts, laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates may change by a material amount in the near term.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

Net Patient Service Revenue (continued)

The provision for doubtful accounts is based upon management's assessment of expected net collections considering historical experience and other collection indicators. Throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience. The results of this review are then used to make any modifications to the provision for doubtful accounts to establish an appropriate allowance for uncollectible accounts.

Charity Care

SHC provides either full or partial charity care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as net patient service revenue. SHC also provides services to other indigent patients under Medi-Cal and other publicly sponsored programs, which reimburse at amounts less than the cost of the services provided to the recipients. The difference between the cost of services provided to these indigent persons and the expected reimbursement is included in the estimated cost of charity care.

Premium Revenue

UHA has capitated agreements with various health maintenance organizations ("HMOs") to provide medical services to enrollees. Under these agreements, monthly payments are received based on the number of health plan enrollees. These receipts are recorded as premium revenue in the consolidated statements of operations and changes in net assets. Costs are accrued when services are rendered under these contracts, including cost estimates of incurred but not reported ("IBNR") claims. The IBNR accrual (which is included in accounts payable and accrued liabilities in the consolidated balance sheets) includes an estimate of the costs of services for which UHA is responsible, including referrals to outside healthcare providers.

Income Taxes

SHC, UHA, SHC-VC and SHC Advantage are not-for-profit corporations and tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code. SBC LLC, SEROC, CareCounsel and SHI are limited liability companies and taxable income flows through to the individual members. SUMIT is currently exempt from all taxes until March 31, 2035. TRA is a limited liability company, but has elected to be taxed as a corporation. PEAC is a taxable corporation. SHC and its subsidiaries have no uncertain tax positions pertaining to unrelated business income.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

Self-Insurance Plans

SHC and SHC-VC self-insure for professional liability risks, postretirement medical benefits, workers' compensation and health and dental benefits. These liabilities are reflected as self-insurance reserves in the consolidated balance sheets.

- **Professional Liability** — SHC and SHC-VC are self-insured through SUMIT for medical malpractice and general liability losses under claims-made coverage. SHC and SHC-VC also maintain professional liability reserves for claims not covered by SUMIT which total \$5,249 and \$817 as of August 31, 2017, respectively. As of August 31, 2016, this coverage was \$5,036 and \$1,122 for SHC and SHC-VC, respectively. Since September 1, 2005, SUMIT has retained 100% of the risk related to the first \$15,000 per occurrence. The next \$165,000 is transferred to various reinsurance companies. Prior to September 1, 2005, SHC maintained various coverage limits.
- **Postretirement Medical Benefits** — Liabilities for post-retirement medical claims for current and retired employees are actuarially determined.
- **Workers' Compensation** — SHC and SHC-VC purchase insurance for workers' compensation claims with a \$750 deductible per occurrence. Workers' compensation insurance provides statutory limits for the State of California. An actuarial estimate of retained losses (or losses retained within the deductible) has been used to record a liability.
- **Health and Dental** — Liabilities for health and dental claims for current employees are based on estimated costs.

Fair Value of Financial Instruments

Due to the short-term nature of cash and cash equivalents, accounts payable and accrued liabilities, and accrued salaries and related benefits, their carrying value approximates their fair value. The fair value of the amounts payable under third-party reimbursement contracts is not readily determinable. The fair value of long-term debt is estimated based on quoted market prices for the bonds or similar financial instruments.

Concentration of Credit Risk

Financial instruments, which potentially subject SHC to concentrations of credit risk, consist principally of cash and cash equivalents, patient accounts receivable, and investments in University managed pools.

SHC's concentration of credit risk relating to patient accounts receivable is limited by the diversity and number of patients and payers. Patient accounts receivable consist of amounts due from commercial insurance companies, governmental programs, private pay patients and other third-party payers.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to patient accounts receivable allowances, amounts due to third party payers, retirement plan obligations, and self-insurance reserves. Actual results could differ from those estimates.

Reclassification

Certain reclassifications have been made to the 2016 consolidated financial statements to conform to the 2017 presentation. Such reclassifications had no effect on excess of revenues over expenses as previously reported.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

Recent Pronouncements

The Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) is the sole source of authoritative non-governmental U.S. generally accepted accounting principles.

Pension service costs - In March 2017, the FASB issued an ASC update which requires that an employer report the service cost component of pension costs in the same line item as employee compensation costs within operating income. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, and will not be eligible for capitalization. The guidance is effective for SHC during the fiscal year ending August 31, 2020. SHC is currently evaluating the impact that this guidance will have on the consolidated financial statements.

Consolidation - In January 2017, the FASB issued an ASC update which reinstates the presumption that a not-for-profit (“NFP”) entity that is a general partner controls a limited partnership. The amendments in this update also add guidance on when an NFP limited partner should consolidate a for-profit limited partnership. The guidance is effective for SHC during the fiscal year ending August 31, 2018. SHC is currently evaluating the impact that this guidance will have on the consolidated financial statements.

Debt issuance costs - In April 2015, the FASB issued an ASC update which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, and amortization of those costs reported as interest expense. This guidance is effective for SHC during the fiscal year ending August 31, 2017, and early adoption is permitted. In August 2015, the FASB issued a supplemental ASU which allows an entity to present debt issuance costs related to a line of credit arrangement as an asset and subsequently amortize the costs ratably over the term of the line of credit arrangement. The recognition and measurement guidance for debt issuance costs is not affected. SHC has adopted the guidance on debt issuance costs in fiscal year 2017; however fiscal year 2016 amounts have not been reclassified.

Revenue recognition - In May 2014, the FASB issued an ASC update to improve the consistency of revenue recognition practices across industries for economically similar transactions. Subsequently, the FASB has issued several amendments and updates to the original standard. The core principle is that an entity recognizes revenue for goods or services to customers in an amount that reflects the consideration it expects to receive in return. In August 2015, the FASB voted to defer the implementation of the new guidance. The guidance is effective for SHC during the fiscal year ending August 31, 2019, and should be applied on a retrospective or modified retrospective basis. SHC is currently evaluating the impact that this guidance will have on its consolidated financial statements.

Fair value - In May 2015, the FASB issued an ASC update which removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient as well as limiting disclosure requirement to investments for which the entity has elected to measure the fair value using that practical expedient. The guidance is effective for SHC during the fiscal year ending August 31, 2018, and should be applied on a retrospective basis for each period presented. SHC is currently evaluating the impact that this guidance will have on its consolidated financial statements.

Leases - In February 2016, the FASB issued an ASC update which requires lessees to recognize operating and financing lease liabilities and corresponding right-of-use assets on the balance sheet. The guidance is effective for SHC during the fiscal year ending August 31, 2020, and should be applied on a retrospective basis. SHC is currently evaluating the impact that this guidance will have on its consolidated financial statements.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

Recent Pronouncements (continued)

Not-for-profit reporting - In August 2016, the FASB issued an ASC update which modifies current NFP reporting requirements. The ASC update changes the way NFPs classify net assets and results in significant changes to financial reporting and disclosures for NFPs. The guidance is effective for SHC during the fiscal year ending August 31, 2019, and should be applied on a retrospective basis. SHC is currently evaluating the impact that this guidance will have on its consolidated financial statements.

Statement of cash flows - In August 2016, the FASB issued an ASC update which intends to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The guidance is effective for SHC during the fiscal year ending August 31, 2020, and should be applied on a retrospective basis. SHC is currently evaluating the impact that this guidance will have on its consolidated financial statements.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

3. Net Patient Service Revenue

SHC has agreements with third-party payers that provide for payments at amounts different from SHC's established rates. A summary of payment arrangements with major third-party payers follows:

- **Medicare** — Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Medicare reimburses hospitals for covered outpatient services rendered to its beneficiaries by way of an outpatient prospective payment system based on ambulatory payment classifications.

Inpatient non-acute services, certain outpatient services and medical education costs related to Medicare beneficiaries are paid based, in part, on a cost reimbursement methodology. SHC is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare administrative contractor. The estimated amounts due to or from the program are reviewed and adjusted annually based on the status of such audits and any subsequent appeals. Differences between final settlements and amounts accrued in previous years are reported as adjustments to net patient service revenue in the year examination is substantially completed. SHC's Medicare cost reports have been audited by the Medicare administrative contractor through August 31, 2008. Professional services are reimbursed based on a fee schedule.

- **Medi-Cal** — Inpatient services rendered to Medi-Cal program beneficiaries are reimbursed at a prospectively determined rate per discharge. Outpatient services are reimbursed based upon prospectively determined fee schedules. Professional services are reimbursed based on a fee schedule.
- **Managed Care Organizations** — SHC has entered into agreements with numerous third-party payers to provide patient care to beneficiaries under a variety of payment arrangements. These include arrangements with:
 - Commercial insurance companies, including workers' compensation plans, which reimburse SHC at negotiated charges.
 - Managed care contracts such as those with HMOs and PPOs, which reimburse SHC at contracted or per diem rates, which are usually less than full charges.
 - Counties in the State of California, which reimburse SHC for certain indigent patients covered under county contracts.
- **Uninsured** — For uninsured patients that do not qualify for charity care, SHC recognizes revenue on the basis of its standard rates for services less an uninsured discount applied to the patient's account that approximates the average discount for managed care payers.

Stanford Health Care
Notes to Consolidated Financial Statements
(in thousands of dollars)

3. Net Patient Service Revenue (Continued)

Patient service revenue, net of contractual allowances (but before provision for doubtful accounts), by major payor for the years ended August 31 is as follows:

	<u>2017</u>	<u>2016</u>
Medicare	\$ 858,076	\$ 755,658
Medi-Cal	93,699	106,728
Managed Care - Discounted Fee for Services	3,108,719	2,870,437
Self pay and other	206,191	239,248
Related party	<u>44,845</u>	<u>47,214</u>
Patient service revenue, net of contractual allowances	\$ 4,311,530	\$ 4,019,285
Provision for doubtful accounts	(77,004)	(126,280)
Net patient service revenue	<u>\$ 4,234,526</u>	<u>\$ 3,893,005</u>

SHC recognized net patient service revenue adjustments of \$24,265 and \$4,303 as a result of prior years favorable developments related to reimbursement for the years ended August 31, 2017 and 2016, respectively.

Amounts due from Blue Cross, Medicare, and Blue Shield as a percentage of net patient accounts receivable at August 31 are as follows:

	<u>2017</u>	<u>2016</u>
Blue Cross	21%	18%
Medicare	14%	12%
Blue Shield	11%	11%

SHC does not believe significant credit risks exist with these payers.

California Hospital Quality Assurance Fee Program

The State of California enacted legislation in 2009 which established a Hospital Quality Assurance Fee ("HQAF") Program and a Hospital Fee Program. These programs imposed a provider fee on certain California general acute care hospitals that, combined with federal matching funds, would be used to provide supplemental payments to certain hospitals and support the State's effort to maintain health care coverage for children. The effective period of this Hospital Fee Program was April 1, 2009 through December 31, 2010. The State received final approval of the rates from the Centers for Medicare & Medicaid Services ("CMS") in December 2010.

Subsequent legislation extended the HQAF and Hospital Fee programs from January 1, 2011 through June 30, 2011, which was approved by CMS in December 2011.

Additional legislation extended the HQAF and Hospital Fee programs for 30 months from July 1, 2011 through December 31, 2013. CMS approved the 30 month fee-for-service ("FFS") Medi-Cal supplement in June 2012. CMS approved 24 months and 6 months of the Medi-Cal Managed Care ("MMC") supplement in June 2013 and November 2014, respectively.

State legislation Senate Bill 239 further extended the HQAF and Hospital Fee programs for another 36 months from January 1, 2014 through December 31, 2016. In December 2014, CMS approved the 36 month FFS Medi-Cal supplement. As of August 31, 2017, CMS has approved 18 months of the MMC non-expansion supplement, and 12 months of the MMC expansion supplement, which are additional funds in excess of the matching (non-expansion) funds.

Stanford Health Care
Notes to Consolidated Financial Statements
(in thousands of dollars)

3. Net Patient Service Revenue (Continued)

California Hospital Quality Assurance Fee Program (continued)

SHC recognized \$45,616 and \$55,195 in net patient service revenue under these programs and \$41,594 and \$45,809 in other expense for HQAF to the California Department of Health Care Services for the years ended August 31, 2017 and 2016, respectively. SHC recorded \$6,230 in deferred revenue as of August 31, 2017, pending CMS approval.

4. Charity Care and Uncompensated Costs

SHC engages in numerous community benefit programs and services. These services include health research, education and training and other benefits for the larger communities that are excluded from the information below.

Uncompensated charity care is provided to vulnerable populations. Additionally, Medi-Cal and Medicare program reimbursements do not cover the estimated costs of services provided.

Information related to SHC's charity care for the years ended August 31 is as follows:

	<u>2017</u>	<u>2016</u>
Charity care at established rates	\$ 99,916	\$ 85,246
Estimated cost of charity care, net	\$ 21,997	\$ 19,365

The estimated cost of providing charity care is based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on SHC's total expenses divided by gross patient service charges. SHC received \$663 and \$799 during the years ended August 31, 2017 and 2016, respectively, from contributions that were restricted for the care of indigent patients.

Estimated cost of services in excess of reimbursement for the years ended August 31 is as follows:

	<u>2017</u>	<u>2016</u>
Charity care	\$ 21,997	\$ 19,365
Medi-Cal	343,594	283,260
Medicare	629,967	585,728
Total	<u>\$ 995,558</u>	<u>\$ 888,353</u>

5. Contributions Receivable

Contributions are recorded at the discounted net present value of the future cash flows, adjusted for the risk of donor default, using a discount rate of 2.11% for new receivables recorded in 2017 and 1.44% for receivables recorded in 2016.

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5. Contributions Receivable (Continued)

Contributions receivable at August 31 are expected to be realized in the following periods:

	<u>2017</u>	<u>2016</u>
In one year or less	\$ 14,772	\$ 11,531
Between one year and five years	82,647	86,428
More than five years	<u>2,750</u>	<u>11,352</u>
	100,169	109,311
Less: discount/allowance	<u>(10,161)</u>	<u>(11,558)</u>
Total contributions receivable, net	90,008	97,753
Less: current portion	<u>(13,668)</u>	<u>(10,525)</u>
Contributions receivable, net of current portion	<u>\$ 76,340</u>	<u>\$ 87,228</u>

Contributions receivable at August 31 are to be utilized for the following purposes:

	<u>2017</u>	<u>2016</u>
Plant replacement and expansion	\$ 94,517	\$ 102,142
Other patient and clinical services	<u>5,652</u>	<u>7,169</u>
Total	<u>\$ 100,169</u>	<u>\$ 109,311</u>

There were no conditional pledges at August 31, 2017 and 2016.

6. Investments and Investments in University Managed Pools

The composition of investments held directly by SHC at August 31 is as follows:

	<u>2017</u>		<u>2016</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Short term investments:				
Mutual funds	<u>\$ 233,463</u>	<u>\$ 233,533</u>	<u>\$ 105,025</u>	<u>\$ 103,627</u>
Investments:				
Cash and cash equivalents	\$ 44,552	\$ 44,552	\$ 44,085	\$ 44,085
Mutual funds	65,455	66,399	58,370	59,744
Other	<u>696</u>	<u>713</u>	<u>209</u>	<u>209</u>
Total	<u>\$ 110,703</u>	<u>\$ 111,664</u>	<u>\$ 102,664</u>	<u>\$ 104,038</u>

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6. Investments and Investments in University Managed Pools (Continued)

The composition of investments in University managed pools at August 31 is as follows:

	<u>Fair Value</u>	
	<u>2017</u>	<u>2016</u>
Investments in University managed pools:		
Merged Pool	\$1,280,875	\$1,310,047
Expendable Funds Pool	6,318	6,442
Total	<u>\$1,287,193</u>	<u>\$1,316,489</u>

The Merged Pool (“MP”) is the primary investment pool in which funds are invested. The MP is invested with the objective of maximizing long-term total return. It is a unitized pool in which the fund holders purchase investments and withdraw funds based on a monthly share value. The MP’s investments at August 31, 2017 and 2016 consist of approximately 3% and 4% cash and cash equivalents, 7% and 6% fixed income, 27% and 27% public equity securities, 8% and 9% real estate, 9% and 9% natural resources, 20% and 20% absolute returns, and 26% and 25% private equity securities, respectively.

7. Fair Value Measurements

Fair value is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability.

The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity. In addition, the fair value of liabilities should include consideration of non-performance risk.

Accounting guidance expands the disclosure requirements around fair value and establishes a fair value hierarchy for valuation inputs. The hierarchy prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels which are determined by the lowest level input that is significant to the fair value measurement in its entirety.

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7. Fair Value Measurements (Continued)

These levels are:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the measurement date. Financial assets and liabilities in Level 1 include U.S. Treasury securities and listed equities.

Level 2: Pricing inputs are based on quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in inactive markets, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include asset-backed securities, corporate bonds and loans, municipal bonds and interest rate swap instruments.

Level 3: Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of the fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, third party appraisals, discounted cash flow models, and fund manager estimates.

The following table summarizes SHC's assets and liabilities measured at fair value on a recurring basis as of August 31, based on the inputs used to value them:

	2017			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	\$ 710,109	\$ -	\$ -	\$ 710,109
Short term investments:				
Mutual funds	-	233,533	-	233,533
Assets limited as to use, held by trustee:				
Cash and cash equivalents	58,134	-	-	58,134
Investments:				
Cash and cash equivalents	44,552	-	-	44,552
Mutual funds	-	66,399	-	66,399
Other	-	-	713	713
Investments	44,552	66,399	713	111,664
Investments in University managed pools	-	1,287,193	-	1,287,193
Total assets	<u>\$ 812,795</u>	<u>\$ 1,587,125</u>	<u>\$ 713</u>	<u>\$ 2,400,633</u>
Liabilities				
Interest rate swap instruments	\$ -	\$ 245,966	\$ -	\$ 245,966
2016				
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	\$ 690,460	\$ -	\$ -	\$ 690,460
Short term investments:				
Mutual funds	-	103,627	-	103,627
Assets limited as to use, held by trustee:				
Cash and cash equivalents	235,788	-	-	235,788
Investments:				
Cash and cash equivalents	44,085	-	-	44,085
Mutual funds	-	59,744	-	59,744
Other	-	-	209	209
Investments	44,085	59,744	209	104,038
Investments in University managed pools	-	1,316,489	-	1,316,489
Total assets	<u>\$ 970,333</u>	<u>\$ 1,479,860</u>	<u>\$ 209</u>	<u>\$ 2,450,402</u>
Liabilities				
Interest rate swap instruments	\$ -	\$ 331,334	\$ -	\$ 331,334

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7. Fair Value Measurements (Continued)

The table below sets forth a summary of the changes in the fair value of the level 3 investments for the year ended August 31:

	<u>2017</u>	<u>2016</u>
Balance, beginning of year	\$ 209	\$ -
Purchases	504	209
Balance, end of year	<u>\$ 713</u>	<u>\$ 209</u>

8. Property and Equipment

Property and equipment consist of the following as of August 31:

	<u>2017</u>	<u>2016</u>
Land and improvements	\$ 68,885	\$ 67,816
Buildings and leasehold improvements	1,446,312	1,321,441
Equipment	<u>1,052,857</u>	<u>944,194</u>
	2,568,054	2,333,451
Less: Accumulated depreciation	(1,467,545)	(1,314,850)
Construction-in-progress	<u>1,768,837</u>	<u>1,383,279</u>
Property and equipment, net	<u>\$ 2,869,346</u>	<u>\$ 2,401,880</u>

Depreciation and amortization expense totaled \$154,686 and \$136,442 for the years ending August 31, 2017 and 2016, respectively, and is included in the consolidated statements of operations and changes in net assets.

Medical equipment acquired under capital leases totaled \$9,294 and \$8,104 as of August 31, 2017 and 2016, respectively, and building improvements acquired under capital leases totaled \$1,970 as of August 31, 2017 and 2016, and are included in property and equipment in the consolidated balance sheets. Amortization expense under capital leases is included in depreciation expense in the consolidated statements of operations and changes in net assets. Accumulated amortization was \$8,608 and \$7,741 as of August 31, 2017 and 2016, respectively.

Interest expense on debt issued for construction projects and income earned on the funds held pending use are capitalized until the projects are placed in service and depreciated over the estimated useful life of the asset. Capitalized interest expense net of capitalized investment income was \$25,815 and \$24,190 for the years ended August 31, 2017 and 2016, respectively.

Certain land and building, with a carrying value of \$9,729 at August 31, 2016 was used as collateral on notes payable (see Note 9).

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Notes to Consolidated Financial Statements

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9. Debt Obligations

SHC's outstanding debt at August 31 is summarized below:

	Years of Maturity	Effective Interest Rates 2017/2016	Outstanding Principal	
			2017	2016
Fixed Rate Obligations				
2008 Series A-1 Refunding Revenue Bonds	2017-2040	5.14%	\$ 67,410	\$ 67,835
2008 Series A-2 Refunding Revenue Bonds	2017-2040	5.32%/5.25%	99,725	100,350
2008 Series A-3 Refunding Revenue Bonds	2017-2040	5.29%/5.49%	80,615	81,140
2010 Series A Refunding Revenue Bonds	2017-2031	4.66%/5.46%	119,315	124,875
2010 Series B Refunding Revenue Bonds	2023-2036	4.95%/5.20%	146,710	146,710
2012 Series A Revenue Bonds	2028-2051	3.98%/5.00%	340,000	340,000
2012 Series B Refunding Revenue Bonds	2018-2023	2.30%/4.71%	41,340	47,445
2015 Series A Revenue Bonds	2052-2054	4.10%/4.82%	100,000	100,000
Note payable, collateralized by certain land and building	2024	4.25%	-	4,870
Variable Rate Obligations				
2008 Series B Refunding Revenue Bonds	2041-2045	0.84%/0.55%	168,200	168,200
2012 Series C Revenue Bonds	2039-2051	1.04%/0.78%	60,000	60,000
2012 Series D Revenue Bonds	2024-2051	1.23%/0.75%	100,000	100,000
2015 Series B Revenue Bonds	2052-2054	1.38%/0.90%	75,000	75,000
Revolving Line of Credit	2020	1.53%	135,000	-
Total principal amounts			1,533,315	1,416,425
Unamortized original issue premiums/discounts, net			43,606	46,320
Unamortized costs of issuance			(10,857)	-
Current portion of long-term debt			(13,335)	(13,756)
Revolving line of credit, current			(135,000)	-
Debt subject to short-term remarketing arrangements			(228,200)	(228,200)
Long-term portion, net of current portion			\$ 1,189,529	\$ 1,220,789

In June 2008, the California Health Facilities Financing Authority ("CHFFA"), on behalf of SHC, issued Variable Rate Demand Bonds ("VRDB's") in the aggregate principal amount of \$428,500 (the "2008 Bonds") to refund its previously issued 2006 Bonds. The 2008 Bonds were comprised of \$260,300 of 2008 Series A VRDB's that were issued as Series A-1, Series A-2, and Series A-3; and \$168,200 of 2008 Series B VRDB's that were issued as Series B-1 and Series B-2.

In June 2009, SHC remarketed the 2008 Series A-1 bonds in the aggregate principal amount of \$70,500. In June 2010, SHC converted the 2008 Series A-1 bonds from an annual put mode to a long-term fixed interest rate mode. The remarketing of the 2008 Series A-1 bonds generated an original issue premium of approximately \$140; that, pursuant to the requirements of the underlying documents, was used to reduce the principal amount of the bonds from \$70,500 to \$70,360.

In June 2010, CHFFA, on behalf of SHC, issued fixed rate revenue bonds in the aggregate principal amount of \$296,055 (the "2010 Bonds"). The 2010 Bonds were comprised of \$149,345 of 2010 Series A bonds, proceeds of which were used to refund the 1998B bonds, and \$146,710 of 2010 Series B bonds, proceeds of which were used to refund the 2003 Series B, C and D bonds. The issuance of the 2010 Series A and Series B bonds generated original issue premiums of \$10,944 and \$3,292, respectively.

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9. Debt Obligations (Continued)

In June 2011, SHC remarketed the 2008 Series A-2, A-3 and B-2 bonds in the aggregate principal amount of \$272,365. SHC converted the 2008 Series A-2 bonds from a weekly interest rate mode and the 2008 Series A-3 bonds from a multi-annual put mode to a long-term fixed interest rate mode. The remarketing of the 2008 Series A-3 bonds generated an original issue premium of approximately \$1,535; that, pursuant to the requirements of the underlying documents, was used to reduce the principal amount of the bonds from \$85,700 to \$84,165. SHC converted the 2008 Series B-2 bonds from a weekly interest rate mode to a commercial paper mode. As a part of the conversion, the 2008 Series B-2 bonds were split into two sub-series in the amount of \$42,050 each. Bonds in a commercial paper mode are remarketed for various periods that can be no longer than 270 days and are established at the beginning of each commercial paper rate period. Bondholders in a commercial paper mode have the option to tender their bonds only at the end of the commercial paper rate period.

In May 2012, CHFFA, on behalf of SHC, issued four series of revenue bonds in the aggregate principal amount of \$568,320 (the "2012 Bonds"). The 2012 Bonds were comprised of \$340,000 of 2012 Series A bonds, \$68,320 of Series B bonds, \$60,000 of Series C bonds and \$100,000 of Series D bonds. The issuance of the 2012 Series A and Series B bonds generated original issue premiums of \$29,097 and \$10,877, respectively. Proceeds of the 2012 Series A, C and D bonds will be used to finance a portion of the New Stanford Hospital. Proceeds of the 2012 Series B bonds were used to advance refund the 2003 Series A bonds.

In June 2015, CHFFA, on behalf of SHC, issued two series of revenue bonds in the aggregate principal amount of \$175,000 (the "2015 Bonds"). The 2015 Bonds were comprised of \$100,000 of 2015 Series A bonds, and \$75,000 of Series B bonds. The 2015 Series A bonds generated an original issue premium of \$5,627. Proceeds of the 2015 Series A and B bonds will be used to finance a portion of the New Stanford Hospital.

In May 2017, SHC entered into a \$200,000 revolving credit facility. Drawdowns from the revolving credit facility bear interest at a floating rate equal to the applicable London Interbank Offered Rate ("LIBOR") plus a specified margin. The amount outstanding on this credit facility was \$135,000 as of August 31, 2017.

The 2008 Series B-1 bonds are in a weekly interest rate mode and are remarketed every 7 days at the then prevailing interest rate. Bondholders in a weekly interest rate mode have the option of tendering their bonds on a weekly basis. The 2012 Series C bonds are in a Windows weekly floating index mode and cannot be tendered for 180 days after a 30 day notice and remarketing period. The 2008 Series B bonds and the 2012 Series C bonds are supported by SHC's self-liquidity and are classified as current liabilities. The 2012 Series D and 2015 Series B bonds are also in a floating index mode with monthly interest rate resets and were directly placed with U.S. Bank. The 2012 Series D and 2015 Series B bonds are not subject to remarketing or tender until May 13, 2020 and June 28, 2024, respectively. Both series of bonds are classified as long-term liabilities.

The 2015 Bonds, together with the 2012, 2010, and 2008 Bonds are collectively referred to as the "Revenue Bonds". The Revenue Bonds are limited obligations of CHFFA and are payable solely from payments made by SHC. Payments of principal and interest on the Revenue Bonds are collateralized by a pledge against the revenues of SHC secured under a master trust indenture between SHC and the master trustee. The master trust indenture includes, among other things, limitations on additional indebtedness, liens on property, restrictions on the disposition or transfer of assets, and maintenance of certain financial ratios. SHC may redeem the Revenue Bonds, in whole or in part, prior to the stated maturities. Total debt outstanding under the master trust indenture is in the aggregate principal amounts of \$1,533,315 and \$1,411,555 as of August 31, 2017 and 2016, respectively.

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9. Debt Obligations (Continued)

Scheduled principal payments on long-term debt are summarized below:

	<u>Scheduled Maturities</u>	<u>Revolving Line of Credit</u>	<u>Bonds Supported by SHC Liquidity</u>	<u>Total</u>
2018	\$ 13,335	\$ 135,000	\$ 228,200	\$ 376,535
2019	14,505	-	-	14,505
2020	14,235	-	-	14,235
2021	16,045	-	-	16,045
2022	15,775	-	-	15,775
Thereafter	1,096,220	-	-	1,096,220
	<u>\$ 1,170,115</u>	<u>\$ 135,000</u>	<u>\$ 228,200</u>	<u>\$ 1,533,315</u>

The scheduled principal payments above represent the annual payments required under debt repayment schedules. The current portion of long-term obligations, including debt subject to short term remarketing arrangements, includes payments scheduled to be made in 2018, pay down of the balance outstanding under the revolving line of credit, and the VRDB's supported by SHC's liquidity. The VRDB's supported by self-liquidity provide the bondholder with an option to tender the bonds to SHC. Generally accepted accounting principles require that bonds supported by SHC's liquidity be classified as current liabilities.

In the event SHC receives notice of any optional tender of the 2008 Series B-1 bonds or the 2012 Series C bonds, or if any bonds become subject to mandatory tender, the purchase price of the bonds will be paid from the remarketing of such bonds. However, if the remarketing proceeds are insufficient, SHC will have a current obligation to purchase any remaining bonds. SHC maintains sufficient liquidity to provide for the full and timely purchase price of any bonds tendered in the event of a failed remarketing.

The estimated fair value of the Revenue Bonds as of August 31, 2017 and 2016 was \$1,517,350 and \$1,585,366, respectively, and is considered level 2 based on the inputs used to value the Revenue Bonds as defined in Note 7.

In 1998, SHC advance refunded its 1993 bonds in the amount of \$89,520 by issuing the 1998 Series B bonds. As of August 31, 2017 and 2016, \$12,095 and \$17,490, respectively, of advance refunded bonds, which are considered extinguished, remain outstanding.

Interest Rate Swap Agreements

SHC entered into various interest rate swap agreements to manage fluctuations in cash flows resulting from variable rate debt interest risk. Under the terms of the current agreements, SHC pays a fixed interest rate, determined at inception, and receives a variable rate on the underlying notional principal amount based on a percentage of the One Month LIBOR.

SHC currently has nine outstanding interest rate exchange agreements that were originally entered into in 2003, 2006 and 2008 with maturities through November 2051. Various agreements were amended and restated to forward interest rate swaps in 2010 and 2012. The effective dates of these amended agreements became 2012 and 2016, respectively. As a result, cash flows on these agreements did not commence until 2012 and 2016.

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9. Debt Obligations (Continued)

Interest Rate Swap Agreements (continued)

The following is a summary of the outstanding positions under these interest rate swap agreements at August 31, 2017:

<u>Description</u>	<u>Current Notional</u>	<u>Maturity Date</u>	<u>Rate Paid</u>	<u>Rate Received</u>
2003 Series B	\$ 48,800	11/15/2036	3.365%	70% 1-month LIBOR
2003 Series C	48,700	11/15/2036	3.365%	70% 1-month LIBOR
2003 Series D	52,500	11/15/2036	3.365%	70% 1-month LIBOR
Subtotal LIBOR Swaps	150,000			
2008 Series A-1	67,550	11/01/2040	3.693%	70% 1-month LIBOR
2008 Series A-2	102,775	11/15/2051	3.999%	67% 1-month LIBOR
2008 Series A-3	84,600	11/15/2051	3.902%	67% 1-month LIBOR
Subtotal LIBOR Swaps	254,925			
2012 Series A	68,350	11/15/2045	4.081%	67% 1-month LIBOR
2012 Series B	68,375	11/15/2045	4.077%	67% 1-month LIBOR
2012 Series C	34,175	11/15/2045	4.008%	67% 1-month LIBOR
Subtotal Forward Swaps	170,900			
Total	<u>\$ 575,825</u>			

SHC designates its interest rate swaps that are used to minimize the variability in cash flows of interest-bearing liabilities or forecasted transactions caused by changes in interest rates as hedging instruments at the inception of each contract, with the intention of maintaining hedge accounting treatment over the term of the agreement. However, circumstances may arise whereby the representations made at the inception of the agreement became invalid, or the structure of the bonds is changed, resulting in de-designation of the hedge. In June 2008, the underlying bonds that were being hedged were refinanced and as a result, none of the swap agreements are treated as a hedge for accounting purposes.

The fair value of interest rate swaps (all of which are designated as non-hedging instruments) is shown on the balance sheets as of August 31 as follows:

<u>Description</u>	<u>Fair Value</u>		<u>Balance Sheet Location</u>
	<u>2017</u>	<u>2016</u>	
Fixed Payment Swaps	\$ 245,966	\$ 331,334	Other long-term liabilities

The change in fair value of the interest rate swaps (all of which are designated as non-hedging instruments) is shown on the consolidated statements of operations and changes in net assets for the years ended August 31 as follows:

<u>Description</u>	<u>Unrealized Gains (Losses)</u>		<u>Statement of Operations Location</u>
	<u>2017</u>	<u>2016</u>	
Fixed Payment Swaps	\$ 85,368	\$ (115,958)	Interest rate swap mark to market adjustments

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9. Debt Obligations (Continued)

Interest Rate Swap Agreements (continued)

SHC has two swap agreements which require mutual posting of collateral by SHC and the counterparties if the termination values exceed a predetermined threshold dollar amount. There was \$10,090 and \$36,230 of cash collateral posted by SHC at August 31, 2017 and 2016, respectively.

Upon the occurrence of certain events of default or termination events identified in the derivative contracts, either SHC or the counterparty could terminate the contracts in accordance with their terms. Termination results in the payment of a termination amount by one party that attempts to compensate the other party for its economic losses. If interest rates at the time of termination are lower than those specified in the derivatives contract, SHC will make a payment to the counterparty. Conversely, if interest rates at such time are higher, the counterparty will make a payment to SHC.

Bond Interest Expense

The components of bond interest expense for the years ended August 31 are as follows:

	<u>2017</u>	<u>2016</u>
Interest and fees	\$ 25,976	\$ 25,678
Swap settlements	<u>17,195</u>	<u>13,497</u>
Bond interest expense	<u>\$ 43,171</u>	<u>\$ 39,175</u>
Interest capitalized as a cost of construction	\$ 25,815	\$ 24,190

10. Retirement Plans

SHC provides retirement benefits through defined benefit and defined contribution retirement plans covering substantially all benefit eligible employees.

Defined Contribution Retirement Plan

Employer contributions to the defined contribution retirement plan are based on a percentage of participant annual compensation. Employer contributions to this plan for SHC employees, excluding LPCH employees (see Note 13), totaling \$83,262 and \$69,180, UHA employer contributions totaling \$3,485 and \$2,526, and SHC-VC employer contributions totaling \$3,737 and \$7,479, for the years ended August 31, 2017 and 2016, respectively, are included in salaries and benefits expense in the consolidated statements of operations and changes in net assets.

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10. Retirement Plans (Continued)

Defined Benefit Pension Plan

Certain employees of SHC are covered by a noncontributory defined benefit pension plan (the "Staff Pension Plan"). Benefits are based on years of service and the employee's compensation. Contributions to the plans are based on actuarially determined amounts sufficient to meet the benefits to be paid to plan participants.

As of August 31, 2004, SHC assumed the pension liability of the LPCH employees. SHC received \$187 and \$193 in cash for the years ending August 31, 2017 and 2016, respectively, which represented the current year pension expense related to LPCH employees.

The valuation of the Staff Pension Plan uses assumptions for future mortality improvements. For the fiscal year ending August 31, 2017, these assumptions were updated to include four additional years of Social Security Administration data resulting in a small decrease to the benefit obligation.

For the fiscal year ending August 31, 2017, the valuation of the Staff Pension Plan reflects updated demographic assumptions for retirement, withdrawal, and benefit commencement age for terminated vested participants. These assumptions were developed from the results of the 2017 experience study, which was based on census data for the Staff Pension Plan for the 2014 through 2017 plan years, and slightly decreased the benefit obligation.

During the fiscal year ending August 31, 2016, the Staff Pension Plan was amended to allow for a temporary lump sum window for deferred vested participants. During the window, eligible participants were contacted and offered an opportunity to take the lump sum value of their benefit, resulting in \$17,217 in lump sum paid from the plan. This large lump sum payment triggered settlement accounting which required a \$6,079 recognition of the plan's deferred losses, and also reduced the projected benefit obligation and assets by \$17,217.

Postretirement Medical Benefit Plan

SHC currently provides health insurance coverage for SHC employees upon retirement as early as age 55, with years of service as defined by specific criteria. The health insurance coverage for retirees who are under age 65 is the same as that provided to active employees. A Medicare supplement option is provided for retirees over age 65.

During the fiscal year ending August 31, 2016, the demographic assumptions used in the valuation of the Postretirement Medical Benefit Plan were reviewed and updated, resulting in a \$17,600 decrease in the accumulated postretirement benefit obligation. The decrease was primarily due to lower expectation of plan utilization in the future.

The following tables present information on plan assets and obligations, costs, and actuarial assumptions for the Staff Pension Plan and the Postretirement Medical Benefit Plan for the years ended August 31, 2017 and 2016, respectively.

The tables for the Postretirement Medical Benefit Plan include SHC and LPCH employees. The total postretirement medical benefit liability was \$84,179 and \$76,644 as of August 31, 2017 and 2016, respectively. SHC recorded a liability within self-insurance reserves in the consolidated balance sheets of \$65,823 and \$59,895 as of August 31, 2017 and 2016, respectively, which represents the liability for SHC employees excluding LPCH employees.

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10. Retirement Plans (Continued)

The change in pension and other post-retirement plan assets and the related change in benefit obligations, using a measurement date of August 31, as of and for the years ended August 31 are as follows:

	Staff Pension Plan Obligations		Postretirement Medical Benefits Net of Medicare Part D Subsidy	
	2017	2016	2017	2016
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 191,021	\$ 197,889	\$ -	\$ -
Actual return on plan assets	13,794	24,034	-	-
Employer contributions	3,207	-	6,439	6,029
Participants contributions	-	-	925	1,043
Plan settlements	-	(17,217)	-	-
Benefits paid	(12,811)	(11,989)	(7,524)	(7,234)
Medicare subsidies received	-	-	160	162
Expenses paid	(1,735)	(1,696)	-	-
	<u>\$ 193,476</u>	<u>\$ 191,021</u>	<u>\$ -</u>	<u>\$ -</u>
Fair value of plan assets at end of year	\$ 193,476	\$ 191,021	\$ -	\$ -
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 256,484	\$ 249,109	\$ 76,644	\$ 84,751
Service cost	2,842	1,644	2,317	2,052
Interest cost	8,296	9,806	2,422	3,295
Participants contributions	-	-	925	1,043
Plan settlements	-	(17,217)	-	-
Benefits paid	(12,811)	(11,989)	(7,524)	(7,234)
Medicare subsidies received	-	-	160	162
Expenses paid	(1,735)	(1,696)	-	-
Plan amendments	-	-	5,136	2,289
Actuarial (gain) loss	(7,855)	26,827	4,099	(9,714)
	<u>\$ 245,221</u>	<u>\$ 256,484</u>	<u>\$ 84,179</u>	<u>\$ 76,644</u>
Benefit obligation at end of year	\$ 245,221	\$ 256,484	\$ 84,179	\$ 76,644
Amounts recognized in consolidated balance sheets:				
Plan assets minus benefit obligation	\$ (51,745)	\$ (65,463)	\$ (84,179)	\$ (76,644)
Net benefit liability recognized	<u>\$ (51,745)</u>	<u>\$ (65,463)</u>	<u>\$ (84,179)</u>	<u>\$ (76,644)</u>
Amounts recognized in consolidated balance sheets:				
Current liabilities	\$ -	\$ -	\$ (7,063)	\$ (5,485)
Noncurrent liabilities	(51,745)	(65,463)	(77,116)	(71,159)
	<u>\$ (51,745)</u>	<u>\$ (65,463)</u>	<u>\$ (84,179)</u>	<u>\$ (76,644)</u>
Net benefit liability recognized	\$ (51,745)	\$ (65,463)	\$ (84,179)	\$ (76,644)
Amounts recognized in unrestricted net assets:				
Prior service cost	\$ -	\$ -	\$ (7,636)	\$ (4,102)
Net (loss) gain	(77,362)	(91,341)	9,117	14,131
	<u>\$ (77,362)</u>	<u>\$ (91,341)</u>	<u>\$ 1,481</u>	<u>\$ 10,029</u>
Unrestricted net assets	\$ (77,362)	\$ (91,341)	\$ 1,481	\$ 10,029

Stanford Health Care
Notes to Consolidated Financial Statements
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10. Retirement Plans (Continued)

The estimated net loss for the Staff Pension Plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year is \$2,605.

The estimated net gain and prior service cost for the Postretirement Medical Benefit Plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year are \$580 and \$1,602, respectively.

Total benefit obligation at the end of the year for the Postretirement Medical Benefit Plan excluding Medicare Part D subsidy increased to \$85,723.

The accumulated benefit obligation for the Staff Pension Plan was \$243,235 and \$254,108 as of August 31, 2017 and 2016, respectively.

Net benefit expense related to the plans for the years ended August 31 includes the following components:

	Staff Pension Plan	
	Obligations	
	2017	2016
Service cost	\$ 2,842	\$ 1,644
Interest cost	8,296	9,806
Expected return on plan assets	(10,682)	(11,909)
Amortization of net actuarial loss	3,012	2,272
Settlement loss recognized	-	6,079
Total net periodic benefit cost	<u>\$ 3,468</u>	<u>\$ 7,892</u>

	Postretirement Medical Benefits			
	Net of Medicare		Excluding Medicare	
	Part D Subsidy		Part D Subsidy	
	2017	2016	2017	2016
Service cost	\$ 2,317	\$ 2,052	\$ 2,317	\$ 2,052
Interest cost	2,422	3,295	2,512	3,415
Amortization of prior service cost	1,602	773	1,602	773
Amortization of net actuarial gain	(915)	(313)	(1,123)	(537)
Total net periodic benefit cost	<u>\$ 5,426</u>	<u>\$ 5,807</u>	<u>\$ 5,308</u>	<u>\$ 5,703</u>

Changes recognized in unrestricted net assets for the years ended August 31 include the following components:

	Staff Pension Plan		Postretirement Medical Benefits	
	Obligations		Net of Medicare	
	2017	2016	2017	2016
Net (gain) loss arising during period	\$ (10,967)	\$ 14,702	\$ 4,099	\$ (9,714)
New prior service cost	-	-	5,136	2,289
Amortizations				
Prior service cost	-	-	(1,602)	(773)
(Loss) gain	(3,012)	(2,272)	915	313
Settlement loss recognized	-	(6,079)	-	-
Total recognized in unrestricted net assets	<u>\$ (13,979)</u>	<u>\$ 6,351</u>	<u>\$ 8,548</u>	<u>\$ (7,885)</u>
Total recognized in net periodic benefit cost and unrestricted net assets	<u>\$ (10,511)</u>	<u>\$ 14,243</u>	<u>\$ 13,974</u>	<u>\$ (2,078)</u>

Stanford Health Care
Notes to Consolidated Financial Statements
(in thousands of dollars)

10. Retirement Plans (Continued)

Actuarial Assumptions

The weighted-average assumptions used to determine benefit obligations are as follows for the years ended August 31:

	Staff Pension Plan Obligations		Postretirement Medical Benefits	
	2017	2016	2017	2016
Weighted-average assumptions				
Discount rate	3.56%	3.32%	3.33%	3.07%
Rate of compensation increase	3.00%	3.00%	N/A	N/A

The discount rate, expected rate of return on plan assets, and the projected covered payroll growth rates used in determining the above net benefit expense are as follows for the years ended August 31:

	Staff Pension Plan Obligations		Postretirement Medical Benefits	
	2017	2016	2017	2016
Weighted-average assumptions				
Discount rate	3.32%	4.20%	3.07%	4.01%
Expected return on plan assets	6.00%	6.50%	N/A	N/A
Rate of compensation increase	3.00%	3.00%	N/A	N/A

To develop the assumption for the expected rate of return on plan assets, SHC considered the historical and future expected returns. An independent investment consulting firm provided SHC with an estimate of the future expected returns for each asset class based on SHC's asset allocation targets. The evaluation of the historical returns and the future expected returns resulted in the use of 6.00% as the assumption for the expected return on plan assets.

To determine the accumulated post-retirement benefit obligation as of August 31, 2017, a 6.75% annual rate of increase in the per capita cost of covered health care was assumed for calendar year 2017, declining gradually to 4.50% by 2038, and remaining at this rate thereafter.

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the post-retirement medical benefit plan. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post-retirement benefit obligation by \$1,937 and the aggregate service and interest cost by \$101. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post-retirement benefit obligation by \$1,754 and the aggregate service and interest cost by \$91.

Plan Assets

SHC's Staff Pension Plan weighted-average asset allocations as of the measurement date August 31, 2017 and 2016, respectively, by asset category are as follows:

<u>Asset Category</u>	<u>August 31, 2017</u>	<u>August 31, 2016</u>
Debt securities	50%	50%
Equity securities	50%	49%
Other	0%	1%
Total	100%	100%

Stanford Health Care
Notes to Consolidated Financial Statements
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10. Retirement Plans (Continued)

Plan Assets (continued)

The following table summarizes SHC's Staff Pension Plan assets measured at fair value on a recurring basis as of August 31, based on the inputs used to value them as defined in Note 7:

	2017			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 1,247	\$ -	\$ -	\$ 1,247
Mutual funds	192,229	-	-	192,229
Total assets	<u>\$ 193,476</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 193,476</u>

	2016			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 1,075	\$ -	\$ -	\$ 1,075
Mutual funds	189,946	-	-	189,946
Total assets	<u>\$ 191,021</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 191,021</u>

Plan Investments

The investment objective of the Staff Pension Plan funds is to maximize the total rate of return (income and appreciation) within the limits of prudent risk taking and Section 404 of the Employee Retirement Income Security Act. The funds are diversified across asset classes to achieve an optimal balance between risk and return and between income and capital appreciation. Many of the pension liabilities are long-term. The investment horizon is also long-term; however, the investment plan also ensures adequate near-term liquidity to meet benefit payments.

The allowable asset mix range and target asset allocations are:

<u>Asset Category</u>	<u>Acceptable Range</u>	<u>Target Allocation</u>
Equity securities	36% to 60%	50%
Debt securities	20% to 80%	50%

Appropriate investments include common, preferred and convertible equities of domestic and foreign companies, mutual and commingled trust funds, top tier commercial paper, certificates of deposit, and fixed income securities whose assets are rated investment grade or better.

Financial futures and options on futures traded on exchanges are also permitted for hedging purposes. Prohibited investments include commodities, unregistered securities and short sales. Derivative products may not be used to leverage a portfolio or to speculate. All assets must have readily ascertainable market value and be easily marketable.

Portfolios are expected to be well diversified with respect to industry and economic sectors. Equity investments in any one company shall be limited to the greater of 5% of the market value of the portfolio at time of purchase or twice the applicable benchmark weighting of the security. The investment manager shall not hold more than 15% of any company's outstanding equity.

Stanford Health Care
Notes to Consolidated Financial Statements
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10. Retirement Plans (Continued)

Plan Investments (continued)

Fixed income investments may consist of U.S. government, U.S. government guaranteed, and U.S. government agency securities. Corporate bond holdings must have an investment grade credit rating at the time of purchase and during the holding period. No single issuer of fixed income or cash equivalent securities (with the exception of the U.S. Government and its Agencies) will account for more than 10% of the market value of the fixed income securities in a manager's portfolio.

Concentration of Risk

SHC manages a variety of risks, including market, credit, and liquidity risks, across plan assets through investment managers. Concentration of risk is defined as an undiversified exposure to one of the above-mentioned risks that increases the exposure of the loss of plan assets unnecessarily. Risk is minimized by diversifying our exposure to such risks across a variety of instruments, markets, and counterparties. As of August 31, 2017, SHC did not have concentrations of risk in any single entity, manager, counterparty, sector, industry or country.

Expected Contributions

SHC expects to make \$34,800 to its Staff Pension Plan for both SHC and LPCH employees during the fiscal year ending August 31, 2018. SHC expects to contribute \$5,687 to its Postretirement Medical Benefit Plan for only SHC employees during the fiscal year ending August 31, 2018.

Expected Benefit Payments

The following benefit payments, which reflect expected future service, are expected to be paid for the fiscal years ending August 31:

	Pension Benefits	Postretirement Medical Benefits	
		Net of Medicare Part D Subsidy	Excluding Medicare Part D Subsidy
2018	\$ 13,748	\$ 7,063	\$ 7,212
2019	14,133	6,980	7,127
2020	14,463	7,009	7,152
2021	14,758	7,055	7,194
2022	14,986	7,079	7,214
2023 - 2027	75,373	32,976	33,554

Stanford Health Care
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11. Unrestricted Net Assets

The changes in consolidated unrestricted net assets attributable to the controlling financial interest of SHC and the noncontrolling interests, for the years ended August 31, are as follows:

	<u>Total</u>	<u>Controlling Interest</u>	<u>Noncontrolling Interests</u>
Balance as of September 1, 2015	\$ 2,490,372	\$ 2,467,393	\$ 22,979
Excess of revenues over expenses	69,904	71,864	(1,960)
Noncontrolling capital distribution	(1,000)	-	(1,000)
Other changes in unrestricted net assets	(90,106)	(90,220)	114
Balance as of August 31, 2016	2,469,170	2,449,037	20,133
Excess of revenues over expenses	484,518	482,781	1,737
Noncontrolling capital contributions	301	-	301
Other changes in unrestricted net assets	(60,816)	(60,705)	(111)
Balance as of August 31, 2017	<u>\$ 2,893,173</u>	<u>\$ 2,871,113</u>	<u>\$ 22,060</u>

12. Temporarily and Permanently Restricted Net Assets

Temporarily Restricted Net Assets

Temporarily restricted net assets consist of the following at August 31:

	<u>2017</u>	<u>2016</u>
Plant replacement and expansion	\$ 540,785	\$ 513,585
Other patient services	42,520	41,382
Clinical services	8,342	11,098
Indigent care	7,314	6,953
Education	4,290	4,068
Total	<u>\$ 603,251</u>	<u>\$ 577,086</u>

Permanently Restricted Net Assets

In 2009, California adopted a version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). SHC has interpreted UPMIFA as requiring the preservation of the original gift as of the gift date of donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, SHC 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 portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with the standard of prudence prescribed by UPMIFA.

Stanford Health Care
Notes to Consolidated Financial Statements
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12. Temporarily and Permanently Restricted Net Assets (Continued)

Permanently Restricted Net Assets (continued)

In accordance with UPMIFA, SHC considers the following factors in making a determination to appropriate or accumulate endowment funds:

1. The duration and preservation of the fund.
2. The purposes of SHC and the donor restricted endowment fund.
3. General economic conditions.
4. The possible effect of inflation and deflation.
5. The expected total return from income and the appreciation of investments.
6. Other resources of the organization.
7. The investment policies of the organization.

Endowment funds by net asset classification as of August 31, 2017 and 2016 are as follows:

	2017			2016		
	Temporarily Restricted	Permanently Restricted	Total	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment	\$ 12,567	\$ 8,144	\$ 20,711	\$ 10,723	\$ 7,894	\$ 18,617
Total endowment	\$ 12,567	\$ 8,144	\$ 20,711	\$ 10,723	\$ 7,894	\$ 18,617

Changes in SHC's endowment for the years ended August 31, 2017 and 2016 are as follows:

	2017			2016		
	Temporarily Restricted	Permanently Restricted	Total	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 10,723	\$ 7,894	\$ 18,617	\$ 10,666	\$ 7,694	\$ 18,360
Investment return:						
Investment income	491	-	491	491	-	491
Mark to market adjustments	1,717	-	1,717	(21)	-	(21)
Total investment return	2,208	-	2,208	470	-	470
Contributions	-	250	250	-	200	200
Expenditures	(364)	-	(364)	(413)	-	(413)
Endowment net assets, end of year	\$ 12,567	\$ 8,144	\$ 20,711	\$ 10,723	\$ 7,894	\$ 18,617

The following provides descriptions of amounts classified as permanently restricted net assets and temporarily restricted net assets (endowment only). The portion of endowment funds that is required to be retained permanently or temporarily, either by explicit donor stipulation or by California UPMIFA, as of August 31, 2017 and 2016 is as follows:

	2017			2016		
	Temporarily Restricted	Permanently Restricted	Total	Temporarily Restricted	Permanently Restricted	Total
Clinical services	\$ 1,302	\$ 4,250	\$ 5,552	\$ 958	\$ 4,000	\$ 4,958
Education	4,975	1,435	6,410	4,274	1,435	5,709
Indigent care and other	6,290	2,459	8,749	5,491	2,459	7,950
Total endowment classified as net assets	\$ 12,567	\$ 8,144	\$ 20,711	\$ 10,723	\$ 7,894	\$ 18,617

Stanford Health Care

Notes to Consolidated Financial Statements

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12. Temporarily and Permanently Restricted Net Assets (Continued)

Permanently Restricted Net Assets (continued)

All of SHC's endowment, totaling \$20,711 and \$18,617 at August 31, 2017 and 2016, respectively, are invested in the MP. The funds are held in perpetuity and invested to generate income to support operating and strategic initiatives.

Return Objectives and Risk Parameters

The return objective for the endowment assets is to generate optimal total return while maintaining an appropriate level of risk established by the University.

Strategies Employed for Achieving Investment Objectives

SHC relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gain) and current yield (interest and dividend) managed by the MP.

13. Related-Party Transactions

Transactions with the University and SoM

SHC has various transactions with the University and the SoM. SHC records expense transactions where direct and incremental economic benefits are received by SHC.

Expenses paid to the University and the SoM are reported as operating expenses in the consolidated statements of operations and changes in net assets and are management's best estimates of SHC's arms-length payments of such amounts for its market specific circumstances. To the extent that payments to the University and the SoM exceed an arms-length estimated amount relative to the benefits received by SHC, they are recorded as transfers to the University and the SoM in other changes in net assets.

SHC purchases certain services from the University and the SoM. Payment for these services is based on management's best estimate of its market specific circumstances.

Services provided by the SoM include physician services that benefit SHC, such as emergency room coverage, physicians providing medical direction to SHC, and physicians providing service to the clinical practice, which are covered by the Professional Services Agreement ("PSA"). Such expenses are reflected as purchased services in the consolidated statements of operations and changes in net assets, and total \$678,239 and \$607,274 for the years ended August 31, 2017 and 2016, respectively.

Services provided by the University and other SoM non-physician services include telecommunications, transportation, utilities, and certain administrative services, such as legal and internal audit. Total costs incurred by SHC were \$99,616 and \$104,044 for the years ended August 31, 2017 and 2016, respectively, and are reflected in various categories in the consolidated statements of operations and changes in net assets.

SHC paid service fees to the University in the amount of \$2,211 for the years ended August 31, 2017 and 2016. The service fees represent costs for the utilization of infrastructure owned by the University such as road improvements, parking garages and generators and are reflected in the consolidated statements of operations and changes in net assets as other expense. Expected payments over the next 16 years total \$19,437. Annual service fees range from approximately \$2,369 for the year ending August 31, 2018 to \$690 for the year ending August 31, 2033.

Stanford Health Care

Notes to Consolidated Financial Statements

(in thousands of dollars)

13. Related-Party Transactions (Continued)

Transactions with the University and SoM (continued)

SHC also received payment for services provided to the University including primarily building maintenance, housekeeping, and security. Costs incurred by SHC in providing these services are reflected in the respective categories in the consolidated statements of operations and changes in net assets. Reimbursement from the University totaled \$38,088 and \$37,844 for the years ended August 31, 2017 and 2016, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

In addition, SHC received certain grant monies for clinical trials from the University. Grant revenue totaled \$6,767 and \$5,748 for the years ended August 31, 2017 and 2016, respectively, and is reflected in the consolidated statements of operations and changes in net assets as net patient service revenue and recoveries.

During the year ended August 31, 2016, SHC paid \$5,500 to the University. The amount represented a prepayment of a 51 year lease for property owned by the University. The short term portion of \$108 is included in prepaid expenses and other in the consolidated balance sheets as of August 31, 2017 and 2016. The remaining amount included in other assets in the consolidated balance sheets is \$3,702 and \$3,810 as of August 31, 2017 and 2016, respectively.

For the years ended August 31, 2017 and 2016, SHC transferred \$69,071 and \$57,821, respectively, to the University. These funds are used by the University to support the academic mission of the SoM and its initiatives as well as the general support of the academic community and physical plant. For the years ended August 31, 2017 and 2016, SHC also transferred \$305 and \$31,123, respectively, to the University which represents excess consideration paid in the acquisition of the Stanford Blood Center. Total transfers of \$69,376 and \$88,944 for the years ended August 31, 2017 and 2016, respectively, are included in other changes in unrestricted net assets in the consolidated statements of operations and changes in net assets.

SHC also received equity transfers of \$2,748 and \$2,645 during the years ended August 31, 2017 and 2016, respectively, which represented restricted gifts originally donated to the University. These gifts were subsequently re-designated mostly for SHC patient care services and the New Stanford Hospital and are included in changes in temporarily restricted net assets in the consolidated statements of operations and changes in net assets.

Transactions with LPCH

SHC and LPCH share certain departments, including facilities design and construction, materials management, managed care contracting, compliance and general services. Shared service costs are included in the respective categories on the consolidated statements of operations and changes in net assets, and are allocated between SHC and LPCH based on negotiated rates. Reimbursement received from LPCH totaled \$31,360 and \$30,340 for the years ended August 31, 2017 and 2016, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

SHC provides various services to LPCH. These services include operating room, cardiac catheterization, interventional radiology, radiation oncology and laboratory. The cost of these services is charged back to LPCH based on a percentage of charges intended to approximate cost or a cost per procedure. Costs of these purchased services are reflected in the appropriate category in the consolidated statements of operations and changes in net assets. Reimbursement of purchased services from LPCH totaled \$44,845 and \$47,214 for the years ended August 31, 2017 and 2016, respectively, and is reflected in the consolidated statements of operations and changes in net assets as net patient service revenue.

Stanford Health Care
Notes to Consolidated Financial Statements
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13. Related-Party Transactions (Continued)

Transactions with LPCH (continued)

Other services provided by SHC include services provided by interns and residents, building maintenance, IT and utilities. Reimbursement of these services totaled \$40,681 and \$33,448 for the years ended August 31, 2017 and 2016, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

During the year ended August 31, 2016, SHC transferred \$3,300 to LPCH which represented a partial reimbursement of prior year transfers due to revised estimate on capital projects.

14. Operating and Capital Leases

SHC leases various equipment and facilities under non-cancelable lease agreements expiring at various dates. Total rental expense (included in other expense in the consolidated statements of operations and changes in net assets) under these leases for the years ended August 31, 2017 and 2016 was \$97,667 and \$89,951, respectively.

Net minimum future lease payments under all non-cancelable operating leases and capital lease obligations for periods subsequent to August 31, 2017 are as follows:

Year Ending August 31,	<u>Operating</u>	<u>Capital</u>
2018	\$ 87,336	\$ 398
2019	84,232	98
2020	72,137	82
2021	62,857	66
2022	59,218	-
Thereafter	<u>128,886</u>	-
	<u>\$ 494,666</u>	644
Less amount representing interest		(41)
Subtotal		<u>603</u>
Current portion		<u>(378)</u>
Long-term portion, net of current portion		<u>\$ 225</u>

Capital lease obligations totaled \$603 of which \$378 is included in accounts payable and accrued liabilities on the consolidated balance sheets. The remaining capital lease obligation of \$225 is included in other long term liabilities on the consolidated balance sheets.

SHC leases space in its medical office buildings to others under non-cancelable operating lease arrangements. Future minimum base rentals to be received under these leases in place as of August 31, 2017 are as follows:

Year Ending August 31,	
2018	\$ 4,926
2019	2,260
2020	1,349
2021	876
2022	902
Thereafter	<u>9,607</u>
	<u>\$ 19,920</u>

Stanford Health Care

Notes to Consolidated Financial Statements

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15. Commitments and Contingencies

SHC is aware of certain asserted and unasserted legal claims. While the outcome cannot be determined at this time, management is of the opinion that the liability, if any, from these actions will not have a material effect on SHC's financial position.

SHC has irrevocable standby letters of credit in the amount of \$21,583, which are required as security for the workers' compensation self-insurance arrangements and \$2,130 to serve as a security deposit for certain construction projects being undertaken by SHC. No amounts have been drawn on these letters of credit as of August 31, 2017.

At August 31, 2017, SHC had contractual obligations of approximately \$309,432 primarily related to the construction of the new hospital and other capital projects and approximately \$342,918 to support SHC's operations, such as maintenance, food services, valet services and other purchased services.

Effective December 23, 2014, SHC entered into a five year agreement with a global technology services and outsourcing company, pursuant to which SHC will receive certain information technology services. Under the terms of the agreement, SHC will be charged fixed fees for one-time transition services, ongoing recurring and event-based fees for information technology services, and additional fees plus expenses for project work agreed upon pursuant to work orders. SHC has the right to extend the agreement for up to two consecutive one-year periods. SHC anticipates that it will spend approximately \$36,000 over the initial term of the agreement. SHC has certain rights to reduce the scope of services to be purchased and to terminate the agreement early for a termination fee. The amount of the termination fee depends on when the right to terminate is exercised, what services are terminated, and changes monthly from \$1,136 to terminate all services in the month ending September 30, 2017 and decreasing gradually to \$459 for the month ending December 31, 2019.

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation, as well as to regulatory actions unknown or unasserted at this time. Government activity with respect to investigations and allegations concerning possible violations of regulations by healthcare providers could result in the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. SHC is subject to similar regulatory reviews, and while such reviews may result in repayments and/or civil remedies that could have a material effect on SHC's financial results of operations in a given period, management believes that such repayments and/or civil remedies would not have a material effect on SHC's financial position.

As with many medical centers across the country, information security and privacy is a growing risk area based on developments in the law and expanding mobile technology practices. SHC has policies, procedures, and training in place to safeguard protected information, but select incidents have occurred in the past and may occur in the future involving potential or actual disclosure of such information (including, for example, certain identifiable information relating to patients or research participants). In most cases, there has been no evidence of unauthorized access to, or use/disclosure of, such information, yet laws may require reporting to potentially affected individuals and federal and state governmental agencies. Governmental agencies have the authority to investigate and request further information about an incident or safeguards, to cite SHC for a deficiency or regulatory violation, and/or require payment of fines, corrective action, or both. California law also allows a private right to sue for a breach of medical information. The cost of such possible consequences has not been material to date to SHC, and management does not believe that any future consequences of these incidents will be material to the consolidated financial statements.

The percentage of SHC employees that are covered by collective bargaining arrangements is approximately 31%. There are currently no expired agreements.

Stanford Health Care
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15. Commitments and Contingencies (Continued)

California's Hospital Seismic Safety Act requires licensed acute care functions to be conducted only in facilities that meet specified seismic safety standards. Facilities classified by the State of California as non-compliant in the event of an earthquake must be retrofitted, replaced or removed from acute-care service by applicable deadlines in 2020 or 2030.

The California Office of Statewide Health Planning and Development has classified a substantial portion of Stanford Hospital as compliant with seismic safety structural standards until 2030 and beyond. Certain patient care activities are located in existing buildings that are structurally compliant until 2030. However, these facilities have utility system configurations that must be modified no later than January 1, 2020 in order to remain in use for acute patient care. SHC is constructing a new hospital facility to address seismic safety requirements, which will also enable retrofit work of the existing hospital facility utility infrastructure.

Amendments of the Hospital Seismic Safety Act, through Senate Bill ("SB") 90 and SB 499, allow extensions to compliance timelines for hospitals that meet certain eligibility requirements. SHC has received approval from the State to extend the compliance deadline through 2019 for all buildings subject to the requirement. These extensions will allow sufficient time to construct the new hospital and mitigate the deficiencies of the existing facility.

In June 2011, the Palo Alto City Council certified the Final Environmental Impact Report, land use changes, permits and a Development Agreement with SHC, LPCH and the University as part of a Renewal Project. In July 2011, the Palo Alto City Council provided final approval for the Renewal Project at the second reading of the Development Agreement. The Renewal Project will rebuild Stanford Hospital and expand LPCH to assure adequate capacity, meet State-mandated earthquake safety standards, and provide modern, technologically-advanced hospital facilities. The Renewal Project also includes replacement of outdated laboratory facilities at the SoM and remodeling of Hoover Pavilion. SHC's share of the estimated cost is approximately \$2.1 billion. As of August 31, 2017, SHC has capitalized \$1,520 million, inclusive of \$124 million in capitalized interest, related to this project.

Based on current estimated schedules, management projects that the Renewal Project construction will be complete in 2019.

16. Functional Expenses

Expenses are categorized on a functional basis for the years ended August 31:

	<u>2017</u>	<u>2016</u>
Patient services	\$ 3,811,682	\$ 3,553,997
Management and general	396,871	384,711
Fundraising	11,966	10,911
Total functional expenses	<u>\$ 4,220,519</u>	<u>\$ 3,949,619</u>

17. Subsequent Events

SHC has evaluated subsequent events occurring between the end of the most recent fiscal year and December 5, 2017, the date the financial statements were issued.

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**Report of Independent Auditors
On Accompanying Consolidating Information**

To the Board of Directors
Stanford Health Care

We have audited the consolidated financial statements of Stanford Health Care (“SHC”) as of August 31, 2017 and for the year then ended and our report thereon appears on page one of this document. That audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and changes in net assets and cash flows of the individual companies.

PricewaterhouseCoopers LLP

December 5, 2017

Stanford Health Care
Consolidating Balance Sheet
August 31, 2017
(in thousands of dollars)

	SHC	UHA	SHC-VC	SBC LLC	SHI	SEROC	PEAC	Care Counsel	SHC Advantage	Eliminations	Total
Assets											
Current assets:											
Cash and cash equivalents	\$ 603,771	\$ 2,688	\$ 49,963	\$ 11,694	\$ 23,416	\$ 6,100	\$ 6,578	\$ 278	\$ 5,621	\$ -	\$ 710,109
Short term investments	233,533	-	-	-	-	-	-	-	-	-	233,533
Patient accounts receivable, net of allowance for doubtful accounts	541,297	32,047	31,844	-	-	2,046	-	-	-	3,500	610,734
Other receivables	61,768	3,922	4,108	709	62	1,725	253	234	547	(2,216)	71,112
Inventories	47,723	1,083	5,983	1,770	-	-	-	-	-	-	56,559
Prepaid expenses and other	32,561	7,107	1,750	65	278	143	634	27	6	(43)	42,528
Due from related parties	9,163	19,622	2,720	3,887	47	-	-	-	-	(35,439)	-
Total current assets	1,529,816	66,469	96,368	18,125	23,803	10,014	7,465	539	6,174	(34,198)	1,724,575
Investments	45,265	-	-	-	59,837	-	6,562	-	-	-	111,664
Investments at equity	59,103	-	7,152	-	-	-	-	-	-	-	66,255
Investments in University managed pools	1,246,102	-	-	-	41,091	-	-	-	-	-	1,287,193
Assets limited as to use, held by trustee	58,134	-	-	-	-	-	-	-	-	-	58,134
Property and equipment, net	2,701,461	29,679	134,952	2,155	-	1,099	-	-	-	-	2,869,346
Other assets	152,958	18,022	3,425	-	-	831	144	17	311	(63,263)	112,445
Investments in related entities	292,172	3,273	-	-	-	-	-	-	-	(295,445)	-
Total assets	\$ 6,085,011	\$ 117,443	\$ 241,897	\$ 20,280	\$ 124,731	\$ 11,944	\$ 14,171	\$ 556	\$ 6,485	\$ (392,906)	\$ 6,229,612
Liabilities and Net Assets											
Current liabilities:											
Accounts payable and accrued liabilities	\$ 257,239	\$ 22,221	\$ 18,599	\$ 3,361	\$ 399	\$ 389	\$ 2,073	\$ 97	\$ 3,710	\$ (189)	\$ 307,899
Accrued salaries and related benefits	207,896	27,219	20,610	-	-	-	-	34	-	-	255,759
Due to related parties	97,263	2,720	4,872	144	788	74	47	374	586	(35,439)	71,429
Third-party payor settlements	18,294	-	(145)	-	-	-	-	-	-	-	18,149
Current portion of long-term debt	13,335	-	2,070	-	-	-	-	-	-	(2,070)	13,335
Revolving line of credit	135,000	-	-	-	-	-	-	-	-	-	135,000
Debt subject to short-term remarketing arrangements	228,200	-	-	-	-	-	-	-	-	-	228,200
Self-insurance reserves and other	27,233	2,131	2,263	165	14,062	-	-	-	-	-	45,854
Total current liabilities	984,460	54,291	48,269	3,670	15,249	463	2,120	505	4,296	(37,698)	1,075,625
Self-insurance reserves and other, net of current portion	87,351	-	6,141	64	29,791	-	7,469	-	-	-	130,816
Other long-term liabilities	273,446	1,769	65,377	-	-	-	-	-	-	(63,263)	277,329
Pension liability	51,745	-	-	-	-	-	-	-	-	-	51,745
Long-term debt, net of current portion	1,189,529	-	-	-	-	-	-	-	-	-	1,189,529
Total liabilities	2,586,531	56,060	119,787	3,734	45,040	463	9,589	505	4,296	(100,961)	2,725,044
Net assets:											
Unrestricted											
Stanford Health Care	2,887,352	61,383	121,781	16,546	63,532	6,889	3,273	51	2,189	(291,883)	2,871,113
Noncontrolling interests	-	-	-	-	16,159	4,592	1,309	-	-	-	22,060
Total unrestricted	2,887,352	61,383	121,781	16,546	79,691	11,481	4,582	51	2,189	(291,883)	2,893,173
Temporarily restricted	602,984	-	329	-	-	-	-	-	-	(62)	603,251
Permanently restricted	8,144	-	-	-	-	-	-	-	-	-	8,144
Total net assets	3,498,480	61,383	122,110	16,546	79,691	11,481	4,582	51	2,189	(291,945)	3,504,568
Total liabilities and net assets	\$ 6,085,011	\$ 117,443	\$ 241,897	\$ 20,280	\$ 124,731	\$ 11,944	\$ 14,171	\$ 556	\$ 6,485	\$ (392,906)	\$ 6,229,612

The supplemental information has been prepared in a manner consistent with generally accepted accounting principles and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The supplemental combining information is presented only for purposes of additional analysis and not as a presentation of the financial position and results of the individual entities.

Stanford Health Care
Consolidating Statement of Operations and Changes in Net Assets
Year Ended August 31, 2017
(in thousands of dollars)

	SHC	UHA	SHC-VC	SBC LLC	SHI	SEROC	PEAC	Care Counsel	SHC Advantage	Eliminations	Total
Operating revenues:											
Net patient service revenue	\$ 3,785,780	\$ 251,887	\$ 272,909	\$ -	\$ -	\$ 9,187	\$ -	\$ -	\$ -	\$ (8,233)	\$ 4,311,530
Provision for doubtful accounts	(61,731)	(3,519)	(11,711)	-	-	(36)	-	-	(7)	-	(77,004)
Net patient service revenue less provision for doubtful accounts	3,724,049	248,368	261,198	-	-	9,151	-	-	-	(8,233)	4,234,526
Premium revenue	959	70,627	-	-	-	-	-	-	14,457	(5,396)	80,647
Other revenue	41,450	12,323	7,609	71,704	25,916	109	4,580	2,020	-	(36,387)	129,324
Net assets released from restrictions used for operations	9,869	-	35	-	-	-	-	-	-	-	9,904
Total operating revenues	3,776,327	331,318	268,842	71,704	25,916	9,260	4,580	2,020	14,450	(50,016)	4,454,401
Operating expenses:											
Salaries and benefits	1,717,071	111,219	153,416	22	-	1,802	-	2,978	-	(148)	1,986,360
Professional services	37,280	890	3,355	102	1,126	731	578	26	599	(1,836)	42,851
Supplies	493,900	59,496	38,261	16,488	-	82	-	17	2,125	(24,293)	586,056
Purchased services	975,403	199,637	32,334	33,793	10,601	1,057	-	213	20,829	(137,847)	1,136,020
Depreciation and amortization	134,810	7,974	10,722	840	-	340	-	-	-	-	154,686
Interest	43,519	54	2,234	5	-	15	-	-	-	-	43,643
Other	318,413	23,978	38,978	5,272	14,699	1,479	3,407	318	670	(22,860)	384,354
Expense recoveries from related parties	(175,259)	(20,345)	(3,027)	(203)	-	-	-	(1,151)	-	86,534	(113,451)
Total operating expenses	3,545,137	382,903	276,273	56,299	26,426	5,506	3,985	2,401	24,223	(102,634)	4,220,519
Income (loss) from operations	231,190	(51,585)	(7,431)	15,405	(510)	3,754	595	(381)	(9,773)	52,618	233,882
Interest and investment income	17,089	43	402	-	1,101	-	42	-	4	(3,356)	15,325
Earnings on equity method investments	5,114	-	-	-	-	-	-	-	-	-	5,114
Increase (decrease) in value of University Managed pools	144,020	-	-	-	4,615	-	-	-	-	(3,806)	144,829
Interest rate swap mark to market adjustments	85,368	-	-	-	-	-	-	-	-	-	85,368
Excess (deficiency) of revenues over expenses	482,781	(51,542)	(7,029)	15,405	5,206	3,754	637	(381)	(9,769)	45,456	484,518
Other changes in unrestricted net assets:											
Transfer to Stanford University, net	(69,071)	-	-	(305)	-	-	-	-	-	-	(69,376)
Transfer between SHC and SHC-VC	(10,544)	-	10,544	-	-	-	-	-	-	-	-
Change in net unrealized gains on investments	1,148	18	-	-	(456)	-	26	-	-	322	1,058
Net assets released from restrictions used for:											
Purchase of property and equipment	762	-	558	-	-	-	-	-	-	-	1,320
Change in pension and postretirement liability	6,182	-	-	-	-	-	-	-	-	-	6,182
Noncontrolling capital contribution (distribution), net	-	73,617	-	(15,000)	4	-	1,001	250	9,000	(68,571)	301
Increase (decrease) in unrestricted net assets	411,258	22,093	4,073	100	4,754	3,754	1,664	(131)	(769)	(22,793)	424,003
Changes in temporarily restricted net assets:											
Transfer from Stanford University	2,748	-	-	-	-	-	-	-	-	-	2,748
Contributions and other	28,196	-	345	-	-	-	-	-	-	-	28,541
Investment income	4,662	-	-	-	-	-	-	-	-	-	4,662
Gains on University managed pools	1,438	-	-	-	-	-	-	-	-	-	1,438
Net assets released from restrictions used for:											
Operations	(9,869)	-	(35)	-	-	-	-	-	-	-	(9,904)
Purchase of property and equipment	(762)	-	(558)	-	-	-	-	-	-	-	(1,320)
Increase (decrease) in temporarily restricted net assets	26,413	-	(248)	-	-	-	-	-	-	-	26,165
Changes in permanently restricted net assets:											
Contributions	250	-	-	-	-	-	-	-	-	-	250
Increase in permanently restricted net assets	250	-	-	-	-	-	-	-	-	-	250
Increase (decrease) in net assets	437,921	22,093	3,825	100	4,754	3,754	1,664	(131)	(769)	(22,793)	450,418
Net assets, beginning of year	3,060,559	39,290	118,285	16,446	74,937	7,727	2,918	182	2,958	(269,152)	3,054,150
Net assets, end of year	\$ 3,498,480	\$ 61,383	\$ 122,110	\$ 16,546	\$ 79,691	\$ 11,481	\$ 4,582	\$ 51	\$ 2,189	\$ (291,945)	\$ 3,504,568

The supplemental information has been prepared in a manner consistent with generally accepted accounting principles and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The supplemental combining information is presented only for purposes of additional analysis and not as a presentation of the financial position and results of the individual entities.

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APPENDIX C

SUMMARY OF PRINCIPAL DOCUMENTS

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SUMMARY OF PRINCIPAL DOCUMENTS

The following is a summary of certain provisions of the Amended and Restated Master Indenture of Trust, dated as of June 1, 2011 and effective as of June 16, 2011 (as supplemented and amended from time to time pursuant to its terms, the “Master Indenture”), between Stanford Health Care, formerly known as Stanford Hospital and Clinics (the “Corporation”), and The Bank of New York Mellon Trust Company, N.A., as master trustee (the “Master Trustee”), the Supplemental Master Indenture of Trust for Obligation No. 40, dated as of January 1, 2018 (“Supplement No. 40”), between the Corporation and the Master Trustee, and the Indenture, dated as of January 1, 2018 (the “Indenture”), between the Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee. This summary does not purport to be complete or definitive, is supplemental to the summary of other provisions of such documents described elsewhere in this Offering Memorandum and is qualified in its entirety by reference to the full terms of the Master Indenture, Supplement No. 40 and the Indenture, as applicable. All capitalized terms used and not otherwise defined in this Offering Memorandum have the meanings assigned to such terms in the Indenture or, if not set forth in the Indenture, in the Master Indenture.

DEFINITIONS OF CERTAIN TERMS

Accountant means, for purposes of the Master Indenture, any independent certified public accountant or firm of independent certified public accountants selected by the Obligated Group Representative.

Accountant means, for purposes of the Indenture, any independent certified public accountant or firm of such accountants of national reputation selected by the Corporation.

Account Control Agreement means an agreement providing for control of deposit accounts within the meaning of Division 9 of the California Commercial Code, including Section 9104 of the California Commercial Code, entered into by one or more Members of the Obligated Group, the Master Trustee and a Depository Bank.

Administrative Fees and Expenses means any application, commitment, financing or similar fee charged, or reimbursement for administrative or other expenses incurred, by the Trustee.

Affiliated Corporation means any corporation which, directly or indirectly through one or more intermediaries, controls, is controlled by or is under common control with, an Obligated Group Member.

Amended Master Indenture Effective Date means June 16, 2011.

Annual Debt Service means for each Fiscal Year the sum (without duplication) of the aggregate amount of principal and interest scheduled to become due and payable in such Fiscal Year on all Long-Term Indebtedness of the Obligated Group then Outstanding (by scheduled maturity, acceleration, mandatory redemption or otherwise, but not including purchase price coming due as a result of a mandatory or optional tender or put), less any amounts of such principal or interest to be paid during such Fiscal Year from (a) the proceeds of Indebtedness or (b) moneys or Government Obligations deposited in trust for the purpose of paying such principal or interest; provided that if a Financial Products Agreement is being entered into by any Obligated Group Member concurrently or substantially concurrently with the incurrence of Long-Term Indebtedness and with respect to such Long-Term Indebtedness or if a Financial Products Agreement has been entered into by any Obligated Group Member with respect to Long-Term Indebtedness, interest on such Long-Term Indebtedness shall be included in the calculation of Annual Debt Service by including for each Fiscal Year an amount equal to the amount of interest payable on such Long-Term Indebtedness in such Fiscal Year at the rate or rates stated in such Long-Term Indebtedness plus any Financial Product Payments under a Financial Products Agreement payable in such Fiscal Year minus any Financial Product Receipts under a Financial Products Agreement receivable in such Fiscal Year; provided that in no event shall any calculation made pursuant to this clause result in a number less than zero being included in the calculation of Annual Debt Service. For purposes of computing Annual Debt Service, the principles and assumptions set forth under the definition of Maximum Annual Debt Service shall be applied.

Appraisal Institute means the global membership association of professional real estate appraisers designated by that name or any successor thereto.

Authorized Representative means, for purposes of the Indenture, with respect to the Corporation, the Chair or Vice Chair of its governing body, its chief executive officer, its chief operating officer, its chief financial officer, or any other person designated as an Authorized Representative of the Corporation by a Certificate of the Corporation signed by its chief executive officer, its chief operating officer or its chief financial officer and filed with the Trustee.

Balloon Indebtedness means either (a) Long-Term Indebtedness or (b) Commercial Paper Indebtedness or Short-Term Indebtedness which is intended to be refinanced upon or prior to its maturity so that such Commercial Paper Indebtedness or Short-Term Indebtedness, as applicable, and the Indebtedness intended to be used to refinance such Commercial Paper Indebtedness or Short-Term Indebtedness, as applicable, will be scheduled to be outstanding for a total of more than three hundred sixty-five (365) days as certified in an Officer's Certificate, in either case twenty-five percent (25%) or more of the original principal of which matures (or is redeemable at the option of the holder) in the same Fiscal Year, if such twenty-five percent (25%) or more is not to be amortized below twenty-five percent (25%) by mandatory redemption prior to such Fiscal Year.

Beneficial Owner means any Person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any of the Bonds (including any Person holding Bonds through nominees, depositories or other intermediaries).

Bonds means the Stanford Health Care Taxable Bonds, Series 2018, together with any Additional Bonds, authorized by, and at any time Outstanding pursuant to, the Indenture.

Bondholder or **Holder**, whenever used with respect to a Bond, means the Person in whose name such Bond is registered.

Book Value means, when used in connection with Property, Plant and Equipment or other Property of any Obligated Group Member, the value of such property, net of accumulated depreciation, as it is carried on the books of such Obligated Group Member and in conformity with GAAP, and when used in connection with Property, Plant and Equipment or other Property of the Obligated Group, means the aggregate of the values so determined with respect to such Property of each Obligated Group Member determined in such a way that no portion of such value of Property of any Obligated Group Member is included more than once.

Business Day means a day that is not a Saturday, Sunday or legal holiday on which banking institutions in the State of California, the State of New York or in any state in which the office of the Master Trustee or the Trustee is located are authorized to remain closed or a day on which the New York Stock Exchange is closed.

Certificate, Statement, Request, Consent or **Order** of any Obligated Group Member or of the Master Trustee means, respectively, a written certificate, statement, request, consent or order signed in the name of such Obligated Group Member by an Authorized Representative or in the name of the Master Trustee by a Responsible Officer.

Certificate, Statement and Request of the Corporation mean, respectively, a written certificate, statement or request signed in the name of the Corporation by an Authorized Representative.

Code means the Internal Revenue Code of 1986, as amended, or any successor statute thereto and any regulations promulgated thereunder. Reference to any particular Code section shall, in the event of such a successor Code, be deemed to be a reference to the successor to such Code section.

Collateral means all of the following whether now existing or hereafter created or acquired (a) all Gross Revenues, (b) all accounts comprising the Gross Revenue Fund, (c) all accounts and accounts receivable, including health-care-insurance receivables and (d) all proceeds of any of the foregoing. The terms "accounts" and "health-care- insurance receivables" are used in the Master Indenture with meanings as defined in the California Commercial Code Division 9. Notwithstanding the foregoing, "Collateral" shall not include Restricted Assets.

Commercial Paper Indebtedness means Indebtedness with a maturity not in excess of two hundred seventy (270) days, the proceeds of which are to be used: (i) to provide interim financing for capital improvements, (ii) to

support current operations or (iii) for other corporate purposes. Commercial Paper Indebtedness shall not constitute Short-Term Indebtedness for any purpose under the Master Indenture.

Comparable Treasury Issue means the United States Treasury security or securities selected by a Designated Investment Banker as having an actual or interpolated maturity comparable to the remaining term of the Bonds to be redeemed that would be used, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of a comparable maturity to the remaining term of such Bonds.

Comparable Treasury Price means, with respect to any redemption date, the average of the Primary Treasury Dealer Quotations for such redemption date or, if the Designated Investment Banker obtains only one Primary Treasury Dealer Quotation, such Primary Treasury Dealer Quotation.

Completion Indebtedness means any Long-Term Indebtedness incurred for the purpose of financing the completion of construction or equipping of any project for which Long-Term Indebtedness has theretofore been incurred in accordance with the provisions of the Master Indenture, to the extent necessary to provide a completed and fully equipped facility of the type and scope contemplated at the time said Long-Term Indebtedness was incurred, and in accordance with the general plans and specifications for such facility as originally prepared in connection with the related financing as certified by an Officer's Certificate.

Corporate Trust Office means the office of the Master Trustee at which its principal corporate trust business is conducted, which at the date hereof is located at 400 South Hope Street, Suite 400, Los Angeles, California 90071, or at such other or additional offices as shall be specified by the Master Trustee in a writing delivered to the Obligated Group Representative.

Corporation means Stanford Health Care, formerly known as Stanford Hospital and Clinics, a nonprofit public benefit corporation duly organized and validly existing under the laws of the State of California, or any corporation that is the surviving, resulting or transferee corporation in any merger, consolidation or transfer of assets permitted under the Master Indenture.

Counsel means an attorney duly admitted to practice law before the highest court of any state.

Debt Service Coverage Ratio means, for any Fiscal Year, the ratio determined by dividing Income Available for Debt Service for such Fiscal Year by Maximum Annual Debt Service.

Default means, for purposes of the Master Indenture, an event that, with the passage of time or the giving of notice or both, would become an Event of Default or, for purposes of the Indenture, an event that, with the passage of time or the giving of notice or both, would become an Event of Default.

Depository Bank means a financial institution which has entered into an Account Control Agreement with one or more Obligated Group Members and the Master Trustee.

Designated Investment Banker means a Primary Treasury Dealer appointed by the Corporation.

DTC means The Depository Trust Company, a limited purpose trust company organized under the laws of the State of New York, and its successors and assigns.

Electronic Notice means notice delivered by Electronic Means.

ERISA means the Employee Retirement Income Security Act of 1974, as amended.

Event of Default means, for purposes of the Indenture, any of the events of default specified in the Indenture, and means, for purposes of the Master Indenture, any of the events of default specified in the Master Indenture.

Existing Obligations means the Obligations listed on Exhibit B to the Master Indenture.

Existing Parity Financial Product Extraordinary Payments means the Parity Financial Product Extraordinary Payments listed on Exhibit C to the Master Indenture.

Fair Market Value, when used in connection with Property, means the fair market value of such Property as determined by either:

(1) an appraisal of the portion of such Property which is real property made within five years of the date of determination by a member of the Appraisal Institute and by an appraisal of the portion of such Property which is not real property made within five years of the date of determination by any expert qualified in relation to the subject matter, provided that any such appraisal shall be performed by an Independent Consultant, adjusted for the period, not in excess of five years, from the date of the last such appraisal for changes in the implicit price deflator for the gross national product as reported by the United States Department of Commerce or its successor agency, or if such index is no longer published, such other index certified to be comparable and appropriate in an Officer's Certificate delivered to the Master Trustee;

(2) a bona fide offer for the purchase of such Property made on an arm's-length basis within six months of the date of determination, as established by an Officer's Certificate; or

(3) an officer of the Obligated Group Representative (whose determination shall be made in good faith and set forth in an Officer's Certificate filed with the Master Trustee) if the fair market value of such Property is less than or equal to the greater of \$5,000,000 or 2.5% of cash and equivalents as shown on the most recent Financial Statements.

Favorable Opinion of Bond Counsel means an opinion of Bond Counsel, addressed to the Trustee, to the effect that the action proposed to be taken with respect to the Bonds is authorized or permitted by the Indenture and will not, in and of itself, adversely affect any exclusion of interest on the Bonds from gross income for purposes of federal income taxation.

Financial Product Extraordinary Payments means any payments required to be paid to a counterparty by an Obligated Group Member pursuant to a Financial Product Agreement in connection with the termination thereof, tax gross-up payments, expenses, default interest, and any other payments or indemnification obligations to be paid to a counterparty by an Obligated Group Member under a Financial Product Agreement, which payments are not Financial Product Payments.

Financial Product Extraordinary Receipts means any payments required to be paid to an Obligated Group Member by a counterparty pursuant to a Financial Product Agreement in connection with the termination thereof, tax gross-up payments, expenses, default interest, and any other payments or indemnification obligations to be paid to an Obligated Group Member by a counterparty under a Financial Product Agreement, which payments are not Financial Product Receipts.

Financial Product Payments means regularly scheduled payments required to be paid to a counterparty by an Obligated Group Member pursuant to a Financial Products Agreement.

Financial Product Receipts means regularly scheduled payments required to be paid to an Obligated Group Member by a counterparty pursuant to a Financial Products Agreement.

Financial Products Agreement means any interest rate exchange agreement, hedge or similar arrangement, including, without limitation, an interest rate swap, asset swap, a constant maturity swap, a forward or futures contract, cap, collar, option, floor, forward or other hedging agreement, arrangement or security, direct funding transaction or other derivative, however denominated and whether entered into on a current or forward basis, identified to the Master Trustee in an Officer's Certificate of the Obligated Group Representative as having been entered into by an Obligated Group Member with a Qualified Provider: (a) with respect to Indebtedness (which is either then-Outstanding or to be incurred after the date of such Certificate) identified in such Certificate for the purpose of (1) reducing or otherwise managing the Obligated Group Member's risk of interest rate changes or (2) effectively converting the Obligated Group Member's interest rate exposure, in whole or in part, from a fixed rate exposure to a variable rate exposure, or

from a variable rate exposure to a fixed rate exposure; or (b) for any other interest rate, investment, asset or liability management purpose.

Financial Statements means financial statements complying with the provisions set forth in the Master Indenture and described under the caption “Master Indenture - Covenants - Preparation and Filing of Financial Statements, Certificates and Other Information.”

Fiscal Year means the period beginning on September 1 of each year and ending on the next succeeding August 31, or any other twelve-month period hereafter designated by the Obligated Group Representative as the fiscal year of the Obligated Group.

Fitch means Fitch, Inc., doing business as Fitch Ratings, a corporation organized and existing under the laws of the State of Delaware, its successors and their assigns, or, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated by the Corporation by notice in writing to the Trustee.

GAAP means accounting principles generally accepted in the United States of America, consistently applied.

Governing Body means, when used with respect to any Obligated Group Member, its board of directors, board of trustees or other board or group of individuals in which all of the powers of such Obligated Group Member are vested, except for those powers reserved to the corporate membership of such Obligated Group Member by the articles of incorporation or bylaws of such Obligated Group Member.

Government Issuer means any municipal corporation, political subdivision, state, territory or possession of the United States, or any constituted authority or agency or instrumentality of any of the foregoing empowered to issue obligations on behalf thereof, which obligations would constitute Related Bonds under the Master Indenture.

Government Obligations means: (1) direct obligations of the United States of America (including obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States of America) or obligations the timely payment of the principal of and interest on which are fully guaranteed by the United States of America; (2) obligations issued or guaranteed by any agency, department or instrumentality of the United States of America if the obligations issued or guaranteed by such entity are rated in one of the two highest rating categories of a Rating Agency (without regard to any gradation of such rating category); (3) certificates which evidence ownership of the right to the payment of the principal of and interest on obligations described in clauses (1) and/or (2), provided that such obligations are held in the custody of a bank or trust company in a special account separate from the general assets of such custodian; and (4) obligations the interest on which is excluded from gross income for purposes of federal income taxation pursuant to Section 103 of the Code, and the timely payment of the principal of and interest on which is fully provided for by the deposit in trust of cash and/or obligations described in clauses (1), (2) and/or (3).

Governmental Unit shall have the meaning set forth in Section 150 of the Code.

Gross Revenue Fund means the fund by that name established pursuant to the provisions of the Master Indenture.

Gross Revenues means all revenues, income, receipts and money now existing or hereafter received by each Obligated Group Member, including: (a) gross revenues collected from its operations and possession of and pertaining to its properties; (b) gifts, grants, bequests, donations and contributions; (c) proceeds derived from (i) condemnation, (ii) insurance, (iii) accounts and accounts receivable, including health-care-insurance receivables, (iv) payment intangibles, (v) inventory and other tangible and intangible property, (vi) medical reimbursement programs and agreements, (vii) contract rights and other rights and assets now or hereafter owned, held or possessed by or on behalf of any Obligated Group Member; and (d) rentals received from the lease of real estate. The terms “accounts,” “health-care-insurance receivables,” “payment intangibles,” and “inventory” as used in the Master Indenture shall the meanings ascribed to such terms in the California Commercial Code Divisions 8 and 9. Notwithstanding the foregoing, “Gross Revenues” shall not include Restricted Assets.

Guaranty means all loan commitments and all obligations of any Obligated Group Member guaranteeing in any manner whatever, whether directly or indirectly, any obligation of any other Person, which would, if such other Person were an Obligated Group Member, constitute Indebtedness.

Holder, whenever used with respect to an Obligation, means the registered owner of any Obligation in registered form or the bearer of any Obligation in coupon form which is not registered or is registered to bearer.

Holder or Bondholder, whenever used with respect to a Bond, means the Person in whose name such Bond is registered.

Immaterial Affiliates means Persons that are not Members of the Obligated Group and whose combined total revenues (calculated as if such Persons were Members of the Obligated Group), as shown on their financial statements for their most recently completed fiscal year, were less than ten percent (10%) of the Total Revenues of the Obligated Group (including the Total Revenues of such Persons) as shown on the Financial Statements for the most recently completed Fiscal Year of the Obligated Group.

Income Available for Debt Service means, unless the context provides otherwise, as to any period of time, net income, or excess of revenues over expenses (excluding income from all Irrevocable Deposits) before depreciation, amortization, and interest expense, as determined in accordance with GAAP and as shown on the Financial Statements; provided, that no determination thereof shall take into account:

- (a) any revenue or expense of a Person which is not a Member of the Obligated Group;
- (b) gifts, grants, bequests, donations or contributions, to the extent specifically restricted by the donor to a particular purpose inconsistent with their use for the payment of principal of, redemption premium and interest on Indebtedness or the payment of operating expenses;
- (c) the net proceeds of insurance (other than business interruption insurance) and condemnation awards;
- (d) any gain or loss resulting from the extinguishment of Indebtedness;
- (e) any gain or loss resulting from the sale, exchange or other disposition of assets not in the ordinary course of business;
- (f) any gain or loss resulting from any discontinued operations;
- (g) any gain or loss resulting from pension terminations, settlements or curtailments;
- (h) any unusual charges for employee severance;
- (i) adjustments to the value of assets or liabilities resulting from changes in GAAP;
- (j) unrealized gains or losses on investments, including “other than temporary” declines in Book Value;
- (k) gains or losses resulting from changes in valuation of any hedging, derivative, interest rate exchange or similar contract, including, without limitation, any Financial Products Agreement;
- (l) any Financial Product Extraordinary Payments, Financial Product Extraordinary Receipts, or similar payments on any hedging, derivative, interest rate exchange or similar contract that does not constitute a Financial Products Agreement;
- (m) unrealized gains or losses from the write-down, reappraisal or revaluation of assets;
- (n) changes in the share value of investment pools held or managed by Stanford University; or

(o) other nonrecurring items of any extraordinary nature which do not involve the receipt, expenditure or transfer of assets.

Indebtedness means any Guaranty (other than any Guaranty by any Obligated Group Member of Indebtedness of any other Obligated Group Member) and any obligation of any Obligated Group Member (1) for repayment of borrowed money, (2) with respect to finance leases or (3) under installment sale agreements; provided, however, that if more than one Obligated Group Member shall have incurred or assumed a Guaranty of a Person other than an Obligated Group Member, or if more than one Obligated Group Member shall be obligated to pay any obligation, for purposes of any computations or calculations under the Master Indenture, such Guaranty or obligation shall be included only one time. Financial Products Agreements and physician income guaranties shall not constitute Indebtedness.

Indenture means the Indenture, as originally executed or as it may from time to time be supplemented, modified or amended by any Supplemental Indenture.

Independent Consultant means a firm (but not an individual) which (1) is in fact independent, (2) does not have any direct financial interest or any material indirect financial interest in any Obligated Group Member (other than the agreement pursuant to which such firm is retained), (3) is not connected with any Obligated Group Member as an officer, employee, promoter, trustee, partner, director or person performing similar functions and (4) is qualified to pass upon questions relating to the financial affairs of organizations similar to the Obligated Group or facilities of the type or types operated by the Obligated Group and having the skill and experience necessary to render the particular opinion or report required by the provision hereof in which such requirement appears.

Industry Restrictions means federal, state or other applicable governmental laws or regulations, including conditions imposed specifically on the Obligated Group Members or the Obligated Group Members' facilities, or general industry standards or general industry conditions placing restrictions and limitations on the rates, fees and charges to be fixed, charged and collected by the Obligated Group Members.

Insurance Consultant means a Person or firm (which may be an insurance broker or agent of an Obligated Group Member) which (1) is in fact independent, (2) does not have any direct financial interest or any material indirect financial interest in any Obligated Group Member (other than the agreement pursuant to which such Person or firm is retained) and (3) is not connected with any Obligated Group Member as an officer, employee, promoter, underwriter, trustee, partner, director or Person performing similar functions, and designated by the Obligated Group Representative, qualified to survey risks and to recommend insurance coverage for hospitals, health-related facilities and services and organizations engaged in such operations.

Interest Fund means the fund by that name established pursuant to the provisions of the Indenture.

Interest Payment Date means May 15 and November 15 of each year, commencing on the date set forth on the cover page of the Offering Memorandum.

Investment Securities means any of the following:

- (1) United States Government Obligations;
- (2) Obligations of any of the following federal agencies which obligations represent the full faith and credit of the United States of America: (a) Export-Import Bank; (b) Rural Economic Community Development Administration; (c) U.S. Maritime Administration; (d) Small Business Administration; (e) U.S. Department of Housing & Urban Development (PHAs); (f) Federal Housing Administration; and (g) Federal Financing Bank;
- (3) Direct obligations of any of the following federal agencies which obligations are not fully guaranteed by the full faith and credit of the United States of America: (a) senior debt obligations issued by the Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC); (b) obligations of the Resolution Funding Corporation (REFCORP); and (c) senior debt obligations of the Federal Home Loan Bank System;

(4) U.S. dollar denominated deposit accounts, including bank deposit products, trust funds, trust accounts, time deposits, overnight bank deposits, interest bearing deposits, interest bearing money market accounts, certificates of deposit (including those placed by a third party pursuant to an agreement between the Trustee and the Corporation), federal fund and bankers' acceptances with domestic commercial banks (including the Trustee or any of its affiliates) (i) which have a rating on their short term certificates of deposit on the date of purchase of "P-1" by Moody's and "A-1" or "A-1+" by S&P and maturing not more than three hundred sixty (360) calendar days after the date of purchase or (ii) are insured by the Federal Deposit Insurance Corporation;

(5) Commercial paper which is rated at the time of purchase in the single highest classification, "P-1" by Moody's and "A-1" or "A-1+" by S&P and which matures not more than two hundred seventy (270) calendar days after the date of purchase;

(6) Investments in money market mutual funds rated "AAAm" or "AAm-G" or better by S&P or having a rating in the highest investment category granted thereby from Moody's, including, without limitation any mutual fund for which the Trustee or an affiliate of the Trustee serves as investment manager, administrator, shareholder servicing agent, and/or custodian or subcustodian, notwithstanding that (i) the Trustee or an affiliate of the Trustee receives and retains fees from money market funds for services rendered to such funds, (ii) the Trustee collects fees for services rendered pursuant to the Indenture, which fees are separate from the fees received from such money market funds, and (iii) services performed for such money market funds and pursuant to the Indenture may at times duplicate those provided to such money market funds by the Trustee or an affiliate of the Trustee;

(7) Pre-refunded municipal obligations defined as any bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice; and (a) which are rated, based on irrevocable escrow account or fund (the "escrow"), in the highest Rating Category of Moody's or S&P or any successors thereto; or (b) (i) which are fully secured as to principal and interest and redemption premium, if any, by an escrow consisting only of cash or United States Government Obligations, which escrow may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, and (ii) which escrow is sufficient, as verified by an independent certified public accountant, to pay principal of and interest and redemption premium, if any, on the bonds or other obligations described in this paragraph on the maturity date or dates specified in the irrevocable instructions referred to above, as appropriate;

(8) Municipal obligations rated "Aaa/AAA" or general obligations of states of the United States of America with a rating of "A2/A" or higher by both Moody's and S&P; and

(9) Investment agreements with any financial institution that at the time of investment has long-term obligations rated in one of the three highest Rating Categories by each Rating Agency then rating both the Bonds and such obligations (but in all cases by at least one Rating Agency then rating the Bonds).

Irrevocable Deposit means an irrevocable deposit in trust of cash in an amount, or Government Obligations, or other securities permitted for such purpose pursuant to the terms of the documents governing the payment of or discharge of Indebtedness, the principal of and interest on which will be in an amount sufficient to pay all or a portion of the principal of, premium, if any, and interest on, any such Indebtedness (which would otherwise be considered Outstanding) as the same shall become due. The trustee of such deposit may be the Master Trustee, a Related Bond Trustee or any other trustee or escrow agent authorized to act in such capacity.

Issue Date means the date of original delivery of the Bonds.

Lease means that certain Ground Lease (Hospital Campus) and that certain Ground Lease (Hoover Campus), each made and entered into as of February 1, 2012, between Stanford University, as lessor, and the Corporation, as lessee, which supersede the Restatement and Assignment of Lease (Hospital and Hoover Pavilion), dated November 1, 1997, as amended by Amendment of Lease, dated March 31, 2000, among Stanford University, as lessor, the Corporation, as lessee, and UCSF Stanford Health Care, as assignee, which amended and restated that certain Lease

and License Agreement, dated as of April 20, 1984, between Stanford University, as lessor, and the Corporation, as lessee.

Lien means any mortgage or pledge of, or security interest in, or lien or encumbrance on, any Property, including Gross Revenues, of an Obligated Group Member (i) which secures any Indebtedness or any other obligation of such Obligated Group Member or (ii) which secures any obligation of any Person other than an Obligated Group Member, and excluding liens applicable to Property in which an Obligated Group Member has only a leasehold interest, unless the lien secures Indebtedness of that Obligated Group Member.

Make-Whole Redemption Price means the greater of (1) 100% of the principal amount of the Bonds to be redeemed; or (2) the sum of the present values of the remaining scheduled payments of principal and interest to the maturity date of the Bonds to be redeemed (not including any portion of those payments of interest accrued and unpaid as of the redemption date), discounted to the redemption date on a semi-annual basis assuming a 360-day year consisting of twelve 30-day months at the Treasury Rate plus 15 basis points, plus, in each case, accrued and unpaid interest on such Bonds to, but excluding, the redemption date.

Master Indenture means that certain Amended and Restated Master Indenture of Trust, dated as of June 1, 2011, which took effect on the Amended Master Indenture Effective Date, between Stanford Hospital and Clinics, currently known as Stanford Health Care, and the Master Trustee, and which amended and restated the Original Master Indenture, as originally executed and as it may from time to time be supplemented, modified or amended in accordance with the terms thereof.

Master Trustee means The Bank of New York Mellon Trust Company, N.A., a national banking association organized under the laws of the United States of America, and, subject to the limitations contained in the Master Indenture, any other corporation or association that may be co-trustee with the Master Trustee, and any successor or successors to said trustee or co-trustee in the trusts created under the Master Indenture.

Maximum Annual Debt Service means the greatest amount of Annual Debt Service becoming due and payable in any Fiscal Year including the Fiscal Year in which the calculation is made or any subsequent Fiscal Year; provided, however that for the purposes of computing Maximum Annual Debt Service:

(a) with respect to a Guaranty, there shall be included in the calculation of Annual Debt Service a percentage of the Annual Debt Service (calculated as if such Person were a Obligated Group Member) guaranteed by the Obligated Group Members under the Guaranty, based on the ratio of Income Available for Debt Service of the Person whose indebtedness is guaranteed by the Obligated Group Member (calculated as if such Person were a Obligated Group Member), over the Maximum Annual Debt Service of such Person (calculated as if such Person were a Obligated Group Member) (such ratio being hereinafter referred to as the “Ratio”). If the Ratio is greater than 2.00, no Annual Debt Service on the indebtedness guaranteed shall be included in the calculation of Annual Debt Service. If the Ratio is equal to or less than 2.0, twenty percent (20%) of Annual Debt Service on the indebtedness guaranteed shall be included in the calculation of Annual Debt Service; provided however, that if the indebtedness guaranteed shall be in default, one hundred percent (100%) of such indebtedness shall be included in the calculation of Annual Debt Service until such time as either the default is cured, the indebtedness guaranteed is repaid or the Guaranty is terminated.

(b) if interest on Long-Term Indebtedness is payable pursuant to a variable interest rate formula (or if Financial Product Payments or Financial Product Receipts are determined pursuant to a variable rate formula), the interest rate on such Long-Term Indebtedness (or the variable rate formula for such Financial Product Payments or Financial Product Receipts) for periods when the actual interest rate cannot yet be determined shall be assumed to be equal to (i) if such Long-Term Indebtedness (or Financial Products Agreement) was Outstanding during the twelve (12) calendar months immediately preceding the date of calculation, an average of the interest rates per annum which were in effect for such period, and (ii) if such Long-Term Indebtedness (or Financial Products Agreement) was not Outstanding during the twelve (12) calendar months immediately preceding the date of calculation, at the election of the Obligated Group Representative, either (x) an average of the SIFMA Swap Index during the twelve (12) calendar months immediately preceding the date of calculation or (y) an average of the interest rates per annum which would have been in effect for any twelve (12) consecutive calendar months during the eighteen (18) calendar months immediately preceding the date of calculation, as specified in a Certificate of the Obligated Group Representative or,

at the sole option of the Obligated Group Representative, such interest rate as shall be specified in a written statement from an investment banking or financial advisory firm selected by the Obligated Group Representative.

(c) debt service on Long-Term Indebtedness incurred to finance capital improvements shall be included in the calculation of Maximum Annual Debt Service only in proportion to the amount of interest on such Long-Term Indebtedness which is payable in the then-current Fiscal Year from sources other than proceeds of such Long-Term Indebtedness held by a trustee or escrow agent for such purpose (excluding any funds held on deposit in a debt service reserve fund established in connection with such Long-Term Indebtedness);

(d) with respect to Balloon Indebtedness, such Balloon Indebtedness shall be treated, at the sole option of the Obligated Group Representative, as Long-Term Indebtedness bearing interest at an interest rate equal to either a fixed rate equal to the Thirty-Year Revenue Bond Index most recently published in The Bond Buyer prior to the date of calculation or (ii) such interest rate as shall be specified in a written statement from an investment banking or financial advisory firm selected by the Obligated Group Representative, and (x) with substantially level debt service over a period of up to thirty (30) years (which period shall be designated by the Obligated Group Representative) from the date of calculation, or (y) with the debt service being interest only for a designated period of years and then substantially level debt service over a designated period of years (each of which periods shall be designated by the Obligated Group Representative), provided that such periods shall not aggregate in excess of thirty (30) years (by way of example, Annual Debt Service on Balloon Indebtedness could be designated by the Obligated Group Representative to be treated as interest only for twenty-five (25) years and as level payments of principal and interest for the next five (5) years); and

(e) debt service on Commercial Paper Indebtedness shall be treated in the same manner as interest on Long-Term Indebtedness payable pursuant to a variable interest rate formula as provided in clause (b) above.

Member means the Corporation and each other Person that is then obligated as a Member under and as defined in the Master Indenture.

Merger Transaction shall have the meaning specified in the provisions of the Master Indenture and described under the caption “Master Indenture - Covenants - Merger, Consolidation, Sale or Conveyance.”

Moody’s means Moody’s Investors Service, a corporation organized and existing under the laws of the State of Delaware, its successors and their assigns, or, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated by the Corporation by notice to the Trustee.

Nonrecourse Indebtedness means any Indebtedness which is not a general obligation and which is secured by a Lien on Property, Plant and Equipment acquired or constructed with the proceeds of such Indebtedness, liability for which is effectively limited to the Property, Plant and Equipment subject to such Lien, with no recourse, directly or indirectly, to any other Property of any Obligated Group Member or to any Obligated Group Member.

Obligated Group means the Corporation and each other Person which becomes a Member of, and has not withdrawn from, the Obligated Group, in each case pursuant to the terms of the Master Indenture.

Obligated Group Member means the Corporation and each other Person that is then obligated as a Member under and as defined in the Master Indenture.

Obligated Group Representative means the Corporation or such other Obligated Group Member (or Obligated Group Members acting jointly) as may have been designated pursuant to written notice to the Master Trustee executed by the Corporation.

Obligation means any obligation of the Obligated Group, including the Existing Obligations, issued pursuant to the provisions of the Master Indenture, as a joint and several obligation of each Obligated Group Member, which may be in any form set forth in a Related Supplement, including, but not limited to, bonds, notes, obligations, debentures, reimbursement agreements, loan agreements, Financial Products Agreements or leases. Reference to a

Series of Obligations or to Obligations of a Series means Obligations or a Series of Obligations issued pursuant to a single Related Supplement.

Obligation No. 40 means the obligation issued by the Corporation pursuant to the Master Indenture and Supplement No. 40.

Officer's Certificate means a certificate signed by an Authorized Representative of the Obligated Group Representative.

Offering Memorandum means, the Offering Memorandum, dated January 9, 2018, relating to, and used in connection with the sale of, the Bonds, including all appendices thereto.

Opinion of Bond Counsel means a written opinion signed by an attorney or firm of attorneys experienced in the field of public finance whose opinions are generally accepted by purchasers of bonds issued by or on behalf of a Government Issuer.

Opinion of Counsel means, for purposes of the Master Indenture, a written opinion signed by a reputable and qualified attorney or firm of attorneys who may be counsel for the Obligated Group Representative.

Opinion of Counsel means, for purposes of the Indenture, a written opinion of counsel (who may be counsel for the Trustee or the Corporation), selected by the Corporation and acceptable to the Trustee.

Optional Redemption Account means the account by that name in the Redemption Fund established pursuant to the provisions of the Indenture.

Original Master Indenture means that certain Master Indenture of Trust, dated as of December 1, 1990, as supplemented and amended to the Amended Master Indenture Effective Date, between Stanford University Hospital, currently known as Stanford Health Care, and First Interstate Bank, LTD., predecessor master trustee to BNY Western Trust Company, predecessor-in-interest to The Bank of New York Mellon Trust Company, N.A., formerly known as The Bank of New York Trust Company, N.A., as master trustee.

Outstanding, when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture relating to disqualified Bonds) all Bonds theretofore, or thereupon being, authenticated and delivered by the Trustee under the Indenture except: (1) Bonds theretofore cancelled by the Trustee or surrendered to the Trustee for cancellation; (2) Bonds with respect to which all liability shall have been discharged in accordance with the discharge provisions of the Indenture; (3) Bonds for the transfer or exchange of or in lieu of or in substitution for which other Bonds shall have been authenticated and delivered by the Trustee pursuant to the Indenture; and (4) Bonds paid pursuant to the provisions of the Indenture relating to mutilated, lost, destroyed or stolen Bonds.

Outstanding, when used with reference to Indebtedness or Obligations, means, as of any date of determination, all Indebtedness or Obligations theretofore issued or incurred and not paid and discharged other than (1) Obligations theretofore cancelled by the Master Trustee or delivered to the Master Trustee for cancellation or otherwise deemed paid in accordance with the terms hereof, including, without limitation, Obligations securing Related Bonds which have been defeased pursuant to their terms, (2) Obligations in lieu of which other Obligations have been authenticated and delivered or which have been paid pursuant to the provisions of a Related Supplement regarding mutilated, destroyed, lost or stolen Obligations unless proof satisfactory to the Master Trustee has been received that any such Obligation is held by a bona fide purchaser, (3) any Obligation held by any Obligated Group Member, (4) Indebtedness deemed paid and no longer outstanding pursuant to the terms thereof, and (5) Indebtedness for which there has been an Irrevocable Deposit, but only to the extent that payment of debt service on such Indebtedness is payable from such Irrevocable Deposit; provided, however, that if two or more obligations which constitute Indebtedness represent the same underlying obligation (as when an Obligation secures an issue of Related Bonds and another Obligation secures repayment obligations to a bank under a letter of credit which secures such Related Bonds) for purposes of calculating compliance with the various financial covenants contained in the Master Indenture, but only for such purposes, only one of such Obligations shall be deemed Outstanding and the Obligation

so deemed to be Outstanding shall be that Obligation which produces the greatest amount of Annual Debt Service to be included in the calculation of such covenants.

Parity Financial Product Extraordinary Payments means Existing Parity Financial Product Extraordinary Payments and Financial Product Extraordinary Payments that: (i) are with respect to a Financial Products Agreement secured or evidenced by an Obligation; and (ii) have been specified to be payable on a parity with Financial Product Payments in the Related Supplement authorizing the issuance of such Obligation.

Par Call Date means May 15, 2048.

Participating Underwriter means any of the original underwriters of the Bonds required to comply with the Rule in connection with offering of the Bonds.

Permitted Liens means and includes:

(a) Any judgment lien or notice of pending action against any Obligated Group Member so long as the judgment or pending action is being contested and execution thereon is stayed or while the period for responsive pleading has not lapsed;

(b) (i) Rights reserved to or vested in any municipality or public authority by the terms of any right, power, franchise, grant, license, permit or provision of law, affecting any Property, to (A) terminate such right, power, franchise, grant, license or permit, provided that the exercise of such right would not materially impair the use of such Property or materially and adversely affect the Value thereof, or (B) purchase, condemn, appropriate or recapture, or designate a purchase of, such Property; (ii) any liens on any Property for taxes, assessments, levies, fees, water and sewer charges, and other governmental and similar charges and any liens of mechanics, materialmen, laborers, suppliers or vendors for work or services performed or materials furnished in connection with such Property, which are not due and payable or which are not delinquent, or the amount or validity of which are being contested and execution thereon is stayed or, with respect to liens of mechanics, materialmen and laborers, have been due and payable or which are not delinquent, or the amount or validity of which are being contested and execution thereon is stayed or, with respect to liens of mechanics, materialmen and laborers, have been due for less than sixty (60) days or for which a bond has been furnished; (iii) easements, rights-of-way, servitudes, restrictions and other minor defects, encumbrances, and irregularities in the title to any Property which do not materially impair the use of such Property or materially and adversely affect the Value thereof; and (iv) rights reserved to or vested in any municipality or public authority to control or regulate any Property or to use such Property in any manner, which rights do not materially impair the use of such Property in any manner, or materially and adversely affect the Value thereof;

(c) Any Lien in favor of the Master Trustee securing all Outstanding Obligations equally and ratably;

(d) Liens arising by reason of good faith deposits with any Obligated Group Member in connection with leases of real estate, bids or contracts (other than contracts for the payment of money), deposits by any Obligated Group Member to secure public or statutory obligations, or to secure, or in lieu of, surety, stay or appeal bonds, and deposits as security for the payment of taxes or assessments or other similar charges;

(e) Any Lien arising by reason of deposits with, or the giving of any form of security to, any governmental agency or any body created or approved by law or governmental regulation as a condition to the transaction of any business or the exercise of any privilege or license, or to enable any Obligated Group Member to maintain self-insurance or to participate in any funds established to cover any insurance risks or in connection with workers' compensation, unemployment insurance, pension or profit sharing plans or other similar social security plans, or to share in the privileges or benefits required for companies participating in such arrangements;

(f) Any Lien arising by reason of any escrow or reserve fund established to pay debt service with respect to Indebtedness;

(g) Any Lien in favor of a trustee on the proceeds of Indebtedness prior to the application of such proceeds;

- (h) Liens on moneys deposited by patients or others with any Obligated Group Member as security for or as prepayment for the cost of patient care;
- (i) Liens on Property received by any Obligated Group Member through gifts, grants, bequests or research grants, such Liens being due to restrictions on such gifts, grants, bequests or research grants or the income thereon, up to the Fair Market Value of such Property;
- (j) Rights of the United States of America, including, without limitation, the Federal Emergency Management Agency ("FEMA"), or the State of California, including without limitation the California Emergency Management Agency, by reason of FEMA and other federal and State of California funds made available to any Member of the Obligated Group under federal or State of California statutes;
- (k) Liens on Property securing Indebtedness incurred to refinance Indebtedness previously secured by a Lien on such Property, provided that the aggregate principal amount of such new Indebtedness does not exceed the aggregate principal amount of such refinanced Indebtedness;
- (l) Liens granted by an Obligated Group Member to another Obligated Group Member;
- (m) Liens securing Nonrecourse Indebtedness incurred pursuant to the provisions hereof;
- (n) Liens consisting of purchase money security interests (as defined in the UCC) and lessors' interest in capitalized leases;
- (o) Liens on the Obligated Group Members' accounts receivable, provided that at the time of creation of such Lien, the Indebtedness secured by any such Lien shall not exceed thirty percent (30%) of the Obligated Group Members' net accounts receivable as shown on the most recent Financial Statements available at the time of incurrence of the Indebtedness to be secured by such Lien, and provided further that no more than thirty percent (30%) of the Obligated Group Members' net accounts receivable can be utilized for such securitization;
- (p) Liens on revenues constituting rentals in connection with any other Lien permitted under the Master Indenture on the Property from which such rentals are derived;
- (q) The lease or license of the use of a part of an Obligated Group Member's facilities for use in performing professional or other services necessary for the proper and economical operation of such facilities in accordance with customary business practices in the industry;
- (r) Liens on Property due to rights of third party payors for recoupment of excess reimbursement amounts paid to any Obligated Group Member;
- (s) Liens on real property constituting Property not necessary for the delivery of patient care by any Obligated Group Member;
- (t) Liens securing the interest of a vendor or lessor under any conditional sale agreement, capital lease or other title agreement;
- (u) Liens in favor of banking or other depository institutions arising as a matter of law encumbering the deposits of any Obligated Group Member held in the ordinary course of business by such banking institution (including any right of setoff or statutory bankers' liens) so long as such deposit account is not established or maintained for the purpose of providing such Lien, right of setoff or bankers' lien;
- (v) Rights of tenants under leases or rental agreements pertaining to Property, Plant and Equipment owned by any Obligated Group Member so long as the lease arrangement is in the ordinary course of business of such Obligated Group Member;

(w) Deposits of Property by any Obligated Group Member to meet regulatory requirements for a governmental workers' compensation, unemployment insurance or social security program, other than any Lien imposed by ERISA;

(x) Deposits to secure the performance of another party with respect to a bid, trade contract, statutory obligation, surety bond, appeal bond, performance bond or lease (other than a lease that is treated as Indebtedness under GAAP), and other similar obligations incurred in the ordinary course of business of an Obligated Group Member;

(y) Liens resulting from deposits to secure bids from or the performance of another party with respect to contracts incurred in the ordinary course of business of an Obligated Group Member (other than contracts creating or evidencing an extension of credit to the depositor or otherwise for the payment of Indebtedness);

(z) Present or future zoning laws, ordinances or other laws or regulations restricting the occupancy, use or enjoyment of Property, Plant and Equipment of any Obligated Group Member which, in the aggregate, are not substantial in amount, and which do not in any case materially impair the Fair Market Value or use of such Property, Plant and Equipment for the purposes for which it is used or could reasonably be expected to be held or used;

(aa) Liens junior to Liens in favor of the Master Trustee;

(bb) Liens created on amounts deposited by an Obligated Group Member pursuant to a security annex or similar document to collateralize obligations of such Obligated Group Member under a Financial Products Agreement;

(cc) Liens or encumbrances contemplated by or created in connection with or arising out of the Lease; and

(dd) Any other Lien on Property, provided that at the time of creation of such Lien the Value of all Property encumbered by all Liens permitted as described in this clause (dd) does not exceed twenty-five percent (25%) of the total Value of all Property of the Obligated Group Members as shown on the Financial Statements of the Obligated Group for the most recent Fiscal Year available at the time of creation of such Lien.

Person means an individual, association, corporation, firm, limited liability company, partnership, trust or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

Primary Treasury Dealer means one or more entities appointed by the Corporation, which, in each case, is a primary U.S. Government securities dealer in The City of New York, New York, and its or their respective successors.

Primary Treasury Dealer Quotations means, with respect to each Primary Treasury Dealer and any redemption date, the average, as determined by the Designated Investment Banker, of the bid and ask prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Designated Investment Banker by such Primary Treasury Dealer at 3:30 p.m. New York time on the third Business Day preceding such redemption date.

Principal Fund means the fund by that name established pursuant to the provisions of the Indenture.

Principal Office means, solely with respect to the surrender of Bonds for payment, transfer, or exchange, such office as is designated by the Trustee, and for all other purposes, the corporate trust office of the Trustee located at 400 South Hope Street, Suite 500, Los Angeles, California 90071, Attention: Corporate Trust or such other or additional offices as may be designated by the Trustee from time to time; provided, however, that for purposes of the presentation of Bonds for payment, transfer or exchange, the Principal Office shall be the Trustee's designated corporate trust agency or operations office.

Principal Payment Date means, with respect to a Bond, the date on which principal evidenced by such Bond becomes due and payable, whether at maturity, upon redemption, by declaration of acceleration or otherwise.

Prior Project means the acute care hospital facilities and related health care facilities owned and operated by the Corporation being refinanced by the Bonds, as more fully described in the Indenture.

Property means any and all rights, titles and interests in and to any and all assets of any Obligated Group Member, whether real or personal, tangible or intangible and wherever situated.

Property, Plant and Equipment means all Property of any Obligated Group Member which is considered property, plant and equipment of such Obligated Group Member under GAAP.

Qualified Provider means any financial institution or insurance company or corporation which is a party to a Financial Products Agreement if (i) the unsecured long-term debt obligations of such provider (or of the parent or a subsidiary of such provider if such parent or subsidiary guarantees or otherwise assures the performance of such provider under such Financial Products Agreement), or (ii) obligations secured or supported by a letter of credit, contract, guarantee, agreement, insurance policy or surety bond issued by such provider (or such guarantor or assuring parent or subsidiary) are rated in one of the three highest rating categories of a Rating Agency (without regard to any gradation or such rating category) at the time of the execution and delivery of the Financial Products Agreement.

Rating Agency means, as and to the extent applicable, any nationally recognized securities rating service, including Fitch, Moody's or S&P, then maintain a rating on the Bonds at the request, or upon application, of the Corporation.

Rating Category means a generic securities rating category, without regard to any refinement or gradation of such rating category by a numerical modifier or otherwise.

Record Date means with respect to each Interest Payment Date the first day (whether or not a Business Day) of the calendar month during which such Interest Payment Date occurs.

Redemption Fund means the fund by that name established pursuant to the provisions of the Indenture.

Redemption Price means 100% of the principal amount of the Bonds to be redeemed, plus accrued and unpaid interest on the Bonds to be redeemed to, but excluding, the redemption date.

Related Bond Indenture means any indenture, bond resolution, trust agreement, or other comparable instrument pursuant to which a series of Related Bonds are issued.

Related Bond Issuer means the Government Issuer of any issue of Related Bonds.

Related Bond Trustee means the trustee and its successors in the trusts created under any Related Bond Indenture, and if there is no such trustee, means the Related Bond Issuer.

Related Bonds means the revenue bonds or other obligations (including, without limitation, certificates of participation) issued by any Government Issuer, the proceeds of which are loaned or otherwise made available to an Obligated Group Member in consideration of the execution, authentication and delivery of an Obligation or Obligations to or for the order of such Government Issuer.

Related Supplement means an indenture supplemental to, and authorized and executed pursuant to the terms of, the Master Indenture.

Required Payment means any payment, whether at maturity, by acceleration, upon proceeding for redemption or otherwise, including without limitation, Financial Product Payments, Financial Product Extraordinary Payments, required to be made by any Obligated Group Member under the Master Indenture, any Related Supplement or any Obligation.

Responsible Officer means, with respect to the Master Trustee, the president, any vice president, any assistant vice president, any assistant secretary, any assistant treasurer, any senior associate, any associate or any other

officer of the Master Trustee customarily performing functions similar to those performed by the persons above designated or to whom any corporate trust matter is referred because of such person's knowledge of and familiarity with the particular subject.

Responsible Officer means, with respect to the Trustee, the president, any managing director, any vice president, any assistant vice president, the secretary, any assistant secretary, the treasurer, any assistant treasurer, any senior associate, any associate or any other officer of the Trustee within the Principal Office (or any successor corporate trust office) customarily performing functions similar to those performed by the persons who at the time shall be such officers, respectively, or to whom any corporate trust matter is referred at the Principal Office because of such person's knowledge of and familiarity with the particular subject and having direct responsibility for the administration of the Indenture.

Restricted Assets means any gifts, grants, bequests, donations and contributions to the extent specifically restricted by the donor to a particular purpose inconsistent with their use for the payment of Required Payments or the payment of operating expenses.

Revenues means all amounts received by the Corporation or the Trustee for the account of the Corporation pursuant or with respect to Obligation No. 40, including, without limiting the generality of the foregoing, prepayments, insurance proceeds, condemnation proceeds, and all interest, profits or other income derived from the investment of amounts in any fund or account established pursuant to the Indenture, but not including any Additional Payments or Administrative Fees and Expenses or any moneys required to be deposited to, or on deposit in, the Rebate Fund.

S&P means S&P Global Ratings, a business unit of Standard & Poor's Financial Services LLC, a corporation organized and existing under the laws of the State of New York, its successors and assigns, or, if such corporation shall be dissolved or liquidated or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated by the Corporation by notice to the Trustee.

Securities Depository means The Depository Trust Company and its successors and assigns, or any other securities depository selected as set forth in the Indenture.

Serial Bonds means Bonds, maturing by their terms in specified years, for which no Mandatory Sinking Account Payments are provided.

Short-Term Indebtedness means all (i) Indebtedness having an original maturity less than or equal to one year and not renewable at the option of an Obligated Group Member for a term greater than one year from the date of original incurrence or issuance or (ii) Indebtedness with a maturity or renewable at the option of a Obligated Group Member with a term greater than one year, if by the terms of such Indebtedness, no Indebtedness is permitted to be outstanding thereunder for a period of at least twenty (20) consecutive days during each calendar year. For purposes of this definition, (i) only the stated maturity of Indebtedness (and not any tender or put right of the holder of such Indebtedness) shall be taken into account in determining if such Indebtedness constitutes Short-Term Indebtedness under the Master Indenture and (ii) classification of Indebtedness as current or short-term under GAAP shall not be controlling. Commercial Paper Indebtedness shall not constitute Short-Term Indebtedness for any purpose under the Master Indenture.

SIFMA means the Securities Industry & Financial Markets Association.

SIFMA Swap Index means, for purposes of the Master Indenture, on any date, a rate determined on the basis of the seven-day high grade market index of tax-exempt variable rate demand obligations, as produced by Municipal Market Data and published or made available by SIFMA or any Person acting in cooperation with or under the sponsorship of SIFMA or if such index is no longer available SIFMA Swap Index shall refer to an index selected by the Obligated Group Representative, with the advice of an investment banking or financial services firm knowledgeable in health care matters.

Special Record Date means the date established by the Trustee as a record date for the payment of defaulted interest on the Bonds.

Stanford University means The Board of Trustees of the Leland Stanford Junior University, a body having corporate powers under the Constitution and laws of the State of California, and its successors and assigns.

State means the State of California.

Subordinate Financial Product Extraordinary Payment means any Financial Product Extraordinary Payment other than a Parity Financial Product Extraordinary Payment.

Subordinated Indebtedness means Indebtedness specifically subordinated as to payment and security to the payment of all Required Payments and other obligations of the Obligated Group Members under the Master Indenture.

Supplement No. 40 means that certain Supplemental Master Indenture for Obligation No. 40, dated as of January 1, 2018, between the Corporation and the Master Trustee, as originally executed and as amended or supplemented from time to time in accordance with the terms of the Master Indenture.

Supplemental Indenture means any supplemental indenture duly authorized and entered into between the Corporation and the Trustee, supplementing, modifying or amending the Indenture; but only if and to the extent that such Supplemental Indenture is specifically authorized under the Indenture.

Surviving Entity has the meaning set forth in the provisions of the Master Indenture and described under the caption “Master Indenture - Covenants - “Merger, Consolidation, Sale or Conveyance.”

Term Bonds means Bonds payable at or before their specified maturity date or dates from Mandatory Sinking Account Payments established for that purpose and calculated to retire such Bonds on or before their specified maturity date or dates.

Total Revenues means, for the period of calculation in question, the sum of operating revenue (including net patient service revenue, capitation or premium revenue and other revenue) and nonoperating gains (losses), as shown on the Financial Statements of the Obligated Group for the most recent Fiscal Year.

Transaction Test means with respect to any specified transaction, that: (i) no Event of Default or Default then exists; and (ii) following such transaction, the Obligated Group could satisfy the conditions for the issuance of \$1.00 of additional Long-Term Indebtedness set forth in the provisions of the Master Indenture described under the caption “Master Indenture - Covenants - Limitations on Indebtedness - Long-Term Indebtedness,” assuming that such transaction occurred at the start of the most recent Fiscal Year and taking into account any other transaction entered into within the then current Fiscal Year.

Treasury Rate means, with respect to any redemption date, the rate per annum equal to (i) the semiannual equivalent yield to maturity or (ii) if no such semiannual equivalent yield to maturity is available, the interpolated yield to maturity (on a day count basis) of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such redemption date.

Trustee means The Bank of New York Mellon Trust Company, N.A., a national banking association organized and existing under the laws of the United States of America, or any successor thereto, as Trustee under the Indenture, as provided in the Indenture.

UCC means the Uniform Commercial Code of the State of California, as amended from time to time.

United States Government Obligations means direct nonprepayable, noncallable obligations of the United States of America (including obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States of America) or direct nonprepayable, noncallable obligations, the timely payment of the principal of and interest on which is fully and unconditionally guaranteed by the United States of America, including instruments evidencing a direct ownership interest in securities described in this clause such as CATS, TIGRs, and Stripped Treasury Coupons rated or assessed in the highest Rating Categories by S&P and Moody's and held by a custodian for safekeeping on behalf of holders of such securities.

Value, when used with respect to Property, means the aggregate value of all such Property, with each component of such Property valued, at the option of the Obligated Group Representative, at either its Fair Market Value or its Book Value.

MASTER INDENTURE

General

The Master Indenture authorizes the issuance of Obligations by the Obligated Group. An Obligation is stated in the Master Indenture to be a joint and several obligation of each Member of the Obligated Group. The Corporation is currently the only Member of the Obligated Group.

Authorization and Issuance of Obligations

Authorization of Obligations. Pursuant to the provisions of the Master Indenture, each Obligated Group Member authorizes the issuance from time to time of Obligations or Series of Obligations, without limitation as to amount, except as provided in the Master Indenture or as may be limited by law, and subject to the terms, conditions and limitations established in the Master Indenture and in any Related Supplement.

Issuance of Obligations. From time to time when authorized by the Master Indenture and subject to the terms, limitations and conditions established in the Master Indenture or in a Related Supplement, the Obligated Group Representative may authorize the issuance of an Obligation or a Series of Obligations by entering into a Related Supplement. The Obligation or the Obligations of any such Series may be issued and delivered to the Master Trustee for authentication upon compliance with the provisions of the Master Indenture and of any Related Supplement. The Corporation has been designated as the Obligated Group Representative pursuant to the provisions of the Master Indenture.

Covenants

Payment of Required Payments. Each Obligated Group Member jointly and severally covenants, to pay or cause to be paid promptly, all Required Payments at the place, on the dates and in the manner provided in the Master Indenture, or in any Related Supplement or Obligation. Each Obligated Group Member acknowledges that the time of such payment and performance is of the essence of the Obligations under the Master Indenture. Each Obligated Group Member further covenants to faithfully observe and perform all of the conditions, covenants and requirements of the Master Indenture, any Related Supplement and any Obligation.

Maintenance of Properties; Payment of Indebtedness. Each Obligated Group Member covenants to:

(a) maintain its Property, Plant and Equipment in accordance with all valid and applicable governmental laws, ordinances, approvals and regulations including, without limitation, such zoning, sanitary, pollution and safety ordinances and laws and such rules and regulations thereunder as may be binding upon it; provided, however, that no Obligated Group Member shall be required to comply with any law, ordinance, approval or regulation as long as it shall in good faith contest the validity thereof;

(b) maintain and operate its Property, Plant and Equipment in reasonably good working condition, and from time to time make or cause to be made all needful and proper replacements, repairs and improvements so that the operations of such Obligated Group Member will not be materially impaired;

(c) pay and discharge all applicable taxes, assessments, governmental charges of any kind whatsoever, water rates, meter charges and other utility charges which may be or have been assessed or which may have become Liens upon the Property, Plant and Equipment, and will make such payments or cause such payments to be made in due time to prevent any delinquency thereon or any forfeiture or sale of any part of the Property, Plant and Equipment, and, upon request, will furnish to the Master Trustee receipts for all such payments, or other evidences satisfactory to the Master Trustee; provided, however, that no Obligated Group Member shall be required to pay any tax, assessment, rate or charge as long as it shall in good faith contest the validity thereof as set out in the definition of Permitted Liens;

(d) pay or otherwise satisfy and discharge all of its obligations and Indebtedness and all demands and claims against it as and when the same become due and payable, other than obligations, Indebtedness, demands or claims (exclusive of the Obligations issued and Outstanding under the Master Indenture) the validity, amount or collectibility of which is being contested in good faith;

(e) at all times comply with all terms, covenants and provisions of any Liens at such time existing upon its Property or any part thereof or securing any of its Indebtedness noncompliance with which would have a material adverse effect on the operations of the Obligated Group or its Property;

(f) use its best efforts to maintain (as long as it is in its best interests and will not materially adversely affect the interests of the Holders) all permits, licenses and other governmental approvals necessary for the operation of its Property; and

(g) take no action or suffer any action to be taken by others which would result in the interest on any Related Bond issued as a tax exempt obligation becoming subject to federal income taxation.

Nothing in the Master Indenture shall be construed to require an Obligated Group Member to maintain any permit, license or other governmental approval, or to continue to operate or maintain any Property, Plant or Equipment, if, in the reasonable good faith judgment of the Obligated Group Member, such permit, license, governmental approval or Property, Plant or Equipment is, or within the next succeeding 12 calendar months is reasonably expected to become, inadequate, obsolete, unsuitable, undesirable or unnecessary for the business of the Obligated Group and failure to maintain or operate such permit, license, governmental approval or Property, Plant or Equipment will not materially adversely impair the operation of the Obligated Group.

Insurance

(a) Each Obligated Group Member covenants and agrees that it will keep the Property, Plant and Equipment and all of its operations adequately insured at all times and carry and maintain such insurance in amounts which are customarily carried, subject to customary deductibles and alternative risk management programs and self-insurance, and against such risks as are customarily insured against by other health care institutions in connection with the ownership and operation of health facilities of similar character and size in the State of California.

(b) The Obligated Group Representative shall employ an Insurance Consultant at least once every two (2) years to review the insurance requirements (including alternative risk management programs and self-insurance) of the Members. If the Insurance Consultant makes recommendations for a change in the insurance coverage required by the Master Indenture, the Obligated Group Members shall change such coverage in accordance with such recommendations, subject to a good faith determination of the Governing Body of the Obligated Group Representative that such recommendations, in whole or in part, are not in the best interests of the Obligated Group Members or that such coverage is not obtainable at commercially reasonable rates. In lieu of maintaining insurance coverage which the Governing Body of the Obligated Group Representative deems necessary, the Obligated Group Members shall have the right to adopt alternative risk management programs which the Governing Body of the Obligated Group Representative determines to be reasonable and which shall not have a material adverse impact on reimbursement from third-party payers, including, without limitation, to self-insure in whole or in part individually or in connection with other institutions, to participate in programs of captive insurance companies, to participate with other health care institutions in mutual or other cooperative insurance or other risk management programs, to participate in state or federal insurance programs, to take advantage of state or federal laws now or hereafter in existence limiting medical and malpractice liability, or to establish or participate in other alternative risk management programs; all as may be approved, in writing, as reasonable and appropriate risk management by the Insurance Consultant.

(c) The Obligated Group Members shall have the right, without giving rise to an Event of Default under the Master Indenture solely on such account, (1) to maintain insurance coverage below that required by the provisions of the Master Indenture described in subsection (a) above, if the Obligated Group Representative furnishes to the Master Trustee a certificate of the Insurance Consultant that the insurance so provided accords the greatest amount of coverage available for the risk being insured against at rates which in the judgment of the Insurance Consultant are reasonable in connection with reasonable and appropriate risk management, or (2) to adopt alternative risk management and self-insurance programs in accordance with the provisions of the Master Indenture described in subsection (b) above.

Against Encumbrances. Each Obligated Group Member, respectively, covenants and agrees that it will not create, assume or suffer to exist any Lien upon the Property of the Obligated Group, except for Permitted Liens. Each Obligated Group Member, respectively, further covenants and agrees that if such a Lien (other than a Permitted Lien) is nonetheless created by someone other than an Obligated Group Member and is assumed by any Obligated Group Member, it will make or cause to be made effective a provision whereby all Obligations will be secured prior to any such Indebtedness or other obligation secured by such Lien.

Limitations on Indebtedness. Each Obligated Group Member covenants that it will not incur any Indebtedness except in accordance with the provisions of the Master Indenture described below:

(a) Long-Term Indebtedness, if prior to the date of incurrence of the Long-Term Indebtedness there is delivered to the Master Trustee an Officer's Certificate to the effect that:

(i) the Debt Service Coverage Ratio for the most recent Fiscal Year for which Financial Statements are available with respect to all Long-Term Indebtedness then Outstanding at the time of such certification and the additional Long-Term Indebtedness to be incurred, but excluding any Long-Term Indebtedness to be refunded with the proceeds of said additional Long-Term Indebtedness to be incurred, was not less than 1.2:1.0;

(ii) the Debt Service Coverage Ratio for the most recent Fiscal Year for which Financial Statements are available was not less than 1.2:1.0 and (ii) the Debt Service Coverage Ratio for each of the two (2) Fiscal Years beginning with the Fiscal Year commencing after the estimated completion of the construction, acquisition or equipping of Property to be financed by such Indebtedness (or, if the proceeds of such Indebtedness are not to be used for the construction, acquisition or equipping of Property, each of the two (2) Fiscal Years beginning with the Fiscal Year commencing after the incurrence of such Indebtedness) with respect to all Long-Term Indebtedness projected to be Outstanding (including the additional Long-Term Indebtedness to be incurred, but excluding any Long-Term Indebtedness to be refunded with the proceeds of said additional Long-Term Indebtedness to be incurred), is projected by the Obligated Group Representative to be not less than 1.25:1.0. Notwithstanding the foregoing, if the Master Trustee receives a report of an Independent Consultant to the effect that Industry Restrictions prevent the Obligated Group Members from generating the required levels of Income Available for Debt Service sufficient to result in a Debt Service Coverage Ratio of not less than 1.25:1.0, the 1.25:1.0 ratio requirement described in this subsection shall be reduced to a ratio of not less than 1.0:1.0; or

(iii) any other Long-Term Indebtedness (including, without limitation, Commercial Paper Indebtedness, treating the amount of Commercial Paper Indebtedness being incurred or Outstanding, as the case may be, as the principal amount for purposes of any calculations made to demonstrate compliance with the provisions of the Master Indenture described under this caption) provided that the aggregate principal amount of such Long-Term Indebtedness, together with any other Long-Term Indebtedness incurred pursuant to the provisions of the Master Indenture described in this clause (3) and then Outstanding, does not, as of the date of incurrence, exceed 10% of Total Revenues.

(b) Completion Indebtedness without limitation;

(c) Short-Term Indebtedness provided that either (i) the provisions of the Master Indenture described in subsection (a) above are satisfied calculated as if such Short-Term Indebtedness was Long-Term Indebtedness or

(ii) the provisions of the Master Indenture described below are satisfied, in either case, as evidenced by an Officer's Certificate delivered to the Master Trustee:

(i) the total amount of such Short-Term Indebtedness shall not exceed 20% of Total Revenues;
and

(ii) the total amount of such Short-Term Indebtedness and Indebtedness incurred pursuant to the provision of the Master Indenture described below in clause (g) then Outstanding shall not exceed 25% of Total Revenues; and

(iii) in every Fiscal Year, there shall be at least a consecutive 20 day period when the balances of such Short-Term Indebtedness is reduced to an amount which shall not exceed 5% of Total Revenues.

(d) Nonrecourse Indebtedness without limitation.

(e) Long-Term Indebtedness, if such Long-Term Indebtedness is issued or incurred to refund Long-Term Indebtedness and if prior to issuance or incurrence thereof there is delivered to the Master Trustee a resolution of the Governing Body of the Obligated Group Representative determining that such refunding is in the best interests of the Obligated Group, which resolution shall also state the reasons for such determination.

(f) Subordinated Indebtedness, without limitation.

(g) Any other Indebtedness, provided that the aggregate principal amount of such Indebtedness, together with the aggregate principal amount of Indebtedness incurred pursuant to the provisions of the Master Indenture described in subsection (c) above, does not, as of the date of incurrence, exceed 25% of Total Revenues.

(h) Reimbursement or other repayment obligations under reimbursement agreements or similar agreements relating to credit facilities and/or liquidity facilities which provide credit support and/or liquidity for Indebtedness.

Gross Revenue Fund

(a) Each Obligated Group Member agrees that, as long as any of the Obligations remain Outstanding, all of the Gross Revenues shall be deposited as soon as practicable upon receipt in one or more deposit accounts designated as the "Gross Revenue Fund" which the Obligated Group Representative established and agreed to maintain pursuant to the provisions of the Original Master Indenture, subject to the provisions of the Master Indenture described in subsection (b) below, at such financial institution or institutions as the Obligated Group Representative shall from time to time designate, in writing, for such purpose (each, a "Depository Bank" and in the Master Indenture collectively called the "Depository Bank") and which has entered into an Account Control Agreement with the Obligated Group Members and the Master Trustee. As security for the payment of Required Payments and the performance by each Obligated Group Member of its other obligations under the Master Indenture, each Obligated Group Member pledges and assigns to the Master Trustee and grants to the Master Trustee a security interest in, all its right, title and interest, whether now owned or hereafter acquired, in and to all Collateral, including Gross Revenues and the Gross Revenue Fund. Each of the Obligated Group Members has executed or shall execute an Account Control Agreement, has executed or shall execute and cause to be filed Uniform Commercial Code financing statements, and has executed or shall execute and deliver such other documents (including, but not limited to, amendments to such Uniform Commercial Code financing statements) as may be necessary in order to perfect or maintain the perfection of such security interest. Each Obligated Group Member authorizes the Master Trustee to execute and file any financing statements and amendments thereto as may be required to perfect or to continue the perfection of the security interest in the Collateral, including, without limitation, financing statements that describe the collateral as being of an equal, greater or lesser scope, or with greater or lesser detail, than as set forth in the definition of Collateral. Each Obligated Group Member covenants that it will not change its name or its type or jurisdiction of organization unless (i) it gives thirty (30) days' notice of such change to the Master Trustee and (ii) before such change occurs it takes all actions as are necessary or advisable to maintain and continue the first priority perfected security interest of the Master Trustee in the Collateral.

(b) Gross Revenues and amounts in the Gross Revenue Fund may be used and withdrawn by each Obligated Group Member at any time for any lawful purpose, except as otherwise provided in the Master Indenture. In the event that any Obligated Group Member is delinquent for more than one (1) Business Day in the payment of any Required Payment, the Master Trustee shall notify the Obligated Group Representative of such delinquency, and, unless such Required Payment is paid within ten (10) days after receipt of such notice, the Master Trustee shall be entitled to deliver an Order (as such term is defined in the Account Control Agreement) to the Depository Bank. Upon delivery of the Order with respect to the Gross Revenue Fund, exclusive control over the Gross Revenue Fund shall be exercised by the Master Trustee as provided in the Account Control Agreement. All Gross Revenues shall continue to be deposited in the Gross Revenue Fund as provided pursuant to the provisions of the Master Indenture described in subsection (a) above and the Master Trustee shall continue to exercise exclusive control over the Gross Revenue Fund until the amounts on deposit in said Gross Revenue Fund are sufficient to pay in full (or have been used to pay in full) all Required Payments in default and until all other then-existing Events of Default known to the Master Trustee shall have been made good or cured to the satisfaction of the Master Trustee or provision deemed by the Master Trustee to be adequate shall have been made therefor. During any period that the Gross Revenue Fund is subject to the exclusive control of the Master Trustee, the Master Trustee shall use and withdraw from time to time amounts in said fund, to make Required Payments as such payments become due (whether by maturity, prepayment, redemption, acceleration or otherwise), and, if such amounts shall not be sufficient to pay in full all such payments due on any date, then to the payment of debt service on Obligations, ratably, without any discrimination or preference, and to such other payments in the order which the Master Trustee, in its discretion, shall determine to be in the best interests of the Holders of the Obligations, without discrimination or preference. During any period that the Gross Revenue Fund is subject to the exclusive control of the Master Trustee, no Obligated Group Member shall be entitled to use or withdraw any of the Gross Revenues unless (and then only to the extent that) the Master Trustee in its sole discretion so directs for the payment of current or past due operating expenses of such Obligated Group Member; provided, however, that Obligated Group Members may submit requests to the Master Trustee as to which expenses to pay and in which order. Each Obligated Group Member agrees to execute and deliver all instruments as may be required to implement by the Master Indenture. Each Obligated Group Member further agrees that a failure to comply with the terms of the Master Indenture shall cause irreparable harm to the Master Trustee from time to time of the Obligations, and shall entitle the Master Trustee, with or without notice to the Obligated Group Representative, to take immediate action to compel the specific performance of the obligations of each of the Obligated Group Members pursuant to the provisions of the Master Indenture described under this caption.

(c) Upon receipt of Gross Revenues, each Obligated Group Member covenants and agrees: (i) to deposit all Gross Revenues in the Gross Revenue Fund and not in any other fund or account; (ii) that the Gross Revenue Fund will be held as a deposit at the Depository Bank; and (iii) that the Gross Revenue Fund will not be moved from the Depository Bank without the prior written consent of the Master Trustee, which consent shall not be unreasonably withheld.

Notwithstanding any other provision of the Master Indenture, the Gross Revenue Fund may consist of any number of deposit accounts provided that each such deposit account shall be established at a Depository Bank which has entered into an Account Control Agreement with the Master Trustee and one or more Obligated Group Members.

Debt Coverage

(a) Each Obligated Group Member, respectively, further covenants and agrees to manage its operations such that Income Available for Debt Service for the Obligated Group calculated at the end of each Fiscal Year will be not less than 1.10 times Maximum Annual Debt Service.

(b) Within 5 months after the end of each Fiscal Year, the Obligated Group Representative shall compute the Debt Service Coverage Ratio for the Obligated Group for such Fiscal Year and furnish to the Master Trustee an Officer's Certificate setting forth the results of such computation. The Obligated Group Representative covenants that if at the end of such Fiscal Year the Debt Service Coverage Ratio shall have been less than 1.1:1.0, it will promptly employ an Independent Consultant to make recommendations as to a revision of the rates, fees and charges of the Obligated Group or the methods of operation of the Obligated Group to increase the Debt Service Coverage Ratio to at least 1.1:1.0 for subsequent Fiscal Years (or, if in the opinion of the Independent Consultant, the attainment of such level is impracticable, to the highest practicable level). Copies of the recommendations of the Independent Consultant shall be filed with the Master Trustee within ninety (90) days of the retention of the

Independent Consultant. Each Obligated Group Member shall, promptly upon its receipt of such recommendations, subject to applicable requirements or restrictions imposed by law and to a good faith determination by the Governing Body of the Obligated Group Representative that such recommendations are in the best interest of the Obligated Group, revise its rates, fees and charges or its methods of operation or collections and shall take such other action as shall be in conformity with such recommendations.

If either (i) the Obligated Group complies in all material respects with the reasonable recommendations of the Independent Consultant with respect to their rates, fees, charges and methods of operation or collection or (ii) the Obligated Group Representative determines that such recommendations are not in the best interests of the Obligated Group (and accordingly will not be followed) as evidenced by an Officer's Certificate filed with the Master Trustee, the Obligated Group will be deemed to have complied with the covenants set forth in the Master Indenture for such Fiscal Year, notwithstanding that the Debt Service Coverage Ratio shall be less than 1.1:1.0; provided, however, that the Debt Service Coverage Ratio shall not be reduced to less than 1.0:1.0 for any Fiscal Year. Notwithstanding the foregoing, the Obligated Group Members shall not be excused from taking any action or performing any duty required under the Master Indenture and no other Event of Default shall be waived by the operation of the provisions of the Master Indenture.

(c) If a written report of an Independent Consultant is delivered to the Master Trustee stating that Industry Restrictions have made it impossible for the Debt Service Coverage Ratio of 1.1:1.0 to be met, then such ratio shall be reduced to 1.0:1.0.

(d) Notwithstanding the foregoing, an Obligated Group Member may permit the rendering of services or the use of its Property without charge or at reduced charges, at the discretion of the Governing Body of such Obligated Group Member, to the extent necessary for maintaining its tax-exempt status or the tax-exempt status of its Property, Plant and Equipment or its eligibility for grants, loans, subsidies or payments from governmental entities, or in compliance with any recommendation for free services that may be made by an Independent Consultant; provided, however, that the Debt Service Coverage Ratio shall not be reduced to a ratio of less than 1.0:1.0.

Limitation on Disposition of Assets

(a) Each Obligated Group Member covenants that it will not sell, lease or otherwise dispose of any part of its Property in any Fiscal Year (other than (i) such Property as is described in Exhibit D to the Master Indenture which may be disposed of by the Obligated Group solely upon the written consent of the Obligated Group Representative; (ii) in the ordinary course of business; or (iii) as part of a disposition of all or substantially all of its assets as permitted by the Master Indenture, with a Book Value in excess of 10% of the Book Value of the Property of the Obligated Group, unless prior to said disposition:

(i) there shall have been delivered to the Master Trustee an Officer's Certificate to the effect that such Property is or shall become within the next two (2) Fiscal Years inadequate, obsolete, unsuitable, undesirable or unnecessary for the operation and functioning of the primary business of the Obligated Group Members; or

(ii) there shall have been delivered to the Master Trustee an Officer's Certificate to the effect that the Value of the Property so disposed of by the Obligated Group Members in any Fiscal Year pursuant to the provision described in the Master Indenture does not exceed 5% of the total Value of the Property of the Obligated Group; or

(iii) there shall have been delivered to the Master Trustee an Officer's Certificate to the effect that such Property is being transferred to a Person who is not an Obligated Group Member if such Person shall become a Member pursuant to the Master Indenture substantially simultaneously with such transfer; or

(iv) there shall have been delivered to the Master Trustee an Officer's Certificate to the effect that such Property is being transferred to another Person in connection with a sale/leaseback or lease/leaseback financing transaction relating to such Property; or

(v) there shall have been delivered to the Master Trustee an Officer's Certificate to the effect that the disposition is for Fair Market Value and does not materially adversely affect the operations of the Obligated Group; or

(vi) there shall have been delivered to the Master Trustee an Officer's Certificate to the effect that the Transaction Test is satisfied.

(b) Notwithstanding the foregoing, nothing shall prohibit any disposition of assets among Obligated Group Members nor shall prohibit the Obligated Group Members from: (1) making loans, including, without limitation, employee relocation loans, physician recruitment loans or other credit/funding extensions, provided that such loans or other credit/funding extensions are in writing and the Master Trustee receives an Officer's Certificate to the effect that (x) such loans are in furtherance of the exempt purposes of the Obligated Group Members or (y) the Obligated Group Members reasonably expect such loans to be repaid and such loans bear interest at a reasonable rate of interest and on commercially reasonable terms; or (2) transferring restricted gifts for the Obligated Group Members to an Affiliated Corporation which has the purpose to receive and disburse such restricted gifts.

Merger, Consolidation, Sale or Conveyance. Each Obligated Group Member covenants that it will not merge or consolidate with any other Person that is not an Obligated Group Member or sell or convey all or substantially all of its assets to any Person that is not an Obligated Group Member (a "Merger Transaction") unless:

(a) After giving effect to the Merger Transaction, (i) the successor or surviving entity (hereinafter, the "Surviving Entity") is an Obligated Group Member, or (ii) the Surviving Entity (x) shall be a corporation or other entity organized and existing under the laws of the United States of America or any state thereof, (y) shall become an Obligated Group Member pursuant to the Master Indenture and (z) pursuant to the Related Supplement required by the Master Indenture, shall expressly assume in writing the due and punctual payment of all Required Payments of the disappearing Obligated Group Member under the Indenture;

(b) The Master Trustee receives an Officer's Certificate to the effect that the Transaction Test is satisfied in connection with the Merger Transaction;

(c) So long as any Related Bonds that are tax-exempt obligations are Outstanding, the Master Trustee receives an Opinion of Bond Counsel to the effect that, under then existing law, the consummation of the Merger Transaction, in and of itself, would not result in the inclusion of interest on such Related Bonds in gross income for purposes of federal income taxation;

(d) The Master Trustee receives an Opinion of Counsel to the effect that: (i) all conditions in the Master Indenture relating to the Merger Transaction have been complied with and the Master Trustee is authorized to join in the execution of any instrument required to be executed and delivered; (ii) the Surviving Entity meets the conditions set forth in the Master Indenture and is liable on all Obligations then Outstanding; (iii) the Merger Transaction will not adversely affect the validity of any Obligations then Outstanding and such Obligations then Outstanding are enforceable against the Surviving Entity in accordance with their respective terms; and (iv) the Merger Transaction will not cause the Master Indenture or any Obligations to be subject to registration under federal or state securities laws or the Trust Indenture Act of 1939, as amended (or, that any such registration, if required, has occurred); and

(e) The Surviving Entity shall be substituted for its predecessor in interest in all Obligations and agreements then in effect which affect or relate to any Obligation, and the Surviving Entity shall execute and deliver to the Master Trustee appropriate documents in order to effect the substitution.

From and after the effective date of such substitution (as set forth in the above-mentioned documents), the Surviving Entity shall be treated as though it were an Obligated Group Member as of the date of the execution of the Master Indenture and shall thereafter have the right to participate in transactions under the Master Indenture relating to Obligations to the same extent as the other Obligated Group Members. All Obligations issued under the Master Indenture on behalf of a Surviving Entity shall have the same legal rank and benefit under the Master Indenture as Obligations issued on behalf of any other Obligated Group Member.

Preparation and Filing of Financial Statements, Certificates and Other Information

(a) Each Obligated Group Member covenants that it will keep adequate records and books of accounts in which complete and correct entries shall be made (said books shall be subject to the inspection by the Master Trustee (which inspection the Master Trustee is not required to make) during regular business hours after reasonable notice and under reasonable circumstances).

(b) The Obligated Group Representative covenants that it will furnish to the Master Trustee and any Related Bond Issuer that shall request the same in writing:

(i) As soon as practicable, but in no event more than 5 months after the last day of each Fiscal Year, one or more financial statements which, in the aggregate, shall include the Obligated Group Members. Such financial statements:

(A) may consist of (i) consolidated or combined financial results including one or more Members of the Obligated Group and one or more other Persons required to be consolidated or combined with such Member(s) of the Obligated Group under GAAP or (ii) special purpose financial statements including only Members of the Obligated Group;

(B) shall be audited by an Accountant selected by the Obligated Group Representative and shall be prepared in accordance with GAAP (except, in the case of special purpose financial statements, for required consolidations);

(C) shall include a consolidated or combined balance sheet, statement of operations and changes in net assets; and

(D) if financial statements delivered to the Master Trustee pursuant to the provisions of the Master Indenture described in this subsection include financial information with respect to any Person who is not an Obligated Group Member or an Immaterial Affiliate as provided pursuant to clause (3) below or do not include financial information with respect to all Obligated Group Members, then the financial statements shall contain a consolidating or combining schedule from which financial information solely relating to the Obligated Group Members and Immaterial Affiliates may be derived.

(ii) At the time of the delivery of financial statements complying with the provisions of the Master Indenture described under subsection (b) above (such financial statements being hereinafter referred to as the "Financial Statements"), a certificate of the chief financial officer of the Obligated Group Representative, stating that the Obligated Group Representative has made a review of the activities of the Obligated Group Members during the preceding Fiscal Year for the purpose of determining whether or not the Obligated Group Members have complied with all of the terms, provisions and conditions of the Master Indenture and that each Obligated Group Member has kept, observed, performed and fulfilled each and every covenant, provision and condition of the Master Indenture on its part to be performed and none of such Obligated Group Members is in default in the performance or observance of any of the terms, covenants, provisions or conditions, or if any Obligated Group Member shall be in default, such certificate shall specify all such defaults and the nature thereof.

(iii) Notwithstanding the foregoing, the results of operation and financial position of Immaterial Affiliates need not be excluded from Financial Statements delivered to the Master Trustee pursuant to the provisions of the Master Indenture described under this caption, and such results of operation and financial position may be considered as if they were a portion of the results of operation and financial position of the Obligated Group Members for all purposes of the Master Indenture notwithstanding the inclusion of the results of operation and financial position of such Immaterial Affiliates.

(c) The Master Trustee shall not be obligated to review, verify, or analyze any Financial Statements delivered to the Master Trustee under the Master Indenture, and shall only retain such Financial Statements as a repository for the Holders.

Membership in Obligated Group. Additional Obligated Group Members may be added to the Obligated Group from time to time, provided that prior to such addition the Master Trustee receives:

(a) a copy of a resolution of the Governing Body of the proposed new Obligated Group Member which authorizes the execution and delivery of a Related Supplement and compliance with the terms of the Master Indenture;

(b) a Related Supplement executed by the Obligated Group Representative, the new Obligated Group Member and the Master Trustee pursuant to which the proposed new Obligated Group Member (i) agrees to become an Obligated Group Member, (ii) agrees to be bound by the terms of the Master Indenture, the Related Supplements and the Obligations, and (iii) irrevocably appoints the Obligated Group Representative as its agent and attorney-in-fact and grants to the Obligated Group Representative the requisite power and authority to execute Related Supplements authorizing the issuance of Obligations or Series of Obligations, to execute and deliver Obligations and to make payments on all Obligations;

(c) an Opinion of Counsel to the effect that: (i) the proposed new Obligated Group Member has taken all necessary action to become an Obligated Group Member, and upon execution of the Related Supplement, such proposed new Obligated Group Member will be bound by the terms of the Master Indenture; (ii) the addition of such Obligated Group Member would not adversely affect the validity of any Obligation then Outstanding; and (iii) the addition of such Obligated Group Member will not cause the Master Indenture or any Obligations to be subject to registration under federal or state securities laws or the Trust Indenture Act of 1939, as amended (or, that any such registration, if required, has occurred);

(d) an Officer's Certificate to the effect that immediately after the addition of the proposed new Obligated Group Member, the Transaction Test would be satisfied; and

(e) so long as any Related Bonds that are tax-exempt obligations are Outstanding, an Opinion of Bond Counsel to the effect that the addition of the proposed new Obligated Group Member will not, in and of itself, result in the inclusion of interest on any Related Bonds in gross income for purposes of federal income taxation.

Withdrawal from Obligated Group. Any Obligated Group Member may withdraw from the Obligated Group and be released from further liability or obligation under the provisions of the Master Indenture, provided that prior to such withdrawal the Master Trustee receives:

(a) the written consent of the Obligated Group Representative to the withdrawal of such Obligated Group Member;

(b) an Officer's Certificate to the effect that immediately following the withdrawal of such Obligated Group Member, the Transaction Test would be satisfied; and

(c) an Opinion of Counsel to the effect that: (i) the withdrawal of such Obligated Group Member would not adversely affect the validity of any Obligation then Outstanding; and (ii) the withdrawal of such Obligated Group Member will not cause the Master Indenture or any Obligations to be subject to registration under federal or state securities laws or the Trust Indenture Act of 1939, as amended (or, that any such registration, if required, has occurred).

Upon compliance with the conditions contained in the provisions of the Master Indenture described under this caption, the Master Trustee shall execute any documents reasonably requested by the withdrawing Obligated Group Member to evidence the termination of such Obligated Group Member's obligations under the Master Indenture, under all Related Supplements and under all Obligations.

Notwithstanding the foregoing, the Corporation may not withdraw from the Obligated Group unless prior to or concurrently with such withdrawal, the Corporation shall transfer all or substantially all of its assets to another Member of the Obligated Group.

Defaults and Remedies

Events of Default. Each of the following events shall be an Event of Default under the Master Indenture:

(a) Failure on the part of the Obligated Group Members to make due and punctual payment of the principal of, redemption premium, if any, interest on, or any other Required Payment on, any Obligation.

(b) Any Obligated Group Member shall fail to observe or perform any other covenant or agreement under the Master Indenture (including covenants or agreements contained in any Related Supplement or Obligation) and shall not have cured such failure within sixty (60) days after the date on which written notice of such failure, requiring the failure to be remedied, shall have been given to the Obligated Group Representative by the Master Trustee or to the Obligated Group Representative and the Master Trustee by the Holders of 25% in aggregate principal amount of Outstanding Obligations; provided that if such failure can be remedied but not within such 60 day period, such failure shall not become an Event of Default for so long as the Obligated Group Representative shall diligently proceed to remedy the failure.

The Corporation has proposed amendment of the percentage set forth in subsection (b) above from 25% in aggregate principal amount of Outstanding Obligations to a majority in aggregate principal amount of Outstanding Obligations. Upon securing the consent of the Holders of 100% in aggregate principal amount of Outstanding Obligations, such amendment will take effect. By purchasing the Bonds, the purchasers and Beneficial Owners will be deemed to have consented to such amendment.

(c) A court having jurisdiction shall enter a decree or order for relief in respect of any Obligated Group Member in an involuntary case under any applicable federal or state bankruptcy, insolvency or other similar law, or appointing a receiver, liquidator, assignee, custodian, trustee, sequestrator (or similar official) of any Obligated Group Member or for any substantial part of the Property of any Obligated Group Member, or ordering the winding up or liquidation of its affairs, and such decree or order shall remain unstayed and in effect for a period of sixty (60) consecutive days.

(d) Any Obligated Group Member shall commence a voluntary case under any applicable federal or state bankruptcy, insolvency or other similar law, or shall consent to the entry of an order for relief in an involuntary case under any such law, or shall consent to the appointment of or taking possession by a receiver, liquidator, assignee, trustee, custodian, sequestrator (or similar official) of any Obligated Group Member or for any substantial part of its Property, or shall make any general assignment for the benefit of creditors, or shall fail generally to pay its debts as they become due or shall take any corporate action in furtherance of the foregoing.

(e) An event of default shall exist under any Related Bond Indenture.

The Obligated Group Representative agrees that, as soon as practicable, and in any event within ten (10) days after such event, the Obligated Group Representative shall notify the Master Trustee of any event which is an Event of Default under the Master Indenture which has occurred and is continuing, which notice shall state the nature of such event and the action which the Obligated Group Members propose to take with respect thereto.

Acceleration; Annulment of Acceleration

(a) Upon the occurrence and during the continuation of an Event of Default under the Master Indenture, the Master Trustee may, and, upon (i) the written request of the Holders of not less than 25% in aggregate principal amount of Outstanding Obligations or of any Holder if an Event of Default under the Master Indenture has occurred or (ii) the acceleration of any Obligation pursuant to the terms of the Related Supplement under which such Obligation was issued, the Master Trustee shall, by notice to the Members, declare all Outstanding Obligations immediately due and payable, whereupon such Obligations shall become and be immediately due and payable, anything in the

Obligations or in the Master Indenture to the contrary notwithstanding; provided, however, that if the terms of any Related Supplement give a Person the right to consent to acceleration of the Obligations issued pursuant to such Related Supplement, the Obligations issued pursuant to such Related Supplement may not be accelerated by the Master Trustee unless such consent is properly obtained pursuant to the terms of such Related Supplement. In the event of acceleration, an amount equal to the aggregate principal amount of all Outstanding Obligations, plus all interest accrued thereon and, to the extent permitted by applicable law, which accrues on such principal and interest to the date of payment, shall be due and payable on the Obligations. Notwithstanding the foregoing, no Obligation shall be accelerated if the Event of Default is the result of the nonpayment of a Subordinate Financial Product Extraordinary Payment issued on or after the date of effectiveness of the Master Indenture.

The Corporation has proposed amendment of the percentage set forth in subsection (a) above from 25% in aggregate principal amount of Outstanding Obligations to a majority in aggregate principal amount of Outstanding Obligations. Upon securing the consent of the Holders of 100% in aggregate principal amount of Outstanding Obligations, such amendment will take effect. By purchasing the Bonds, the purchasers and Beneficial Owners will be deemed to have consented to such amendment.

(b) At any time after the Obligations have been declared to be due and payable, and before the entry of a final judgment or decree in any proceeding instituted with respect to the Event of Default that resulted in the declaration of acceleration, the Master Trustee may annul such declaration and its consequences if:

(i) the Obligated Group Members have paid (or caused to be paid or deposited with the Master Trustee moneys sufficient to pay) all payments then due on all Outstanding Obligations (other than payments then due only because of such declaration);

(ii) the Obligated Group Members have paid (or caused to be paid or deposited with the Master Trustee moneys sufficient to pay) all fees and expenses of the Master Trustee then due;

(iii) the Obligated Group Members have paid (or caused to be paid or deposited with the Master Trustee moneys sufficient to pay) all other amounts then payable by the Obligated Group under the Master Indenture; and

(iv) every Event of Default (other than a default in the payment of the principal or other payments of such Obligations then due only because of such declaration) has been remedied.

No such annulment shall extend to or affect any subsequent Event of Default or impair any right with respect to any subsequent Event of Default.

Additional Remedies and Enforcement of Remedies

(a) Upon the occurrence and continuance of any Event of Default, the Master Trustee may, and upon the written request of the Holders of not less than 25% in aggregate principal amount of Outstanding Obligations (and upon indemnification of the Master Trustee to its satisfaction by the Obligated Group for any such request), shall, proceed to protect and enforce its rights and the rights of the Holders under the Master Indenture by such proceedings as the Master Trustee may deem expedient, including but not limited to:

(i) Enforcement of the right of the Holders to collect amounts due or becoming due under the Obligations;

(ii) Civil action upon all or any part of the Obligations;

(iii) Civil action to require any Person holding moneys, documents or other property pledged to secure payment of amounts due or to become due on the Obligations to account as if it were the trustee of an express trust for the Holders of Obligations;

(iv) Civil action to enjoin any acts which may be unlawful or in violation of the rights of the Holders of Obligations; and

(v) Enforcement of any other right or remedy of the Holders conferred by law or by the Master Indenture.

The Corporation has proposed amendment of the percentage set forth in subsection (a) above from 25% in aggregate principal amount of Outstanding Obligations to a majority in aggregate principal amount of Outstanding Obligations. Upon securing the consent of the Holders of 100% in aggregate principal amount of Outstanding Obligations, such amendment will take effect. By purchasing the Bonds, the purchasers and Beneficial Owners will be deemed to have consented to such amendment.

(b) Regardless of the occurrence of an Event of Default, if requested in writing by the Holders of not less than 25% in aggregate principal amount of the Outstanding Obligations (and upon indemnification of the Master Trustee to its satisfaction for such request), the Master Trustee shall institute and maintain such proceedings as it may be advised shall be necessary or expedient (1) to prevent any impairment of the security under the Master Indenture by any acts which may be unlawful or in violation of the Master Indenture, or (2) to preserve or protect the interests of the Holders. However, the Master Trustee shall not comply with any such request or institute and maintain any such proceeding that is in conflict with any applicable law or the provisions of the Master Indenture or (in the sole judgment of the Master Trustee) is unduly prejudicial to the interests of the Holders not making such request.

Application of Moneys After Default. During the continuance of an Event of Default, all moneys received by the Master Trustee pursuant to any right given or action taken under the provisions of the Master Indenture described under the caption “Default and Remedies” (after payment of the costs of the proceedings resulting in the collection of such moneys and payment of all fees, expenses and other amounts owed to the Master Trustee) shall be applied as follows:

(a) Unless all Outstanding Obligations have become or have been declared due and payable (or if any such declaration is annulled in accordance with the terms of the Master Indenture):

First: To the payment of all installments of interest then due on the Obligations (including (i) Financial Product Payments to the extent made pursuant to a Financial Products Agreement secured or evidenced by an Obligation and (ii) Parity Financial Product Extraordinary Payments), in the order of their due dates, and, if the amount available is not sufficient to pay in full all installments of interest, Financial Product Payments to the extent made pursuant to a Financial Products Agreement secured or evidenced by an Obligation, and Parity Financial Product Extraordinary Payments due on the same date, then to the payment thereof ratably, according to the amounts of interest, Financial Product Payments to the extent made pursuant to a Financial Products Agreement secured or evidenced by an Obligation, and Parity Financial Product Extraordinary Payments due on such date, without any discrimination or preference;

Second: To the payment of all installments of principal then due on the Obligations (whether at maturity or by call for redemption) and other unpaid Required Payments in the order of their due dates, and, if the amount available is not sufficient to pay in full all installments of principal due on the same date, then to the payment thereof ratably, according to the amounts of principal due on such date, without any discrimination or preference;

Third: To the payment of all Subordinate Financial Product Extraordinary Payments in the order of their due dates, and, if the amount available is not sufficient to pay in full all Subordinate Financial Product Extraordinary Payments due on the same date, then to the payment thereof ratably, according to the amounts of Subordinate Financial Product Extraordinary Payments due on such date, then to the payment thereof ratably, according to the amounts of Subordinate Financial Product Extraordinary Payments due on such date, without any discrimination or preference.

(b) If all Outstanding Obligations have become or have been declared due and payable (and such declaration has not been annulled under the terms of the Master Indenture):

First: To the payment of the principal and interest and other Required Payments (including (i) Financial Product Payments to the extent made pursuant to a Financial Products Agreement secured or evidenced by an Obligation and (ii) Parity Financial Product Extraordinary Payments, but excluding Subordinate Financial Product Extraordinary Payments) then due and unpaid on the Obligations, and, if the amount available is not sufficient to pay in full the whole amount then due and unpaid, then to the payment thereof ratably, without preference or priority of principal over interest, of interest over principal, of any installment or payment over any other installment or payment or of any Obligation over any other Obligation, according to the amounts due respectively, without any discrimination or preference; and

Second: To the payment of all Subordinate Financial Product Extraordinary Payments in the order of their due dates, and, if the amount available is not sufficient to pay in full all Subordinate Financial Product Extraordinary Payments due on the same date, then to the payment thereof ratably, according to the amounts of Subordinate Financial Product Extraordinary Payments due on such date, without any discrimination or preference.

Such moneys shall be applied at such times as the Master Trustee shall determine, having due regard for the amount of moneys available and the likelihood of additional moneys becoming available in the future. Upon any date fixed by the Master Trustee for the application of such moneys to the payment of principal, interest on the amounts of principal to be paid on such date shall cease to accrue, provided such moneys are applied by the Master Trustee to the payment of such principal. The Master Trustee shall give such notices as it may deem appropriate of the deposit with it of such moneys or of the fixing of such dates. The Master Trustee shall not be required to make payment to the Holder of any unpaid Obligation until such Obligation is presented to the Master Trustee for appropriate endorsement of any partial payment or for cancellation if fully paid.

Whenever all Obligations have been paid under the terms of the Master Indenture and all fees and expenses of the Master Trustee have been paid, any balance remaining shall be paid to the Person entitled to receive such balance. If no other Person is entitled thereto, then the balance shall be paid to the Members of the Obligated Group or such Person as a court of competent jurisdiction may direct.

Remedies Not Exclusive. No remedy granted by the terms of the Master Indenture is intended to be exclusive of any other remedy. Each remedy shall be cumulative and shall be in addition to every other remedy given under the Master Indenture or existing at law or in equity.

Remedies Vested in the Master Trustee. All rights of action (including the right to file proof of claims) under the Master Indenture or under any of the Obligations may be enforced by the Master Trustee without the possession of any of the Obligations or the production thereof in any proceeding relating thereto. Any proceeding instituted by the Master Trustee may be brought in its name as the Master Trustee without the necessity of joining any Holders as plaintiffs or defendants. Subject to the provisions of the Master Indenture described above under the caption "Application of Moneys After Default," any recovery or judgment shall be for the equal benefit of the Holders of the Outstanding Obligations.

Master Trustee to Represent Holders. The Master Trustee is by the Master Indenture irrevocably appointed as trustee and attorney in fact for the Holders for the purpose of exercising on their behalf the rights and remedies available to the Holders under the provisions of the Master Indenture, the Obligations, any Related Supplement and applicable provisions of law, in each case subject to the provisions of the Master Indenture described below under the caption "Holders' Control of Proceedings." The Holders, by taking and holding the Obligations, shall be conclusively deemed to have so appointed the Master Trustee.

Holders' Control of Proceedings. If an Event of Default has occurred and is continuing, notwithstanding anything in the Master Indenture to the contrary, the Holders of at least a majority in aggregate principal amount of Outstanding Obligations shall have the right (upon the indemnification of the Master Trustee to its satisfaction) to direct the method and/or place of conducting any proceeding to be taken in connection with the enforcement of the terms of the Master Indenture. Such direction must be in writing, signed by such Holders and delivered to the Master Trustee. However, the Master Trustee shall not follow any such direction that is in conflict with any applicable law or the provisions of the Master Indenture or (in the sole judgment of the Master Trustee) is unduly prejudicial to the interests of the Holders not joining in such direction. Nothing shall impair the right of the Master Trustee to take any

other action authorized by the Master Indenture which it may deem proper and which is not inconsistent with such direction by Holders.

Termination of Proceedings. In case any proceeding instituted by the Master Trustee with respect to any Event of Default is discontinued or abandoned for any reason or is determined adversely to the Master Trustee or the Holders, then the Obligated Group Members, the Master Trustee and the Holders shall be restored to their former positions and rights under the Master Indenture. All rights, remedies and powers of the Master Trustee and the Holders shall continue as if no such proceeding had been taken.

Waiver of Event of Default

(a) No delay or omission of the Master Trustee or of any Holder to exercise any right with respect to any Event of Default shall impair such right or shall be construed to be a waiver of or acquiescence to such Event of Default. Every right and remedy given by the Master Indenture to the Master Trustee and the Holders may be exercised from time to time and as often as may be deemed expedient by them.

(b) The Master Trustee may waive any Event of Default which in its opinion has been remedied before the entry of a final judgment or decree in any proceeding instituted by it under the provisions of the Master Indenture, or before the completion of the enforcement of any other remedy under the Master Indenture.

(c) Upon the written request of the Holders of at least a majority in aggregate principal amount of Outstanding Obligations, the Master Trustee shall waive any Event of Default under the Master Indenture and its consequences; provided, however, that, except under the circumstances set forth in the Master Indenture, the failure to pay the principal of, premium, if any, or interest on any Obligation when due may not be waived without the written consent of the Holders of all Outstanding Obligations.

(d) In case of any waiver by the Master Trustee of an Event of Default, the Obligated Group Members, the Master Trustee and the Holders shall be restored to their former positions and rights. No waiver shall extend to, or impair any right with respect to, any other Event of Default.

Appointment of Receiver. Upon the occurrence and continuance of any Event of Default, the Master Trustee shall be entitled (a) without declaring the Obligations to be due and payable, (b) after declaring the Obligations to be due and payable, or (c) upon the commencement of any proceeding to enforce any right of the Master Trustee or the Holders, to the appointment of a receiver or receivers of any or all of the Property of the Obligated Group Members (without the necessity of notice to any Obligated Group Member or any other Person), with such powers as the court making such appointment shall confer. Each Obligated Group Member consents, and will if requested by the Master Trustee, consent at the time of application by the Master Trustee for appointment of a receiver, to the appointment of such receiver and agrees that such receiver may be given the right, to the extent the right may lawfully be given, to take possession of, operate and deal with such Property and the revenues, profits and proceeds therefrom, with the same effect as the Obligated Group Member could, and to borrow money and issue evidences of indebtedness as such receiver.

Remedies Subject to Provisions of Law. All rights, remedies and powers provided by the Master Indenture may be exercised only to the extent that the exercise thereof does not violate any applicable provision of law. All the provisions of the Master Indenture are intended to be subject to all applicable mandatory provisions of law that may be continuing and to be limited to the extent necessary so that they will not render any provision of the Master Indenture invalid or unenforceable under the provisions of any applicable law.

Notice of Default. Within ten (10) days after a Responsible Officer of the Master Trustee has actual knowledge or has received written notice of the occurrence of an Event of Default, the Master Trustee shall mail notice of such Event of Default to all Holders, unless such Event of Default has been cured before the giving of such notice, the term "Event of Default" for purposes of the provisions of the Master Indenture being described under this caption being limited to the events specified in the provisions of the Master Indenture described above under the caption "Events of Default" under subsection (a) through (f), not including any grace periods provided for in subsection (b), (c) and (d). Except in the case of default in the payment of the principal of or premium, if any, or interest on any of

the Obligations and the Events of Default specified in the Master Indenture, the Master Trustee shall be protected in withholding such notice if and so long as the Master Trustee in good faith determines that the withholding of such notice is in the best interest of the Holders.

Supplements and Amendments

Supplements Not Requiring Consent of Holders. The Obligated Group Representative (acting for itself and as agent for each Obligated Group Member) and the Master Trustee may, without the consent of or notice to any of the Holders, enter into one or more Related Supplements for any of the following purposes:

- (a) To correct any ambiguity or formal defect or omission in the Master Indenture;
- (b) To correct or supplement any provision which may be inconsistent with any other provision or to make any other provision with respect to matters or questions arising under the Master Indenture, which, in either case, does not materially and adversely affect the interests of the Holders;
- (c) To grant or confer ratably upon all of the Holders any additional benefits, rights, remedies, powers or authority, including, without limitation, the addition of provisions providing for the creation of a credit group which credit group shall consist of all Obligated Group Members and Persons designated as affiliates of Obligated Group Members, or to add to the covenants of and restrictions on the Obligated Group Members;
- (d) To qualify the Master Indenture under the Trust Indenture Act of 1939, as amended, or corresponding provisions of federal law from time to time in effect;
- (e) To create and provide for the issuance of an Obligation or Series of Obligations as permitted under the Master Indenture;
- (f) To obligate a successor to any Obligated Group Member as provided in the Master Indenture;
- (g) To add a new Obligated Group Member as provided in the Master Indenture; or
- (h) To make any other change which does not materially and adversely affect the interests of the Holders.

Supplements Requiring Consent of Holders

(a) Other than Related Supplements referred to in the provisions of the Master Indenture described above under the caption "Supplements Not Requiring Consent of Holders," and subject to the terms contained in the Master Indenture and described under this caption, the Holders of not less than a majority in aggregate principal amount of the Outstanding Obligations shall have the right to consent to and approve the execution by the Obligated Group Representative (acting for itself and as agent for each Obligated Group Member) and the Master Trustee of such Related Supplements as shall be deemed necessary or desirable for the purpose of modifying, altering, amending, adding to or rescinding any of the terms contained in the Master Indenture; provided, however, with respect to any Obligation registered in the name of a Related Bond Trustee and securing a Related Series of Bonds, payment of the principal of and interest on which is insured or otherwise guaranteed by a municipal bond insurance policy or is secured by a letter of credit, the provider of such municipal bond insurance or letter of credit shall be deemed to be the Holder of such Obligation for purposes of consenting to and approving the execution of Related Supplements for purposes of the Master Indenture, except as otherwise provided in the applicable Related Supplement or Obligation; and provided, further, however, that nothing in the Master Indenture shall permit or be construed as permitting a Related Supplement which would:

- (i) extend the stated maturity of, or time for paying interest on, any Obligation or reduce the principal amount of or the redemption premium or rate of interest or change the method of calculating interest payable on, or reduce any other Required Payment on any Obligation without the consent of the Holder of such Obligation;

(ii) modify, alter, amend, add to or rescind any of the terms or provisions contained in the Master Indenture so as to affect the right of the Holders of any Obligations in default as to payment to compel the Master Trustee to declare the principal of all Obligations to be due and payable, without the consent of the Holders of all Obligations then Outstanding; or

(iii) reduce the aggregate principal amount of Obligations then Outstanding the consent of the Holders of which is required to authorize such Related Supplement, without the consent of the Holders of all Obligations then Outstanding.

(b) The Master Trustee may execute a Related Supplement (in substantially the form delivered to it) without liability or responsibility to any Holder (whether or not such Holder has consented to the execution of such Related Supplement) if the Master Trustee receives: (i) a Request of the Obligated Group Representative to enter into such Related Supplement; (ii) a certified copy of the resolution of the Governing Body of the Obligated Group Representative approving the execution of such Related Supplement; (iii) the proposed Related Supplement; and (iv) an instrument or instruments executed by the Holders of not less than the aggregate principal amount or number of Obligations specified in the provisions of the Master Indenture described in subsection (a) above for the Related Supplement in question which instrument or instruments shall refer to the proposed Related Supplement and shall specifically consent to and approve the execution thereof in substantially the form of the copy thereof as on file with the Master Trustee.

(c) Any such consent shall be binding upon the Holder of the Obligation giving such consent and upon any subsequent Holder of such Obligation and of any Obligation issued in exchange therefor (whether or not such subsequent Holder thereof has notice thereof), unless such consent is revoked in writing by the Holder of such Obligation giving such consent or by a subsequent Holder thereof by filing with the Master Trustee, prior to the execution by the Master Trustee of such Related Supplement, such revocation and, if such Obligation or Obligations are transferable by delivery, proof that such Obligations are held by the signer of such revocation. At any time after the Holders of the required principal amount or number of Obligations shall have filed their consents to the Related Supplement, the Master Trustee shall file a written statement to that effect with the Obligated Group Representative. Such written statement shall be conclusive evidence that such consents have been so filed.

(d) If the Holders of the required principal amount or number of the Outstanding Obligations have consented to the execution of such Related Supplement, no Holder shall have any right to object to the execution thereof, to object to any of the terms and provisions contained therein or the operation thereof, to question the propriety of the execution thereof or to enjoin or restrain the Master Trustee or the Obligated Group Representative from executing such Related Supplement or from taking any action pursuant to the provisions thereof.

Execution and Effect of Supplements

(a) In executing any Related Supplement permitted by the Master Indenture, the Master Trustee shall be entitled to receive and to rely upon an Opinion of Counsel stating that the execution of such Related Supplement is authorized or permitted by the Master Indenture. The Master Trustee may (but shall not be obligated to) enter into any Related Supplement that materially and adversely affects the Master Trustee's own rights, duties or immunities.

(b) Upon the execution and delivery of any Related Supplement in accordance with the provisions of the Master Indenture described under the caption "Supplements and Amendments," the provisions of the Master Indenture shall be deemed modified in accordance therewith. Such Related Supplement shall form a part of the Master Indenture for all purposes and every Holder shall be bound thereby.

(c) Any Obligation authenticated and delivered after the execution and delivery of any Related Supplement in accordance with the Master Indenture may, and, if required by the Obligated Group Representative or the Master Trustee shall, bear a notation in form approved by the Master Trustee as to any matter provided for in such Related Supplement. If the Obligated Group Representative or the Master Trustee shall so determine, new Obligations so modified as to conform in the opinion of the Master Trustee and the Governing Body of the Obligated Group Representative to any such Related Supplement may be prepared and executed by the Obligated Group Representative and authenticated and delivered by the Master Trustee in exchange for and upon surrender of Obligations then Outstanding.

Amendment of Related Supplements. Any Related Supplement may provide that the provisions thereof may be amended without the consent of or notice to any of the Holders, or pursuant to such terms and conditions as may be specified in such Related Supplement. If a Related Supplement does not contain provisions relating to the amendment thereof, the amendment of such Related Supplement shall be governed by the provisions of the Master Indenture described under the caption “Supplements and Amendments.”

Satisfaction and Discharge

The Master Indenture shall cease to be of further effect if: (i) all Obligations previously authenticated (other than any Obligations which have been mutilated, destroyed, lost or stolen and which have been replaced or paid as provided in any Related Supplement) and not cancelled are delivered to the Master Trustee for cancellation; or (ii) all Obligations not previously cancelled or delivered to the Master Trustee for cancellation are paid; or (iii) a deposit is made in trust with the Master Trustee (or with one or more national banking associations or trust companies acceptable to the Master Trustee pursuant to an agreement between an Obligated Group Member and such national banking associations or trust companies in form acceptable to the Master Trustee) in cash or Government Obligations or both, sufficient to pay at maturity or upon redemption all Obligations not previously cancelled or delivered to the Master Trustee for cancellation, including principal and interest or other payments (including Financial Product Payments and Financial Product Extraordinary Payments) due or to become due to such date of maturity, redemption date or payment date, as the case may be; and all other sums payable under the Master Indenture by the Obligated Group Members are also paid.

SUPPLEMENTAL MASTER INDENTURE FOR OBLIGATION NO. 40

General

Supplement No. 40 provides for the issuance of Obligation No. 40 and provides the terms and form thereof. Obligation No. 40 further secures the obligation of the Corporation arising under and pursuant to the Indenture.

Payments on Obligation No. 40; Credits

Principal of and interest on Obligation No. 40 are payable in any lawful money of the United States of America or United States Government Obligations. Except as provided pursuant to the provisions of Supplement No. 40 described in subsection (b) below with respect to credits and as described under the caption “Prepayment of Obligation No. 40” below regarding prepayment, payments on the principal of and interest on Obligation No. 40 shall be made at the times and in the amounts specified in Obligation No. 40 by the Corporation (i) depositing the same with or to the account of the Trustee at or prior to the opening of business on the day such payments shall become due or payable (or on the next succeeding business day if such date is a Saturday, Sunday or bank holiday in the city in which the principal corporate trust office of the Trustee is located) and (ii) giving a notice to the Master Trustee and the Trustee of each payment of principal or interest on Obligation No. 40, specifying the amount paid, and identifying such payment as a payment on Obligation No. 40.

The Corporation shall receive credit for payment on Obligation No. 40, in addition to any credits resulting from payment or prepayment from other sources, as follows:

- (i) On installments of interest on Obligation No. 40 in an amount equal to moneys deposited in the Interest Account created under the Indenture, to the extent such amounts have not previously been credited against payments on Obligation No. 40;
- (ii) On installments of principal of Obligation No. 40 in an amount equal to moneys deposited in the Principal Account created under the Indenture, to the extent such amounts have not previously been credited on Obligation No. 40;
- (iii) On installments of principal and interest, respectively, on Obligation No. 40 in an amount equal to the principal amount of Bonds for the payment or redemption of which sufficient amounts (as determined by the provisions of the Indenture described below under the caption “Indenture - Discharge of

the Indenture”) in lawful money of the United States of America or United States Government Obligations are on deposit as provided pursuant to the discharge provisions of the Indenture, to the extent such amounts have not been previously credited against payments on Obligation No. 40, and the interest on such Bonds from and after the date fixed for payment at maturity or redemption thereof. Such credits shall be made against the installments of principal of and interest on Obligation No. 40 that would have been used, but for such call for redemption, to pay principal of and interest on such Bonds when due at maturity or called for redemption; and

(iv) On installments of principal and interest, respectively, on Obligation No. 40 in an amount equal to the principal amount of Bonds acquired by the Corporation and delivered to the Trustee for cancellation or purchased by the Trustee and cancelled, and the interest on such Bonds from and after the date interest thereon has been paid prior to cancellation. Such credits shall be made against the installments of principal of and interest on Obligation No. 40 that would have been used, but for such cancellation, to pay principal of and interest on such Bonds when due and, with respect to Bonds called for mandatory purchase or redemption, against principal installments that would have been used to pay Bonds of the same maturity.

Prepayment of Obligation No. 40

So long as all amounts that have become due under Obligation No. 40 have been paid, the Corporation shall have the right, at any time and from time to time, to pay in advance and in any order of due dates all or part of the amounts to become due under Obligation No. 40. Prepayments may be made by payments of lawful money of the United States of America, United States Government Obligations, or surrender of Bonds as described above under the caption “Payments on Obligation No. 40; Credits.” All such prepayments shall be deposited upon receipt in the Redemption Fund and, at the request of and as determined by the Corporation, credited against payments due under Obligation No. 40 or used for the redemption or purchase of Outstanding Bonds in the manner and subject to the terms and conditions set forth in the Indenture. Notwithstanding any such redemption or surrender of Bonds, as long as any Bond remains outstanding under the Indenture or any additional payments required to be made under Obligation No. 40 remain unpaid, the Corporation shall not be relieved of its obligations under the Master Indenture, including Supplement No. 40.

Prepayments made under Supplement No. 40 shall be credited against amounts to become due on Obligation No. 40 as described above, under the caption “Payments on Obligation No. 40; Credits.”

The Corporation may also prepay all of its indebtedness under Obligation No. 40 by providing for prepayment of the Bonds in accordance with the defeasance provisions of the Indenture.

Registration, Number, Negotiability and Transfer of Obligations

Except as described in the paragraph immediately following this paragraph, so long as any Bond remains outstanding, Obligation No. 40 shall consist of a single Obligation without coupons registered as to principal and interest in the name of the Trustee and no transfer of Obligation No. 40 shall be registered under the Master Indenture except for transfers to a successor Trustee.

Upon the principal of all Obligations then Outstanding being declared immediately due and payable upon and during the continuance of an Event of Default, Obligation No. 40 may be transferred if and to the extent the Trustee requests that the restrictions described in the preceding paragraph on transfers be terminated.

Right to Redeem

Obligation No. 40 shall be subject to redemption, in whole or in part, prior to the maturity at the times and in the amounts applicable to redemption of the Bonds as specified in the Indenture; provided that in no event shall any portion of Obligation No. 40 be redeemed unless a corresponding amount of Bonds are also redeemed.

INDENTURE

The Indenture sets forth the terms of the Bonds, the nature and extent of the security for the Bonds, various rights of the Bondholders and the rights, duties and immunities of the Trustee.

Establishment and Pledge of Indenture Fund

Subject only to the provisions of the Indenture permitting or requiring the application thereof for the purposes and on the terms and conditions set forth therein, the Indenture Fund and all amounts held therein are pledged, assigned and transferred by the Corporation to the Trustee for the benefit of the Bondholders to secure the full payment of the principal, Redemption Price or Make-Whole Redemption Price and interest on the Bonds in accordance with their terms and the provisions of the Indenture. The Corporation grants to the Trustee a security interest in and acknowledges and agrees that the Indenture Fund and all amounts on deposit therein shall constitute collateral security to secure the full payment of the principal, Redemption Price or Make-Whole Redemption Price and interest on the Bonds in accordance with their terms and the provisions of the Indenture.

Nothing in the Indenture or in the Bonds, expressed or implied, shall be construed to constitute a security interest under the Uniform Commercial Code or otherwise in the assets of the Corporation other than in any interest of the Corporation in the Indenture Fund and/or the amounts on deposit therein. No recourse for the payment of the principal, Redemption Price or Make-Whole Redemption Price or interest on any Bond, or for any claim based thereon or otherwise in respect thereof, and no recourse under or upon any obligation, covenant or agreement of the Corporation in the Indenture or in any Supplemental Indenture or in any Bond, or because of the creation of any indebtedness represented thereby, shall be had against any past, present or future employee, agent or officer of the Corporation or of any successor entity, either directly or through any successor entity, whether by any constitution, statute or rule of law, or by the enforcement of any assessment or penalty or otherwise, it being expressly understood that all such liability is expressly waived and released as a condition of, and as a consideration for, the execution of the Indenture and the issue of the Bonds. No officer or agent of the Corporation, nor any individual executing the Bonds, shall in any event be subject to any personal liability or accountability by reason of the issuance of the Bonds.

Funds and Accounts

The Indenture creates an Indenture Fund (and a Bond Fund and a Redemption Fund thereunder). The Indenture also creates an Interest Account and Principal Account under the Bond Fund. All of the funds and accounts are to be held by the Trustee.

Application of Proceeds of Bonds. The proceeds of the Bonds will be used for general corporate purposes.

Indenture Fund. The Trustee establishes, for the sole benefit of the Bondholders, a master fund referred to in the Indenture as the “Indenture Fund” containing the Bond Fund and the Redemption Fund and each of the accounts contained therein. The Indenture Fund and each of the funds and accounts in the Indenture Fund shall be identified on the books of the Trustee with reference hereto and shall be maintained by the Trustee and held in trust apart from all other moneys and securities held under the Indenture or otherwise, and the Trustee shall have the exclusive and sole right of withdrawal therefrom in accordance with the terms of the Indenture. All amounts deposited with the Trustee pursuant to the Indenture shall be held, disbursed, allocated and applied by the Trustee only as provided in the Indenture.

Bond Fund. Upon the receipt thereof, the Trustee shall deposit all payments received from the Corporation (other than amounts that are to be deposited in the Redemption Fund or income or profit from investments that are to be applied pursuant to the Indenture) in a special fund designated the “Bond Fund” that the Trustee shall establish and maintain and hold in trust and that shall be disbursed and applied only as authorized in the Indenture.

At the times specified below, the Trustee shall allocate within the Bond Fund in the following order of priority the following amounts to the following accounts or funds, each of which the Trustee shall establish and maintain and hold in trust and each of which shall be disbursed and applied only as hereinafter authorized: (1) on each Interest Payment Date, the Trustee shall deposit in the “Interest Account” the aggregate amount of interest becoming due and

payable on such Interest Payment Date on all Bonds then Outstanding, until the balance in said account is equal to said aggregate amount of interest; and (2) on each Principal Payment Date, the Trustee shall deposit in the “Principal Account” the aggregate amount of principal becoming due and payable on such Principal Payment Date, until the balance in said account is equal to said aggregate amount of such principal.

Interest Account. All amounts in the Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying interest on the Bonds as it shall become due and payable (including accrued interest on any Bonds redeemed prior to maturity pursuant to the Indenture).

Principal Account. All amounts in the Principal Account shall be used and withdrawn by the Trustee solely to pay at maturity the Bonds.

Redemption Fund. Upon the receipt thereof, the Trustee shall deposit the following amounts in a special fund designated the “Redemption Fund” which the Trustee shall establish and maintain and hold in trust: (1) all moneys deposited by the Corporation with the Trustee directed to be deposited in the Redemption Fund; and (2) all interest, profits and other income received from the investment of moneys in the Redemption Fund.

All amounts deposited in the Redemption Fund shall be used and withdrawn by the Trustee solely for the purpose of redeeming Bonds, in the manner and upon the terms and conditions specified in the Indenture, at the date of redemption for which notice has been given; provided that, at any time prior to the selection of Bonds for such redemption, the Trustee shall, upon direction of the Corporation, apply such amounts to the purchase of Bonds at public or private sale, as and when and at such prices (including brokerage and other charges, but excluding accrued and unpaid interest, which is payable from the Interest Account) as the Corporation may direct, except that the purchase price (exclusive of accrued interest) may not exceed the Make-Whole Redemption Price or Redemption Price then applicable to such Bonds; and provided further that in lieu of redemption at such date of redemption, or in combination therewith, amounts in such account may be transferred to the Principal Account as set forth in a Request of the Corporation.

Payments by the Corporation; Allocation of Funds. On or before 10:00 AM (Pacific Time) on each Payment Date, until the principal of and interest on the Bonds shall have been fully paid or provision for such payment shall have been made as provided in the Indenture, the Corporation shall pay to the Trustee a sum equal to the amount payable on such Payment Date as principal of and interest on the Bonds, less the amounts, if any, in the Bond Fund and available therefor. Each payment made pursuant to this paragraph, together with other available amounts, if any, in the Bond Fund, shall at all times be sufficient to pay the total amount of interest and principal (whether at maturity or upon acceleration) becoming due and payable on the Bonds on such Payment Date. If on any Payment Date the available amounts held by the Trustee in the accounts within the Bond Fund are insufficient to make any required payments of principal of (whether at maturity or upon acceleration) and interest on the Bonds as such payments become due, the Corporation shall promptly pay such deficiency to the Trustee.

The obligations of the Corporation to make the payments required by the immediately preceding paragraph and to perform and observe the other agreements on its part contained in the Indenture shall be a general obligation of the Corporation, absolute and unconditional, irrespective of any defense or any rights of set-off, recoupment or counterclaim it might otherwise have against the Trustee, and during the term of the Indenture, the Corporation shall pay all payments required to be made by the immediately preceding paragraph (which payments shall be net of any other obligations of the Corporation) as prescribed therein and all other payments required under the Indenture, free of any deductions and without abatement, diminution or set-off. Until such time as the principal of and interest on the Bonds shall have been fully paid, or provision for the payment thereof shall have been made as required by the Indenture, the Corporation: (i) will not suspend or discontinue any payments provided for in the immediately preceding paragraph; (ii) will perform and observe all of its other covenants contained in the Indenture; and (iii) except as otherwise provided in the Indenture, will not terminate the Indenture for any cause, including, without limitation, the occurrence of any act or circumstances that may constitute failure of consideration, destruction of or damage to all or a portion of the projects financed with the proceeds of the Bonds, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State of California or any political subdivision of either of these, or any failure of the Trustee to perform and observe any covenant, whether express or implied, or any duty, liability or obligation arising out of or connected with the Indenture, except to the extent permitted by the Indenture.

Validity of Bonds

The recital contained in the Bonds that the same are issued pursuant to the Indenture shall be conclusive evidence of their validity and of compliance with the provisions of the Indenture in their issuance.

Additional Bonds

The Corporation may, from time to time, without the consent of the Bondholders, issue additional bonds under the Indenture in addition to the Bonds (the “Additional Bonds”). If issued, the Additional Bonds will have the same interest rate, redemption provisions and maturity date as the Bonds. As a condition to the issuance of Additional Bonds there shall be delivered to the Trustee a certificate of the Corporation, certifying that, after consultation with counsel experienced in federal securities and tax laws, the issuance and consolidation of such Additional Bonds will not cause (i) any adverse tax impact on the Holders of Outstanding Series 2018 Bonds, (ii) the Outstanding Series 2018 Bonds to be required to be registered under the Securities Act of 1933, as amended or (iii) the Indenture to be required to be qualified under the Trust Indenture Act of 1939, as amended.

Redemption of Bonds

Terms of Redemption. On or after the Par Call Date, the Bonds are subject to optional redemption prior to maturity, in whole or in part, at the written direction of the Corporation to the Trustee. Such redemption shall be in accordance with the terms of the Bonds as directed by the Corporation, at the Redemption Price, as described in the Bonds. The Bonds are also subject to make-whole redemption prior to maturity, in whole or in part, at the election of the Corporation, at the Make-Whole Redemption Price. Such optional make-whole redemption shall be in accordance with the terms of the Bonds as directed by the Corporation. The Corporation shall retain an independent accounting firm or an independent financial advisor to determine the Make-Whole Redemption Price of the Bonds to be redeemed and perform all actions and make all calculations required to determine such Make-Whole Redemption Price. The Trustee and the Corporation may conclusively rely on such accounting firm’s or financial advisor’s calculations in connection with, and its determination of, the Make-Whole Redemption Price, and neither the Trustee nor the Corporation shall have any liability for such reliance. The determination of the Make-Whole Redemption Price by such accounting firm or financial advisor shall be conclusive and binding on the Trustee, the Corporation and the Holders of the Bonds.

The Bonds are redeemable prior to maturity at the written direction of the Corporation to the Trustee not less than five (5) Business Days nor more than sixty (60) days prior to the date that notice of redemption is due to be given by the Trustee in accordance with the Indenture.

Selection of Bonds for Redemption. If the Bonds are registered in book-entry only form and so long as the Securities Depository or its nominee is the sole registered owner of the Bonds, if less than all of the Bonds are called for redemption, the particular Bonds or portions thereof to be redeemed shall be selected on a pro rata pass-through distribution of principal basis in accordance with the customary procedures and operational arrangements of the Securities Depository then in effect, but, if such operational arrangements do not allow for redemption on a pro rata pass-through distribution of principal basis, the Bonds shall be selected for redemption, in accordance with the customary procedures of the Securities Depository, or by lot. If the Securities Depository or its nominee is no longer the sole registered owner of the Bonds, and if less than all of the Bonds are called for redemption, the Trustee shall select the Bonds to be redeemed on a pro rata basis.

Notice of Redemption. Notice of redemption shall be sent by the Trustee by first class mail or using Electronic Means not less than seven (7) days (or, if longer, the minimum number of days necessary to comply with the operational requirements of the Securities Depository then in effect), nor more than sixty (60) days prior to the redemption date, to the respective Holders of any Bonds designated for redemption at their addresses appearing on the bond registration books of the Trustee. If the Bonds are no longer held by the Securities Depository or its successor or substitute, the Trustee shall also give notice of redemption by overnight mail to such securities depositories and/or securities information services as shall be designated in a Certificate of the Corporation. Each notice of redemption shall state the date of such notice, the date of issue of the Bonds, the redemption date, the Make-Whole Redemption Price (or method for determining such price) or Redemption Price, as applicable, the place or places of redemption (including the name and appropriate address or addresses of the Trustee), the maturity, the CUSIP number (if any),

the conditions, if any, to the redemption, and, in the case of Bonds to be redeemed in part only, the portion of the principal amount thereof to be redeemed. Each such notice shall also state that, on such date, there will become due and payable on each such Bond the Make-Whole Redemption Price or Redemption Price (as applicable) thereof, or such specified portion of the principal amount thereof, in the case of a Bond to be redeemed in part only, and that from and after such redemption date interest thereon shall cease to accrue, and shall require that such Bonds be then surrendered.

Notice of redemption of the Bonds shall be given to the applicable Holders by the Trustee, at the expense of the Corporation, for and on behalf of the Corporation.

Failure by the Trustee to give notice pursuant to the Indenture to any one or more of the securities information services, intermediaries or depositories designated by the Corporation, or the insufficiency of any such notice, shall not affect the sufficiency of the proceedings for redemption. Failure by the Trustee to send notice of redemption pursuant to the Indenture to any one or more of the respective Holders of any Bonds designated for redemption shall not affect the sufficiency of the proceedings for redemption with respect to the Holders to whom such notice was mailed.

The Corporation may instruct the Trustee to provide conditional notice of redemption, which may be conditioned upon the receipt of moneys or any other event. Additionally, any notice given pursuant to the Indenture may be rescinded by written notice given to the Trustee by the Corporation no later than five (5) Business Days prior to the date specified for redemption. The Trustee shall give notice of such rescission, as soon thereafter as practicable, in the same manner, to the same Persons, as notice of such redemption was given pursuant to the Indenture.

Partial Redemption of Bonds. Upon surrender of any Bond redeemed in part only, the Corporation shall execute (but need not prepare) and the Trustee shall prepare or cause to be prepared, authenticate and deliver to the Holder thereof, at the expense of the Corporation, a new Bond or Bonds of Authorized Denominations, equal in aggregate principal amount to the unredeemed portion of the Bond surrendered in part.

Effect of Redemption. Moneys for payment of the Make-Whole Redemption Price or Redemption Price of the Bonds (or portion thereof called for redemption in accordance with the Indenture) shall be held by the Trustee, and, if any conditions specified in the notice of redemption have been satisfied, paid by the Trustee, on the date fixed for redemption designated in such notice. The Bonds (or portion thereof) so called for redemption shall become due and payable at the Make-Whole Redemption Price or Redemption Price specified in (or pursuant to the method of calculating the Make-Whole Redemption Price specified in) such notice, interest on the Bonds so called for redemption shall cease to accrue and such Bonds (or portion thereof) shall cease to be entitled to any benefit or security under the Indenture, and the Holders of such Bonds shall have no rights in respect thereof except to receive the payment of such Make-Whole Redemption Price or Redemption Price from funds held by the Trustee for such payment.

All Bonds redeemed pursuant to the provisions of the Indenture shall be cancelled by the Trustee upon surrender thereof and delivered to, or upon the order of, the Corporation.

Purchase in Lieu of Redemption. Each Holder or Beneficial Owner, by purchase and acceptance of any Bonds, irrevocably grants to the Corporation the option to purchase such Bonds, in whole or in part, at any time such Bonds are subject to optional redemption pursuant to the Indenture. Such Bonds are to be purchased at a purchase price equal to the then applicable redemption price of such Bonds. The Corporation shall direct the Trustee to provide notice of mandatory purchase, such notice to be provided, as and to the extent applicable, in accordance with the notice of redemption provisions of the Indenture and to select Bonds subject to mandatory purchase in the same manner as Bonds called for redemption pursuant to the Indenture. On the date fixed for purchase of any Bonds in lieu of redemption, the Corporation shall pay the purchase price of such Bond to the Trustee in immediately available funds, and the Trustee shall pay the same to the Holders of the Bonds being purchased against delivery thereof. No purchase of any Bonds in lieu of redemption shall operate to extinguish the indebtedness evidenced by such Bonds. No Holder or Beneficial Owner may elect to retain a Bond subject to mandatory purchase in lieu of redemption. The Corporation may exercise its option to purchase Bonds, in whole or in part, in accordance with the purchase in lieu of redemption provisions of the Indenture.

Use of Securities Depository

Notwithstanding any provision of the Indenture to the contrary:

The Bonds shall be initially issued as fully registered Bonds, registered in the name of “Cede & Co.,” as nominee of the Securities Depository, in the principal amount of the Bonds. Registered ownership of the Bonds, or any portion thereof, may not thereafter be transferred except: (1) to any successor of the Securities Depository or its nominee, or to any substitute depository designated pursuant to clause (2) of this paragraph (“substitute depository”); provided that any successor of the Securities Depository or substitute depository shall be qualified under any applicable laws to provide the service proposed to be provided by it; (2) to any substitute depository designated by the Corporation and not objected to by the Trustee, upon (i) the resignation of the Securities Depository or its successor (or any substitute depository or its successor) from its functions as depository or (ii) a determination by the Corporation that the Securities Depository or its successor (or any substitute depository or its successor) is no longer able to carry out its functions as depository; provided that any such substitute depository shall be qualified under any applicable laws to provide the services proposed to be provided by it; or (3) to any Person as provided below, upon (i) the resignation of the Securities Depository or its successor (or substitute depository or its successor) from its functions as depository; provided that no substitute depository can be obtained or (ii) a determination by the Corporation that it is in the best interests of the Corporation to remove the Securities Depository or its successor (or any substitute depository or its successor) from its functions as depository.

In the case of any transfer pursuant to clause (1) or clause (2) of the immediately preceding paragraph, upon receipt of the Outstanding Bonds by the Trustee, together with a Certificate of the Corporation to the Trustee, new Bonds shall be executed and delivered in the principal amount of the Bonds, registered in the name of such successor or such substitute depository, or their nominees, as the case may be, all as specified in such Certificate of the Corporation. In the case of any transfer pursuant to clause (3) of the immediately preceding paragraph, upon receipt of the Outstanding Bonds by the Trustee together with a Certificate of the Corporation to the Trustee, new Bonds shall be executed and delivered in such denominations and registered in the names of such persons as are requested in such a Certificate of the Corporation, subject to the limitations of the Indenture, provided the Trustee shall not be required to deliver such new Bonds within a period less than sixty (60) days from the date of receipt of such Certificate of the Corporation.

In the case of partial redemption or an advance refunding of the Bonds evidencing all or a portion of the principal amount Outstanding, the Securities Depository shall make an appropriate notation on the Bonds indicating the date and amounts of such reduction in principal, in form acceptable to the Trustee.

The Corporation and the Trustee shall treat the Person in whose name any Bond is registered as the Bondholder thereof for all purposes of the Indenture and any applicable laws, notwithstanding any notice to the contrary received by the Corporation or the Trustee. So long as the Outstanding Bonds are registered in the name of Cede & Co. or its registered assign, the Corporation and the Trustee shall cooperate with Cede & Co., as sole registered Bondholder, and its registered assigns, in effecting payment of the principal, Make-Whole Redemption Price or Redemption Price of and interest on the Bonds by arranging for payment in such manner that funds for such payments are properly identified and are made immediately available on the date they are due, all in accordance with the letter of representations of the Corporation to the Securities Depository or as otherwise agreed by the Trustee and the Securities Depository.

Certain Covenants

Punctual Payment. The Corporation shall punctually pay the principal, Make-Whole Redemption Price or Redemption Price and interest to become due in respect of all the Bonds, in strict conformity with the terms of the Bonds and the Indenture. When and as paid in full, all Bonds shall be delivered to the Trustee and shall thereafter be cancelled by the Trustee and delivered to, or upon the order of, the Corporation.

Power to Issue Bonds. The Corporation is duly authorized to issue the Bonds and to enter into the Indenture in the manner and to the extent provided in the Indenture. The Bonds are and will be the legal, valid and binding obligations of the Corporation in accordance with their terms, and the Corporation and the Trustee shall at all times, to the extent permitted by law, defend, preserve and protect such obligations and all the rights of the Bondholders

under the Indenture against all claims and demands of all Persons, subject to the limitations set forth in the Indenture relating to the Trustee.

Replacement of Obligation No. 40. Obligation No. 40 shall be surrendered by the Trustee and delivered to the Master Trustee for cancellation upon the terms and conditions set forth in the Indenture, which include receipt by the Trustee of: (a) a Request of the Corporation requesting such surrender and delivery and stating that the Corporation has become a member of an obligated group (the “New Group”) under a master indenture (other than the Master Indenture) (the “Replacement Master Indenture”) and that an obligation is being issued to the Trustee under the Replacement Master Indenture; (b) a properly executed obligation (the “Replacement Obligation”) issued under the Replacement Master Indenture and registered in the name of the Trustee with the same tenor and effect as Obligation No. 40 (in a principal amount equal to the then-Outstanding principal amount of 2018 Series Taxable Bonds), authenticated by the master trustee under the Replacement Master Indenture; (c) an Opinion of Counsel to the Corporation to the effect that the Replacement Obligation has been validly issued under the Replacement Master Indenture and constitutes a valid and binding obligation of the Corporation and each of the other members of the New Group; (d) a copy of the Replacement Master Indenture, certified as a true and accurate copy by the master trustee under the Replacement Master Indenture; (e) written confirmation from each Rating Agency then rating the 2018 Series Taxable Bonds that the replacement of Obligation No. 40 will not, by itself, result in a reduction in the then-current ratings on the 2018 Series Taxable Bonds; and (f) a certificate of the Master Trustee to the effect that Obligation No. 40 has been cancelled.

Accounting Records and Financial Statements. With respect to each fund or account established and maintained by the Trustee pursuant to the Indenture, the Trustee shall at all times keep, or cause to be kept, proper books of record and account prepared in accordance with corporate trust accounting standards, in which complete and accurate entries shall be made of all transactions relating to the receipt, investment, disbursement, allocation and application of payments received from the Corporation and the proceeds of the Bonds. Such books of record and account shall be available for inspection by the Corporation and any Bondholder, or his or her agent or representative duly authorized in writing, with prior notice, during the Trustee’s normal business hours and under reasonable circumstances.

Continuing Disclosure. Unless otherwise available on the Municipal Securities Rulemaking Board’s Electronic Municipal Market Access system (EMMA) (or a successor thereto or to the functions thereof), copies of the Corporation’s annual audited consolidated financial statements and certain quarterly unaudited consolidated financial information will be posted on the Corporation’s website or with Digital Assurance Certification, LLC, or furnished to the Trustee, subject to the terms of the Indenture.

Events of Default and Remedies of Bondholders

Events of Default. The following events shall be “Events of Default”: (a) default in the due and punctual payment of the principal, Make-Whole Redemption Price or Redemption Price of any Bond when and as the same shall become due and payable, whether at maturity as therein expressed, by proceedings for redemption, by acceleration or otherwise; (b) default in the due and punctual payment of any interest on any Bond when and as such interest shall become due and payable; (c) default by the Corporation in the performance or observance of any of the other covenants, agreements or conditions on its part contained in the Indenture or in the Bonds (other than any covenant, agreement or condition a default in the performance or observance of which is specifically addressed elsewhere in the Indenture), if such default shall have continued for a period of sixty (60) days after written notice thereof, specifying such default and requiring the same to be remedied and stating that such notice is a “Notice of Default” under the Indenture, shall have been given to the Corporation by the Trustee, or to the Corporation and the Trustee by the Holders of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding; (d) the commencement by the Corporation of a voluntary case under the federal bankruptcy laws, or if the Corporation shall become insolvent or unable to pay its debts as they become due, or shall make an assignment for the benefit of creditors, or shall apply for, consent to or acquiesce in the appointment of, or taking possession by, a trustee, receiver, custodian or similar official or agent for itself or any substantial part of its property; (e) the appointment of a trustee, receiver, custodian or similar official or agent for the Corporation or for any substantial part of its property and such trustee or receiver shall not be discharged within sixty (60) days; (f) an order or decree for relief in an involuntary case under the federal bankruptcy laws shall be entered against the Corporation, or a petition seeking reorganization, readjustment, arrangement, composition, or other similar relief as to it under the federal bankruptcy laws or any similar

law for the relief of debtors shall be brought against it and shall be consented to by it or shall remain undismissed for sixty (60) days; or (g) an Event of Default under the Master Indenture.

Failure of the Corporation to make payment on the Bonds shall not constitute an Event of Default if timely payment is made by the Obligated Group on Obligation No. 40 in place of payment on the Bonds.

Acceleration of Maturities. If an Event of Default shall occur, then, and in each case during the continuance of such Event of Default, the Trustee may, upon notice in writing to the Corporation, notify the Master Trustee of such Event of Default, make a demand for payment under Obligation No. 40 and request the Master Trustee in writing to give notice to the Members pursuant to the Master Indenture declaring the principal of all the Obligations then Outstanding, and the interest accrued thereon, to be due and payable immediately. Upon any such declaration by the Master Trustee and upon notice in writing to the Corporation, the Trustee shall declare the principal of the Bonds, and the interest accrued thereon, to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable, anything in the Indenture or in the Bonds to the contrary notwithstanding.

Any such declaration, however, is subject to the condition that if, at any time after such declaration and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, there shall be deposited with the Trustee a sum sufficient to pay all the principal, Make-Whole Redemption Price or Redemption Price of, and overdue interest on, the Bonds, and the reasonable charges and expenses of the Trustee, and any and all other Defaults actually known to the Trustee (other than in the payment of principal of and interest on the Bonds due and payable solely by reason of such declaration) shall have been cured to the reasonable satisfaction of the Trustee or provision reasonably deemed by the Trustee to be adequate shall have been made therefor, then, and in every such case, the Trustee shall, on behalf of the Holders of all of the Bonds, by written notice to the Corporation, rescind and annul such declaration and its consequences and waive such Default; but no such rescission and annulment shall extend to or shall affect any subsequent Default, or shall impair or exhaust any right or power consequent thereon.

Application of Moneys Collected by the Trustee. If an Event of Default shall occur and be continuing, all moneys then held or thereafter received by the Trustee under any of the provisions of the Indenture (subject to the provisions of the Indenture requiring moneys to be held for payment of particular Bonds) shall be applied by the Trustee as follows and in the following order:

(A) To the payment of any expenses necessary in the opinion of the Trustee to protect the interests of the Holders of the Bonds and payment of reasonable fees and expenses of the Trustee (including reasonable fees and disbursements of its counsel) incurred in and about the performance of its powers and duties under the Indenture; and

(B) To the payment of the principal, Make-Whole Redemption Price or Redemption Price of and interest then due on the Bonds (upon presentation of the Bonds to be paid, and stamping thereon of the payment if only partially paid, or surrender thereof if fully paid) subject to the provisions of the Indenture, as follows:

(1) Unless the principal of all of the Bonds shall have become or have been declared due and payable,

First: To the payment to the Persons entitled thereto of all installments of interest then due in the order of the maturity of such installments, and, if the amount available shall not be sufficient to pay in full any installment or installments due on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the Persons entitled thereto, without any discrimination or preference; and

Second: To the payment to the Persons entitled thereto of the unpaid principal, Make-Whole Redemption Price or Redemption Price of any Bonds which shall have become due, whether at maturity or by call for redemption, in the order of their due dates, with interest on the overdue principal at the rate borne by the Bonds, and, if the amount available shall not be sufficient to pay in full all the Bonds due on any date, together with such interest, then to the payment thereof ratably, according to the amounts of principal, Make-Whole Redemption Price or Redemption Price due on such date to the Persons entitled thereto, without any discrimination or preference.

(2) If the principal of all of the Bonds shall have become or have been declared due and payable, to the payment of the principal and interest then due and unpaid upon the Bonds, with interest on

the overdue principal at the rate borne by the Bonds, and, if the amount available shall not be sufficient to pay in full the whole amount so due and unpaid, then to the payment thereof ratably, without preference or priority of principal over interest, or of interest over principal, or of any installment of interest over any other installment of interest, or of any Bond over any other Bond, according to the amounts due respectively for principal and interest, to the Persons entitled thereto without any discrimination or preference.

Trustee to Represent Bondholders. The Trustee is irrevocably appointed (and the successive respective Holders of the Bonds, by taking and holding the same, shall be conclusively deemed to have so appointed the Trustee) as trustee and true and lawful attorney-in-fact of the Holders of the Bonds for the purpose of exercising and prosecuting on their behalf such rights and remedies as may be available to such Holders under the provisions of the Bonds, the Indenture, Obligation No. 40 and applicable provisions of any law. Upon the occurrence and continuance of an Event of Default or other occasion giving rise to a right in the Trustee to represent the Bondholders, the Trustee in its discretion may, and upon the written request of the Holders of not less than a majority in aggregate principal amount of the Bonds then Outstanding, and upon being indemnified to its satisfaction therefor, shall, proceed to protect or enforce its rights or the rights of such Holders by such appropriate action, suit, mandamus or other proceedings as it shall deem most effectual to protect and enforce any such right, at law or in equity, either for the specific performance of any covenant or agreement contained in the Indenture, or in aid of the execution of any power granted in the Indenture, or for the enforcement of any other appropriate legal or equitable right or remedy vested in the Trustee, or in such Holders under the Bonds, the Indenture or any applicable law; and upon instituting such proceeding, the Trustee shall be entitled, as a matter of right, to the appointment of a receiver of the amounts pledged under the Indenture, pending such proceedings. If more than one such request is received by the Trustee from the Holders, the Trustee shall follow the written request executed by the Holders of the greatest percentage (which percentage shall be, in any case, not less than a majority in aggregate principal amount) of the Bonds then Outstanding. All rights of action under the Indenture or the Bonds or otherwise may be prosecuted and enforced by the Trustee without the possession of any of the Bonds or the production thereof in any proceeding relating thereto, and any such suit, action or proceeding instituted by the Trustee shall be brought in the name of the Trustee for the benefit and protection of all the Holders of such Bonds, subject to the provisions of the Indenture.

Bondholders' Direction of Proceedings. The Holders of a majority in aggregate principal amount of the Bonds then Outstanding shall have the right, by an instrument or concurrent instruments in writing executed and delivered to the Trustee, and upon indemnifying the Trustee to its satisfaction therefor, to direct the time, method and place of conducting all remedial proceedings taken by the Trustee under the Indenture, provided that such direction shall not be otherwise than in accordance with law and the provisions of the Indenture, and that the Trustee shall have the right to decline to follow any such direction which in the opinion of the Trustee would be unjustly prejudicial to Bondholders not parties to such direction.

Limitation on Bondholders' Right to Sue. No Holder of any Bond shall have the right to institute any suit, action or proceeding at law or in equity, for the protection or enforcement of any right or remedy under the Indenture, Obligation No. 40 or any applicable law with respect to such Bond, unless (1) such Holder shall have given to the Trustee written notice of the occurrence of an Event of Default; (2) the Holders of not less than a majority in aggregate principal amount of the Bonds then Outstanding shall have made written request upon the Trustee to exercise the powers granted in the Indenture or to institute such suit, action or proceeding in its own name; (3) such Holder or Holders shall have offered to the Trustee indemnity reasonably satisfactory to it against the costs, expenses and liabilities to be incurred in compliance with such request; and (4) the Trustee shall have refused or omitted to comply with such request for a period of sixty (60) days after such written request shall have been received by, and such offer of indemnity shall have been made to, the Trustee.

Such notification, request, offer of indemnity and refusal or omission are declared by the Indenture, in every case, to be conditions precedent to the exercise by any Holder of Bonds of any remedy under the Indenture or under law; it being understood and intended that no one or more Holders of Bonds shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Indenture or the rights of any other Holders of Bonds, or to enforce any right under the Indenture or applicable law with respect to the Bonds, except in the manner provided in the Indenture, and that all proceedings at law or in equity to enforce any such right shall be instituted, had and maintained in the manner provided in the Indenture and for the benefit and protection of all Holders of the Outstanding Bonds, subject to the provisions of the Indenture.

Absolute Obligation of Corporation. Notwithstanding any other provision of the Indenture, or in the Bonds, nothing shall affect or impair the obligation of the Corporation, which is absolute and unconditional, to pay the principal, Make-Whole Redemption Price or Redemption Price of and interest on the Bonds to the respective Holders of the Bonds at their date of maturity, or upon call for redemption, as provided in the Indenture, or, subject to the provisions of the Indenture regarding limitation on Bondholders' right to sue, affect or impair the right of such Holders to enforce such payment pursuant to the terms of the Bonds.

Termination of Proceedings. In case any proceedings taken by the Trustee or any one or more Bondholders on account of any Event of Default shall have been discontinued or abandoned for any reason or shall have been determined adversely to the Trustee or the Bondholders, then in every such case the Corporation, the Trustee and the Bondholders, subject to any determination in such proceedings, shall be restored to their former positions and rights under the Indenture, severally and respectively, and all rights, remedies, powers and duties of the Corporation, the Trustee and the Bondholders shall continue as though no such proceedings had been taken.

Remedies Not Exclusive. No remedy conferred in the Indenture upon or reserved to the Trustee or to the Holders of the Bonds is intended to be exclusive of any other remedy or remedies, and each and every such remedy, to the extent permitted by law, shall be cumulative and in addition to any other remedy given under the Indenture or now or hereafter existing at law or in equity or otherwise.

Delay or Omission Not Waiver. No delay or omission of the Trustee or of any Holder of the Bonds to exercise any right or power arising upon the occurrence of any Default shall impair any such right or power or shall be construed to be a waiver of any such Default or an acquiescence therein; and every power and remedy given by the Indenture to the Trustee or to the Holders of the Bonds may be exercised from time to time and as often as may be deemed expedient.

Waiver of Past Defaults. The Trustee may, and upon request of the Holders of not less than a majority in aggregate principal amount of the Outstanding Bonds shall, on behalf of the Holders of all the Bonds waive any past Default under the Indenture and its consequences, except a Default: (A) In the payment of the principal, Make-Whole Redemption Price or Redemption Price of or interest on any Bond, or (B) in respect of a covenant or other provision of the Indenture which, pursuant to the Indenture, cannot be modified or amended without the consent of the Holder of each Outstanding Bond affected. Upon any such waiver, such Default shall cease to exist, and any Event of Default arising therefrom shall be deemed to have been cured, for every purpose of the Indenture, but no such waiver shall extend to any subsequent or other Default or impair any right consequent thereon.

Undertaking for Costs. Subject to the provisions of the Indenture regarding the Trustee's rights to compensation and indemnification, the parties to the Indenture agree, and each Holder of any Bond by such Person's acceptance thereof shall be deemed to have agreed, that any court may in its discretion require, in any suit for the enforcement of any right or remedy under the Indenture, or in any suit against the Trustee for any action taken or omitted by it as Trustee, the filing by any party litigant in such suit of an undertaking to pay the costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorneys fees, against any party litigant in such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant; but the provisions of this paragraph shall not apply to any suit instituted by the Trustee or to any suit instituted by any Bondholder or group of Bondholders holding in the aggregate more than a majority in aggregate principal amount of the Outstanding Bonds.

Notice of Default. Upon a Responsible Officer's actual knowledge of the existence of any Default under the Indenture, the Trustee shall notify the Corporation in writing as soon as practicable, but in any event within five (5) Business Days.

Upon a Responsible Officer's actual knowledge of the existence of any Default under the Indenture, the Trustee shall transmit by mail to all Bondholders, as their names and addresses appear in the bond register, notice of such Default under the Indenture within sixty (60) days, unless such Default shall have been cured or waived; provided, however, that, except in the case of a Default in the payment of the principal, Make-Whole Redemption Price or Redemption Price or interest on any Bond, the Trustee shall be protected in withholding such notice if and so long as the board of directors, the executive committee or a trust committee of directors or Responsible Officers of the Trustee in good faith determine that the withholding of such notice is in the interest of the Bondholders; provided,

further, that in the case of any Default as specified in (c) under “Events of Default” above, no such notice to Bondholders shall be given until at least thirty (30) days after the date of the applicable Notice of Default.

The Trustee

Duties, Immunities and Liabilities of Trustee. The Trustee shall, prior to an Event of Default, and after the curing or waiver of all Events of Default which may have occurred, perform such duties and only such duties as are specifically set forth in the Indenture, and, except to the extent required by law, no implied covenants or obligations shall be read into the Indenture against the Trustee. The Trustee shall, during the existence of any Event of Default (which has not been cured or waived), exercise such of the rights and powers vested in it by the Indenture, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of such person’s own affairs.

The Corporation may remove the Trustee at any time unless an Event of Default shall have occurred and then be continuing, and shall remove the Trustee if at any time requested to do so by an instrument or concurrent instruments in writing signed by the Holders of not less than a majority in aggregate principal amount of the Bonds then Outstanding (or their attorneys duly authorized in writing) or if at any time the Trustee shall cease to be eligible in accordance with the Indenture, or shall become incapable of acting, or shall be adjudged as bankrupt or insolvent, or a receiver of the Trustee or its property shall be appointed, or any public officer shall take control or charge of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation, in each case by giving written notice of such removal to the Trustee, and thereupon shall appoint a successor Trustee by an instrument in writing.

The Trustee may at any time resign by giving written notice of such resignation to the Corporation and by giving the Bondholders notice of such resignation by mail at the addresses shown on the registration books of the Trustee. Upon receiving such notice of resignation, the Corporation shall promptly appoint a successor Trustee by an instrument in writing. The Trustee shall not be relieved of its duties until such successor Trustee has accepted appointment.

Any removal or resignation of the Trustee and appointment of a successor Trustee shall become effective upon acceptance of appointment by the successor Trustee. If no successor Trustee shall have been appointed and have accepted appointment within thirty (30) days of giving notice of removal or notice of resignation as aforesaid, the outgoing Trustee or any Bondholder (on behalf of itself and all other Bondholders) may petition any court of competent jurisdiction for the appointment of a successor Trustee, and such court may thereupon, after such notice (if any) as it may deem proper, appoint such successor Trustee. Any successor Trustee appointed under the Indenture shall signify its acceptance of such appointment by executing and delivering to the Corporation and to its predecessor Trustee a written acceptance thereof, and thereupon such successor Trustee, without any further act, deed or conveyance, shall become vested with all the moneys, estates, properties, rights, powers, trusts, duties and obligations of such predecessor Trustee, with like effect as if originally named Trustee in the Indenture; but, nevertheless at the request of the successor Trustee, such predecessor Trustee shall execute and deliver any and all instruments of conveyance or further assurance and do such other things as may reasonably be required for more fully and certainly vesting in and confirming to such successor Trustee all the right, title and interest of such predecessor Trustee in and to any property held by it under the Indenture and shall pay over, transfer, assign and deliver to the successor Trustee any money or other property subject to the trusts and conditions set forth in the Indenture. Upon request of the successor Trustee, the Corporation shall execute and deliver any and all instruments as may be reasonably required for more fully and certainly vesting in and confirming to such successor Trustee all such moneys, estates, properties, rights, powers, trusts, duties and obligations. Upon acceptance of appointment by a successor Trustee as provided in this paragraph, the Corporation shall mail or cause to be mailed (at the expense of the Corporation) a notice of the succession of such Trustee to the trusts under the Indenture to the Bondholders at the addresses shown on the registration books of the Trustee. If the Corporation fails to mail such notice within fifteen (15) days after acceptance of appointment by the successor Trustee, the successor Trustee shall cause such notice to be mailed at the expense of the Corporation.

Any successor Trustee shall be a national banking association, trust company or bank having trust powers in the State of California or under the laws of the United States, having a combined capital and surplus of (or if such national banking association, trust company or bank is a member of a bank holding system, its bank holding company

shall have a combined capital and surplus of) at least fifty million dollars (\$50,000,000), and subject to supervision or examination by federal or State of California authority. If such national banking association, bank or trust company publishes a report of condition at least annually, pursuant to law or to the requirements of any supervising or examining authority above referred to, then for the purpose of this subsection the combined capital and surplus of such national banking association, bank or trust company shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. In case at any time the Trustee shall cease to be eligible in accordance with the provisions of this paragraph, the Trustee shall resign immediately in the manner and with the effect specified in the Indenture.

Preservation and Inspection of Documents. All documents received by the Trustee under the provisions of the Indenture shall be retained in its possession and shall be subject upon prior written notice to the inspection of the Corporation and any Bondholder, and their agents and representatives duly authorized in writing, at reasonable hours and under reasonable conditions.

Modification or Amendment of the Indenture

Amendments Permitted. The Indenture and the rights and obligations of the Corporation and of the Holders of the Bonds and of the Trustee may be modified or amended from time to time and at any time by an indenture or one or more Supplemental Indentures, which the Corporation and the Trustee may enter into when the written consent of the Holders of a majority in aggregate principal amount of the Bonds then Outstanding shall have been provided to the Trustee. No such modification or amendment shall (1) extend the fixed maturity of any Bond, or reduce the amount of principal thereof, or reduce the rate of interest thereon, or extend the time of payment of interest thereon, or reduce any redemption price or premium payable upon the redemption thereof, without the consent of the Holder of each Bond so affected, or (2) reduce the aforesaid percentage of Bonds the consent of the Holders of which is required to effect any such modification or amendment, or permit the creation of any lien on the Indenture Fund or the amounts pledged under the Indenture prior to or on parity with the lien created by the Indenture, or deprive the Holders of the Bonds of the lien created by the Indenture on the Indenture Fund and such amounts (except as expressly provided in the Indenture), without the consent of the Holders of all Bonds then Outstanding. It shall not be necessary for the consent of the Bondholders to approve the particular form of any Supplemental Indenture, but it shall be sufficient if such consent shall approve the substance thereof. Promptly after the execution by the Corporation and the Trustee of any Supplemental Indenture pursuant to this paragraph, the Trustee shall mail a notice, setting forth in general terms the substance of such Supplemental Indenture, to the Bondholders at the addresses shown on the registration books of the Trustee. Any failure to give such notice, or any defect therein, shall not, however, in any way impair or affect the validity of any such Supplemental Indenture.

The Indenture and the rights and obligations of the Corporation, of the Trustee and of the Holders of the Bonds may also be modified or amended from time to time and at any time by an indenture or one or more Supplemental Indentures, which the Corporation and the Trustee may enter into without the necessity of obtaining the consent of any Bondholders, but only to the extent permitted by law and only for any one or more of the following purposes: (1) to add to the covenants and agreements of the Corporation contained in the Indenture, to pledge or assign additional security for the Bonds (or any portion thereof), or to surrender any right or power reserved in the Indenture to or conferred upon the Corporation, provided that such covenant, agreement, pledge, assignment or surrender shall not materially adversely affect the interests of the Holders of the Bonds; (2) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of curing or correcting any defective provision, contained in the Indenture, or in regard to matters or questions arising under the Indenture, as the Corporation or the Trustee may deem necessary or desirable, and which shall not materially adversely affect the interests of the Holders of the Bonds; (3) to modify, amend or supplement the Indenture or any Supplemental Indenture in such manner as to permit the qualification hereof under the Trust Indenture Act of 1939, as amended, or any similar federal statute hereafter in effect, and to add such other terms, conditions and provisions as may be permitted by such act or similar federal statute, and which shall not materially adversely affect the interests of the Holders of the Bonds; (4) to provide for the procedures required to permit any Bondholder, at its option, to utilize an uncertificated system of registration of its Bond or to facilitate the registration of the Bonds in the name of a nominee of the Securities Depository in accordance with the provisions of the Indenture; (5) to authorize different denominations of the Bonds and to make correlative amendments and modifications to the Indenture regarding exchangeability of Bonds of different authorized denominations, redemptions of portions of Bonds of particular authorized denominations and similar amendments and modifications of a technical nature; (6) to make any changes required by a Rating Agency in order to obtain or maintain

a rating for the Bonds; (7) to modify, amend or supplement any other provision of the Indenture in a manner that shall not materially adversely affect the interests of the Holders of the Bonds; or (8) to provide for the issuance of Additional Bonds.

The Trustee may in its discretion, but shall not be obligated to, enter into any such Supplemental Indenture authorized by either of the two preceding paragraphs which materially adversely affects the Trustee's own rights, duties or immunities under the Indenture or otherwise.

Effect of Supplemental Indenture. Upon the execution of any Supplemental Indenture pursuant to the Indenture, the Indenture shall be deemed to be modified and amended in accordance therewith, and the respective rights, duties and obligations under the Indenture of the Corporation, the Trustee and all Holders of Bonds Outstanding shall thereafter be determined, exercised and enforced under the Indenture subject in all respects to such modification and amendment, and all the terms and conditions of any such Supplemental Indenture shall be deemed to be part of the terms and conditions of the Indenture for any and all purposes.

Amendment of Particular Bonds. The provisions of the Indenture regarding modification or amendment of the Indenture shall not prevent any Bondholder from accepting any amendment as to the particular Bonds held by such Bondholder, provided that due notation thereof is made on such Bonds.

Defeasance

Discharge of Bonds and Indenture. The Bonds may be paid or discharged by the Corporation or the Trustee on behalf of the Corporation in any of the following ways: (A) by paying or causing to be paid the principal or Make-Whole Redemption Price or Redemption Price and interest on all Bonds Outstanding, as and when the same become due and payable; (B) by depositing with the Trustee, in trust, at or before maturity, moneys or securities in the necessary amount (as provided in the Indenture) to pay when due or redeem all Bonds then Outstanding; or (C) by delivering to the Trustee, for cancellation by it, all Bonds then Outstanding.

If the Corporation shall also pay or cause to be paid all other sums payable under the Indenture by the Corporation, then and in that case at the election of the Corporation (evidenced by a Certificate of the Corporation filed with the Trustee signifying the intention of the Corporation to discharge all such indebtedness and the Indenture and upon receipt by the Trustee of an Opinion of Counsel to the effect that the obligations under the Indenture and the Bonds have been discharged), and notwithstanding that any Bonds shall not have been surrendered for payment, the Indenture and the pledge of the Indenture Fund and all amounts held therein made under the Indenture and all covenants, agreements and other obligations of the Corporation under the Indenture (except as otherwise provided in the Indenture) shall cease, terminate, become void and be completely satisfied and discharged and the Bonds shall be deemed paid. In such event, upon the request of the Corporation, the Trustee shall promptly cause an accounting for such period or periods as may be requested by the Corporation to be prepared and sent to the Corporation and shall execute and deliver to the Corporation all such instruments as may be necessary to evidence such satisfaction and discharge, and the Trustee shall pay over, transfer, assign or deliver to the Corporation all moneys or securities or other property held by it pursuant to the Indenture that are not required for the payment or redemption of Bonds not theretofore surrendered for such payment or redemption.

The Corporation may at any time surrender to the Trustee for cancellation by it any Bonds previously issued and delivered, which the Corporation may have acquired in any manner whatsoever, and such Bonds, upon such surrender and cancellation, shall be deemed to be paid and retired.

Evidence of Rights of Bondholders

The ownership of Bonds shall be proved by the registration books for the Bonds held by the Trustee.

Any request, consent, or other instrument or writing of the Holder of any Bond shall bind every future Holder of the same Bond and the Holder of every Bond issued in exchange therefor or in lieu thereof, in respect of anything done or suffered to be done by the Trustee or the Corporation in accordance therewith or reliance thereon.

Waiver of Personal Liability

No member, officer, agent or employee of the Corporation shall be individually or personally liable for the payment of the principal, Make-Whole Redemption Price or Redemption Price of or interest on the Bonds, or be subject to any personal liability or accountability, by reason of the issuance thereof or the performance of any duty under the Indenture; but nothing contained in the Indenture shall relieve any such member, officer, agent or employee from the performance of any official duty provided by law or by the Indenture.

Governing Law; Venue

The Indenture shall be construed in accordance with and governed by the Constitution and the laws of the State of California applicable to contracts made and performed in the State of California. The Indenture shall be enforceable in the State of California; provided, however, that any action arising under the Indenture shall (unless waived by the Corporation) be filed and maintained in the State of California.

APPENDIX D

INFORMATION REGARDING BOOK-ENTRY ONLY SYSTEM

THE INFORMATION PROVIDED IN THIS APPENDIX D HAS BEEN PROVIDED BY DTC. NO REPRESENTATION IS MADE BY SHC, THE TRUSTEE OR THE UNDERWRITERS AS TO THE ACCURACY OR ADEQUACY OF SUCH INFORMATION PROVIDED BY DTC OR AS TO THE ABSENCE OF MATERIAL ADVERSE CHANGES IN SUCH INFORMATION SUBSEQUENT TO THE DATE OF THIS OFFERING MEMORANDUM.

The Depository Trust Company (“DTC”), New York, New York, will act as securities depository for the Series 2018 Taxable Bonds. The Series 2018 Taxable Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued in the aggregate principal amount of the Series 2018 Taxable Bonds and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company of DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has a Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of the Series 2018 Taxable Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2018 Taxable Bonds on DTC’s records. The ownership interest of each actual purchaser of each Series 2018 Taxable Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2018 Taxable Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their beneficial ownership interests in the Series 2018 Taxable Bonds, except in the event that use of the book-entry system for the Series 2018 Taxable Bonds is discontinued.

To facilitate subsequent transfers, all Series 2018 Taxable Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2018 Taxable Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2018 Taxable Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Series 2018 Taxable Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2018 Taxable Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2018 Taxable Bonds, such as redemptions, defaults, and proposed amendments to the bond documents. For example, Beneficial Owners of the Series 2018 Taxable Bonds may wish to ascertain that the nominee holding the Series 2018 Taxable Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Trustee and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Series 2018 Taxable Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in the Series 2018 Taxable Bonds to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2018 Taxable Bonds unless authorized by a Direct Participant in accordance with DTC's Money Market Instrument Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the issuer of the Series 2018 Taxable Bonds as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2018 Taxable Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, Redemption Price, Make-Whole Redemption Price and interest payments on the Series 2018 Taxable Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the issuer of the Series 2018 Taxable Bonds or the Trustee, on a payment date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participants and not of DTC, its nominee, the Trustee or the issuer of the Series 2018 Taxable Bonds, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, Redemption Price, Make-Whole Redemption Price and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the issuer of the Series 2018 Taxable Bonds or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of the Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to any Series 2018 Taxable Bonds at any time by giving reasonable notice to the issuer of the Series 2018 Taxable Bonds or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be printed and delivered.

The issuer of the Series 2018 Taxable Bonds may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Series 2018 Taxable Bond certificates for the Series 2018 Taxable Bonds will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that SHC believes to be reliable, but SHC takes no responsibility for the accuracy thereof.



Stanford

HEALTH CARE

