

16. Health Science Center Affiliations and Agreements

a. KentuckyOne Healthcare, Inc. Affiliation, Lease and Operating Agreement

In November 2012, the University, Commonwealth, UMC, and KentuckyOne Health, Inc. (KentuckyOne) amended and restated the UMC land lease and executed a new academic affiliation agreement, superseding the one dated July 1, 2007. The initial term is twenty years, beginning on the Integration Date, which was March 1, 2013.

The academic affiliation agreement calls for a strategic programmatic investment fund and plan. KentuckyOne will invest \$114.5 million in key University clinical service lines and departments and \$20.5 million in academic and programmatic investment in clinical services lines at Jewish Hospital and St. Mary's Healthcare, Inc. (Jewish Hospital) facilities. An additional \$3.0 million per annum for twenty years will be made available for research. As of June 30, 2016, the University received \$23.0 million and \$33.8 million related to the strategic programmatic investments and research initiatives, respectively. To date the University has received \$78.5 million related to strategic investment and research infrastructure. As the University has not yet expended the funds in accordance with the proposals, \$21.2 million is included in current advances and \$28.4 million is included in noncurrent advances in the statement of net position as of June 30, 2016. \$12.0 million in current advances and \$30.8 million in noncurrent advances are represented in the statement of net position as of June 30, 2015. The agreement calls for the payment annually of discretionary funding of \$15.0 million over three years with payment contingent on the achievement of certain performance metrics. During the years ended June 30, 2016 and 2015, the University did not receive the funding for discretionary purposes to support key statewide areas of focus.

The academic affiliation agreement also calls for KentuckyOne to provide an aggregate \$75.0 million per annum in academic support for the initial term of five years subject to annual adjustments to the Medicare base rate. During years six through twenty the academic support will not exceed \$95.0 million or be less than \$55.0 million. The academic support payment includes funding for certain full-time equivalent resident positions over the term of the affiliation agreement. Funding for the years ended June 30, 2016 and 2015 were \$60.7 million and \$61.4 million, respectively, and are included in clinical services and practice plan revenues in the statement of revenues, expenses and changes in net position.

Concurrently with the academic affiliation agreement, KentuckyOne entered into a joint operating agreement with UMC, the Hospital's operator prior to March 1, 2013. KentuckyOne agreed to be the sole and exclusive agent acting for and on behalf of UMC to provide the day-to-day management of the University Hospital, with the exception of the Maintained Procedures, as defined in the agreement. The agreement calls for KentuckyOne to make annual payments of not less than \$7.5 million and not more than \$17.5 million based on the ratio of net operating income to budget for KentuckyOne. The accompanying statements of revenues, expenses, and changes in net position include approximately \$7.5 million for each of the years ended June 30, 2016 and 2015 in clinical services and practice plan revenues related to the joint operating agreement.

Concurrently with the academic affiliation agreement and joint operating agreements, the Commonwealth and the University as lessor amended and restated the lease agreement with UMC to lease the Hospital. The annual lease payment is \$6.5 million through December 31, 2016. At that time, the annual rent escalates by \$500,000 and will continue to escalate every five years thereafter up to \$8.0 million. Included in the joint operating agreement is a provision that \$5.0 million of the annual rent payment will flow to the Quality and Charity Care Trust. The lease provides for additional rent each year to be adjusted annually commensurate with the increase or decrease in the utilities and other operating expenses of the

leased property. The University is required to pay KentuckyOne any amounts related to the utilities and other operating expenses collected from third parties. Lease revenue, net of the amounts sent to the Quality and Charity Care Trust, was \$6.8 million and \$7.5 million for the years ended June 30, 2016 and 2015, and is included in clinical services and practice plan revenues in the statements of revenues, expenses, and changes in net position. Lease expense for the years ended June 30, 2016 and 2015 was \$0.9 million and \$1.4 million, respectively and is included in public service expense in the statements of revenues, expenses, and changes in net position.

The accompanying statements of net position include approximately \$4.9 million and \$4.3 million in accounts receivable for the years ended June 30, 2016 and 2015, respectively, representing amounts due from UMC pursuant to the lease agreement.

The above agreements address the patient care needs of the Hospital's inpatients. The University's School of Medicine operates various clinics, which generate patient care revenues from the treatment of outpatients as well as laboratories that serve both inpatients and outpatients.

b. Quality and Charity Care Trust Transfers for Hospital Operations

In November 2014, the University entered into The Revised Quality and Charity Care Trust agreement (Revised Trust Agreement) with the Commonwealth, Jefferson County, the Louisville Metro Government, and UMC for the purpose of providing medically necessary hospital care, both inpatient and outpatient, to indigent patients in the Louisville area. The Quality and Charity Care Trust, Inc. (Trust) receives government funds and disburses them for Trust operations in accordance with the terms of the agreement.

The Trust, funded by the Commonwealth and the local governments, is charged with the obligation to provide for the health care needs of economically disadvantaged persons who have historically been ministered to by the University as a public service in the course of its teaching programs.

The University and the Commonwealth selected UMC, a Kentucky non-profit corporation, as the provider of the healthcare services through the Hospital. Under the November 2012 joint operating agreement, KentuckyOne agreed to manage the Hospital in a manner consistent with the Revised Trust Agreement. Funding of \$4.9 million and \$4.5 million for the years ended June 30, 2016 and 2015, respectively, provided by the Commonwealth, Louisville Metro Government, and the University is held for the Trust by the University and paid to UMC as specified in the Trust agreement. This funding is not included in the statements of revenues, expenses and changes in net position as it is a pass-through to UMC.

The funds available to the Trust from the government sources are set forth in the Revised Trust Agreement for the term. The government funding is paid to the Trust within thirty days of receipt and approval of the reports by the Commonwealth as required by the Revised Trust Agreement.

At June 30, 2015, the University's statement of net position includes \$0.9 million in accounts payable and accrued liabilities related to their portion of the final government funding for the fiscal year ended June 30, 2016.

c. Norton Healthcare

In December 17, 2015, Norton Healthcare, Inc., (Norton), the University and Commonwealth agreed to a Settlement Agreement, a First Amendment to Lease and a First Amendment to Master Affiliation Agreement. These agreements provide for \$30.0 million annual support payments

from Norton to the University and its affiliates through Individual Agreements for research, academic support, residences and fellowships and related costs. In addition, the agreement stipulates that Norton provide additional financial support to the University of Louisville Pediatrics Department of \$24.0 million over eight years and expend at least \$35.0 million in facility improvements and other capital expenditures at Kosair Children's Hospital. Payments received by the University and its affiliates are included in clinical services and practice plan revenues in the statements of revenues, expenses, and changes in net position. Funding for the agreement for the years ended June 30, 2016 and 2015 was \$35.0 million and \$31.7 million, respectively. The Settlement Agreement also included a payment of \$8.0 million to the Research Foundation for expenses incurred.

d. Cardiovascular Innovation Institute

In October 2003, the University of Louisville and Jewish Hospital Cardiovascular Innovation Institute (the Institute) was incorporated with the purpose including, but not limited to, the development and operation of a world-class institute to test, clinically evaluate, and develop heart assist devices, biosensors, and related technologies to improve the care for patients with heart disease.

The University entered into a Master Facility Agreement with Jewish Hospital to set forth the principles regarding the facility to support the Institute. The Master Facility Agreement called for a research building to be jointly built by the University and Jewish Hospital on land owned by the University. Jewish Hospital has transferred the use of a portion of the building, through a lease, to the Institute or to the University, for exclusive use by the Institute. The building was completed in December 2006.

17. Leases

The University has entered into operating leases related to academic, research and facilities. The University has three operating lease agreements related to use of athletic facilities. Under these lease agreements, the University's rights have been assigned to the Association.

a. Kentucky State Fair Board

The University has entered into a lease agreement with the Kentucky State Fair Board (KSFB) for use of an athletic building. The University's rights under this agreement have been assigned to the Association. The lease has an initial term of 26 years, ending June 30, 2023. Annual lease payments range from \$25,000 to \$66,550. Total lease expense for each of the years ended June 30, 2016 and 2015 amounted to approximately \$61,000.

b. Central Station, LLC

The Association has entered into a lease agreement with AAF-Louisville, LLC (d/b/a Central Station, LLC), a related party, for use of the Central Station Office Building. The lease has an initial term of 21 years, ending September 30, 2026. Annual lease payments started at approximately \$47,000, and are subject to increases based on increases in the CPI. Total lease expenses during the years ended June 30, 2016 and 2015 amounted to approximately \$180,000 and \$84,000, respectively.

c. Louisville Arena Authority, Inc.

In July 2008, the Association entered into a lease agreement with the Arena Authority. The lease has an initial term of 36 years. Annual lease payments are equal to the greater of 10% of gross