Howard County General Hospital, Inc.

Financial Statements
June 30, 2012 and 2011

Howard County General Hospital, Inc.
Index
June 30, 2012 and 2011

REPORT OF INDEPENDENT AUDITORS

To the Board of Trustees of
Howard County General Hospital, Inc.:

In our opinion, the accompanying balance sheets and the related statements of operations and changes in net assets and cash flows present fairly, in all material respects, the financial position of Howard County General Hospital, Inc. (the "Hospital") at June 30, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

September 28, 2012

Howard County General Hospital, Inc.
Balance Sheets
June 30, 2012 and 2011
(in thousands)

	2012	2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,508	$ 7,590
Short-term investments	1,262	937
Assets whose use is limited - used for current liabilities	-	5,677
Patient accounts receivable, net of estimated uncollectibles of $6,149 and $5,115 as of June 30, 2012 and 2011, respectively	27,830	23,285
Due from others	1,571	1,195
Inventories of supplies	3,696	3,899
Prepaid expenses and other current assets	2,306	1,353
Total current assets	41,173	43,936
Assets whose use is limited		
By donors or grantors for:		
Interest in net assets of Howard Hospital Foundation	13,228	14,439
Other	135	135
Total assets whose use is limited	13,363	14,574
Investments	44,895	15,521
Investments in joint ventures	3,485	3,543
Property, plant and equipment	248,479	248,550
Less: allowance for depreciation and amortization	(81,278)	(70,250)
Total property, plant and equipment, net	167,201	178,300
Net pension asset	-	864
Other assets	2,675	4,907
Total assets	$ 272,792	$ 261,645

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

Howard County General Hospital, Inc.
Balance Sheets, Continued
June 30, 2012 and 2011
(in thousands)

	2012	2011
LIABILITIES AND NET ASSETS		
Current liabilities:		
Current portion of long-term debt	$ 40,000	$ 2,800
Accounts payable	6,029	4,241
Accrued liabilities	15,227	14,169
Due to affiliates	3,145	727
Accrued interest	-	2,877
Accrued vacation	6,125	5,852
Advances from third party payors	9,765	8,595
Current portion of estimated malpractice costs	1,073	79
Total current liabilities	81,364	39,340
Long-term debt, net of current portion	-	150,877
Estimated malpractice costs, net of current portion	3,824	2,565
Net pension liability	1,257	-
Long-term affiliate notes payable	109,870	-
Other long-term liabilities	20,601	10,499
Total liabilities	216,916	203,281
Net assets:		
Unrestricted	42,515	43,792
Temporarily restricted	10,301	11,561
Permanently restricted	3,060	3,011
Total net assets	55,876	58,364
Total liabilities and net assets	$ 272,792	$ 261,645

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

Howard County General Hospital, Inc.
Statements of Operations and Changes in Net Assets
for the years ended June 30, 2012 and 2011
(in thousands)

	2012	2011
Operating revenues:		
Net patient service revenue	$ 239,637	$ 229,505
Other revenue	3,194	2,402
Investment income	1,101	299
Total operating revenues	243,932	232,206
Operating expenses:		
Salaries, wages and benefits	108,671	106,555
Purchased services	46,567	45,566
Supplies and other	40,685	40,766
Interest	5,836	5,726
Provision for bad debts	11,108	10,219
Depreciation and amortization	17,315	15,846
Total operating expenses	230,182	224,678
Income from operations	13,750	7,528
Non-operating revenues and expenses:		
Interest expense on swap agreements	(1,513)	(1,508)
Change in market value of swap agreement	(9,990)	2,204
Realized and unrealized gains on investments	64	975
Loss on early retirement of debt	(3,581)	0
Excess of revenues (under) over expenses	(1,270)	9,199
Contributions to affiliates	(1,733)	(579)
Changes in unrealized gains on investments	-	567
Change in funded status of defined benefit plan	(1,597)	1,800
Net assets released from restictions used for purchase of property, plant and equipment	3,323	3,557
Change in unrestricted net assets	(1,277)	14,544
Changes in temporarily restricted net assets:		
Gifts, grants and bequests	3,323	1,692
Net change in Howard Hospital Foundation	(1,260)	542
Net assets released from restrictions used for purchase of property, plant and equipment	(3,323)	(3,557)
Change in temporarily restricted net assets	(1,260)	(1,323)
Changes in permanently restricted net assets:		
Net change in Howard Hospital Foundation	49	0
Decrease in permanently restricted net assets	49	0
Change in net assets	(2,488)	13,221
Net assets at beginning of year	58,364	45,143
Net assets at end of year	$ 55,876	$ 58,364

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

Howard County General Hospital, Inc.
Statements of Cash Flows
for the years ended June 30, 2012 and 2011
(in thousands)

	2012	2011
Operating activities:		
Change in net assets	$ (2,488)	$ 13,221
Adjustments to reconcile change in net assets		
to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	17,315	15,846
Provision for bad debts	11,108	10,219
Net realized and changes in unrealized gains on investments	(64)	(1,542)
Change in market value of swap agreement	9,990	(2,204)
Change in funded status of defined benefit plan	1,597	(1,800)
Restricted contributions and investment income received	(3,323)	(1,692)
Gains on and returns of equity investments	58	503
Contributions to affiliates	1,733	579
Change in assets and liabilities:		
Patient accounts receivable	(15,653)	(10,281)
Inventories of supplies, prepaid expenses and other current assets	(132)	(556)
Due to/from affiliates, net	2,418	(56)
Other assets	36	(65)
Accounts payable, accrued liabilities and accrued vacation	4,813	(6,751)
Advances from third party payors	1,170	938
Accrued pension benefit costs	525	852
Estimated malpractice costs	5	191
Other long-term liabilities	112	137
Net cash and cash equivalents provided by operating activities	29,220	17,539
Investing activities:		
Purchases of property, plant and equipment	(7,608)	(13,720)
Purchases of investment securities	(35,929)	(11,470)
Sales of investment securities	11,971	6,891
Change in interest in net assets of Howard Hospital Foundation	1,211	(542)
Net cash and cash equivalents used in investing activities	(30,355)	(18,841)
Financing activities:		
Proceeds from restricted contributions and investment income received	3,323	1,692
Repayment of long-term debt	(114,107)	(2,675)
Proceeds from affiliate notes payable	110,570	0
Contributions to affiliates	(1,733)	(579)
Net cash and cash equivalents used in financing activities	(1,947)	(1,562)
Decrease in cash and cash equivalents	(3,082)	(2,864)
Cash and cash equivalents at beginning of year	7,590	10,454
Cash and cash equivalents at end of year	$ 4,508	$ 7,590

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

1. Organization and Summary of Significant Accounting Policies

Organization. The Johns Hopkins Health System Corporation ("JHHS") is the sole member of Howard County General Hospital, Inc. (the "Hospital" or "HCGH"). JHHS is a not-for-profit organization incorporated in the State of Maryland to, among other things, formulate policy among and provide centralized management for JHHS affiliates ("Affiliates"). In addition, JHHS provides certain shared services, including legal, coordination of marketing, and other functions for which HCGH is charged separately. The Hospital is a not-for-profit, community based health care institution governed by a board of trustees operated for the purpose of providing appropriate and effective health care services to the physically and mentally ill, the injured, obstetrical patients, and persons needing diagnostic and/or preventative services. The Hospital is committed to serve as the primary community health care resource for Howard County and adjacent communities and recognizes the need to be responsive to the needs of the population it serves. The Hospital's mission is to provide health care services, within the resources available, to all whom present themselves, regardless of race, creed, national origin, age or sex.

JHHS appoints HCGH's Board of Trustees. HCGH's Articles of Incorporation provide that JHHS' Board of Trustees will approve HCGH's annual operating budget and capital budgets, significant programmatic changes at HCGH, and other significant changes to HCGH including amendments of its articles of incorporation or bylaws, mergers, or dissolutions.

Use of estimates. The preparation of financial statements in accordance 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. Actual results could differ from those estimates.

Basis of presentation. The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Cash and cash equivalents. Cash and cash equivalents include amounts invested in accounts with depository institutions which are readily converted to cash, with original maturities of three months or less. Total deposits maintained at these institutions at times exceed the amount insured by federal agencies and therefore, bear a risk of loss. HCGH has not experienced such losses on these funds.

Inventories of supplies. Inventories of supplies are composed of medical supplies and drugs. Inventories of supplies are recorded at lower of cost or market using a first in, first out method.

Assets whose use is limited. Assets whose use is limited or restricted by the donor are recorded at fair value at the date of donation, which is then considered cost. Investment income or losses on investments of temporarily or permanently restricted assets is recorded as an increase or decrease in temporarily or permanently restricted net assets to the extent restricted by the donor or law. The cost of securities sold is based on the specific identification method.

Assets whose use is limited include assets held by trustees under debt agreements. These assets consist primarily of cash and short term investments, and accrued interest. The carrying amounts reported in the Balance Sheets approximate fair value.

Howard Hospital Foundation. Funds for the benefit of HCGH are owned, held and managed by Howard Hospital Foundation, Inc ("HHF"), a separate, not-for-profit Maryland corporation chartered in 1976. The affairs of HHF are managed by a Board of Trustees who is self-perpetuating. HCGH records an interest in net assets of HHF resulting from unrestricted, temporarily restricted and permanently restricted contributions that were solicited and held by HHF to be used exclusively for HCGH. HCGH records its interest in the net assets of HHF under assets whose use is limited.

Valuation of investments. Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value in the Balance Sheets. Debt and equity securities traded on a national securities and international exchange are valued as of the last reported sales price on the last business day of the fiscal year; investments traded on the over-the-counter market and listed securities for which no sale was reported on that date are valued at the average of the last reported bid and ask prices.

Investments include equity method investments in managed funds, which include hedge funds, private partnerships and other investments which do not have readily ascertainable fair values and may be subject to withdrawal restrictions. Investments in hedge funds, private partnerships, and other investments in managed funds (collectively "alternative investments"), are accounted for under the equity method, which approximates fair value. The equity method income or loss from these alternative investments is included in the Statements of Operations as an unrealized gain or loss within excess of revenues over (under) expenses.

Alternative investments are less liquid than HCGH's other investments. These instruments may contain elements of both credit and market risk. Such risks include, but are not limited to, limited liquidity, absence of oversight, dependence upon key individuals, emphasis on speculative investments, and nondisclosure of portfolio composition.

Investment income earned on cash balances (interest and dividends) are reported in the operating income section of the Statements of Operations under 'investment income'. Realized gains or losses related to the sale of investments, other than temporary impairments, and unrealized gains or losses on alternative investments are included in the non-operating section of the Statement of Operations included in excess of revenues over (under) expenses unless the income or loss is restricted by donor or law. Unrealized gains or losses on investments other than alternative investments are excluded from excess of revenues (under) over expenses.

On April 1, 2011, HCGH changed the classification of certain investments to a trading portfolio from available for sale. Accordingly, cumulative unrealized gains of $410 thousand were reclassified from unrestricted net assets to non-operating income included in the 'realized and unrealized gains (losses) on investments' within the Statement of Operations and Changes in Net Assets. This change was made as management's intent with respect to the nature of the investment portfolios has changed.

Investments in companies in which HCGH does not have control, but has the ability to exercise significant influence over operating and financial policies are accounted for using the equity method of accounting, and operating results flow through the investment income on the Statements of Operations and Change in Net Assets. Dividends paid are recorded as a reduction of the carrying amount of the investment.

Property, plant and equipment. Property, plant and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each asset class of depreciable asset and is computed using the straight-line method. Estimated useful lives assigned by HCGH range from 3 to 40 years. Interest costs incurred on borrowed funds, net of income earned, during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Repairs and maintenance costs are expensed as incurred. When property, plant and equipment are retired, sold or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is included in operations.

Gifts of long-lived assets such as land, buildings or equipment are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expiration of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Impairment of long-lived assets. Long-lived assets are reviewed for impairment when events and circumstances indicate that the carrying amount of an asset may not be recoverable. HCGH's policy is to record an impairment loss when it is determined that the carrying amount of the asset exceeds the sum of the expected undiscounted future cash flows resulting from use of the asset and its eventual disposition. Impairment losses are measured as the amount by which the carrying amount of the asset exceeds its fair value and are reported in the non-operating section of the Statement of Operations and Changes in Net Assets. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell.

Financing expenses. Financing expenses incurred in connection with the issuance of the Maryland Health and Higher Educational Facilities Authority ("MHHEFA") 1998 and 2008 Series Revenue Bonds have been capitalized and are included in other assets in the Balance Sheets. Unamortized financing expenses were approximately $2.1 million as of June 30, 2011. In April 2012, HCGH redeemed the outstanding MHHEFA 1998 Series Revenue Bonds and wrote off the remaining $2.0 million of unamortized financing expense as early retirement of the debt and is recorded in the non-operating section of the Statement of Operations. These expenses were being amortized over the terms of the bond issues using the effective interest method. Amortization expense of $117 thousand and $160 thousand was recorded in the years ended June 30, 2012 and 2011, respectively.

Accrued vacation. HCGH records a liability for amounts due to employees for future absences which are attributable to services performed in the current and prior periods.

Estimated malpractice costs. The provision for estimated medical malpractice claims includes estimates of the ultimate gross costs for both reported claims and claims incurred but not reported. Additionally, an insurance recovery has been recorded representing the amount expected to be recovered from the self insured captive insurance company.

Swap agreement. The value of the interest rate swap agreement entered into by HCGH is adjusted to market value monthly at the close of each accounting period based upon quotations from market makers. The change in market value, if any, is recorded in the Statements of Operations and Changes in Net Assets. Entering into interest rate swap agreements involves, to varying degrees, elements of credit, default, prepayment, market and documentation risk in excess of the amounts recognized on the Balance Sheets. Such risks involve the possibility that there will be no liquid market for these agreements, the counterparty to these agreements may default on its obligation to perform and there may be unfavorable changes in interest rates.

Temporarily and permanently restricted net assets. Temporarily restricted net assets are those whose use has been limited by donors or law to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity. Income generated from these assets is available for general program support. Permanently restricted net assets consist of endowment assets included in HHF.

Donor restricted gifts. Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Unconditional promises to give cash to HCGH over periods exceeding one year are discounted using a rate of return that a market participant would expect to receive over such periods, which will vary based on the pledge, at the date the pledge is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose for the restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Statements of Operations and Changes in Net Assets as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying combined financial statements.

Excess of revenues (under) over expenses. The Statements of Operations and Changes in Net Assets include excess of revenues (under) over expenses. Changes in unrestricted net assets which are excluded from excess of revenues (under) over expenses, consistent with industry practice, include changes in unrealized gains and losses on investments other than trading securities, change in funded status of defined benefit plans, cumulative effect of changes in accounting principle, permanent transfers of assets to and from affiliates for other than goods and services, and 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).

Income taxes. HCGH qualifies under Section 501(c)(3) of the Internal Revenue Code and is therefore, not subject to tax under current income tax regulations.

FASB's guidance on accounting for uncertainty in income taxes clarifies the accounting for uncertainty of income tax positions. This guidance defines the threshold for recognizing tax return positions in the financial statements as "more likely than not" that the position is sustainable, based on its technical merits. This guidance also provides guidance on the measurement, classification and disclosure of tax return positions in the financial statements. There is no impact on HCGH's financial statements during the years ended June 30, 2012 and 2011.

New Accounting Standards. Effective July 1, 2011, HCGH adopted the provisions of ASU 2010-06, "Improving Disclosures about Fair Value Measurements", which affects entities required to make disclosures about recurring and nonrecurring fair value measurements. This ASU requires that the Level 3 fair value roll forward activity be displayed gross, breaking out the purchases, issuances, sales and settlement activity. The adoption of this ASU did not have a significant impact on HCGH's disclosures.

Effective July 1, 2011, HCGH adopted the provisions of ASU 2010-23, "Measuring Charity Care for Disclosure", which states that direct and indirect cost be used as the measurement basis for charity care disclosure purposes and that the method used to determine such costs also be disclosed. The adoption of this ASU had no impact on HCGH'S financial condition, results of operations or cash flows.

Effective July 1, 2011, HCGH adopted the provisions of ASU 2010-24, "Presentation of Insurance Claims and Related Insurance Recoveries", which clarifies that health care entities should not net insurance recoveries against the related claims liabilities. In connection with HCGH'S adoption of ASU 2010-24, HCGH recorded an increase in its assets and liabilities in the accompanying consolidated Balance Sheet as of June 30, 2012 as follows:

Caption on Combined Balance Sheet	2012
Prepaid expenses and other current assets	$ 994
Other assets	1,254
Total assets	$ 2,248
Current portion of estimated malpractice costs	$ 994
Estimated malpractice costs, net of current portion	1,254
Total liabilities	$ 2,248

The assets and liabilities represent HCGH's estimated self-insured captive insurance recoveries for claims reserves and certain claims in excess of self-insured retention levels. The insurance recoveries and liabilities have been allocated between short-term and long-term assets and liabilities based upon the expected timing of the claims payments. The adoption had no impact on HCGH's results of operations or cash flows.

2. Net Patient Service Revenue

HCGH has agreements with third-party payors that provide for payments to HCGH at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. 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. Adjustments mandated by the Health Services Cost Review Commission are also included in contractual adjustments, a portion of which are also included in established rates.

HCGH provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Such patients are identified based on information obtained from the patient and subsequent analysis. Because HCGH does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Direct and indirect costs for these services amounted to $5.0 million and $3.9 million for the years ended June 30, 2012 and 2011, respectively. The costs of providing charity care services are 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 costs to charges is calculated based on HCGH's total expenses (less bad debt expense) divided by gross patient service revenue.

Revenue from the Medicare and Medicaid programs accounted for approximately 39% and 9%, respectively, of the Hospital's net patient service revenue for the year ended June 30, 2012 and 39% and 10% respectively, of the Hospital's net patient service revenue for the year ended June 30, 2011. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to change by a material amount in the near term.

Approximately 28% and 24% of gross patient account receivables were due from the Medicare program, 13% and 15% from the Medicaid program, 13% and 17% from the Blue Cross program and 46% and 44% from health maintenance organizations, other third-party payors and individual payors as of June 30, 2012 and 2011, respectively.

3. **Fair Value Measurements**

FASB's guidance on the fair value option for financial assets and financial liabilities permits companies to choose to measure many financial assets and liabilities, and certain other items at fair value. This guidance requires a company to record unrealized gains and losses on items for which the fair value option has been elected in its performance indicator. The fair value option may be applied on an instrument by instrument basis. Once elected, the fair value option is irrevocable for that instrument. The fair value option can be applied only to entire instruments and not to portions thereof. HCGH has not elected fair value accounting for any asset or liability that was not currently required to be measured at fair value.

HCGH follows the guidance on fair value measurements, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. This guidance applies to other accounting pronouncements that require or permit fair value measurements and, accordingly, this guidance does not require any new fair value measurements. Adopting this guidance did not have a material impact on HCGH's financial position and results of operations.

This guidance discusses valuation techniques such as the market approach, cost approach and income approach. This guidance establishes a three-tier level hierarchy for fair value measurements based upon the transparency of inputs used to value an asset or liability as of the measurement date. The three-tier hierarchy prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Observable inputs such as quoted market prices for identical assets or liabilities in active markets;
- Level 2 – Observable inputs for similar assets or liabilities in an active market, or other than quoted prices in an active market that are observable either directly or indirectly; and
- Level 3 – Unobservable inputs in which there is little or no market data that require the reporting entity to develop its own assumptions. There are no instruments requiring Level 3 classification.

The financial instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Each of the financial instruments below has been valued utilizing the market approach.

The following table presents the financial instruments carried at fair value as of June 30, 2012 grouped by hierarchy level:

Assets	**Total Fair Value**	**Level 1**	**Level 2**
Cash equivalents (1)	$ 285	$ -	$ 285
Certificates of deposit (1)	48	-	48
U.S. Treasuries (2)	11,627	-	11,627
Corporate bonds (2)	17,524	-	17,524
Asset backed securities (2)	7,878	-	7,878
Equity and equity funds (3)	4,183	-	4,183
Fixed income funds (4)	1,369	-	1,369
Totals	$ 42,914	$ -	$ 42,914
Liabilities			
Interest rate swap agreement (5)	$ 18,872	$ -	$ 18,872

The following table presents the financial instruments carried at fair value as of June 30, 2011 grouped by hierarchy level:

Assets	Total Fair Value	Level 1	Level 2
Cash equivalents (1)	$ 307	$ -	$ 307
Certificates of deposit (1)	47	-	47
U.S. Treasuries (2)	7,798	-	7,798
Corporate bonds (2)	3,181	-	3,181
Asset backed securities (2)	1,980	-	1,980
Equities and equity funds (3)	4,622	-	4,622
Fixed income funds (4)	1,404	-	1,404
Totals	$ 19,339	$ -	$ 19,339
Liabilities			
Interest rate swap agreement (5)	$ 8,882	$ -	$ 8,882

(1) Cash equivalents include money market funds. Certificates of deposit are carried at amortized cost, which approximates fair value, which are rendered level 2. Money market funds are valued based on the NAV and are classified as level 2.
(2) For investments in U.S. Treasuries (notes, bonds, and bills), corporate bonds, and asset backed securities, fair value is based on the average of the last reported bid and ask prices; therefore these investments are rendered level 2. These investments fluctuate in value based upon changes in interest rates. Until April 1, 2011, significant changes in the credit quality of the underlying entity were analyzed and any other than temporary impairments was recorded upon that determination, if any.
(3) Equities include commingled trusts and hedge funds. The commingled trusts and hedge funds are valued regularly within each month utilizing NAV per unit and are rendered level 2.
(4) Fixed income funds are investments in commingled trusts investing in fixed income instruments. The underlying fixed investments are principally U.S. Treasuries, corporate bonds, commercial paper, and asset backed securities. The commingled trusts are valued regularly within each month utilizing NAV per unit and are rendered level 2.
(5) The interest rate swap agreements are valued using a pricing service at net present value. These evaluated prices render these instruments level 2. The volatility in the fair value of the swap agreements change as long-term interest rates change.

During 2012 and 2011, there were no transfers between level 1 and 2.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair value. Furthermore, while HCGH believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value as of the reporting date.

Financial instruments are reflected in the Combined Balance Sheets as of June 30, 2012 and 2011 as follows (in thousands):

	2012	**2011**
Cash equivalents measured at fair value	$ 285	$ 307
Cash	4,223	7,283
Total cash and cash equivalents	$ 4,508	$ 7,590
Short and long-term investments measured at fair value	$ 42,629	$ 13,355
Investments accounted for under equity method	7,013	6,646
Total short and long-term investments	$ 49,642	$ 20,001
Assets whose use is limited measured at fair value	$ -	$ 5,677
Interest in net assets of HHF/Children's Garden	13,363	14,574
Total assets whose use is limited	$ 13,363	$ 20,251

HCGH holds alternative investments that are not traded on national exchanges or over-the counter markets. HCGH is provided a net asset value per share for these alternative investments that has been calculated in accordance investment company rules, which among other requirements, indicates that the underlying investments be measured at fair value. There are no unfunded commitments related to HCGH's alternative investments.

The following table displays information by major alternative investment category as of June 30, 2012 and 2011 (in thousands):

As of June 30, 2012:

Description	**Market Value**	**Liquidity**	**Notice Period**	**Receipt of Proceeds**
Global asset allocation	$2,190	Monthly	5 days	At least 95% within 15 days, remaining within 30 days of redemption date
Fund of funds	1,230	Monthly, quarterly or annually	25 - 70 days	At least 90% within 60 days, remaining received after the audit or as SPV shares
Hedge funds	108	Quarterly - last day of the calendar quarter	60 days	95% within 30 days, 5% within 120 days
	$3,528			

As of June 30, 2011:

Description	Market Value	Liquidity	Notice Period	Receipt of Proceeds
Global asset allocation	$1,957	Monthly	5 to 14 days	Within 15 days, or 95% within 1 business days of the redemption date; 5% after the 12th business day of the month
Fund of funds	1,030	Monthly, quarterly or annually	30 to 60 days	Within 5 days, or 95% in 1 - 30 days, 5% within 60 days or after annual audit
Hedge funds	116	Quarterly - last day of the calendar quarter	60 days	95% within 30 days of redemption date; 5% within 120 days of redemption date
	$3,103			

The estimated total fair value of long-term debt, based on quoted market prices for the same or similar issues, was approximately $40.0 million and $153.0 million as of June 30, 2012 and 2011, respectively.

4. **Investments and Assets Whose Use is Limited**

Investments (short and long-term) as of June 30 consisted of the following (in thousands):

	2012	2011
	Market Value	Market Value
Investments in affiliates	$ 3,485	$ 3,543
U.S. Treasuries	11,627	2,121
Certificates of deposit	48	47
Corporate bonds	17,524	3,184
Asset backed securities	7,878	1,980
Fixed income funds	1,369	1,404
Equities and equity index funds	4,183	4,619
Alternative investments	3,528	3,103
	$ 49,642	$ 20,001

Included in investments as of June 30, 2012 and 2011 are $46.1 million and $16.4 million, respectively of investments pooled together with other JHHS affiliates.

Assets whose use is limited as of June 30 consisted of the following (in thousands):

	2012	2011
	Market	**Market**
U.S. Treasuries	$ -	$ 5,677
Interest in net assets of Howard Hospital Foundation	13,228	14,439
Other	135	135
	$ 13,363	$ 20,251

Realized and unrealized gains (losses) on investments for the years ended June 30, 2012 and 2011, included in non-operating revenues and expenses section of the Statement of Operations consisted of the following:

	2012	2011
Realized gains on investments	$ 37	$ 84
Unrealized gains on trading investments	27	891
Total	$ 64	$ 975

5. **Investments in Joint Ventures**

HCGH has a 25% investment interest in Ten Acres Medical Center, LLC (“Ten Acres”) obtained in exchange for contributed land with an original cost of $4.0 million. The 75% member is Columbia Investment Properties, LLC (“CIP”). Ten Acres is a Maryland Limited Liability Company formed to develop, own, operate, manage or dispose of a medical office building (the “Project”) on a portion of the HCGH campus in Howard County, Maryland. The Project consists of approximately a 170,000 square foot medical office building that was completed in August 2009. The term of the joint venture shall continue perpetually unless otherwise agreed upon pursuant to the operating agreement.

Ten Acres is managed by a Board of Managers consisting of one HCGH appointed manager and three CIP appointed members. Profits and losses, as well as additional contributed capital, shall be allocated to the members equal to each members’ percentage ownership interest. Distributions shall be made in accordance with the provisions of the operating agreement as determined by the Board of Managers. Ten Acres began operations in August 2009. Ten Acres is accounted for under the equity method of accounting. HCGH’s investment in Ten Acres was $1.9 million and $2.1 million as of June 30, 2012 and 2011, respectively. HCGH’s gain on this investment was $767 thousand and $352 thousand for the year ended June 30, 2012, and 2011, respectively. In addition, HCGH received cash dividends from Ten Acres of $551 thousand and $600 thousand for the year ended June 30, 2012 and 2011, respectively.

HCGH invested $1.6 million for a 20% interest in the Central Maryland Radiation Oncology Center, LLC (“CMROC”) which is located in the new Ten Acres building. HCGH’s investment in CMROC was $1.5 million for the years ended June 30, 2012 and 2011. The operating losses were $45 thousand and $123 thousand during the years ended June 30, 2012 and 2011, respectively. HCGH has guaranteed 50% of the total debt of CMROC that amounts to $1.8 million as of June 30, 2012.

6. **Property, Plant and Equipment**

Property, plant and equipment and accumulated depreciation and amortization consisted of the following as of June 30 (in thousands):

	2012		2011	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Land and land improvements	$ 8,889	$ 134	$ 8,306	$ 58
Building and improvements	168,101	39,303	164,127	33,248
Fixed and moveable equipment	71,387	41,841	71,108	36,944
Construction in progress	102	-	5,009	-
	$ 248,479	$ 81,278	$ 248,550	$ 70,250

Accruals for purchases of property, plant and equipment as of June 30, 2012 and 2011 amounted to $388 thousand and $3.3 million, respectively, and are included in accounts payable in the Balance Sheets. Depreciation and amortization expense for years ended June 30, 2012 and 2011 was $15.8 million and $14.6 million, respectively. Amortization expense for the years ended June 30, 2012 and 2011 was $1.5 million and $1.2 million, respectively.

There was no impairment charges recorded for the years ended June 30, 2012 and 2011 respectively.

During the year ended June 30, 2012 HCGH retired fully depreciated long-lived assets determined to have no future value. The original cost and accumulated depreciation of these long-lived assets was $4.8 million. There were no retirements of long-lived assets in 2011.

7. **Debt**

Debt as of June 30 is summarized as follows (in thousands):

	2012		2011	
MHHEFA Bonds and Notes:	Current Portion	Long-term Portion	Current Portion	Long-term Portion
1998 Series Revenue Bonds – net of original issue discount of $1,703 as of June 30, 2011	$ -	$ -	$ 2,800	$ 110,877
2008 Series Revenue Bonds	40,000	-	-	40,000
	$ 40,000	$ -	$ 2,800	$ 150,877

Obligated Group

The Johns Hopkins Health System Obligated Group ("JHHS Obligated Group") consists of JHH, JHBMC, HCGH, SHHS and SHI. JHBMC was admitted into the JHHS Obligated Group in 2004 as part of a plan of debt refinancing. SHHS and SHI were admitted into the JHHS Obligated Group in 2010 as part of a JHH debt issuance. HCGH was admitted to the JHHS Obligated Group in May 2012 as part of a JHH debt issuance. All of the debt of JHH, JHBMC, HCGH, SHI and SHHS are parity debt, and as such are collateralized equally and ratably by a claim on and a security interest in all of JHH's, JHBMC's, HCGH's, SHI's, and SHHS' receipts as defined in the Master Loan Agreement with MHHEFA. JHH, JHBMC, HCGH, SHI and SHHS are required to achieve a defined minimum debt service coverage ratio each year, maintain adequate insurance coverage, and comply with certain restrictions on their ability to incur additional debt. As of June 30, 2012, JHH, JHBMC, HCGH, SHI, and SHHS were in compliance with these requirements. As of June 30, 2012 the outstanding JHH, JHBMC, HCGH, SHI, and SHHS parity debt was $1.1 billion. As of June 30, 2011 the outstanding JHH, JHBMC, SHI, and SHHS parity debt was $946.0 million.

1998 Series-Revenue Bonds

In June 1998, Howard County Acquisition Corporation (now known as HCGH) borrowed $133.9 million through the issuance by MHHEFA of its 1998 Johns Hopkins Medicine Howard County General Hospital Series Revenue Bonds (“1998 Bonds”) with stated interest rates ranging from 4.15% to 5.00%. Annual principal repayments range from $2.9 million to $3.1 million, are due July 1 of each year until 2013. The 1998 bonds include three series of term bonds - $21.9 million due July 1, 2019, $54.3 million due July 1, 2029, and $30.3 million due July 1, 2033. The annual sinking fund payments on these term bonds range from $3.2 million on July 1, 2014 to $8.1 million on July 1, 2033.

In April 2012, HCGH redeemed all of the outstanding principal of the 1998 Bonds that amounted to $110.6 million. In connection with the redemption, HCGH wrote off $1.6 million of the unamortized original issue discount as early retirement of debt and is recorded in the non-operating section of the Statement of Operations.

2008 Series-Revenue Bonds

In May 2008, HCGH borrowed $40.0 million through the issuance of its 2008 Series Revenue Bonds (“2008 Bonds”) to finance the expansion, renovation and equipping of HCGH’s acute care hospital. The 2008 Bonds are due July 1, 2046, and pay interest monthly at a variable rate based on the bonds sold by a designated re-marketing agent on a weekly basis. The rates for the years ended June 30, 2012 and 2011 were approximately 0.13% and 0.23%, respectively. Mandatory annual sinking fund installments begin July 1, 2034, ranging from $2.3 million to $3.9 million. The 2008 Bonds are collateralized by a pledge of the receipts of HCGH and guaranteed by the Johns Hopkins Health System Obligated Group.

In connection with the 2008 Bonds, HCGH entered into a $40.5 million direct-pay letter of credit agreement with PNC Bank, National Association to provide for the payment of principal and interest on the 2008 Bonds. This agreement includes the principal amount of the debt plus 42 days of interest at the maximum rate of 10%, and expires on May 8, 2013, subject to extension or earlier termination. Since this agreement expires before June 30, 2013, the $40.0 million has been reclassified to current portion of long-term debt on the Balance Sheet as of June 30, 2012. The advances are repayable on the earliest of the date that is 367 days from the date of such advance, the date of termination, the date of receipts by HCGH of the proceeds of any subsequent issuances of notes and the final due date. There have been no amounts drawn on the letter of credit as of June 30, 2012 or 2011. Since this letter of credit expires before June 30, 2013, the outstanding balance of $40.0 million has been reclassified as short term in the Balance Sheet.

Total maturities of debt and the sinking fund requirements during the next five fiscal years and thereafter are as follows as of June 30, 2012 (in thousands):

2013	$ 40,000
2014	-
2015	-
2016	-
2017	-
Thereafter	-
	$ 40,000

Interest costs incurred related to debt in the amount of $7.3 million was paid during the year ended June 30, 2012, of which $29 thousand was capitalized and $7.3 million was expensed. Interest costs incurred relating to debt in the amount of $7.7 million was paid during the year ended June 30, 2011, of which $434 thousand was capitalized and $7.2 million was expensed.

8. **Derivative Financial Instruments**

HCGH's primary objective for holding derivative financial instruments is to manage interest rate risk. Derivative financial instruments are recorded at fair value and are included in other long-term liabilities. The total notional amount of interest rate swap agreements was $40.0 million as of June 30, 2012 and 2011.

HCGH follows accounting guidance on derivative financial instruments that is based on whether the derivative instrument meets the criteria for designation as cash flow or fair value hedges. The criteria for designating a derivative as a hedge include the assessment of the instrument's effectiveness in risk reduction, matching of the derivative instrument to its underlying transaction, and the assessment of the probability that the underlying transaction will occur. All of HCGH's derivative financial instruments are interest rate swap agreements without hedge accounting designation.

The value of interest rate swap agreements entered into by HCGH are adjusted to market value monthly at the close of each accounting period based upon quotations from market makers. Entering into interest rate swap agreements involves, to varying degrees, elements of credit, default, prepayment, market and documentation risk in excess of the amounts recognized on the Balance Sheets. Such risks involve the possibility that there will be no liquid market for these agreements, the counterparty to these agreements may default on its obligation to perform and there may be unfavorable changes in interest rates. HCGH does not hold derivative instruments for the purpose of managing credit risk, limits the amount of credit exposure to any one counterparty and enters into derivative transactions with high quality counterparties. HCGH recognizes gains and losses from changes in fair values of interest rate swap agreements as a non-operating revenue or expense within the performance indicator excess of revenues over expenses on the Statements of Operations.

Fair value of derivative instruments as of June 30 (in thousands):

	Derivatives reported as liabilities			
	Balance Sheet Caption	**2012 Fair Value**	**Balance Sheet Caption**	**2011 Fair Value**
Interest rate swaps not designated as hedging instruments	Other long-term liabilities	$ 18,872	Other long-term liabilities	$ 8,882

Derivatives not designated as hedging instruments as of June 30 (in thousands):

Derivatives not designated as hedges

Classification of derivative gain (loss) in the Statement of Operations	Amount of gain (loss) recognized in change in unrestricted net assets 2012	2011
Interest rate swaps:		
Change in market value of swap agreement	$ (9,990)	$ 2,204

The following is a description of HCGH's interest rate swap agreement:

In May 2006, HCGH entered into a fixed payor interest rate swap agreement with Goldman, Sachs & Co. The notional amount of this swap agreement is $40.0 million and carries a term of 32 years, with payments that began in June 2007. HCGH will pay Goldman, Sachs & Co. a fixed annual rate of 3.946% on the notional amount of the swap agreement in return for the receipt of a floating rate of interest equal to 67% of the one month LIBOR rate. The floating rate payments from the interest rate swap agreement are intended to substantially offset the floating rate of the 2008 Bonds. The floating rates as of June 30, 2012 and 2011 were 0.16% and 0.13%, respectively. JHHS has guaranteed the prompt payment of this interest rate swap agreement.

This swap agreement has certain collateral thresholds whereby, on a daily basis, if the market value of the swap agreement declines such that its devaluation exceeds the threshold, cash must be deposited by HCGH with the swap counterparty for the difference between the threshold amount and the fair value. As of June 30, 2012 and 2011 no collateral was required to be posted to the swap counter party.

9. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets as of June 30 (in thousands), are restricted to:

	2012	2011
Health care services	$ 5,697	$ 5,832
Purchase of property, plant and equipment	4,604	5,729
	$ 10,301	$ 11,561

Permanently restricted net assets as of June 30 (in thousands), are restricted to:

	2012	2011
Health care services	$ 3,060	$ 3,011

10. Pension Plan

HCGH sponsors a cash balance defined benefit pension plan (the "Plan"). HCGH contributed 7.5% of each employee's base compensation up to $25 thousand and 11.3% of base compensation in excess of $25 thousand. The Plan's assets are invested in a diversified portfolio of stocks, bonds and money market certificates managed by a bank trust department. As of January 1, 1996, accruals under the Plan were frozen. Employees now participate in a 401(k) plan. Effective for the year ended June 30, 2007, HCGH adopted the provisions of statement of financial accounting standards employer's accounting for defined benefit pension and other postretirement plans. This guidance requires that the funded status of defined benefit postretirement plans be recognized on HCGH's Balance Sheet, and changes in the funded status be reflected as a change in net assets.

The change in benefit obligation, plan assets, and funded status of the Plan is shown below (in thousands):

	2012	**2011**
Change in benefit obligation		
Benefit obligation at beginning of year	$ 10,099	$ 10,173
Interest cost	551	550
Actuarial gain (loss)	1,631	91
Benefits paid	(799)	(715)
Benefit obligation as of June 30	$ 11,482	$ 10,099
Change in plan assets		
Fair value of plan assets at beginning of year	$ 10,963	$ 10,089
Actual return on plan assets	12	1,616
Benefits paid	(750)	(742)
Fair value of plan assets as of June 30	$ 10,225	$ 10,963
Funded status as of June 30,		
Fair value of plan assets	$ 10,225	$ 10,963
Projected benefit obligation	11,482	10,099
Funded status	$ (1,257)	$ 864

Amounts recognized in the Balance Sheets consist of (in thousands):

Net pension asset (liability)	$ (1,257)	$ 864

Amounts not yet recognized in net periodic benefit cost and included in unrestricted net assets consist of (in thousands):

	2012	**2011**
Actuarial net loss	$ 5,510	$ 3,913
Accumulated benefit obligation	$ 11,482	$ 10,099

Net periodic pension benefit cost

	2012	2011
Components of net periodic pension cost (in thousands):		
Interest cost	$ 551	$ 550
Expected return on plan assets	(724)	(627)
Amortization of prior service cost	400	649
Net periodic pension benefit expense	$ 227	$ 572

The actuarial net loss for the defined benefit plans that will be amortized from unrestricted net assets into net periodic benefit costs in 2013 is $636 thousand.

The assumptions used in determining net periodic pension cost for the plan are as follows for the year ended June 30:

	2012	2011
Discount rate	6.03%	6.04%
Expected return on plan assets	8.25%	8.25%

The assumptions used in determining the benefit obligation for the plan are as follows as of July 1:

	2012	2011
Discount rate	4.66%	6.03%
Expected return on plan assets	8.00%	8.25%

The expected rate of return on the plan assets assumption was developed based on historical returns for the major asset classes. This review also considered both current market conditions and projected future conditions.

Plan Assets

HCGH's pension plan weighted average asset allocations as of June 30 by asset category are as follows:

Asset class	**2012**	**2011**
Cash and cash equivalents	4.88%	4.44%
Equities and equity funds	30.69%	35.98%
Fixed income funds	26.15%	15.57%
Alternatives	38.28%	44.01%
Total	100.00%	100.00%

The Plan's assets are invested, along with JHHS plan assets in a Master Trust, among and within various asset classes in order to achieve sufficient diversification in accordance with HCGH risk tolerance. This is achieved through the utilization of asset managers and systematic allocation to investment management style(s), providing a broad exposure to different segments of the fixed income and equity markets. The Plan strives to allocate assets between equity securities (including global asset allocation) and debt securities at a target rate of approximately 75% and 25%, respectively.

Fair Value of Plan Assets

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between a market participant at the measurement date. The three-tier hierarchy prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Observable inputs such as quoted market prices for identical assets or liabilities in active markets;
- Level 2 – Observable inputs for similar assets or liabilities in an active market, or other than quoted prices in an active market that are observable either directly or indirectly; and
- Level 3 – Unobservable inputs in which there is little or no market data that require the reporting entity to develop its own assumptions.

The following table presents the plan assets carried at fair value as of June 30, 2012 and 2011, grouped by hierarchy level (in thousands):

As of June 30, 2012

Assets	**Total Fair Value**	**Level 1**	**Level 2**
Cash equivalents (1)	$ 499	$ -	$ 499
Equities and equity funds (2)	3,138	242	2,896
Fixed income funds (3)	2,674	2,357	317
Alternatives (4)	3,914	-	3,914
Totals	$ 10,225	$ 2,599	$ 7,626

As of June 30, 2011

Assets	**Total Fair Value**	**Level 1**	**Level 2**
Cash equivalents (1)	$ 487	$ -	$ 487
Equities and equity funds (2)	3,944	-	3,944
Fixed income funds (3)	1,707	1,568	139
Alternatives (4)	4,825	-	4,825
Totals	$ 10,963	$ 1,568	$ 9,395

(1) Cash equivalents include money market funds and are carried at amortized cost, which approximates fair value, which renders them level 2.
(2) Equities include individual equities. Equity funds include investments in mutual funds, commingled trusts and hedge funds. The individual equities and mutual funds are valued based on the closing price on the primary market and are rendered level 1. The commingled trusts and hedge funds are valued regularly within each month utilizing NAV per unit and are rendered level 2.
(3) Fixed income funds are investments in mutual funds and commingled trusts investing in fixed income instruments. The underlying fixed investments are principally U.S. Treasuries, corporate bonds, commercial paper, and asset backed securities. The mutual funds are valued based on the closing price on the primary market and are rendered level 1. The commingled trusts are valued regularly within each month utilizing NAV per unit and are rendered level 2.
(4) Alternative investments include investments that are not traded on national exchanges or over-the-counter markets. These investments are valued at using a net asset value per share that has been calculated in accordance with investment company rules, which among other things, indicates that

the underlying investments be measured at fair value. This valuation technique renders these investments level 2.

There are no unfunded commitment related to the Plans' alternative investments. The following table displays information by major alternative investment category as of June 30, 2012 and 2011 (in thousands):

June 30, 2012

Description	Fair Market Value	Liquidity	Notice Period	Receipt of Proceeds
Global asset allocation	$ 1,797	Monthly	5 - 30 days	(1)
Fund of funds	813	Quarterly	45 days	(2)
Hedge funds	865	Monthly or quarterly, or bi-annually	30 - 65 days	(3)
Credit funds	317	Annual	60 - 90 days	(4)
Distressed credit	122	December 31, 2013		
	$ 3,914			

(1) Within 15 days, or 95% on redemption date and 5% on third business day
(2) 90% within 30 days; 10% within 60 days
(3) 90 - 95% within 3 - 30 days, 5 - 10% after 10 - 30 days or after annual audit
(4) Within 30 days, or 90% within 10 days, 10% after annual audit

June 30, 2011

Description	Fair Market Value	Liquidity	Notice Period	Receipt of Proceeds
Global asset allocation	$ 2,116	Monthly	5 - 30 days	(5)
Fund of funds	1,505	Monthly, quarterly or annually	30 - 65 days	(6)
Hedge funds	562	Monthly or quarterly	30 - 65 days	(7)
Credit funds	433	Annual	60 - 90 days	(8)
Distressed credit	209	December 31, 2013		
	$ 4,825			

(5) Within 15 days, or 95% on redemption date and 5% on third business day
(6) Within 5 days, or 90% within 30 to 60 days, 10% after annual audit
(7) 90-95% within 30 days, 5-10% after 10 days or after annual audit
(8) Within 30 days, or 90% within 10 days, 10% after annual audit

Contributions and Estimated Future Benefit Payments (Unaudited):

HCGH is not required to contribute to its pension plan in 2012.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in each of the following fiscal years as of June 30, 2012 (in thousands):

2013	$ 2,809
2014	899
2015	984
2016	1,053
2017	1,242
2018-2022	4,175

HCGH also has a 401(k) savings Plan available to all employees. The revised plan provides that HCGH will contribute 1% to 2% of each employee's total compensation in addition to contributing from fifty cents to one dollar and fifty cents, based on years of service, for each dollar contributed by the employee. HCGH's contribution match basis is limited to 6% of the employee's total compensation. HCGH funded $3.1 million and $2.9 million for the years ended June 30, 2012 and 2011, respectively.

11. Maryland Health Services Cost Review Commission

HCGH's charges are subject to review and approval by the Commission. HCGH management has filed the required forms with the Commission and believes HCGH is in compliance with Commission requirements. The total rate of reimbursement for services to patients under the Medicare and Medicaid programs is based on an agreement between the Center for Medicare and Medicaid Services and the Commission. Management believes that this program will remain in effect at least through June 30, 2013. Effective April 1, 1999, the Commission developed a methodology to control inpatient hospital charges and HCGH elected to be paid under the new methodology. The methodology established a charge per admission cap for each hospital. The hospital specific charge per admission is adjusted annually to reflect cost inflation, and is also adjusted for changes in the hospital's case mix index. Certain highly tertiary inpatient cases such as solid organ transplants, bone marrow transplants and certain oncology cases are treated as exclusions from the charge per case methodology. Effective July 1, 2011, the Commission modified this methodology in an effort to reduce readmissions at Maryland hospitals. Under a Charge per Episode ("CPE") methodology, hospitals are allowed to retain any rate authority lost due to reductions in readmissions. Conversely, hospitals are not granted any additional rate authority for any increases to readmissions.

In fiscal 2011, the HSCRC implemented a new methodology to establish a charge per visit ("CPV") for certain types of outpatient services. The hospital specific charge per visit is adjusted annually to reflect cost inflation and is also adjusted for changes in case mix. This methodology is primarily focused on ambulatory surgery procedures, medical clinic visits and emergency room visits. The methodology also includes other types of outpatient services including infusion procedures, therapies, mental health and major radiology procedures. Certain types of visits such as radiation therapy, psychiatric day hospital and certain types of recurring visits will be treated as exclusions under this methodology. In March 2012, the HSCRC voted to suspend the CPV methodology for fiscal 2012. The HSCRC has not yet provided a timeline for the establishment of a replacement methodology. It is expected that some type of outpatient constraint system will be put in place sometime during fiscal 2013.

The Commission approves hospital rates on a departmental unit rate basis. Individual unit rates are the basis for hospital reimbursement for inpatient excluded cases and for hospital outpatient services. Under the Commission rate methodology, amounts collected for services to patients under the Medicare and Medicaid programs are computed at approximately 94% of Commission approved charges. Other payors are eligible to receive up to a 2.25% discount on prompt payment of claims.

12. **Professional and General Liability Insurance**

JHU, JHHS and its affiliates, including HCGH, participate in an agreement with four other medical institutions to provide a program of professional and general liability insurance for each member institution. As part of this program, the participating medical institutions have formed a risk retention group (“RRG”) and a captive insurance company to provide self-insurance for a portion of their risk.

JHH and JHU each have a 10% ownership interest in the RRG and the captive insurance company. The medical institutions obtain primary and excess liability insurance coverage from commercial insurers and the RRG. The primary coverage is written by the RRG, and a portion of the risk is reinsured with the captive insurance company. Commercial excess insurance and reinsurance is purchased under a claims-made policy by the participating institutions for claims in excess of the primary coverage retained by the RRG and the captive. Primary retentions are $1.0 million per incident. Primary coverage is insured under a retrospectively rated claims-made policy; premiums are accrued based upon an estimate of the ultimate cost of the experience to date of each participating member institution. The basis for loss accruals for unreported claims under the primary policy is an actuarial estimate of asserted and unasserted claims including reported and unreported incidents and includes cost associated with settling claims. Projected losses were discounted at .73% and 1.2% as of June 30, 2012 and 2011, respectively.

HCGH’s participation in the RRG and the captive insurance company does not extend to claims incurred prior to its purchase by JHHS. HCGH is self insured for these claims unless they were reported to HCGH’s previous insurance company prior to its purchase by JHHS. HCGH has established an additional loss accrual and is funding a separate deposit account with the RRG to cover estimated liabilities related to these claims.

Professional and general liability insurance expense incurred by HCGH was $.9 million, and $1.2 million for years ended June 30, 2012 and 2011, respectively, and is included in purchased services on the Statements of Operations and Changes in Net Assets. Reserves were $4.9 million, and $2.6 million for years ended June 30, 2012 and 2011, respectively.

13. **Transactions with Related Parties**

During the years ended June 30, 2012 and 2011, HCGH engaged in transactions with JHHS, and its affiliates, JHH, JHCP, Johns Hopkins HealthCare, LLC (“JHHC”), Johns Hopkins Medicine International, LLC (“JHI”), HCGH OBGYN Associates Series, LLC (“HCGH OBGYN”), and Johns Hopkins Home Care Group, Inc. (“JHHCG”).

Significant expense transactions (in thousands):

	2012	**2011**
JHH blood lab services	$ 7,388	$ 7,462
Purchasing, legal, and other services provided by JHHS	6,786	5,986
JHH clinical engineering services	810	674

Due from (to) related party balances as of June 30 (in thousands):

	2012	2011
Due to JHHS	$ (821)	$ (327)
Due to HCGH OBGYN	(3)	-
Due to JHHC	(4)	(4)
Due to JHH	(2,000)	(267)
Due to JHI	(25)	(21)
Due to JHHCG	(18)	-
Due to JHCP	(274)	(108)
Total due to Affiliates	$ (3,145)	$ (727)

Broadway Services, Inc. ("BSI"), a related organization, is a wholly-owned subsidiary of the Dome Corporation. The Dome Corporation is owned equally by JHHS and JHU. BSI provides the HCGH with security and manages its housekeeping services. During the years ended June 30, 2012 and 2011, HCGH incurred expenses of approximately $1.6 million and $1.8 million, respectively for these services.

In March 2012, HCGH and JHH entered into a short-term Promissory Note ("Affiliate Note") in the amount of $110.6 million, and carried an interest rate of 2.75%. The Affiliate Note principal and accrued interest was due on May 31, 2012, or upon an earlier long-term extension of the Affiliate Note. The proceeds of the Affiliate Note were placed in HCGH's debt service reserve trust for the purpose of redeeming the 1998 Bonds. In May 2012, the Affiliate Note was extended, and has a final due date of July 1, 2033. The Affiliate Note carries an interest rate that resets annually and varies from 4.11% to 4.82%, and is payable semi-annually. Principal payments are due on July 1 of each year and range from $700 thousand in 2013 to $7.2 million in 2034.

14. Contracts, Commitments and Contingencies

Commitments for leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. The following is a schedule by year of the future minimum lease payments under operating leases as of June 30, 2012, that have initial or remaining lease terms in excess of one year (in thousands).

2013	$ 873
2014	872
2015	894
2016	917
2017	941

Rental expense for all operating leases for years ended June 30, 2012 and 2011 were $1.0 million and $1.2 million, respectively.

15. Functional Expenses

HCGH provides general health care services to residents within its geographic location. Expenses relating to these services were $197.8 million and $191.7 million for health care services, and $32.4 million and $33.0 million for general and administrative services for the years ended June 30, 2012 and 2011, respectively.

16. **Howard Hospital Foundation**

Interest in net assets of HHF of $13.2 million and $14.4 million as of June 30, 2012 and 2011 respectively, are presented in long-term assets on the Balance Sheets of HCGH.

HHF assets consist of cash and cash equivalents of $1.0 million and $874 thousand, marketable securities of $6.9 million and $7.8 million, and other assets of $5.7 million and $5.9 million as of June 30, 2012 and 2011, respectively.

Liabilities of HHF were $275 thousand and $163 thousand and net assets were $13.2 million and $14.4 million as of June 30, 2012 and 2011, respectively. The changes in net assets were ($1.3) million and $542 thousand for the years ended June 30, 2012 and 2011, respectively.

HCGH made transfers to HHF in the amounts of $1.0 million, and $1.0 million for the years ended June 30, 2012 and 2011, respectively. HHF made transfers to HCGH to reimburse HCGH for operating costs and other program support paid by HCGH on behalf of HHF amounting to $1.0 million, and $1.0 million for the years ended June 30, 2012 and 2011, respectively.

17. **Subsequent Events**

HCGH has performed an evaluation of subsequent events through September 28, 2012, which is the date the financial statements were issued.