HARFORD MEMORIAL HOSPITAL, INC. AND
UPPER CHESAPEAKE MEDICAL CENTER, INC.

Combined Financial Statements and Combining Schedules

December 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

HARFORD MEMORIAL HOSPITAL, INC. AND
UPPER CHESAPEAKE MEDICAL CENTER, INC.

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KPMG LLP
1 East Pratt Street
Baltimore, MD 21202-1128

Independent Auditors' Report

The Boards of Directors
Harford Memorial Hospital, Inc. and
Upper Chesapeake Medical Center, Inc.:

We have audited the accompanying combined balance sheets of Harford Memorial Hospital, Inc. and Upper Chesapeake Medical Center, Inc. (the Hospitals or the Obligated Group) as of December 31, 2010 and 2009, and the related combined statements of operations and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Hospitals' management. Our responsibility is to express an opinion on these combined 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 financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospitals' internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Harford Memorial Hospital, Inc. and Upper Chesapeake Medical Center, Inc. as of December 31, 2010 and 2009, and the combined results of their operations, the combined changes in their net assets, and their combined cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining information included in schedules 1 and 2 is presented for purposes of additional analysis of the 2010 combined financial statements rather than to present the financial position and results of operations of the individual corporations. The combining information has been subjected to the auditing procedures applied in the audits of the 2010 combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

KPMG LLP

April 26, 2011

HARFORD MEMORIAL HOSPITAL, INC. AND
UPPER CHESAPEAKE MEDICAL CENTER, INC.

Combined Balance Sheets

December 31, 2010 and 2009

(In thousands)

Assets		**2010**	**2009**
Current assets:			
Cash and cash equivalents	$	32,385	28,145
Current portion of assets held by trustee (notes 2, 7, and 13)		2,934	4,238
Board-designated and other investments (notes 2, 7, and 13)		95,890	75,636
Patient accounts receivable, net of allowance and contractuals of $11,381 and $10,523 in 2010 and 2009, respectively (note 3)		30,994	30,639
Prepaid expenses and other current assets		9,771	9,805
Total current assets		171,974	148,463
Due from affiliates (note 12)		9,674	7,111
Assets held by trustee, less current portion (notes 2 and 13)		5,796	5,286
Property, plant, and equipment, net (notes 4, 7, and 14)		181,797	180,600
Other assets (note 5)		1,232	1,638
Total assets	$	370,473	343,098
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	$	16,196	15,389
Accrued salaries, benefits, and other (notes 8 and 9)		20,494	18,326
Line of credit (note 6)		—	2,000
Current portion of long-term debt (notes 7 and 13)		13,013	13,148
Advances from third-party payors		5,818	5,818
Total current liabilities		55,521	54,681
Due to affiliates (note 12)		37	58
Long-term debt, less current portion (notes 7 and 13)		162,267	164,642
Other long-term liabilities (notes 7 and 14)		37,761	30,397
Pension liability (note 8)		3,842	9,001
Total liabilities		259,428	258,779
Unrestricted net assets		111,045	84,319
Total liabilities and net assets	$	370,473	343,098

See accompanying notes to combined financial statements.

HARFORD MEMORIAL HOSPITAL, INC. AND
UPPER CHESAPEAKE MEDICAL CENTER, INC.

Combined Statements of Operations and Changes in Net Assets

Years ended December 31, 2010 and 2009

(In thousands)

		2010	2009
Operating activities:			
Unrestricted revenues, gains, and other support:			
Net patient service revenue (notes 3, 7, 9, and 11)	$	292,581	288,340
Other		4,519	4,437
Total unrestricted revenues, gains, and other support		297,100	292,777
Expenses (note 15):			
Salaries		108,459	105,911
Employee benefits (notes 8 and 9)		24,723	25,495
Provision for bad debts		21,987	22,722
Supplies and other operating expenses		109,807	105,675
Depreciation and amortization (notes 4 and 5)		12,009	11,598
Interest and amortization (notes 4, 5, and 7)		5,986	5,822
Total expenses		282,971	277,223
Operating income		14,129	15,554
Nonoperating income:			
Investment income (note 2)		5,215	7,497
Change in the fair value and settlement payments on derivative instruments (note 7)		(11,766)	23,241
Nonoperating (loss) gain		(6,551)	30,738
Excess of revenues over expenses		7,578	46,292
Other changes in unrestricted net assets:			
Contributions for purchases of property and equipment (note 12)		532	385
Equity contribution		26,750	26,750
Pension – related changes other than net periodic pension cost (note 8)		2,793	4,467
Transfers (to) from affiliates, net (note 12)		(10,927)	876
Increase in unrestricted net assets		26,726	78,770
Unrestricted net assets, beginning of year		84,319	5,549
Unrestricted net assets, end of year	$	111,045	84,319

See accompanying notes to combined financial statements.

HARFORD MEMORIAL HOSPITAL, INC. AND
UPPER CHESAPEAKE MEDICAL CENTER, INC.

Combined Statements of Cash Flows

Years ended December 31, 2010 and 2009

(In thousands)

	2010	2009
Cash flows from operating activities:		
Increase in net assets	$ 26,726	78,770
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	12,009	11,598
Amortization of deferred financing costs	245	284
Amortization of bond discount	35	37
Provision for bad debts	21,987	22,722
Realized and unrealized gains on securities	(4,464)	(6,495)
Loss (gains) on interest rate swaps	7,597	(27,661)
Contributions for purchases of property and equipment	(532)	(385)
Equity contribution	(26,750)	(26,750)
Change in funded status of defined benefit plan	(2,793)	(4,467)
Transfers due from (to) affiliates, net	10,927	(876)
Change in assets and liabilities:		
Increase in patient accounts receivable	(22,342)	(21,126)
Increase (decrease) in prepaid expenses and other current assets	34	(1,678)
Increase (decrease) in accounts payable, accrued expenses, and advances from third-party payors	2,975	(6,450)
Increase in amounts due to affiliates, net	(2,584)	(2,185)
Pension liability	(2,366)	(105)
Decrease in other long-term liabilities	(233)	(164)
Net cash provided by operating activities	20,471	15,069
Cash flows from investing activities:		
Property, plant, and equipment additions	(13,045)	(8,613)
Purchases of assets held by trustee, board-designated, other investments, net	(14,996)	(21,231)
Net cash used in investing activities	(28,041)	(29,844)
Cash flows from financing activities:		
Repayment of long-term debt	(2,545)	(980)
Repayment of line of credit	(2,000)	(3,000)
Contributions for purchases of property and equipment	532	385
Equity contribution	26,750	26,750
Transfers (to) from affiliates, net	(10,927)	876
Net cash provided by financing activities	11,810	24,031
Net increase in cash and cash equivalents	4,240	9,256
Cash and cash equivalents, beginning of year	28,145	18,889
Cash and cash equivalents, end of year	$ 32,385	28,145

See accompanying notes to combined financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization

Harford Memorial Hospital, Inc. and Upper Chesapeake Medical Center, Inc. (collectively, the Hospitals or the Obligated Group) are nonprofit, nonstock membership corporations formed under the laws of the State of Maryland, organized for charitable purposes and recognized by the Internal Revenue Service (IRS) as tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code. Until July 1, 1999, Upper Chesapeake Health System, Inc. (UCHS) was the sole member or sole shareholder of the common stock of each of the following entities:

Harford Memorial Hospital, Inc. (HMH)
Upper Chesapeake Medical Center, Inc. (UCMC)
Upper Chesapeake Medical Services, Inc. (UCMS)
Upper Chesapeake Properties, Inc. (UCP)
Upper Chesapeake Health Foundation, Inc. (UCHF)
Upper Chesapeake Health Ventures, Inc. (UCHV)
Upper Chesapeake Residential Hospice House, Inc. (UCRHH)
Hospice of Harford County, LLC (HHC)

In 1998, Upper Chesapeake Health System, Inc. (UCHS) and St. Joseph Medical Center (SJMC) (together, the Members) formed Upper Chesapeake Health System, Inc./St. Joseph Medical Center Venture, LLC (UCHS/SJMC), a Maryland limited liability company. UCHS/SJMC was organized for charitable purposes to coordinate activities of healthcare facilities and other corporate bodies whose purposes include the provision of healthcare services or financial assistance to healthcare facilities in Harford County, Maryland. UCHS/SJMC commenced operations on July 1, 1999. In exchange for an 80% membership interest in UCHS/SJMC, UCHS contributed its interest in certain of its subsidiaries and its 50% investment in Upper Chesapeake/St. Joseph Home Care, Inc. (UCSJHC). Accordingly, the UCHS/SJMC became the sole member or sole shareholder of HMH, UCMC, UCMS, UCP, and UCHV. The Hospitals comprise approximately 98% of the UCHS/SJMC revenues.

On June 26, 2009, UCHS/SJMC purchased SJMC's 20% interest in UCHS/SJMC and subsequently sold this interest to University of Maryland Medical System (UMMS) pursuant to a Membership Interest Purchase Agreement. The parties renamed the joint venture UCHS/UMMS Venture, LLC (the Venture).

On October 1, 2009, the Venture and UMMS executed an Affiliation Agreement (the Agreement) and an Amended and Restated Operating Agreement, which increased UMMS' ownership in the Venture to 34% in exchange for cash, which is designated primarily for use for clinical projects. The Agreement requires profits for each calendar year to be allocated according to ownership percentage.

The Agreement required UMMS to purchase an additional 15% interest in the Venture, which occurred on October 1, 2010. Their total interest in the Venture is now 49%. The purchase of the additional 15% interest was in exchange for cash.

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Under the terms of the Agreement, the Board of Directors consists of 17 seats, 15 controlled by UCHS and 2 controlled by UMMS.

The Agreement also provides that at some point in the future, UMMS may become the sole member of UCHS by contributing a stated amount of immediately available funds, which will be restricted for use related to capital expansion of health services for the residents of Harford County, Maryland and a final contribution of cash on or before December 31, 2018, which will also be restricted for use.

Under the Agreement, 4% cumulative distributions on the purchase price will be earned by UMMS, and will be payable within 120 days after the end of each fiscal year, commencing with the fiscal year ending December 31, 2017, if net cash is available for distribution as calculated under the Agreement. Such distributions will terminate at the time UMMS becomes the sole member of UCHS.

The combined financial statements are prepared on the accrual basis of accounting in accordance with the U.S. generally accepted accounting principles, and include the accounts of HMH and UCMC, which comprise the Obligated Group as defined in the Amended and Restated Master Loan Agreement described in note 7. In combination, all material intercompany balances and transactions have been eliminated.

(b) Cash and Cash Equivalents

Cash equivalents consist primarily of temporary investments with original maturities of three months or less.

(c) Assets Held by Trustee, Board-Designated, and Other Investments

The assets held by trustee, board-designated, and other investments are considered trading and are classified as current or noncurrent assets based on management's intention as to use. All debt and equity securities are reported at fair value principally based on quoted market prices on the combined balance sheets.

Assets limited as to use include assets held by the trustee under an indenture agreement. Board designated investments are set aside by the Board of Directors to fund future capital improvements. The board retains control of these assets and may at their discretion use such assets for other corporate purposes.

Investments are exposed to certain risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, changes in the value of investment securities could occur in the near term, and these changes could materially differ from the amounts reported in the accompanying combined financial statements.

Investment income including unrealized gains and losses, realized gains and losses on investment sales, and interest an dividends are recorded on the accrual basis and are reported as nonoperating gains or losses in the excess of revenues over expenses in the accompanying combined statements of operations and changes in net assets unless the income or loss is restricted by the donor or law. Investment income and net gains that are restricted by the donor are recorded as a component of changes in temporarily or permanently restricted net assets, in accordance with donor-imposed restrictions. Realized gains and losses are determined based on the specific security's original purchase price.

(d) Derivative Instruments and Hedging Activities

The Hospitals account for derivatives and hedging activities in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 815, *Derivatives and Hedging*, which requires entities to recognize all derivative instruments as either assets or liabilities in the balance sheet at their respective fair values.

The Hospitals formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge are recorded in other changes in net assets to the extent that the derivative is effective as a hedge, until earnings are affected by the variability in cash flows of the designated hedged item. The ineffective portion of the change in fair value of a derivative instrument that qualifies as a cash flow hedge is reported in excess of revenues over expenses.

The Hospitals discontinue hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative expires or is sold, terminated, exercised, or management determines that designation of the derivative as a hedging instrument is no longer appropriate.

In all situations in which hedge accounting is discontinued and the derivative is retained, the Hospitals continue to carry the derivative at its fair value on the balance sheet and recognize any subsequent changes in its fair value in excess of revenues over expenses.

(e) Patient Accounts Receivable

Patient accounts receivable are stated at estimated net realizable amounts from patients, third-party payors, and other insurers for services provided.

The Hospitals grant credit to patients, substantially all of whom are local residents. The Hospitals generally do not require collateral or other security in extending credit; however, they routinely obtain assignment of (or are otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans, or policies.

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(f) Inventories

Inventories consisting primarily of drugs and medical/surgical supplies are stated at lower of cost or market and are included in prepaid expenses and other current assets on the combined balance sheets. Cost is determined principally using the first-in, first-out method.

(g) Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost or, if donated, at their fair market value on the date of receipt. Depreciation is taken on a straight-line basis over the estimated useful lives of the depreciable assets. The estimated useful lives of the assets are as follows:

Land improvements	3 – 20 years
Buildings	20 – 40 years
Equipment	5 – 20 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as other changes in unrestricted net assets, 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, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Gains and losses on disposal or sale of long-lived assets are recorded as a component of operating income in the combined statement of operations and changes in net assets.

The Hospitals entered into an agreement during 2007 to lease space in Medical Office Building II (MOB II), which opened during 2008 and is on the campus of UCMC. A nonaffiliated entity developed, owns and operates the MOB II. The Hospitals determined that due to certain structural elements installed by the Hospitals during construction of the space being leased, the Hospitals are required to be treated, for accounting purposes, as the "owner" of the MOB II in accordance with FASB ASC Subtopic 840-40, *Leases – Sale-Leaseback Transactions*.

(h) Deferred Financing Costs

Deferred financing costs, which are classified as other assets, are being amortized on the effective-interest method over the term of the related debt or letters of credit, and are included in interest and amortization.

(i) Bond Discount

The bond discount, which is classified as a reduction of long-term debt, is being amortized on the effective-interest method over the term of the related debt and is included in interest and amortization.

(j) Malpractice Claims

Costs of malpractice claims, which are subject to deductible provisions of the Hospitals' insurance programs are accrued when incidents occur that give rise to the claims if it can be determined that a liability is probable and the amount can be reasonably estimated (note 9).

(k) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospitals are reported at fair value at the date the promise is received. Donor-restricted gifts whose restrictions are met within the same year as received are reported as unrestricted gifts in the accompanying combined statements of operations and changes in net assets. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received.

(l) Net Patient Service Revenue

Patient service revenue of the Hospitals is recorded at rates established by the State of Maryland Health Services Cost Review Commission (HSCRC) and, accordingly, reflects actual charges to patients based on rates in effect during the period in which the services are rendered. The Hospitals have charge per case (CPC) agreements with the HSCRC, which are renewed annually. These CPC agreements establish a prospectively approved average charge per inpatient case (defined as hospital admissions plus births) and an estimated case mix index. These approved CPC targets are adjusted during the rate year for actual changes in case mix. The CPC agreements allow hospitals to adjust approved unit rates, within certain limits, to achieve the average CPC target for each rate year ending June 30.

Outpatient service revenue is recorded using a charge per visit (CPV) methodology for hospital based outpatient services, which is similar in nature to the CPC inpatient methodology discussed above. The CPV methodology establishes prospective per visit charges per outpatient visits for approximately 50% of outpatient services provided. The remaining outpatient services are charged using the established HSCRC unit rates.

Contractual adjustments, which represent the difference between amounts billed as patient service revenue and amounts paid by third-party payors, are accrued in the period in which the related services are rendered.

(m) Charity Care

The Hospitals provide care to patients who meet certain criteria under their charity care policy without charge or at amounts less than their established rates. Because the facilities do not pursue the collection of amounts determined to qualify as charity care, those amounts are not reported as revenue.

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(n) Nonoperating Income

Other activities that are largely unrelated to the Hospitals' primary mission are recorded as other nonoperating income, which includes investment income and change in the fair value and settlement payments on derivative instruments.

(o) Impairment of Long-Lived Assets

Management regularly evaluates whether events or changes in circumstances have occurred that could indicate impairment in the value of long-lived assets. If there is an indication that the carrying amount of an asset is not recoverable, the Hospitals estimate the projected undiscounted cash flows, excluding interest, to determine if an impairment loss should be recognized. The amount of impairment loss is determined by comparing the historical carrying value of the asset to its estimated fair value. Estimated fair value is determined through an evaluation of recent and projected financial performance using standard industry valuation techniques.

In addition to consideration of impairment upon the events or changes in circumstances described above, management regularly evaluates the remaining lives of its long-lived assets. If estimates are changed, the carrying value of affected assets is allocated over the remaining lives.

In estimating the future cash flows for determining whether an asset is impaired and if expected future cash flows used in measuring assets are impaired, the Hospitals group the assets at the lowest level for which there are identifiable cash flows independent of other groups of assets. If such assets are impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Based on management's evaluation, no long-lived assets were identified as impaired for the years ended December 31, 2010 and 2009.

(p) Excess of Revenues over Expenses

The combined 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, consistent with industry practice, include 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), equity contributions, changes in funded status of defined benefit plan, and transfers to or from affiliates.

(q) Use of Estimates

The preparation of the combined financial statements in conformity with U.S. generally accepted accounting principles 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 combined financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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(r) Income Taxes

The Hospitals have been recognized by the IRS as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code.

The Hospitals account for tax provisions in accordance with FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, included in ASC Subtopic 740-10, *Income Taxes – Overall*, which clarifies the accounting for uncertainty in tax provisions. FIN 48 requires that the Hospitals recognize the impact of an uncertain tax position in their financial statements if that position is more likely than not to be sustained on audit, based on the technical merits of the position.

(s) Employee Pension Plan

The Hospitals sponsor a defined benefit pension plan. The plan is actuarially evaluated and involves various assumptions, which are elements of expense and liability measurement. Key assumptions include the discount rate and the expected rate of return on plan assets, retirement, mortality, turnover, and healthcare costs trend rates. The Hospitals evaluate these assumptions annually and modify them as appropriate. The Hospitals froze the defined benefit pension plan as of December 31, 2005.

The Hospitals account for the defined benefit pension plan in accordance with ASC Subtopic 715-20, *Compensation – Retirement Benefits – Defined Benefit Plans – General (ASC Topic 715)*, which requires the recognition of the overfunded or underfunded status of a defined benefit pension plan as an asset or liability in the balance sheet and to recognize any changes in that funded status through unrestricted net assets. Additionally, ASC Topic 715 requires the measurement date for plan assets and liabilities to coincide with the employer's year-end and to disclose in the notes to the combined financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation.

(t) Fair Value Measurements

The Hospitals adopted Statement of Financial Accounting Standards (SFAS) No. 157, included in ASC Topic 820, *Fair Value Measurements and Disclosures,* on January 1, 2008 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the combined financial statements on a recurring basis. ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Hospitals have the ability to access at the measurement date.

(Dollars in thousands)

- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

This pronouncement did not require any new fair value measurements and its adoption did not affect the combined results of operations or financial position of the Hospitals.

(u) New Accounting Pronouncements

In August 2010, the FASB issued ASU No. 2010-23, *Health Care Entities (ASC Topic 954): Measuring Charity Care for Disclosure*. ASU 2010-23 is intended to reduce the diversity in practice regarding the measurement basis used in the disclosure of charity care. ASU 2010-23 requires that cost be used as the measurement basis for charity care disclosure purposes and that cost be identified as the direct and indirect cost of providing the charity care, and requires disclosure of the method used to identify or determine such costs. This ASU is effective for the Hospitals on January 1, 2011. The Hospitals are currently evaluating the impact on their disclosures from the adoption of this pronouncement.

In August 2010, the FASB issued ASU No. 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*. The amendments in the ASU clarify that a health-care entity may not net insurance recoveries against related claim liabilities. In addition, the amount of the claim liability must be determined without consideration of insurance recoveries. This ASU is effective on January 1, 2011. The Hospitals are currently evaluating the impact on their financial position and results of operations from the adoption of this pronouncement.

(2) Assets Held by Trustee, Board Designated, and Other Investments

Assets held by trustee, board designated, and other investments include the following at December 31:

		2010	2009
Investments	$	13,899	13,385
Board-designated investments		81,991	62,251
Funds held by the trustee		8,730	9,524
	$	104,620	85,160

(Dollars in thousands)

Investments and board-designated investments carried at fair value consist of the following at December 31:

	2010		2009	
Cash and cash equivalents	$ 27,526	29%	$ 42,006	56%
Common/preferred stock and mutual funds	28,198	29	26,274	35
Mortgage-backed and asset-backed securities	15,125	16	3,236	4
Corporate bonds and U.S. government obligations	25,041	26	4,120	5
	$ 95,890	100%	$ 75,636	100%

As described in note 7, funds held by the trustee as of December 31, 2010 and 2009 are limited as to use under the Amended and Restated Master Loan Agreement. Funds held by the trustee, which consist of cash and U.S. government agency obligations, are stated at fair value and include the following funds at December 31:

	2010	2009
Debt service funds	$ 2,934	4,238
Debt service reserve funds	5,796	4,049
Equipment and construction funds	—	1,237
Total funds held by the trustee	$ 8,730	9,524

The debt service fund has been established to secure the payment of principal and interest due on the Series 2008 Revenue Bonds (note 7). The debt service reserve fund has been established to provide for future deficiencies, if any, in various bond repayment terms established by the Amended and Restated Master Loan Agreement. If the balance in the debt service reserve funds falls below the minimum requirement as a result of investment losses or withdrawals relating to deficiencies in other specified funds, the Hospitals will be required to make equal monthly payments to the trustee to restore the amount on deposit therein to the minimum required amount within a 24-month period. No requirement to make such payments existed at December 31, 2010 or 2009.

(Dollars in thousands)

Investment income related to unrestricted investments is comprised of the following for the years ended December 31:

		2010	2009
Interest and dividends	$	751	1,002
Loss on sale of investments and board-designated investments, net		(131)	(3,339)
Unrealized gain on investments and board-designated investments, net		4,661	9,896
Unrealized loss on trustee-held funds		(66)	(62)
Total investment return	$	5,215	7,497

(3) Patient Accounts Receivable

The Hospitals had receivables from third-party payors and others, net of contractual allowances, as follows at December 31:

		2010	2009
Medicare	$	10,459	8,476
Medicaid		2,192	3,207
Commercial insurance and HMOs		16,456	16,905
Blue Cross		5,177	4,462
Self-pay and others		8,091	8,112
		42,375	41,162
Less allowance for estimated uncollectibles		11,381	10,523
Patient accounts receivable, net	$	30,994	30,639

Patient service revenue, by payor class, consisted of the following for the years ended December 31:

	2010	2009
Medicare	40%	39%
Medicaid	2	2
Commercial insurance and HMOs	35	35
Blue Cross	15	15
Self-pay and others	8	9
	100%	100%

(Continued)

(Dollars in thousands)

(4) Property, Plant, and Equipment

Property, plant, and equipment are summarized as follows at December 31:

		2010	2009
Land	$	16,217	16,217
Land improvements		1,598	1,559
Buildings		178,376	175,561
Equipment		111,910	106,348
Leasehold improvements		1,591	1,462
		309,692	301,147
Less accumulated depreciation		134,027	122,179
		175,665	178,968
Construction in process		6,132	1,632
	$	181,797	180,600

Depreciation expense for the years ended December 31, 2010 and 2009 was $11,848 and $11,438, respectively.

(5) Other Assets

Other assets consist of the following at December 31:

		2010	2009
Deferred financing costs, net	$	690	935
Intangible assets		385	494
Other intangible assets		157	209
	$	1,232	1,638

Costs incurred with the issuance of the Series 2008 Bonds, approximately $1,359, were deferred and are being amortized over the term of the related debt or letters of credit. Accumulated amortization amounted to $669 and $424 at December 31, 2010 and 2009, respectively. Amortization expense was $245 and $284 for the years ended December 31, 2010 and 2009, respectively, and is included in the interest and amortization line item on the combined statement of operations and changes in net assets.

Bed licenses acquired associated with the purchase of Fallston General Hospital (FGH) in the amount of $2,999 was capitalized and is being amortized over their estimated useful life of 28 years. These bed licenses were transferred to UCMC when FGH closed in 2000. Accumulated amortization amounted to

(Continued)

(Dollars in thousands)

$2,614 and $2,505 at December 31, 2010 and 2009, respectively, and is included in the depreciation and amortization line item on the combined statements of operations and changes in net assets.

Other intangible assets associated with the acquisition of Surgery Pavilion in the amount of $520 were recorded and are being amortized over their estimated useful life of 10 years. Accumulated amortization amounted to $363 and $311 at December 31, 2010 and 2009, respectively, and is included in the depreciation and amortization line item on the combined statements of operations and changes in net assets.

(6) Line of Credit

The Hospitals have an unsecured discretionary line of credit agreement with a bank that permits the Hospitals to borrow up to $5,000 at LIBOR plus 125 basis points (1.51% at December 31, 2010). Principal and interest outstanding under this agreement are due on or before May 31, 2011. The amount outstanding under this agreement was $0 and $2,000 as of December 31, 2010 and 2009, respectively.

(7) Long-Term Debt

Long-term debt consists of the following at December 31:

	2010	2009
Hospital revenue bonds:		
Series 2008 A (due January 1, 2043)	$ 62,705	63,575
Series 2008 B (due January 1, 2043)	58,985	59,855
Series 2008 C (due January 1, 2038)	54,210	55,015
	175,900	178,445
Less bond discount	620	655
	175,280	177,790
Less current portion	13,013	13,148
	$ 162,267	164,642

Pursuant to the Amended and Restated Master Loan Agreement dated August 1, 2008 (the Master Loan Agreement), the Hospitals obtained a loan of $179,425 through the Maryland Health and Higher Educational Facilities Authority (the Authority) in connection with the issuance of their Revenue Bonds – Upper Chesapeake Hospitals Issue, Series 2008A-C Bonds (the Series 2008 Bonds). The loan was obtained to (a) refund the Authority's Revenue Bonds, Upper Chesapeake Hospitals Issue, Series 2007 and (b) finance a portion of the cost of acquisition of certain land and equipment. The 2007 Series Bonds were extinguished in connection with the issuance of the Series 2008 Bonds.

The Series 2008A and 2008B Bonds are variable rate demand bonds, which are remarketed daily and weekly, respectively, and bear interest at a weekly interest rate established by the market. The interest rate on the 2008A and 2008B Bonds at December 31, 2010 was 0.36% and 0.33%, respectively. The Series 2008C Bonds are fixed rate term bonds, which bear interest at 5.5% and 6.0% at December 31, 2010 and 2009, respectively.

(Dollars in thousands)

The Series 2008C Bonds were issued at a discount of $706. Accumulated amortization amounted to $86 and $51 at December 31, 2010 and 2009, respectively.

The Series 2008 Bonds are subject to mandatory annual sinking fund requirements commencing in 2008. Sinking fund payments vary in increasing amounts from $980 to $8,855 with the final installment of $6,995 due in 2043.

Annual principal maturities of long-term liabilities including sinking fund payments at December 31, 2010 are as follows:

2011	$	2,655
2012		2,775
2013		2,890
2014		3,025
2015		3,160
Thereafter		161,395
	$	175,900

The Hospitals are jointly and severally liable under the Master Loan Agreement. The loan principal is payable annually on January 1 and the loan interest is payable to a trustee in monthly amounts for the Series 2008A and Series 2008B Bonds and semiannually for the Series 2008C Bonds. Pursuant to the Master Loan Agreement, the Hospitals are required to maintain certain funds on deposit with the trustee as described in note 2. As security for the performance of its obligations under the Master Loan Agreement, the Obligated Group has granted the Authority a security interest in its revenues.

The Obligated Group is subject to certain covenants as defined in the Master Loan Agreement and in the Branch Banking and Trust Company Letter of Credit Agreement and the Bank of America, N.A. Letter of Credit Agreement (together, the Letter of Credit Agreements), including the maintenance of satisfactory days cash on hand, debt service coverage ratio, and debt to capitalization ratio. The Obligated Group is in compliance with the debt covenants as of December 31, 2010.

Interest payments were $4,923 and $4,530 for the years ended December 31, 2010 and 2009, respectively.

The Series 2008A and Series 2008B Bonds are secured by two separate irrevocable direct pay letters of credit issued by agreements between selected banks and the members of the Obligated Group. The Series 2008B letter of credit agreement was extended during 2010 from August 8, 2011 to November 30, 2013. The irrevocable letters of credit have notional amounts of $63,910 and $60,190 and stated maturity dates of August 8, 2013 and November 30, 2013, respectively. If funds are advanced on the letters of credit to purchase bonds, principal payments are due in ten equal consecutive semiannual installments commencing on the first day of the seventh month after the bank(s) purchases such bonds.

(Dollars in thousands)

If funds are advanced under the letters of credit prior to June 30, 2011, annual principal payments under the letter of credit agreements at December 31, 2010 are as follows:

2011	$	13,013
2012		25,233
2013		25,278
2014		25,333
2015		25,388
Thereafter		61,655
	$	175,900

Total cost of capital for the years ended December 31, 2010 and 2009 was 5.4% and 5.3%, respectively.

A derivative instrument (interest rate swap) was entered into in conjunction with the 2007 Series Bond issuance, with a notional amount of $120,425 at December 31, 2010 at a fixed rate of 3.915% and a floating rate of 67% of one-month LIBOR. The purpose of the swap is to convert variable rate debt to fixed rate debt. During 2007, this derivative instrument met the criteria for hedge accounting. In connection with the issuance of the 2008 Series Bonds, the 2007 Series Bonds were extinguished and the Hospitals discontinued hedge accounting. The unrealized (loss) gain of $(4,772) and $21,631 is included in nonoperating income for the years ended December 31, 2010 and 2009, respectively. The fair value of the interest rate swap was approximately $(21,034) and $(16,262) at December 31, 2010 and 2009, respectively, and is included in other long-term liabilities.

A derivative instrument (basis swap) was entered into in 2006 with a notional amount of $93,570 at December 31, 2010. This basis swap is not a designated hedge as it does not meet the criteria for hedge accounting. Accordingly, the unrealized (loss) gain of $(2,825) and $6,030 is included in nonoperating income for the years ended December 31, 2010 and 2009, respectively. The fair value of the basis swap was approximately $(3,211) and $(386) at December 31, 2010 and 2009, respectively, and is included in other long-term liabilities.

Settlement payments for the years ended December 31, 2010 and 2009 of $(4,169) and $(4,420), respectively, are included in the change in the fair value and settlement payments on derivative instruments.

(8) Employee Benefit Plans

Defined Contribution Plan

The Hospitals sponsor a defined contribution benefit plan, which allows employees to contribute amounts tax-deferred up to certain limits allowable under IRS guidelines. The Hospitals are required to match up to

(Dollars in thousands)

100% of employee contributions up to 4% of employee salaries, based on years of service. The Hospitals are also required to make a contribution of 1% of each employee’s salary for all employees who work more than 1,000 hours annually. Additional contributions are required to be made by the Hospitals for employees aged 50 and older, who have completed 10 years of service. Employees vest in amounts contributed by the Hospitals ratably over a five-year period.

For the years ended December 31, 2010 and 2009, the Hospitals’ expenses related to the defined contribution plan were approximately $2,620 and $2,472, respectively, and are included in the employee benefits line item on the combined statements of operations and changes in net assets located on page 3.

Defined Benefit Plan

The Hospitals participate in a noncontributory defined benefit pension plan (the Plan), administered by UCHS, which covers substantially all employees of HMH, UCMC, UCHF, UCHS and UCSJHC who have completed six months of employment and attained the age of twenty and a half years. UCHS and certain of its subsidiaries make annual contributions to the Plan equal to the minimum funding requirement pursuant to ERISA regulations. UCHS is the plan sponsor and elected to freeze the defined benefit plan on December 31, 2005.

The following tables set forth the changes in the projected benefit obligation, the changes in Plan assets, the Plan’s funded status, and amounts recognized in the combined financial statements at December 31:

		2010	2009
Projected benefit obligation, at beginning of year	$	52,000	46,724
Actual benefit payments		(1,554)	(1,507)
Loss due to differences between actual and assumed experience		1,853	3,592
Interest cost		3,268	3,191
Projected benefit obligation, at end of year		55,567	52,000
Fair value of plan assets, at beginning of year		42,999	33,151
Contributions		4,425	2,950
Actual benefit payments		(1,554)	(1,507)
Return on plan assets		5,855	8,405
Fair value of plan assets, at end of year		51,725	42,999
Funded status	$	(3,842)	(9,001)

(Dollars in thousands)

		2010	2009
Amounts recognized in unrestricted net assets:			
Net actuarial loss	$	(21,222)	(24,007)
Prior service cost		(40)	(48)
Accumulated amount in net assets	$	(21,262)	(24,055)

The estimated amounts that will be amortized from unrestricted net assets into net periodic pension cost in fiscal year ending December 31, 2011 are as follows:

Net actuarial loss	$	(2,238)
Prior service cost		(8)
	$	(2,246)

		2010	2009
Interest cost	$	3,268	3,190
Expected return on plan assets		(3,569)	(3,102)
Loss		2,351	2,749
Net amortization and deferral		8	8
Net periodic pension cost	$	2,058	2,845

Assumptions used to determine benefit obligations as of December 31, 2010 and 2009 were as follows: discount rate of 6.05% and 6.41% in 2010 and 2009, respectively, and expected long-term rate of return on assets of 8.5% in 2010 and 2009. Salary increases are not applicable to 2010 and 2009 because the Plan was frozen on December 31, 2005.

Assumptions used to determine net costs for 2010 and 2009 were: discount rate of 6.41% in 2010 and 6.96% in 2009, and expected long-term rate of return on assets of 8.5% in 2010 and 2009.

The overall long-term rate of return was developed by estimating the expected long-term real return for each asset class within the portfolio, computing an average weighted real rate of return for the portfolio as a whole, reflecting both the Plan's expected asset class allocation and the correlations between the various asset classes and adding that expected real rate of return to the expected long-term rate of inflation. The expected long-term rate of return reflects an expected real rate of return and an underlying inflation component per year.

The investment objective of the Plan is to produce a rate of return as determined by the Plan actuary. The Plan is diversified into equities, fixed income obligations, and cash and cash equivalents, so as to provide a reasonable assurance that no single security or class of securities will have a disproportionate impact on the

(Dollars in thousands)

Plan's rate of return. Equity securities are targeted at 55% with a range from 40% to 70%. Fixed income obligations and cash equivalents are targeted at 30% with a range from 10% to 50%. Periodic rebalancing takes place to maintain the desired allocation. Management may change these allocations at its discretion, although such changes are likely to occur infrequently.

The Plan's asset allocation at December 31, 2010 and 2009 by asset category is as follows:

	2010	**2009**
Asset category:		
Cash and equivalents	10%	9%
Common/preferred stock and mutual funds	70	63
Government bonds	6	4
Corporate bonds	9	5
Mortgage-backed securities	5	9
International funds	—	10
Total	100%	100%

The following table presents the Plan's assets measured at fair value at December 31, 2010 and 2009:

	2010			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents	$ 5,365	—	—	5,365
Common/preferred stock and mutual funds	36,302	—	—	36,302
Mortgage-backed and asset-backed securities	2,262	—	—	2,262
Corporate bonds and U.S. government obligations	7,796	—	—	7,796
Total assets	$ 51,725	—	—	51,725

(Dollars in thousands)

	2009			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents	$ 4,093	—	—	4,093
Common/preferred stock and mutual funds	26,822	—	—	26,822
Mortgage-backed and asset-backed securities	3,892	—	—	3,892
Corporate bonds and U.S. government obligations	3,667	—	—	3,667
International funds	—	4,525	—	4,525
Total assets	$ 38,474	4,525	—	42,999

Equity and debt securities and fixed income obligations are measured using quoted market prices at the reporting date multiplied by the quantity held. Mortgage and asset-backed securities are measured using quoted market prices at the reporting date multiplied by the quantity held.

The Hospitals expect to contribute $4,125 to the Plan in 2011.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid from plan assets:

	Expected benefit payments
Fiscal years:	
2011	$ 2,108
2012	2,372
2013	2,577
2014	2,753
2015	2,996
2016 – 2020	17,903

(9) Certain Significant Risks and Uncertainties

(a) Regulation and Reimbursement

The Hospitals provide general acute healthcare services. The Hospitals and other healthcare providers in Maryland are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the federal Medicare and state Medicaid programs

- Regulation of hospital rates by the HSCRC
- Government regulation, government budgetary constraints, and proposed legislative and regulatory changes
- Lawsuits alleging malpractice and related claims

Such inherent risks require the use of certain management estimates in the preparation of the Hospitals' combined financial statements and it is reasonably possible that a change in such estimates may occur.

The Medicare and state Medicaid reimbursement programs represent a substantial portion of the Hospitals' revenues and the Hospitals' operations are subject to a variety of other federal, state, and local regulatory requirements. Failure to maintain required regulatory approvals and licenses and/or changes in such regulatory requirements could have a significant adverse effect on the Hospitals. Changes in federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on the Hospitals.

(b) Malpractice

Claims alleging malpractice have been asserted against the Hospitals and are currently in various stages of litigation. Additional claims may be asserted arising from services provided to patients through December 31, 2010.

On October 1, 2005, the Hospitals entered into an insurance agreement whereby the malpractice claims are being administered through a captive insurance company (Upper Chesapeake Insurance Company LTD or the Captive) domiciled in the Cayman Islands, which is wholly owned by UCHS. The Captive is managed by HSBC, a management company based in the Cayman Islands, using information provided by their claims administrator, SISCO and actuarial information provided by Towers Watson. The Hospitals incurred premiums for claims-made insurance policies of $3,149 and $3,036 for the years ended December 31, 2010 and 2009, respectively.

In addition, the Hospitals have accrued $2,180 and $1,939 at December 31, 2010 and 2009, respectively, recorded in accrued salaries, benefits, and other in the accompanying combined balance sheets, for claims that are incurred but not reported.

In the opinion of management, based upon information provided by its advisors, estimated malpractice costs accrued at December 31, 2010 and 2009 are adequate to provide for potential losses resulting from pending or threatened litigation or for losses incurred but not reported claims.

(c) Welfare Benefit Plan

The Hospitals participate in a welfare benefit plan established by UCHS effective January 1, 1998. The purpose of this plan is to provide eligible employees and their dependents with coverage for hospital and medical expenses on a self-insured basis, subject to risk retention limits, and to provide dental and vision benefits pursuant to specified insurance policies and contracts. An estimate for incurred-but-not-reported health insurance claims of $1,347 and $1,170 has been accrued and recorded in accrued salaries, benefits, and other in the accompanying combined balance sheets at December 31, 2010 and 2009, respectively.

(d) Workers' Compensation

The Hospitals participate in a self-insured plan for workers' compensation claims. Stop-loss coverage has been purchased through a commercial insurer for claims in excess of $400. Accrued claims of $2,634 and $2,823 include estimates for incidents incurred but not reported and are included in accrued salaries, benefits, and other in the accompanying combined balance sheets at December 31, 2010 and 2009, respectively. The Hospitals maintain a surety bond in the amount of $4,200 and a letter of credit in the amount of $1,680 to secure payments on the outstanding workers' compensation claims as required by the State of Maryland Workers' Compensation Commission.

(e) Unemployment

The Hospitals maintain a letter of credit in the amount of $1,196 for the purpose of securing unemployment benefit payments as required by the State of Maryland.

(f) Litigation

From time to time, the Hospitals are involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Hospitals' future financial position or results of operations.

(g) Asset Retirement Obligation

The Hospitals have recorded an Asset Retirement Obligation (ARO) for asbestos removal. The liability is recognized at its net present value with a corresponding increase to the carrying amount of the long-lived asset to which the ARO relates. The estimated asbestos removal costs are $1,347 and $1,407 as of December 31, 2010 and 2009, respectively, and are included in other long-term liabilities. During 2010, there were payments made of $(77) related to asbestos removal, along with annual accretion of $17.

(Dollars in thousands)

(10) Leases

UCMC, as lessor, expects to receive minimum rents from tenants under operating leases as follows:

2011	$ 815
2012	660
2013	298
2014	280
2015	257
	$ 2,310

The Hospitals have several operating lease agreements for office space, computer and medical equipment, office machines and vehicles. Total rent expense recorded by the Hospitals under these leases was approximately $4,490 and $4,049 for the years ended December 31, 2010 and 2009, respectively.

Future rental payments under noncancelable operating leases with durations in excess of one year are as follows:

2011	$ 3,427
2012	2,946
2013	1,598
2014	423
2015	—
	$ 8,394

(11) Charity Care and Other Deductions from Revenue

The Hospitals provide care to patients regardless of their ability to pay. In identifying charity care, the Hospitals assess the patient's ability to pay, utilizing generally recognized poverty income levels for the community, and identify certain cases where incurred charges are considered to be beyond the patient's ability to pay. The Hospitals maintain records to identify and monitor the level of charity care they provide. These records reflect the amount of charges forgone under their charity care policy and amounted to approximately $3,855 and $3,644 for the years ended December 31, 2010 and 2009, respectively.

(Continued)

(Dollars in thousands)

In addition to the direct charity care noted above, all patients covered by the Medicare and Medicaid and other third-party payors programs are accepted. These programs reimburse the Hospitals at less than the established charges for services provided to recipients. During 2010, the state instituted a charge based on the amount of revenue covered by hospitals for Medicaid Services rendered (Medicaid Assessment). The difference between the charges for these services and the related reimbursement amounts for these and other third-party payors are as follows for the years ended December 31:

	2010	2009
Medicare	$ 13,901	13,143
Medicaid	530	493
Medicaid Assessment	2,620	—
Other third-party payors	4,399	3,871
	$ 21,450	17,507

The Hospitals also provide free services to the community through their “Healthlink” program. The “Healthlink” program provides health information, wellness programs, health screenings, and educational programs.

(12) Related-Party Transactions

UCHS provides management, promotion, and other support services to the Hospitals. Fees relating to such services are allocated to these entities based on management’s estimate of UCHS resources consumed at each entity. Such services were allocated 89.5% and 87.9% to the Hospitals in 2010 and 2009, respectively. Fees to UCHS included in other operating expenses were $9,902 and $9,078 in 2010 and 2009, respectively.

UCMS provides physician and other support services to the Hospitals. Fees to UCMS included in operating expenses were $3,124 and $2,795 for the years ended December 31, 2010 and 2009, respectively.

The Hospitals recognized rental revenue from affiliates of $433 and $439 for the years ended December 31, 2010 and 2009, respectively. This rental revenue is included in other revenue in the combined statements of operations and changes in net assets.

UCHF contributed $532 and $385 to the Hospitals for capital improvements and equipment purchases for the years ended December 31, 2010 and 2009, respectively. These amounts are presented as contributions for purchases of property and equipment in the combined financial statements. UCHF contributed $14 and $147 to the Hospitals for operations for the years ended December 31, 2010 and 2009, respectively.

The Obligated Group transferred $8,349 and $4,730 during 2010 and 2009, respectively, to UCMS, representing an equity contribution.

The Obligated Group also transferred $3,014 during 2010 to UCP representing an equity contribution

(Continued)

(Dollars in thousands)

As a result of the sale of UCSJHC assets, the Venture received a cash distribution of $593 from its joint venture, UCSJHC, and then contributed this amount to the Obligated Group. The Obligated Group recorded their proportionate share of the UCSJHC losses for 2010 of $15.

As discussed in note 1, the Venture received an equity contribution of $26,750 from UMMS on October 1, 2009 and 2010, which was immediately contributed to the Obligated Group.

The Hospitals have entered into an agreement with a bank whereby the Hospitals are the guarantor for an unsecured discretionary line of credit agreement between the bank and UCMS. The line of credit agreement permits UCMS to borrow up to $3,500. The amount outstanding under this agreement was $1,200 as of December 31, 2010 and 2009, respectively.

On July 14, 2010, UCHS and UMMS executed a shareholder operating agreement and declaration of trust (The Trust Agreement) to form the UCHS/UMMS Real Estate Trust. On July 16, 2010, the UCHS/UMMS Real Estate Trust purchased the Barker Property in Havre de Grace, Maryland for approximately $16,500. The Hospitals transferred $3,109 to UCHS for the purchase of the land utilizing proceeds from the UMMS equity contribution in October 2009 of $26,750. The balance is recorded as a Due from Affiliate in the accompanying combined financial statements.

Net amounts receivable from (payable to) affiliates at December 31 are summarized as follows:

		2010	2009
UCHS and subsidiary	$	6,283	2,493
UCMS		3,016	3,120
Captive		(20)	(58)
UCRHH		375	115
UCP		—	1,045
UCHV		(17)	338
	$	9,637	7,053

(13) Fair Value Measurements

(a) Fair Value of Financial Instruments

The following methods and assumptions were used by the Hospitals in estimating the fair value of their financial instruments:

Cash and cash equivalents, assets held by trustee, board designated and other investments, patient accounts receivable, other assets, line of credit, accounts payable, accrued expenses, advances from third-party payors, other long term liabilities and intercompany amounts: The carrying amounts reported in the combined balance sheets approximate the related fair values.

The fair value of a financial instrument is the amount 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.

Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Hospitals own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Hospitals based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, accounts receivable, due from affiliates, other assets, line of credit, accounts payable, advances from third-party payors, due to affiliates, and accrued expenses: The carrying amounts, at face value or cost plus accrued interest, approximate fair value because of the short maturity of these instruments.

Board-designated and other investments: Equity and debt securities classified as trading and fixed income obligations are measured using quoted market prices at the reporting date multiplied by the quantity held. Mortgage and asset-backed securities are measured using quoted market prices at the reporting date multiplied by the quantity held.

Derivative instruments: The fair value of derivative instruments is determined using pricing models developed based on the LIBOR swap rate and other observable market data. The value was determined after considering the potential impact of collateralization and netting agreements, adjusted to reflect nonperformance risk of both the counterparty and the Hospitals.

(b) Long-Term Debt

The Series 2008 Bonds bear interest at variable rate and fixed rates and, at December 31, 2010, had a carrying amount and fair value of $175,900 and $177,151, respectively.

The fair value of the Hospitals' long-term debt is measured using quoted offered-side prices when quoted market prices are available. If quoted market prices are not available, the fair value is determined by discounting the future cash flows of each instrument at rates that reflect, among other things, market interest rates and the Hospitals' credit standing. In determining an appropriate spread to reflect its credit standing, the Hospitals consider credit default swap spreads, bond yields of other long-term debt offered by the Hospitals, and interest rates currently offered to the Hospitals for similar debt instruments of comparable maturities by the Hospitals' bankers as well as other banks that regularly compete to provide financing to the Hospitals.

(Dollars in thousands)

(c) Fair Value Hierarchy

The following table presents assets and liabilities that are measured at fair value on a recurring basis at December 31, 2010 and 2009:

	2010			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents	$ 27,526	—	—	27,526
Common/preferred stock and mutual funds	28,198	—	—	28,198
Mortgage-backed and asset-backed securities	15,125	—	—	15,125
Corporate bonds and U.S. government obligations	33,771	—	—	33,771
Total assets	$ 104,620	—	—	104,620
Liabilities:				
Derivative instruments	$ —	24,245	—	24,245

	2009			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents	$ 42,737	—	—	42,737
Common/preferred stock and mutual funds	26,274	—	—	26,274
Mortgage-backed and asset-backed securities	3,236	—	—	3,236
Corporate bonds and U.S. government obligations	12,913	—	—	12,913
Total assets	$ 85,160	—	—	85,160
Liabilities:				
Derivative instruments	$ —	16,648	—	16,648

(Dollars in thousands)

(14) Medical Office Building II

As discussed in note 1, the Hospitals are required to be treated as the "owner" of MOB II. The asset and financing obligation will be reflected on the Hospitals' combined balance sheets until completion of the lease term, when they will be removed from the Hospitals' combined financial statements. At such time, the net of the remaining obligation and carrying value of the asset will be recognized as a gain on disposal. At December 31, 2010, the recorded amount for the asset is $11,793 and the related liability is $12,169, which are included in buildings and other long-term liabilities, respectively.

The future minimum payments under the financing obligation for the initial lease term (10 years) are as follows:

2011	$	887
2012		913
2013		941
2014		969
2015		998
Thereafter		2,807
Total future minimum financing obligation payments		7,515
Less interest		(4,748)
Present value of future minimum financing obligation payments	$	2,767

(15) Functional Expenses

The Hospitals provide general healthcare services to residents within their geographic locations. Expenses related to providing these services, based on management's estimates of expense allocations, are as follows for the years ended December 31:

		2010	2009
Healthcare services	$	237,587	231,959
General and administrative		45,384	45,264
	$	282,971	277,223

(16) Subsequent Events

The Hospitals evaluated all events and transactions that occurred after December 31, 2010 and through April 26, 2011. The Hospitals did not have any material recognizable subsequent events during this period.

Schedule 1

HARFORD MEMORIAL HOSPITAL, INC. AND
UPPER CHESAPEAKE MEDICAL CENTER, INC.

Combining Balance Sheet Information

December 31, 2010

(In thousands)

Assets		**Upper Chesapeake Medical Center, Inc.**	**Harford Memorial Hospital, Inc.**	**Eliminations**		**Combined**
Current assets:						
Cash and cash equivalents	$	20,493	11,892	—		32,385
Current portion of assets held by trustee		2,465	469	—		2,934
Board-designated and other investments		53,944	41,946	—		95,890
Patient accounts receivable, net		21,239	9,755	—		30,994
Prepaid expenses and other current assets		5,770	4,001	—		9,771
Total current assets		103,911	68,063	—		171,974
Due from affiliates		44,463	—	(34,789)	(a)	9,674
Assets held by trustee, less current portion		4,868	928	—		5,796
Property, plant, and equipment, net		146,439	35,358	—		181,797
Other assets		1,124	108	—		1,232
Total assets	$	300,805	104,457	(34,789)		370,473
Liabilities and Net Assets						
Current liabilities:						
Accounts payable	$	7,024	9,172	—		16,196
Accrued salaries, benefits and other		14,342	6,152	—		20,494
Current portion of long-term debt		10,931	2,082	—		13,013
Advances from third-party payors		4,405	1,413	—		5,818
Total current liabilities		36,702	18,819	—		55,521
Due to affiliates		1,072	33,754	(34,789)	(a)	37
Long-term debt, less current portion		136,304	25,963	—		162,267
Other long-term liabilities		36,414	1,347	—		37,761
Pension liability		3,413	429	—		3,842
Total liabilities		213,905	80,312	(34,789)		259,428
Unrestricted net assets		86,900	24,145	—		111,045
Total liabilities and net assets	$	300,805	104,457	(34,789)		370,473

Combining eliminations:
(a) Eliminate intercompany receivables and payables.

See accompanying independent auditors’ report.

Schedule 2

HARFORD MEMORIAL HOSPITAL, INC. AND
UPPER CHESAPEAKE MEDICAL CENTER, INC.

Combining Statement of Operations Information

Year ended December 31, 2010

(In thousands)

	Upper Chesapeake Medical Center, Inc.	Harford Memorial Hospital, Inc.	Combined
Operating activities:			
Unrestricted revenues, gains, and other support:			
Net patient service revenue	$ 201,643	90,938	292,581
Other	3,279	1,240	4,519
Total unrestricted revenues, gains, and other support	204,922	92,178	297,100
Expenses:			
Salaries	72,564	35,895	108,459
Employee benefits	16,600	8,123	24,723
Provision for bad debts	12,767	9,220	21,987
Supplies and other operating expenses	78,857	30,950	109,807
Depreciation and amortization	8,895	3,114	12,009
Interest and amortization	4,405	1,581	5,986
Total expenses	194,088	88,883	282,971
Operating income	10,834	3,295	14,129
Nonoperating income:			
Investment income	25	5,190	5,215
Change in the fair value and settlement payments on derivative instruments (note 7)	(11,766)	—	(11,766)
Nonoperating (loss) gain	(11,741)	5,190	(6,551)
(Deficiency) excess of revenues over expenses	(907)	8,485	7,578
Other changes in unrestricted net assets:			
Contributions for purchases of property and equipment	337	195	532
Equity contribution	26,750	—	26,750
Pension – related changes other than net periodic pension cost	1,955	838	2,793
Transfers to affiliates, net	(10,927)	—	(10,927)
Increase in unrestricted net assets	$ 17,208	9,518	26,726

See accompanying independent auditors' report.