KENNEDY KRIEGER INSTITUTE, INC. AND AFFILIATES

Combined Financial Statements
June 30, 2017 and 2016

Kennedy Krieger Institute, Inc. and Affiliates
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June 30, 2017 and 2016

Report of Independent Auditors

To the Board of Directors of
Kennedy Krieger Institute, Inc. and Affiliates

We have audited the accompanying combined financial statements of Kennedy Krieger Institute, Inc. and Affiliates (the "Institute"), which comprise the combined balance sheets as of June 30, 2017 and 2016, and the related combined statements of operations, changes in net assets and cash flows for the years then ended.

Management's Responsibility for the Combined Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on the 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Institute's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Institute's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Kennedy Krieger Institute, Inc. and Affiliates as of June 30, 2017 and 2016, and the results of their operations, changes in net assets, and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

Baltimore, Maryland
September 28, 2017

Kennedy Krieger Institute, Inc. and Affiliates
Combined Balance Sheets
As of June 30, 2017 and 2016
(in thousands)

ASSETS	2017	2016
Current assets:		
Cash and cash equivalents	$ 16,955	$ 12,397
Patient receivables, less allowances of $4,715 and $3,750	17,811	19,255
Grant and contract receivable	8,582	7,079
Tuition receivable	4,025	4,611
Pledges receivable	7,410	11,033
Investments limited as to use	24,943	-
Prepaid expenses and other	1,564	1,509
Total current assets	81,290	55,884
Non-current assets:		
Property and equipment, net	121,699	122,508
Investments:		
Board designated endowment	52,227	45,836
Investments limited as to use	7,250	6,544
Pledges receivable, less allowances of $2,561 and $2,366	8,859	10,543
Total non-current assets	190,035	185,431
Total assets	$ 271,325	$ 241,315
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	30,240	25,425
Line of credit	-	2,250
Deferred grant revenue	1,907	2,169
Current portion of tax-exempt bonds	2,361	2,299
Total current liabilities	34,508	32,143
Long-term liabilities:		
Tax-exempt bonds, net	83,473	62,822
Accrued pension	18,193	22,516
Interest rate swap	8,545	12,370
Other long-term liabilities	2,323	2,341
Total long-term liabilities	112,534	100,049
Total liabilities	147,042	132,192
Net assets:		
Unrestricted	86,255	70,500
Temporarily restricted	37,070	37,665
Permanently restricted	958	958
Total net assets	124,283	109,123
Total liabilities and net assets	$ 271,325	$ 241,315

See accompanying notes to combined financial statements.

Kennedy Krieger Institute, Inc. and Affiliates
Combined Statements of Operations
For the years ended June 30, 2017 and 2016
(in thousands)

	2017	2016
Operating revenues:		
Patient service revenue, net of contractual allowances	$ 164,230	$ 149,979
Bad debt expense	(3,583)	(3,170)
Net patient service revenue	160,647	146,809
Tuition revenue	46,870	44,314
Grant and contract revenue	36,518	34,063
Net assets released for operating activities	4,168	6,550
Investment earnings used for operating activities	2,000	2,061
Unrestricted contributions from fundraising activities, net	1,102	1,373
Other operating revenues	1,438	1,857
Total operating revenues	252,743	237,027
Operating expenses:		
Salaries, wages and benefits	182,442	178,120
Supplies, purchased services, and other	51,738	45,776
Depreciation and amortization	9,508	9,287
Rent	2,369	2,257
Interest	1,782	1,525
Total operating expenses	247,839	236,965
Operating revenues over operating expenses	4,904	62
Non-operating activity:		
Investment income and realized (losses), net	(534)	(2,050)
Change in unrealized gains (losses) on investments, net	6,053	(1,408)
Loss on early extinguishment of debt	(167)	-
Realized and unrealized gain (loss) on interest rate swap	2,650	(4,830)
Realized gain on sale of asset	-	716
Restricted fundraising expenses	(988)	(965)
Net non-operating activities	7,014	(8,537)
Excess of revenue (under) over expenses	$ 11,918	$ (8,475)

See accompanying notes to combined financial statements.

Kennedy Krieger Institute, Inc. and Affiliates
Combined Statements of Changes in Net Assets
for the years ended June 30, 2017 and 2016
(in thousands)

	2017	2016
Unrestricted net assets:		
Excess of revenue (under) over expenses	$ 11,918	$ (8,475)
Net assets released from restrictions used for property and equipment	1,414	-
Change in funded status of defined benefit plan, net	2,423	(5,740)
Increase (decrease) in unrestricted net assets	15,755	(14,215)
Unrestricted net assets, beginning of year	70,500	84,715
Unrestricted net assets, end of year	$ 86,255	$ 70,500
Temporarily restricted net assets:		
Contributions from fundraising activities	4,987	7,700
Net assets released from restrictions used for:		
Operating activities	(4,168)	(6,550)
Purchases of property and equipment	(1,414)	-
(Decrease) increase in temporarily restricted net assets	(595)	1,150
Temporarily restricted net assets, beginning of year	37,665	36,515
Temporarily restricted net assets, end of year	$ 37,070	$ 37,665
Permanently restricted net assets:		
Contributions from fundraising activities	-	-
Increase in permanently restricted net assets	-	-
Permanently restricted net assets, beginning of year	958	958
Permanently restricted net assets, end of year	$ 958	$ 958
Increase (decrease) in total net assets	15,160	(13,065)
Total net assets, beginning of year	109,123	122,188
Total net assets, end of year	$ 124,283	$ 109,123

See accompanying notes to combined financial statements.

Kennedy Krieger Institute, Inc. and Affiliates
Combined Statements of Cash Flows
for the years ended June 30, 2017 and 2016
(in thousands)

	2017	2016
Cash flows from operating activities:		
Change in net assets	$ 15,160	$ (13,065)
Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities:		
Net realized and unrealized (gains) losses on investments, net	(6,146)	2,209
Depreciation and amortization	9,508	9,287
Bad debt expense	3,583	3,170
Change in pension liability, net	(4,323)	5,100
Change in valuation of interest rate swap	(3,825)	3,517
Restricted contributions	(3,873)	(5,243)
Loss on early extinguishment of debt	167	-
Gain on sale of asset	-	(716)
Changes in assets and liabilities:		
Patient receivables	(2,139)	(4,666)
Other receivables	4,391	1,341
Prepaid expenses	(55)	102
Accounts payable and accrued expenses	4,815	1,574
Deferred grant revenue	(262)	(983)
Other liabilities	13	1,109
Net cash provided by operating activities	17,014	2,736
Cash flows from investing activities:		
Purchase of property and equipment	(8,699)	(5,642)
Net sales of investments	(245)	1,112
Proceeds from sale of asset	-	865
Changes in investments limited to use	(25,649)	448
Net cash used in investing activities	(34,593)	(3,217)
Cash flows from financing activities:		
Proceeds from issuance of tax-exempt Bonds	50,510	-
Payments due to refunding of Bonds	(27,440)	-
Payments on tax-exempt bonds	(2,262)	(2,247)
Proceeds from line of credit	8,000	12,950
Payments on line of credit	(10,250)	(10,700)
Payments on capital lease obligation	(294)	(200)
Proceeds from restricted contributions	3,873	5,243
Net cash provided by financing activities	22,137	5,046
Net increase in cash and cash equivalents	4,558	4,565
Cash and cash equivalents, beginning of year	12,397	7,832
Cash and cash equivalents, end of year	$ 16,955	$ 12,397
Cash paid during the year for interest	$ 1,782	$ 1,525

See accompanying notes to combined financial statements.

1. DESCRIPTION OF ORGANIZATION

Kennedy Krieger Institute, Inc. and Affiliates (the "Institute") is an internationally recognized organization dedicated to improving the lives of children, adolescents and young adults through comprehensive patient care, education and research. The Institute's primary operating activities include healthcare services, research, training, special education and fundraising.

The operations of the Institute are carried out through a number of legal corporate entities. The combined financial statements of the Institute reflect the accounts of the following separate legal corporate entities:

Kennedy Krieger Institute, Inc.
Kennedy Krieger Children's Hospital, Inc.
Hugo W. Moser Research Institute at Kennedy Krieger, Inc.
Kennedy Krieger Education and Community Services, Inc.
Kennedy Krieger Associates, Inc.
PACT: Helping Children with Special Needs, Inc.
Kennedy Krieger Foundation, Inc.
Madison Street Properties, Inc.

Healthcare services are provided through Kennedy Krieger Children's Hospital, Inc. and include a forty-five bed inpatient unit admitting more than 345 patients yearly, over fifty specialty outpatient clinics generating in excess of 196,000 annual visits and the training of over 400 healthcare professionals each year. Net patient service revenue generated through Healthcare activities represents approximately 64% and 62% of the Institute's operating revenue in fiscal years 2017 and 2016, respectively.

Studies conducted through Research activities within the Hugo W. Moser Research Institute at Kennedy Krieger, Inc. are provided through over 125 government and private awards. Research grant and contract revenue represents approximately 14.4% of the Institute's operating revenue in fiscal years 2017 and 2016. Approximately 76.6% of this revenue comes from departments and agencies of the United States government. Major government sponsors included the Department of Health and Human Services, the Department of Defense and the Department of Justice.

Special education services provided through Kennedy Krieger Education & Community Services, Inc. are conducted through non-public special education schools for students from kindergarten to grade eight, high school, specialized autism programs and partnership programs within public schools. Tuition and related contractual revenue generated through special education services represents approximately 18.5% and 18.7% of the Institute's operating revenue in fiscal years 2017 and 2016, respectively.

Kennedy Krieger Institute, Inc., Kennedy Krieger Children's Hospital, Inc., Hugo W. Moser Research Institute at Kennedy Krieger, Inc., Kennedy Krieger Education and Community Services, Inc., Kennedy Krieger Associates, Inc., and PACT: Helping Children with Special Needs, Inc. are Maryland non-stock corporations organized for charitable, scientific and educational purposes and are tax-exempt under Section 501(c)(3) of the Internal Revenue Code. Kennedy Krieger Foundation, Inc. (the "Foundation"), is a Maryland stock corporation and is tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

Madison Street Properties, Inc. ("MSP") is a tax-exempt supporting organization under Section 509(a)(3) of the Internal Revenue Code and is wholly owned by the Foundation. All real and personal property and leasehold rights owned by the Institute are held by MSP, that in turn leases or subleases the property back to each member of the corporate family utilizing it and also provides property management services, including maintenance, security and housekeeping.

The Institute maintains an independent affiliation with The Johns Hopkins University. The formal relationship between the parties is set forth in an affiliation agreement whereby (i) the medical, scientific and other professional staff of the Institute receive primary and adjunct appointments in the appropriate Johns Hopkins University Schools or departments; and (ii) each Institution's independent corporate status is retained. Goods and services are purchased and sold by each organization through arms length transactions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation
The financial statements of the Institute have been prepared on the accrual basis, which conforms to accounting principles generally accepted in the United States of America. The combined financial statements include the accounts of the Institute after elimination of all significant intercompany accounts and transactions.

The combining supplemental schedules have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. This is the same basis of presentation as the Kennedy Krieger Institute, Inc. and Affiliates Combined Financial Statements

Excess of Revenue over Expenses
The Statements of Operations include excess of revenues over (under) expenses, which is the Institute's performance indicator. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses consistent with industry practice, include unrealized gains and losses on investments, certain pension related transactions and assets acquired using contributions which by donor restrictions were to be used for the purpose of acquiring such assets.

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

Cash and Cash Equivalents
Cash and cash equivalents include investments in highly liquid instruments with original maturities of three months or less. These investments are carried at cost, which approximates market value.

Investments and Investment Income
Investments in equity securities with readily determinable fair values and all investments in debt securities are classified as trading and are recorded at fair value in the Combined Balance Sheets.

Investment income is included in the non-operating activity section of the Statement of Operations. Investment income includes interest and dividends, realized and unrealized gains (losses) on investments.

Allowance for Doubtful Accounts
An allowance for doubtful accounts is recorded for patient receivables which are anticipated to become uncollectible in future periods. Receivables deemed to be uncollectible have been written off.

Grant and Contract Revenue and Receivable
Grant and contract revenues are recorded through cost reimbursement arrangements when allowable costs are incurred, through service rates as services are provided or when contractual terms are satisfied. Grant and contract receivables are recorded when earned. A reserve for uncollectible accounts has been estimated and recorded against grant and contract receivables.

Tuition Revenue and Receivable
Tuition revenue is recognized when earned over the school term (July to June). Tuition receivables are recorded when earned. The Institute does not record an allowance as tuition is paid in full by the local education agencies of the State of Maryland at state approved tuition rates.

Pledges Receivable
Unconditional promises to give cash and other assets to the Institute are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the commitment is received in writing.

Pledges receivable from capital campaigns and other restricted and unrestricted donations, have been recorded net of an allowance for uncollectible pledges. The allowance for uncollectible pledges receivable is estimated based on the nature and source of each pledge including pledge payment history and the donor’s likelihood of honoring the commitment. The allowance is applied to pledges greater than one year. Multi-year pledges are recorded at their estimated present value using a risk-free rate of return of 3% for 2017 and 2016.

Assets Limited as to Use
Assets limited as to use primarily include assets held by trustees under bond indenture, self-insurance trust arrangements, deferred compensation plans and other restricted gift arrangements.

Property and Equipment
Property and equipment acquisitions are recorded at cost. Depreciation is calculated using the straight-line method over the following estimated useful lives:

Buildings and Improvements	30-40 years
Fixed Equipment	10-15 years
Furniture and Equipment	3-5 years

Equipment purchases under grants, where title to the equipment rests with the grantor, are recorded as expenditures of the grant and are not capitalized or depreciated.

Capital Leases
Capital leased assets are amortized over the shorter of their estimated useful lives or the lease term. Depreciation expense on capitalized leased assets is included in depreciation and amortization expenses in the Consolidated Statements of Operations.

Board Designated Investments for Endowment
The Board of Directors of the Institute has designated certain assets, including accumulated unrestricted gifts to serve as an endowment for the Institute. The Board may authorize the withdrawal or transfer of such amounts at any time to further the purpose of the Institute and,

accordingly, such amounts are classified as unrestricted net assets. Iinterest, dividends and realized gains and losses from the endowment are included in investment income and net realized gains on the Combined Statements of Operations. Unrealized gains and losses are recorded in other changes in unrestricted net assets.

Deferred Financing Costs
Costs incurred related to the issuance of bonds payable have been deferred and are being amortized over the life of the bonds using the effective interest method. In fiscal year 2017, the Institute adopted ASU 2015-03, "Simplifying Presentation of Debt Issuance Costs". These debt issuance costs are now presented as a deduction from the carrying value of the associated debt. The Balance Sheet for 2016 was restated for this change.

Accrued Expenses
Accrued expenses are operating expenses that have been incurred but which have not been paid as of the balance sheet date. These expenses are typically periodic and due within one year or less. They include expenses incurred for payroll, employee benefits, subcontracts, interest and other operating items.

Deferred Grant Revenue
Deferred grant revenue has been recorded to reflect the portion of cash received on awarded grants where the grantor restrictions for its use have not been satisfied. Typically, the donor restrictions are satisfied within a year, therefore, deferred grant revenue is classified as a current liability.

Unrestricted, Temporarily Restricted and Permanently Restricted Net Assets
Unrestricted net assets represent those net assets utilized in the operating activities of the Institute.

Temporarily restricted net assets are those whose use by the Institute has been limited by donors, grantors and other contracts to a specific purpose or time period. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Combined Statements of Operations as net assets released from restrictions. Temporarily restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

Permanently restricted net assets represent those net assets that have been restricted by donors to be maintained in perpetuity. The donors of these assets usually permit the Foundation to use all or part of the income earned on the investments for general or specific purposes.

Estimated Professional and General Liability Costs
The provision for estimated professional and general liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Derivatives
The use of derivatives by the Institute is generally limited to interest rate swaps. The Institute follows accounting guidance on derivative financial instruments that are 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. The Institute's only derivative financial instrument is an interest rate swap agreement without hedge accounting designation.

The Institute recognizes its interest rate swap as a liability on the Combined Balance Sheet at fair value. The change in the value of this derivative is recorded as an unrealized gain or loss in the Combined Statements of Operations.

Pension Plans
The Institute follows current technical guidance for reporting and accounting for pension benefits provided to employees. This guidance requires recognition of the funded status of a defined benefit plan in the balance sheet as an asset or liability if the plan is over funded or underfunded, respectively. Changes in the funded status of a plan are required to be recognized in the year in which the changes occur through changes in unrestricted net assets. The guidance also requires the measurement date of the plan's funded status to be the same as the company's fiscal year end.

Short-term investments
Short-term investments are carried at fair value and are comprised of instruments with an average duration of 1 to 3 years.

Investments
The fair values for marketable equity, government, and fixed income securities included in long-term investments are based on quoted market prices. Alternative investments, which are not readily marketable, are carried at estimated fair values as provided by the investment managers and are valued at the latest available unaudited net asset value of the investments.

Long-term Debt Obligations
Management estimates that the fair value of long-term debt is equal to its carrying value.

Assets Whose Use is Limited
Assets whose use is limited are comprised of investments held for construction projects, self-insurance obligations, debt service requirements, deferred compensation and donor restricted funds and are valued as stated above.

Reclassifications
Certain reclassifications have been made to conform with the current year financial statement presentation.

New Accounting Pronouncements
In May 2014, the FASB issued a standard on Revenue from Contracts with Customers. This standard implements a single framework for recognition of all revenue earned from customers. This framework ensures that entities appropriately reflect the consideration to which they expect to be entitled in exchange for goods and services by allocating transaction price to identified performance obligations and recognizing revenue as performance obligations are satisfied. Qualitative and quantitative disclosures are required to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The standard is effective for fiscal years beginning after December 15, 2017. The Institute is evaluating the impact this will have on the combined financial statements beginning in fiscal year 2019.

In May 2015, the FASB issued ASU 2015-07, "Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)". ASU 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. ASU 2015-07 is required to be applied retrospectively to all periods presented beginning in the year of adoption. The amendments in ASU

(in thousands)

2015-07 are effective for years beginning after December 15, 2016. Kennedy Krieger Institute adopted this accounting standard in fiscal year 2017, and there was no impact on the Combined Financial Statements. See footnote 8 “Fair Value Measures”.

In April 2015, the FASB issued ASU 2015-03, “Simplifying the Presentation of Debt Issuance Costs”. ASU 2015-03 requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt, consistent with the presentation of a debt discount. Prior to the issuance of the standard, debt issuance costs were required to be presented in the balance sheet as deferred financing charges (i.e., as an asset). Kennedy Krieger Institute adopted this presentation in fiscal year 2017. See footnote 13 “Debt”.

In February 2016, the FASB issued a standard on Leases. This standard requires lessees to recognize assets and liabilities for the rights and obligations created by leases with terms in excess of 12 months. The recognition, measurement, and presentation of expenses and cash flows arising from a lease will primarily depend on its classification as a finance or operating lease. The accounting by lessors remains largely unchanged. This standard is effective for fiscal years beginning after December 15, 2018. Kennedy Krieger Institute is evaluating the impact this will have on the combined financial statements beginning in Fiscal Year 2020.

In August 2016, the FASB issued a standard on the Presentation of Financial Statements of Not-for-Profit Entities. The new guidance requires improved presentation and disclosures to help not-for-profits provide more relevant information about their resources to donors, grantor, creditors and other users. The standard is effective for fiscal years beginning after December 15, 2017. Kennedy Krieger Institute is evaluating the impacts this will have on the combined financial statements beginning in fiscal year 2019.

3. NET PATIENT SERVICE REVENUE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

Net patient service revenues from inpatient and outpatient services are reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered including estimates for contractual allowances with third-party payors and bad debts.

The Institute has agreements with third-party payors that provide for payments to the Institute at amounts different from its established rates. Net patient service revenue is comprised of the following:

	2017	2016
Gross Inpatient Revenue	$ 57,365	$ 52,748
Less: Contractual Allowances	(10,960)	(10,381)
Bad Debt Expense	(570)	(501)
Net Inpatient Revenue	45,835	41,866
Gross Outpatient Revenue	130,005	118,947
Less: Contractual Allowances	(12,180)	(11,335)
Bad Debt Expense	(3,013)	(2,669)
Net Outpatient Revenue	114,812	104,943
Net Patient Service Revenue	$ 160,647	$ 146,809

(in thousands)

The percentage of patient service revenue generated by payor category for the fiscal years ended June 30, 2017 and 2016 is as follows:

	2017	2016
Medicaid	36%	35%
Blue Cross	25%	24%
Commerical	21%	21%
Managed Care	13%	13%
Self pay and other	3%	5%
Medicare	2%	2%
	100%	100%

The Allowance for Doubtful Accounts is based upon management's assessment of historical and expected net collections considering trends in healthcare coverage, economic conditions and payor mix. Management assesses the adequacy of the allowance periodically based upon historical collection and write off experience. After collection of amounts due from insurers, the Institute follows internal guidelines for placing certain past-due balances with collection agencies.

	2017	2016
Beginning Allowance for doubtful accounts	$ 3,750	$ 3,461
Plus: Bad debt expense	3,583	3,170
Less: Bad debt write-offs, net of recoveries	(2,618)	(2,881)
Ending Allowance for doubtful accounts	$ 4,715	$ 3,750

A summary of the payment arrangements with major third-party payors and patient financial assistance follows.

Maryland Medicaid
Since January 1, 2007 the Institute has been under a prospective payment system ("PPS") with Maryland Medicaid for both inpatient and outpatient services. Service-based per diem rates for inpatient services are annually adjusted by market basket update factors published by the Centers for Medicare and Medicaid Services ("CMS"). Outpatient services are reimbursed as a percentage of charges and subject to the lower of cost versus charges. Base year costs are trended forward annually using the CMS outpatient PPS market basket update factor and compared to actual charges. No retroactive settlement occurs under these arrangements.

Out of State Medicaid
The Institute has entered into payment agreements with many out-of-state Medicaid Plans. The majority of these payment agreements reflect similar rates paid by Maryland Medicaid. No retroactive settlement occurs under these agreements.

Commercial Insurance
The Institute has also entered into payment agreements with commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis of payment to the Institute under these agreements includes prospectively determined rates per day or discharge, discounts from established charges and prospectively determined daily rates. No retroactive settlement occurs under these agreements.

Medicare
Certain inpatient and outpatient services rendered to Medicare beneficiaries are subject to retrospective cost-based reimbursement. Medicare cost reports have been filed through 2016 and final settled through 2014. No significant settlement due to or from the Medicare Program has been estimated and as a result no receivable or payable has been recorded at June 30, 2017 or 2016.

Financial Assistance and Community Benefit
The Institute provides services without charge or at discounted charges to patients who meet certain criteria under its financial assistance policy. The criteria for financial assistance considers the patient or patient's family's ability to pay at time of service. The Institute uses the federal poverty guidelines to determine eligibility for free care or discounted care. In addition, the Institute's policy applies to patients who are medically indigent. The Institute also offers payment plan options to assist patients who experience a financial hardship paying their hospital and professional services bills, but who might not qualify for financial assistance. In January 2016, the Institute expanded its financial assistance policy along with developing a plain language summary of the policy that is distributed to patients at registration.

The cost for services and supplies furnished under the Institute's financial assistance policy aggregated approximately $988 and $938 in 2017 and 2016, respectively. The cost has been estimated based on a cost to charge ratio and applied to financial assistance charges.

In addition to patient financial assistance and payment plan options, the Institute provides various community benefits across the developmental disability populations within the State of Maryland. The foundation of its community benefits envisions that all persons with developmental disabilities ("DD") lead fully inclusive and meaningful lives. A community needs assessment was conducted to understand the needs of the community served. Based on the needs assessment, the Institute promotes and hosts educational forums, provides respite care resources, acts as a resource finder, provides advocacy and legal services, promotes and arranges information exchange among patients, families and professionals, promotes workforces development, is a leader in healthcare training in DD, conducts research, among other things.

(in thousands)

4. TUITION REVENUE

Tuition revenue generated by school programs is summarized as follows:

	2017	2016
High school	$ 13,925	$ 12,792
Lower/middle school	13,089	12,678
Leap/Autism	7,917	7,329
Montgomery County	5,686	5,609
Partnership programs	5,463	5,103
PACT daycare	748	757
Other	42	46
	$ 46,870	$ 44,314

Over 550 students are enrolled in special education programs each year and come from fourteen Maryland counties, Washington, D.C. and other sources. The percentage of tuition revenue generated by jurisdiction is as follows:

	2017	2016
Prince George's County, MD	21.8%	20.9%
Baltimore City, MD	18.7%	18.9%
Other MD Counties	19.5%	19.0%
Baltimore County, MD	15.1%	13.8%
Anne Arundel County, MD	11.4%	12.9%
Montgomery County, MD	8.6%	9.6%
Washington, DC	4.2%	4.0%
Other	0.7%	0.9%
Total	100.0%	100.0%

5. GRANT AND CONTRACT REVENUE

Grant and contract revenue is generated through the following activities:

	2017	2016
Research	$ 28,588	$ 25,759
Community service	6,294	6,771
Training	1,636	1,533
	$ 36,518	$ 34,063

(in thousands)

Research revenue includes all research initiatives funded through government and private sources. Community service revenue consists of services provided to individuals and families with special needs in a community-based setting and is funded through government programs. Training revenue represents government funding of training programs for professionals in the field of developmental disabilities.

Grant and contract revenue includes recoveries of facility and administrative costs, with certain limitations and exclusions. Certain revenues and costs in current and prior years are subject to audit and retroactive settlement. No reserve has been recorded for any potential settlements as amounts are not known or are considered immaterial.

6. CONTRIBUTIONS FROM FUNDRAISING ACTIVITIES

During 2017 and 2016, the Institute recognized contributions from fundraising activities as summarized below:

	2017	2016
Contributions		
Temporarily Restricted	$ 4,987	$ 7,700
Unrestricted	1,102	1,373
Total Contributions	6,089	9,073
Fundraising expenses		
Unrestricted	2,041	1,660
Restricted	988	965
Total Expenses	$ 3,029	$ 2,625

Restricted contributions are made up of annual giving and capital campaign contributions which are classified as temporarily restricted net assets on the Combined Balance Sheets. Permanently restricted contributions reflect gifts where the corpus cannot be utilized but where investment earnings are available for use. These contributions are classified as permanently restricted net assets on the Combined Balance Sheets. Unrestricted contributions reflect gifts with no donor restrictions and are reported on the Combined Statements of Operations.

Fundraising expenses are reported as operating expenses for those expenses related to Unrestricted Contributions and non-operating expenses for those expenses related to Restricted Contributions. Expenses related specifically to special events are netted with the revenue from those events.

(in thousands)

7. INVESTMENTS AND INVESTMENT INCOME

Investments at June 30, 2017 and 2016 consist of the following:

	2017	2016
Board designated endowment		
Fixed income mutual funds	$ 13,403	$ 13,180
Equity mutual funds	38,170	31,780
Absolute return fund	654	876
Total Board designated endowment	52,227	45,836
Investments limited as to use		
Money market funds	9,800	167
Fixed income mutual funds	17,039	1,710
Equity securities and funds	5,354	4,667
Total assets limited to use	32,193	6,544
Total Investments	$ 84,420	$ 52,380

Board Designated for Endowment
The Institute maintains certain investments as Board designated for endowment (“endowment funds”). These endowment funds are made up of unrestricted gifts and bequests and certain reserve funds. They have been set aside by the Institute’s Board of Directors to fund new initiatives and other needs necessary in furtherance of the mission of the Institute and its subsidiary entities. The Board of Directors maintains the power to release these funds. The endowment funds are classified within unrestricted net assets.

Changes in endowment funds held by the Institute at June 30, 2017 and 2016 are as follows:

	2017	2016
Board Designated Endowment, beginning of year	$ 45,836	$ 49,157
Investment return:		
Unrealized (losses)	5,560	(1,443)
Realized (losses) gains	17	(809)
Investment income, net	1,320	969
Total investment return	6,897	(1,283)
Investment earnings appropriated for operating activities	(2,000)	(2,061)
Amount payable	1,494	23
Endowment, end of year	$ 52,227	$ 45,836

The Investment Committee of the Board of Directors (“Investment Committee”) sets the investment policy for the endowment funds, including investment and spending guidelines. Investments of the endowment funds are based on the objective of achieving capital appreciation and investment income. Assets are invested in a manner that is intended to achieve an average annual real return in excess of inflation while assuming an acceptable level of investment risk. To monitor the effectiveness of the investment strategy of endowment funds, performance goals are established and monitored related to benchmark indices and returns earned by comparable funds.

(in thousands)

To satisfy its long-term rate of return objectives of the endowment funds, the Institute employs a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current income (interest and dividends). The investment policy includes a target asset allocation that is well diversified among suitable asset classes and that is expected to generate, on average, the level of expected return necessary to meet the endowment fund's objectives while assuming a level of risk (volatility) consistent with achieving that return.

In September 2015, the Investment Committee of the Board of Directors voted to move the Endowment, Pension and Self-Insured Trust Fund investments to a new investment manager; Vanguard Institutional Advisory Services. The move was completed in December 2015 in which all assets were liquidated with the old manager and invested with Vanguard with the exception of the Absolute return fund.

The asset allocation of the endowment funds at June 30, 2017 and 2016 is summarized below. The Investment Committee regularly reviews the actual asset allocation against the target and periodically rebalances the investment, as appropriate.

	Target	Actual Allocation	
	Allocation	**2017**	**2016**
Equities	70%	73%	69%
Fixed income	30%	26%	29%
Absolute return funds	-	1%	2%
	100%	100%	100%

The investment policy also provides for an endowment earnings withdrawal to be used in support of operating activities, as determined by Institute management and approved through the annual budget. The annual withdrawal is determined based on 4% of the three-year average market value of the portfolio. Withdrawals of $506 and $2,038 were made in 2017 and 2016, respectively to fund operating needs and have been reported as operating revenues.

Investments with a market value of $1,379 and $1,377 as of June 30, 2017 and 2016, respectively have been pledged as collateral under the Institute's self-funded unemployment insurance plan.

(in thousands)

Investments Limited As To Use

Investments limited as to use at June 30, 2017 and 2016 are made up of the following:

	2017	2016
Construction funds (bonds and donor cash)	$ 23,635	$ -
Self insurance trust fund	3,959	3,531
Deferred compensation	1,637	1,291
Capital interest fund	1,308	-
Permanently restricted fund	1,110	998
Planned gifts, net of reserve	249	429
Donor advised fund	295	295
Total investments limited as to use	32,193	6,544
Less current portion	24,943	-
Long-term portion	$ 7,250	$ 6,544

Investment Income and Gains and Losses

Investment income and gains and losses are comprised of the following:

	2017	2016
Investment income		
Interest and dividend income	$ 1,394	$ 812
Realized gain on investments, net	72	(801)
Less: Investment earnings appropriated for operating activites	(2,000)	(2,061)
Net investment income	$ (534)	$ (2,050)
Net unrealized (loss) gain on investments	$ 6,053	$ (1,408)

The Institute reviews investments to determine whether these investments are other-than-temporarily impaired. Factors considered in the evaluation of these assets include the anticipated holding period, the extent and duration of below cost valuation and the current condition and outlook of the business and industry. As a result of this assessment, no impairment losses were recognized in 2017 and 2016.

In addition, two fixed income funds were identified and not deemed other-than-temporarily impaired and are not material for financial statement presentation. The Institute evaluated the near-term prospects of the issuers of each of these two fixed income funds in relation to the severity and duration of the impairment. Based upon this evaluation and the Institute’s intent to hold these investments for a reasonable period of time for a forecasted recovery of fair value, the Institute does not consider these investments to be other-than-temporarily impaired at June 30, 2017.

8. 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. Kennedy Krieger Institute has not elected fair value accounting for any asset or liability that is not currently required to be measured at fair value.

Kennedy Krieger Institute 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.

This guidance discusses valuation techniques such as the market approach, cost approach and income approach. The guidance establishes a three-tier level hierarchy for fair value measurements based upon the transparency of inputs used to value an asset of 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 requires the reporting entity to develop its own assumptions.

The financial instrument's categorization within the hierarch 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 tables present the fair value of investments and liabilities as of June 30, 2017 and June 30, 2016, by the valuation hierarchy defined above and also presents information on the liquidity aspects of each investment.

(in thousands)

Fair Value of Investments
as of June 30, 2017

	Level 1	Level 2	Level 3	Total Fair Value
Investments:				
Money market funds (1)	$ 9,800	$ -	$ -	$ 9,800
Fixed income mutual funds (2)	30,442	-	-	30,442
Equity securities and funds (3)	43,229	-	-	43,229
Alternative investments (4)	-	-	949	949
Total Investments	$83,471	$ -	$ 949	$84,420
Liabilities:				
Interest rate swap	$ -	$ 8,545	$ -	$ 8,545
Total Liabilities	$ -	$ 8,545	$ -	$ 8,545

Fair Value of Investments
as of June 30, 2016

	Level 1	Level 2	Level 3	Total Fair Value
Investments:				
Money market funds (1)	$ 167	$ -	$ -	$ 167
Fixed income mutual funds (2)	14,889	-	-	14,889
Equity securities and funds (3)	36,152	-	-	36,152
Alternative investments (4)	-	-	1,172	1,172
Total Investments	$51,208	$ -	$ 1,172	$52,380
Liabilities:				
Interest rate swap	$ -	$12,370	$ -	$12,370
Total Liabilities	$ -	$12,370	$ -	$12,370

(1) Money market funds include investments in short-term debt securities, including US Treasury bills and commercial paper with same day or next day liquidity.

(2) Fixed income mutual funds include funds whose underlying investments include domestic and international corporate bonds, obligations issued or guaranteed by the U.S. government or its agencies, bankers acceptances, bank certificates of deposit, repurchase agreements, commercial paper, fixed income instruments denominated in currencies of emerging market countries and fixed income instruments represented by forwards or derivatives including options, future contracts and swap agreements. All funds offer next day liquidity. All funds are traded in active markets.

(3) Equity funds include investments in common stock mutual funds with next day liquidity.

(in thousands)

(4) Alternative investments include investments in a pooled investment fund of funds with underlying investments in equity long and short positions, distressed credit and private investments. Distributions from the fund have been limited by the fund of funds manager. In addition, privately held common stock of a privately held company is included. There is currently no market for the common stock.

The Institute has also classified the valuation of its interest rate swap in Level 2 of the fair value hierarchy. For over-the-counter derivatives that trade in liquid markets, such as interest rate swaps, model inputs (i.e. contractual terms, market prices, yield curves, credit curves, and measures of volatility) can generally be verified, and model selection does not involve significant management judgment.

9. PROPERTY AND EQUIPMENT

A summary of property and equipment at June 30, 2017 and 2016 is as follows:

	2017	2016
Land	$ 4,657	$ 4,657
Building and improvements	166,339	164,655
Furniture & equipment	42,308	38,780
	213,304	208,092
Less: Accumulated depreciation	(97,552)	(88,596)
	115,752	119,496
Construction in progress	5,947	3,012
Property and equipment, net	$ 121,699	$ 122,508

Depreciation expense was $9,473 and $9,250 in 2017 and 2016, respectively.

Construction of an 8-story, 130,000 square foot building located in the 800 block of N. Broadway adjacent to the current outpatient clinical care building and parking garage began in the fall of 2017 to house clinical programs and support services. The building is expected to cost $48.5 million and be completed by winter of 2018.

The construction of the building is being financed through the Series 2017A Bonds as further described in Note 13 along with state and private support. Interest incurred during the construction is being capitalized as part of the project costs and totaled $1,308 in 2017.

Capital Lease Obligations

The Institute entered into a lease agreement in May 2016 for computer equipment with a value of $1.1 million and a lease term of four years. The Institute recorded the equipment as a capital lease and is reflected in property and equipment on the Combined Balance Sheets.

(in thousands)

The future minimum lease payments required under the capital lease are as follows:

2018	$ 386
2019	386
2020	354
Total future minimum lease payments	$1,126

10. PLEDGES RECEIVABLE

Pledges receivable at June 30, 2017 and 2016 are summarized below:

	2017	2016
Total pledges receivable	$ 18,830	$ 23,941
Less: Present value adjustment	(971)	(1,196)
Allowance for uncollectible pledges	(1,590)	(1,169)
Net pledges receivable	16,269	21,576
Less: Pledges due within one year	(7,410)	(11,033)
Pledges due in one to five years	$ 8,859	$ 10,543

The present value adjustments for 2017 and 2016 were made utilizing discount rates in effects at the time of the gift. The allowance for uncollectible pledges has been estimated based on management evaluation of each pledge's likelihood to be collected and using historical pledge write-off rates.

11. SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

Financial instruments which potentially subject the Institute to concentrations of credit risk consist primarily of cash and cash equivalents, investments and patient accounts receivable.

The Institute typically maintains cash and cash equivalents in commercial banks. The short-term investments consist primarily of money market funds. The Federal Deposit Insurance Corporation insures funds up to $250,000 per depositor.

The fair value of the Institute's investments are subject to various market fluctuations which include changes in the interest rate environment and general economic conditions.

The Institute records patient receivables due for services provided to patients and others. The majority of these patients either qualify for federal/state assistance programs or have insurance through commercial insurance companies or managed care organizations. The Institute maintains reserves for potential losses and such losses have been within management's expectations. The mix of patient receivables due from patients and third-party payors at June 30, 2017 and 2016 are as follows:

(in thousands)

	2017	2016
Medicaid	12.3%	10.1%
Medicaid Managed Care Organizations	12.1%	10.6%
Total Medical Assistance	24.4%	20.7%
Commercial Insurance	33.5%	34.7%
Blue Cross	22.2%	23.1%
Managed Care	11.9%	11.4%
Self-pay and other	6.5%	6.8%
Medicare	1.5%	3.3%
	100.0%	100.0%

12. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at June 30, 2017 and 2016 are made up of the following:

	2017	2016
Accounts payable and other accrued expenses	$ 12,941	$ 11,014
Payroll	7,581	4,546
Vacation	4,917	4,744
Workers' compensation, unemployment and health benefits	2,686	2,686
Self-insurance - general/professional liability	1,431	1,477
Research subcontracts	684	958
	$ 30,240	$ 25,425

13. DEBT

Tax-exempt Bonds
Tax-exempt bonds issued through Maryland Health and Higher Educational Facilities Authority (“MHHEFA”) at June 30, 2017 and 2016 consisted of the following:

(in thousands)

	2017	2016
MHHEFA Series 2010 Bonds	$ -	$ 27,578
MHHEFA Series 2011 Bonds	17,240	17,896
MHHEFA Series 2012 Bonds	2,785	3,925
MHHEFA Series 2013 Bonds	16,100	16,145
MHHEFA Series 2017A Bonds	23,000	-
MHHEFA Series 2017B Bonds	27,395	-
	86,520	65,544
Less: Current portion	(2,361)	(2,299)
Less: Unamortized deferred financing costs	(686)	(423)
	$ 83,473	$ 62,822

The Series 2010 Bonds were privately placed with BB&T through a $30,000 bond qualified term loan with a maturity of December 1, 2017, and have been refunded in March 2017 through the issuance of the Series 2017B Bonds. The Series 2017B Bonds issued through MHHEFA were privately placed with BB&T through a $27,510 non-bank qualified term loan with a maturity date of April 1, 2027. The loan is being amortized through March 1, 2037. Terms of the loan agreement call for interest to be paid based on a percentage of 30-day LIBOR plus a bank spread. Principal and interest payments are due in monthly installments on the first day of each month.

The Series 2011 Bonds are privately placed with Bank of America through a $19,610 non-bank qualified term loan with a maturity date of June 1, 2021. The loan is being amortized through July 1, 2036. Terms of the loan agreement call for interest to be paid based on a percentage of 30-day LIBOR plus a bank spread. Principal payments are due in monthly installments on the first day of each month.

The Series 2012 Bonds were privately placed in October 2012 with BB&T through a $7,880 non-bank qualified term loan with a maturity date of July 1, 2019. The loan is also being amortized through the same period. Principal and interest are due in monthly installments on the first day of each month. Terms of the loan agreement call for a fixed interest rate of 2.21%.

The Series 2013 Bonds issued through MHHEFA were privately placed with Bank of America through a $16,730 non-bank qualified term loan with a maturity date of July 1, 2023. The loan is being amortized through July 1, 2033. Principal and interest are due in monthly installments on the first day of each month. Terms of the loan call for a fixed interest rate of 3.62%.

The Series 2017A Bonds issued through MHHEFA were privately placed in March 2017 with CapitalOne Municipal Funding through a $23,000 non-bank qualified term loan with a maturity date of April 1, 2027. The loan is being amortized through March 1, 2042. Principal and interest payments are due in monthly installments on the first day of each month. Principal payments do not begin until April 1, 2019. Terms of the loan agreement call for a fixed rate of interest of 3.21%.

The obligated group for the Series 2010, 2011, 2012, 2013 and 2017A and B Bonds (the “Bonds”) include Kennedy Krieger Institute, Inc. and each of its affiliated entities. The Bonds were issued in parity and contain certain restrictions on the Institute’s ability to incur additional indebtedness, restrict its use of facilities, maintain stipulated insurance coverage and maintain a rate structure sufficient to meet its total annual cash requirements. The Institute must maintain compliance with certain financial covenants contained in the bond indentures and loan agreements.

(in thousands)

At June 30, 2017 and 2016, the Institute was in compliance with all covenants in accordance with these agreements.

The aggregate future maturities of bonds payable for the next five years and thereafter are summarized below at June 30, 2017.

2018	$ 2,361
2019	3,125
2020	3,204
2021	3,291
2022	3,384
Thereafter	71,155
	$ 86,520

Unamortized deferred bond financing costs of $686 in 2017 and $423 in 2016 are netted against tax-exempt bonds. Amortization expense was $35 and $37 in 2017 and 2016, respectively. A loss on the early extinguishment of long-term debt associated with the refunding of the 2010 Bonds was recorded in 2017 in the amount of $167.

Line of Credit
The Institute maintains a working capital line of credit with Bank of America. The committed amount under the line of credit is $10,000 and is committed through December 31, 2017. Total draws of $0 and $2,250 were outstanding against the line of credit at June 30, 2017 and 2016, respectively. The line of credit is secured by a pledge on the revenues of the Institute and the financial covenant requirements are consistent with those of the Series 2011 and 2013 Bonds held by the bank.

14. RETIREMENT PLANS

The Institute maintains defined benefit and defined contribution plans covering substantially all of its employees.

Defined Benefit Plan
The Institute’s defined benefit pension plan (the “plan”) provides benefits to staff-level employees based on years of service and the employees’ final average compensation. The Institute’s policy is to annually fund the amount necessary to meet minimum funding requirement under ERISA. Contributions of $1,900 and $1,225 were made for 2017 and 2016, respectively.

The net periodic benefit cost calculated in accordance with current guidance for employer’s accounting for pension obligations is $2,479 and $1,740 for 2017 and 2016, respectively.

The following table sets for the plan’s funded status and benefit obligations recognized in the Institute’s financial statements at June 30, 2017 and 2016:

(in thousands)

	2017	2016
Change in benefit obligation:		
Projected benefit obligation at beginning of year	$ 56,876	$ 53,266
Interest cost	2,229	2,287
Actuarial loss (gain)	(1,089)	3,479
Benefits paid	(1,321)	(2,156)
Projected benefit obligation at end of year	$ 56,695	$ 56,876
Change in plan assets:		
Fair value of plan assets at beginning of year	$ 34,359	$ 35,850
Actual return on plan assets	3,564	(560)
Employer contribution	1,900	1,225
Benefits paid	(1,321)	(2,156)
Fair value of plan assets at end of year	$ 38,502	$ 34,359
Funded status at end of year	$ (18,193)	$ (22,516)
Recognized in noncurent liabilities		
Amounts not yet recognized in net periodic benefit cost and included in unrestricted net assets:		
Accumulated actuarial loss	$ (20,660)	$ (25,562)
Net unrestricted net assets previously reflected	2,467	3,046
Net amount recognized	$ (18,193)	$ (22,516)
Components of net periodic pension cost:		
Interest cost	$ 2,229	$ 2,287
Expected return on plan assets	(2,234)	(2,503)
Loss on amortization	2,484	1,956
Net periodic pension cost	$ 2,479	$ 1,740
Changes in net assets not yet reflected in the statement of operations:		
Unrecognized net loss (gain)	$ (2,418)	$ 6,541
Amortization of unrecognized net loss	(2,484)	(1,956)
Total changes in plan assets and obligations not yet reflected	$ (4,902)	$ 4,585
Total changes in plan assets and benefit obligations	$ (2,424)	$ 6,325
Unrecognized net loss to be amortized over next fiscal year	$ (1,874)	$ 2,484

(in thousands)

	2017	**2016**
Additional information:		
Accumulated benefit obligation	$56,694	$56,876
Expected contributions in fiscal year ending June 30, 2017	$2,100	$1,500

Expected benefit payments for fiscal year ending June 30, 2017:

2018	$ 1,653
2019	1,728
2020	1,861
2021	2,047
2022	2,227
Next five years	12,799

Weighted-average assumptions to determine benefit obligations:	**2017**	**2016**
Discount rate	4.07%	3.97%
Salary increase	Non applicable	Non applicable
Measurement date	June 30	June 30
Participant census data used	January 1, 2017	January 1, 2016

Weighted-average assumptions to determine pension expense:	**2017**	**2016**
Discount rates	3.97%	4.35%
Expected return on plan assets	6.50%	7.00%
Salary increase	Non applicable	Non applicable

The discounted rate assumption for fiscal years ending 2017 and 2016 were determined using the actuary's proprietary yield curve, under which the plan's projected benefit payments are matched against a series of spot rates derived from a market basket of high quality fixed income securities.

In determining the expected long-term rate of return on plan assets, the Institute evaluated the historical long-term rate of return for each class of asset in the plan and utilized a proprietary portfolio return calculator in determining an acceptable range of expected returns.

The following tables present fair value measurements for plan assets as of June 30, 2017 and 2016 by the valuation hierarchy as defined in footnote 8 and also includes the liquidity aspects of each investment:

(in thousands)

Fair Value of Investments
as of June 30, 2017

	Level 1	Level 2	Level 3	Total Fair Value
Investments:				
Fixed income mutual funds (2)	$ 13,323	$ -	$ -	$ 13,323
Equity securities and funds (3)	24,926	-	-	24,926
Alternative investments (4)	-	-	253	253
Total Investments	$ 38,249	$ -	$ 253	$ 38,502

Fair Value of Investments
as of June 30, 2016

	Level 1	Level 2	Level 3	Total Fair Value
Investments:				
Money market funds (1)	$ 165	$ -	$ -	$ 165
Fixed income mutual funds (2)	11,774	-	-	11,774
Equity securities and funds (3)	22,074	-	-	22,074
Alternative investments (4)	-	-	346	346
Total Investments	$ 34,013	$ -	$ 346	$ 34,359

(1) Money market funds include investments in short-term debt securities, including US Treasury bills and commercial paper with same day or next day liquidity.

(2) Fixed income mutual funds include funds whose underlying investments include domestic and international corporate bonds, obligations issued or guaranteed by the U.S. government or its agencies, bankers acceptances, bank certificates of deposit, repurchase agreements, commercial paper, fixed income instruments denominated in currencies of emerging market countries and fixed income instruments represented by forwards or derivatives including options, future contracts and swap agreements. All funds offer next day liquidity. All funds are traded in active markets.

(3) Equity funds include investments in common stock mutual funds with next day or monthly liquidity.

(4) Alternative investments include investments in a pooled investment fund of funds with underlying investments in equity long and short positions, distressed credit and private investments. Distributions from the fund have been limited by the fund of funds manager. In addition, privately held common stock of a privately held company is included. There is currently no market for the common stock.

(in thousands)

The plan's target allocations and actual asset allocation at June 30, by asset category, was as follows:

	Target Allocation	Actual Allocation 2017	Actual Allocation 2016
Equities	65%	65%	64%
Fixed income	35%	34%	35%
Absolute return funds	-	1%	1%
	100%	100%	100%

The objectives of the plan's investment strategy are to maximize the plan's funded status and minimize the Institute's contributions and plan expense.

The Investment Committee establishes a target asset allocation and regularly reviews the actual asset allocation against the target. It also periodically rebalances the investment allocations, as appropriate.

Defined Contribution Plan

The Institute maintains a qualified defined contribution retirement plan which is in compliance with section 401(k) of the Internal Revenue Code. The 401(k) plan is active and available to all employees (including all faculty and senior staff members) and provides for up to a 50% employer match on employee contributions up to certain levels of compensation. During 2017 and 2016, the aggregate contributions to the 401(k) plan were $16,293 and $14,948.

Deferred Compensation (457(b)) Plan

The Institute also offers a non-qualified deferred compensation plan for certain of its executives which allows for the deferral of compensation up to IRS limits. A deferred balance of $1,637 and $1,290 in fiscal years 2017 and 2016, respectively, was reported in Investments limited as to use in the Combined Balance Sheet. An associated liability of an equal amount is included in Other long-term liabilities in the Combined Balance Sheet. The Institute makes no contributions to the Deferred Compensation Plan.

15. INTEREST RATE SWAP

The Institute manages the fixed/variable mix of its debt portfolio, including hedging exposure to increasing interest expense on variable rate debt, by utilizing an interest rate swap. The Institute maintains a fixed payor interest rate swap which hedges the variable interest rate risk on the majority of the outstanding balance of the Series 2017B and 2011 Series Bonds. Under the terms of the agreement with a local bank, the Institute pays a fixed rate of 3.636% and receives 67% of 30-day LIBOR on notional amounts that reduce annually until July 2036. Notional amounts of $37,273 and $37,887 were effective June 30, 2017 and 2016, respectively. Under the terms of the agreement, no collateral requirements exist on the part of the Institute.

The fair value of the interest rate swap and the related unrealized (losses) were as follows as of June 30, including the classification on the Combined Balance Sheets and Statements of Operations:

(in thousands)

	Fair Market Value 2017	Fair Market Value 2016
Interest rate swap liability	$ 8,545	$ 12,370

	Amount recognized in Non-operating activity 2017	Amount recognized in Non-operating activity 2016
Unrealized gain (loss) on interest rate swap valuation	$ 3,825	$ (3,517)
Interest rate swap payments	(1,175)	(1,313)
Total	$ 2,650	$ (4,830)

16. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets were held for the following purposes at June 30, 2017 and 2016:

	2017	2016
Capital Campaigns	$ 18,579	$ 18,453
Research and clinical projects	18,491	19,212
	$ 37,070	$ 37,665

During 2017 and 2016, temporarily restricted net assets were released by satisfying donor restrictions in the following amounts:

	2017	2016
Property and equipment	$ 1,414	$ -
Operating activities	4,168	6,550
Total	$ 5,582	$ 6,550

Permanently restricted net assets were held in perpetuity for the following purpose at June 30, 2017 and 2016:

	2017	2016
Restricted for the Physically Challenged Sports Program	$ 958	$ 958

17. SELF INSURANCE

Professional and General Liability

The Institute maintains a self-insurance trust (the "Trust") for general and professional liability to cover liability claims arising out of the ordinary course of its business. Excess coverage with an insurance company is in place to cover losses above self-insured retention levels.

Assets in the Trust are to provide for payment of professional and general liability claims and expenses. Potential losses from asserted and unasserted claims are accrued based on estimates that incorporate the Institute's past experience, as well as other considerations, including the nature of each claim or incident, applicable insurance coverage and relevant trend factors.

An accrued liability related to asserted and unasserted self-insured general and professional liability claims of $1,431 and $1,477 has been recorded at June 30, 2017 and 2016, respectively, and is included in Accrued expenses. Investments in the Trust have a market value of $3,959 and $3,531 at June 30, 2017 and 2016, respectively and are reported in Investments limited as to use on the Combined Balance Sheets.

Workers' Compensation, Unemployment and Health Benefits

The Institute self-insures its workers' compensation, unemployment and employee health and dental benefits. Losses from claims identified by the Institute, as well as provisions for estimated losses for incurred but not reported incidents, are accrued based on estimates that incorporate the past experience of the Institute, as well as other considerations, including the nature of the claims or incidents and relevant trend factors. An accrued liability of $2,686 and $2,686 has been recorded at June 30, 2017 and 2016, respectively for these self-insured plans and is included in accrued expenses on the Combined Balance Sheets.

18. COMMITMENTS AND CONTINGENCIES

Litigation

The Institute is involved in claims and litigation on professional liability and personnel matters that arise in the ordinary course of its business. This litigation is not expected to result in losses that exceed insurance limits or have a materially adverse effect on the Institute's financial position.

There have been claims filed against the Hugo W. Moser Research Institute at Kennedy Krieger, Inc. arising out of two Federally-funded research studies performed in the early 1990s. The Institute has insurance believed adequate to cover any compensatory damages awarded for these claims. In some of these claims, the plaintiff has asserted punitive damages, which if awarded, would not be covered by insurance. Management believes that it is unlikely that punitive damages would be awarded in any of these claims. The outcome of these claims is not probable or estimable; therefore, no liability has been recorded on the Combining Balance Sheets at June 30, 2017 and 2016.

Rental Lease Commitments

Through the creation of MSP, all property and major equipment is leased/subleased to each operating entity. These transactions are eliminated through the combining of the Institute's financial statements.

(in thousands)

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 future minimum lease payments under operating leases as of June 30, 2017, that have initial or remaining lease terms in excess of one year.

2018	$ 2,011
2019	1,398
2020	1,212
2021	1,241
2022	1,126
Thereafter	570
	$ 7,558

Rent expense on external lease commitments for the years ended June 30, 2017 and 2016 was $2,369 and $2,257 respectively.

Charitable Gift Annuities

The Institute has received charitable gift annuities from donors from which the Institute has guaranteed payments to the donor on a quarterly basis until the donor's death.

The Institute has recorded gift annuities, net of reserves, consistent with the rates adopted by the American Council on Gift Annuities at the time of issuance of the gift annuity. Assets maintained on outstanding annuity agreements exceed the amount of the reserve. Gift annuities with a market value of $747 and $959 and reserves for annuity payments of $498 and $529 to make gift annuity payments have been recorded in 2017 and 2016, respectively, and are included in Investments limited as to use on the Combined Balance Sheets.

19. FUNCTIONAL EXPENSES

The Institute provides specialty pediatric health care services, administers professional training programs, conducts laboratory and clinical research, operates special education school programs, administers community-based services, conducts fundraising activities and operates ancillary ventures. Expenses related to providing these services are as follows:

	2017	**2016**
Special pediatric healthcare services	$ 123,877	$ 117,463
Research	27,168	21,350
Education/community services	41,915	40,758
Fundraising activities	3,029	2,625
Operation of facilities	26,156	28,060
General and administrative	26,682	27,674
	$ 248,827	$ 237,930

20. SUBSEQUENT EVENTS

Kennedy Krieger Institute has evaluated subsequent events through September 28, 2017, which is the date the Financial Statements were issued. There have been no events subsequent to that date that needed to be disclosed.

Report of Independent Auditors

To the Board of Directors of
Kennedy Krieger Institute, Inc. and Affiliates

We have audited the combined financial statements of Kennedy Krieger Institute, Inc. and Affiliates, as of June 30, 2017 and for the year then ended and our report thereon appears on pages 1-2 of this document. That audit was conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The combining information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining information is fairly stated, in all material respects, in relation to the combined financial statements taken as a whole. The combining information is presented for purposes of additional analysis of the combined financial statements rather than to present the balance sheet, statement of operations and statement of changes in net assets of the individual companies and is not a required part of the combined financial statements. Accordingly, we do not express an opinion on the balance sheet, statement of operations and statement of changes in net assets of the individual companies.

PricewaterhouseCoopers LLP

September 28, 2017

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SUPPLEMENTAL COMBINING FINANCIAL STATEMENTS

Kennedy Krieger Institute, Inc. and Affiliates
Combining Balance Sheet Information
June 30, 2017

	Kennedy Krieger Children's Hospital, Inc	Hugo W. Moser Research Institute at Kennedy Krieger, Inc.	Kennedy Krieger Education & Community Services, Inc.	Kennedy Krieger Foundation, Inc.	PACT: Helping Children with Special Needs, Inc.	Madison Street Properties, Inc.	Combining Eliminations	Combined Totals
Assets								
Current assets:								
Cash and cash equivalents	$ 8,621,841	`		$ 7,642,315	$ 690,621			$ 16,954,777
Patient receivables, net	17,661,526				149,571			17,811,097
Grant and contract receivable	108,329	$ 7,434,850	$ 846,380		192,691			8,582,250
Tuition receivable			4,024,807					4,024,807
Pledges receivable				7,401,564	8,166			7,409,730
Investments limited as to use				5,487,655		$ 19,455,704		24,943,359
Due from affiliates	88,996,472		7,694,381	2,225,485			$ (98,916,338)	-
Prepaid expenses and other	1,404,843	156,011	185,000	2,096	1,697		(185,000)	1,564,647
Total Current Assets	116,793,011	7,590,861	12,750,568	22,759,115	1,042,746	19,455,704	(99,101,338)	81,290,667
Non-current assets:								
Property and equipment, net						121,698,962		121,698,962
Investments:								
Board designated endowment				51,901,713	325,479			52,227,192
Investments limted as to use	5,596,141			1,653,256				7,249,397
Pledges receivable, net				8,856,064	2,514			8,858,578
Total non-current assets	5,596,141	-	-	62,411,033	327,993	121,698,962	-	190,034,129
Total assets	$ 122,389,152	$ 7,590,861	$ 12,750,568	$ 85,170,148	$ 1,370,739	$ 141,154,666	$ (99,101,338)	$ 271,324,796
Liabilities and net assets								
Current liabilities:								
Accounts payable and accrued expenses	28,408,449	683,722	64,563	459,508	74,390	549,668		30,240,300
Due to affiliates		14,063,741			399,822	84,452,775	(98,916,338)	-
Deferred grant revenue	20,034	1,740,453	80,792		65,903			1,907,182
Line of credit								-
Current portion of tax-exempt bonds						2,360,580		2,360,580
Total Current Liabilities	28,428,483	16,487,916	145,355	459,508	540,115	87,363,023	(98,916,338)	34,508,062
Non-current Liabilities:								
Tax-exempt bonds						83,472,757		83,472,757
Accrued pension	18,192,575							18,192,575
Interest rate swap						8,544,934		8,544,934
Other long-term liabilities	2,323,700							2,323,700
Total long-term liabilities	20,516,275	-	-	-	-	92,017,691	-	112,533,966
Total liabilities	48,944,758	16,487,916	145,355	459,508	540,115	179,380,714	(98,916,338)	147,042,028
Net assets:								
Unrestricted	69,848,774	(13,884,100)	11,852,505	56,477,494	370,990	(38,226,048)	(185,000)	86,254,615
Temporarily restricted	3,595,620	4,987,045	752,708	27,274,924	459,634			37,069,931
Permanently restricted				958,222				958,222
Total net assets	73,444,394	(8,897,055)	12,605,213	84,710,640	830,624	(38,226,048)	(185,000)	124,282,768
Total liabilities and net assets	$ 122,389,152	$ 7,590,861	$ 12,750,568	$ 85,170,148	$ 1,370,739	$ 141,154,666	$ (99,101,338)	$ 271,324,796

Kennedy Krieger Institute, Inc. and Affiliates
Combining Statement of Operations
Year Ended June 30, 2017

	Kennedy Krieger Children's Hospital, Inc	Hugo W. Moser Research Institue at Kennedy Krieger, Inc.	Kennedy Krieger Education & Community Services, Inc.	Kennedy Krieger Foundation Inc.	PACT: Helping Children with Special Needs, Inc.	Madison Street Properties Inc.	Combining Eliminations	Combined Totals
Operating revenues:								
Patient service revenue, net	$153,843,338	$ 4,015,403	$ 2,526,228		$ 261,090			$160,646,059
Tuition revenue	42,150		46,079,545		747,841			46,869,536
Grant and contract revenue	1,635,931	28,588,262	4,668,611		1,625,772			36,518,576
Net assets released for operating activities	1,393,006	1,238,667	1,112,674	$1,429,413	408,420		$ (1,414,026)	4,168,154
Investment earnings used for operating activities		2,000,000						2,000,000
Unrestricted contributions from								-
fundraising activities, net				1,102,269				1,102,269
Other operating revenues	616,921				377,469	$29,916,041	(29,471,960)	1,438,471
Total operating revenues	157,531,346	35,842,332	54,387,058	2,531,682	3,420,592	29,916,041	(30,885,986)	252,743,065
Operating expenses:								
Salaries, wages and benefits	112,353,909	19,406,527	40,211,211	1,079,253	2,724,706	6,666,209		182,441,815
Supplies, purchased services and other	23,072,841	13,915,432	6,779,792	1,717,499	602,195	9,246,027	(3,596,150)	51,737,636
Space costs, net	16,135,522	4,298,726	6,154,111	243,770	111,929	(1,068,248)	(25,875,810)	-
Depreciation					1,571	9,506,123		9,507,694
Rent						2,369,498		2,369,498
Interest						1,782,408		1,782,408
Total operating expenses	151,562,272	37,620,685	53,145,114	3,040,522	3,440,401	28,502,017	(29,471,960)	247,839,051
Operating revenues over (under) expenses	5,969,074	(1,778,353)	1,241,944	(508,840)	(19,809)	1,414,024	(1,414,026)	4,904,014
Non-operating activity:								
Investment income and realized gains (losses), net	131,252			(672,719)	5,993	1,813		(533,661)
Change in unrealized gains on investments, net	336,818			5,647,250	23,971	44,755		6,052,794
Realized and unrealized (loss) on interest rate swap						2,650,177		2,650,177
Loss on early extinguishment of debt						(167,435)		(167,435)
Restricted fundraising expenses				(988,292)				(988,292)
Net non-operating activity	468,070	-	-	3,986,239	29,964	2,529,310	-	7,013,583
Excess of revenues over (under) expenses	$ 6,437,144	$ (1,778,353)	$ 1,241,944	$3,477,399	$ 10,155	$ 3,943,334	$ (1,414,026)	$ 11,917,597

Kennedy Krieger Institute, Inc. and Affiliates
Combining Statement of Changes in Net Assets
Year Ended June 30, 2017

	Kennedy Krieger Children's Hospital, Inc	Hugo W. Moser Research Institue at Kennedy Krieger, Inc.	Kennedy Krieger Education & Community Services, Inc.	Kennedy Krieger Foundation Inc.	PACT: Helping Children with Special Needs, Inc.	Madison Street Properties Inc.	Combining Eliminations	Combined Totals
Unrestricted net assets:								
Excess of revenue over (under) expenses	$ 6,437,144	$ (1,778,353)	$ 1,241,944	$ 3,477,399	$ 10,155	$ 3,943,334	$ (1,414,026)	$ 11,917,597
Net assets released from restrictions used for property and equipment							1,414,026	1,414,026
Change in funded status of defined benefit plan	2,423,751							2,423,751
Increase (decrease) in unrestricted net assets	8,860,895	(1,778,353)	1,241,944	3,477,399	10,155	3,943,334	-	15,755,374
Unrestricted net assets, beginning of year	60,987,879	(12,105,747)	10,610,561	53,000,095	360,835	(42,169,382)	$ (185,000)	70,499,241
Unrestricted net assets, end of year	$69,848,774	$ (13,884,100)	$ 11,852,505	$56,477,494	$ 370,990	$ (38,226,048)	$ (185,000)	$ 86,254,615
Temporarily restricted net assets:								
Contributions from fundraising activities	1,095,299	981,352	1,167,327	1,627,977	115,303			4,987,258
Net assets released from restrictions used for operating activities	(1,284,977)	(1,238,667)	(806,677)	(429,413)	(408,420)			(4,168,154)
Net assets released from restrictions used for property and equipment	(108,029)		(305,997)	(1,000,000)				(1,414,026)
Increase (decrease) in temporarily restricted net assets	(297,707)	(257,315)	54,653	198,564	(293,117)			(594,922)
Temporarily restricted net assets, beg. of year	3,893,327	5,244,360	698,055	27,076,360	752,751			37,664,853
Temporarily restricted net assets, end of year	$ 3,595,620	$ 4,987,045	$ 752,708	$27,274,924	$ 459,634	$ -	$ -	$ 37,069,931
Permanently restricted net assets:								
Contributions received								
Increase in permanently restricted net assets								
Permanently restricted net assets, beg, of yr				958,222				958,222
Permanently restricted net assets, end of year	-	-	-	958,222	-	-	-	958,222
Increase(decrease) in net assets	8,563,188	(2,035,668)	1,296,597	3,675,963	(282,962)	3,943,334		15,160,453
Net assets, beginning of year	64,881,206	(6,861,387)	11,308,616	81,034,677	1,113,586	(42,169,382)	(185,000)	109,122,316
Net assets, end of year	$73,444,394	$ (8,897,055)	$ 12,605,213	$84,710,640	$ 830,624	$ (38,226,048)	$ (185,000)	$124,282,769