Northwestern Memorial HealthCare®

Quarterly Report

As of and for the First Quarter Ended November 30, 2016

Northwestern Memorial HealthCare and Subsidiaries

NORTHWESTERN MEMORIAL HEALTH CARE
OFFICER'S CERTIFICATE

Ladies and Gentlemen:

Pursuant to Section 411(A) of the Amended and Restated Master Trust Indenture dated as of May 1, 2004, as amended and supplemented, between Northwestern Memorial HealthCare ("NMHC") and Wells Fargo Bank, National Association (as successor to J.P. Morgan Trust Company, National Association), as master trustee, the undersigned does hereby certify that attached hereto is a true and correct copy of the balance sheet and statement of operations for NMHC and subsidiaries for the quarterly period ended November 30, 2016, subject to year-end adjustment in the final audited financial statements.

This 14th day of January, 2017.

NORTHWESTERN MEMORIAL HEALTHCARE

By: John A. Orsini

Name: John A. Orsini
Title: Senior Vice President, CFO and Treasurer

NORTHWESTERN MEMORIAL HEALTHCARE
AND SUBSIDIARIES
Unaudited Condensed Consolidated Financial Statements
As of and for the First Quarter Ended November 30, 2016

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Forward-Looking Information:

Certain statements included or incorporated by reference in this report constitute "forward-looking statements." Such statements are generally identifiable by the terminology used such as "plan," "expect," "estimate," "budget" or similar words. The achievement of certain results or other expectations contained in such forward- looking statements involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Northwestern Memorial HealthCare and Subsidiaries do not plan to issue any updates or revisions to those forward-looking statements if or when changes to its expectations, or events, conditions or circumstances on which such statements are based, occur.

Northwestern Memorial HealthCare and Subsidiaries

Condensed Consolidated Balance Sheets

(Dollars in thousands)

	November 30, 2016	August 31, 2016
	(Unaudited)	Note A
Assets		
Current Assets:		
Cash and cash equivalents	$ 174,208	$ 218,163
Short-term investments	5,699	10,474
Current portion of investments, including assets limited as to use	128,121	296,029
Patient accounts receivable, net of estimated allowances for uncollectible accounts of $173,041 at November 30, 2016 and $174,234 at August 31, 2016, respectively	639,904	599,772
Current portion of pledges and grants receivable, net	19,941	20,121
Current portion of insurance recoverable	11,731	11,716
Inventories	62,370	60,338
Other current assets	139,283	139,159
Total current assets	1,181,257	1,355,772
Investments, including assets limited as to use, less current portion	4,991,164	4,843,924
Property and equipment, at cost:		
Land	348,841	348,841
Buildings	3,357,824	3,339,542
Equipment and furniture	1,041,445	1,017,617
Construction in progress	442,614	349,738
	5,190,724	5,055,738
Less accumulated depreciation	1,887,051	1,821,853
	3,303,673	3,233,885
Prepaid pension cost	48,762	43,488
Insurance recoverable, less current portion	68,919	64,339
Other assets, net	170,207	170,778
Total assets	**$ 9,763,982**	**$ 9,712,186**

Continued on next page.

Northwestern Memorial HealthCare and Subsidiaries

Condensed Consolidated Balance Sheets (continued)

(Dollars in thousands)

	November 30, 2016	August 31, 2016
	(Unaudited)	Note A
Liabilities and net assets:		
Current Liabilities		
Accounts payable	$ 192,404	$ 237,282
Accrued salaries and benefits	207,956	304,521
Grants and academic support payable, current portion	50,110	50,753
Accrued expenses and other current liabilities	138,726	164,279
Due to third-party payors	413,131	406,123
Current accrued liabilities under self-insurance programs	89,708	89,789
Current maturities of long-term debt	43,353	29,565
Short-term debt	87,281	—
Long-term debt subject to short-term remarketing agreements	—	318,795
Total current liabilities	1,222,669	1,601,107
Long-term debt, less current maturities	1,344,030	1,077,180
Accrued liabilities under self-insurance programs, less current portion	509,898	495,352
Grants and academic support payable, less current portion	99,222	98,937
Interest rate swaps	111,475	150,107
Other liabilities	142,617	139,910
Total liabilities	3,429,911	3,562,593
Net assets:		
Unrestricted:		
Undesignated	5,738,907	5,556,407
Board-designated	223,819	221,750
Non-controlling interest in consolidated venture	(2,203)	(2,244)
Total unrestricted	5,960,523	5,775,913
Temporarily restricted	211,404	211,769
Permanently restricted	162,144	161,911
Total net assets	6,334,071	6,149,593
Total liabilities and net assets	**$ 9,763,982**	**$ 9,712,186**

Note A: The August 31, 2016 financial statement information was derived from and should be read in conjunction with the Northwestern Memorial HealthCare and Subsidiaries 2016 audited consolidated financial statements.
See accompanying notes to the interim condensed consolidated financial statements.

Northwestern Memorial HealthCare and Subsidiaries
Condensed Consolidated Statements of Operations and Changes in Net Assets
(Unaudited)
(Dollars in thousands)

	Three Months Ended November 30, 2016	Three Months Ended November 30, 2015
Revenue		
Net patient service revenue	$ 1,164,165	$ 969,742
Provision for uncollectible accounts	37,541	48,069
Net patient service revenue after provision for uncollectible accounts	1,126,624	921,673
Rental and other revenue	62,866	43,728
Net assets released from donor restrictions and federal and state grants	4,911	4,150
Total revenue	1,194,401	969,551
Expenses		
Salaries	483,201	405,633
Employee benefits	78,760	59,520
Supplies	203,032	167,539
Purchased services	111,496	85,584
Depreciation and amortization	67,786	70,413
Insurance	31,120	27,140
Rent and utilities	22,440	17,711
Repairs and maintenance	17,643	12,318
Interest	11,738	14,115
Illinois Hospital Assessment	26,793	19,917
Other	29,394	30,169
Total expenses	1,083,403	910,059
Operating income	110,998	59,492
Nonoperating gains (losses)		
Investment return	34,301	(3,065)
Change in fair value of interest rate swaps	38,632	(4,724)
Loss on extinguishment of long term debt	(82)	—
Grants and academic support provided	(3,437)	(2,328)
Other	2,043	(211)
Total nonoperating gains (losses), net	71,457	(10,328)
Excess of revenue over expenses	182,455	49,164
Net loss attributable to non-controlling interest in subsidiaries	(277)	(106)
Excess of revenue over expenses attributable to NMHC and Subsidiaries	$ 182,732	$ 49,270

Continued on next page.

Northwestern Memorial HealthCare and Subsidiaries
Condensed Consolidated Statements of Operations and Changes in Net Assets (continued)
(Unaudited)
(Dollars in thousands)

	Three Months Ended November 30,					
	2016			2015		
	Total	Controlling	Non-controlling	Total	Controlling	Non-controlling
Unrestricted net assets						
Excess (deficiency) of revenue over expenses	$ 182,455	$ 182,732	$ (277)	$ 49,164	$ 49,270	$ (106)
Net assets released from restrictions used for property and equipment additions	1,389	1,389	—	2,292	2,292	—
Postretirement-benefit-related changes other than net periodic pension cost	1,351	1,351	—	115	115	—
Other	(585)	(903)	318	(1,018)	—	(1,018)
Increase (decrease) in unrestricted net assets	184,610	184,569	41	50,553	51,677	(1,124)
Temporarily restricted net assets						
Contributions	4,873	4,873	—	8,666	8,666	—
Investment return	3,392	3,392	—	3,321	3,321	—
Net assets released from restrictions used for:						
Operating expenses, charity care, and research and education	(7,031)	(7,031)	—	(5,657)	(5,657)	—
Property and equipment additions	(1,389)	(1,389)	—	(2,292)	(2,292)	—
Change in fair value of split-interest agreements	—	—	—	112	112	—
Other	(210)	(210)	—	(53)	(53)	—
(Decrease) increase in temporarily restricted net assets	(365)	(365)	—	4,097	4,097	—
Permanently restricted net assets						
Contributions	339	339	—	48	48	—
Change in fair value of split-interest agreements	(106)	(106)	—	(453)	(453)	—
Increase (decrease) in permanently restricted net assets	233	233	—	(405)	(405)	—
Change in net assets	184,478	184,437	41	54,245	55,369	(1,124)
Net assets, beginning of period	6,149,593	6,151,837	(2,244)	5,485,050	5,486,621	(1,571)
Net assets, end of period	$ 6,334,071	$ 6,336,274	$ (2,203)	$ 5,539,295	$ 5,541,990	$ (2,695)

Northwestern Memorial HealthCare and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(Dollars in thousands)

	Three Months Ended November 30, 2016	2015
Operating activities		
Change in net assets	$ 184,478	$ 54,245
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Postretirement benefit-related changes other than net periodic pension cost	(1,351)	(115)
Change in fair value of interest rate swaps	(38,632)	4,724
Loss on extinguishment of long-term debt	82	—
Net unrestricted realized investment return and net change in unrestricted and restricted unrealized investment gains/losses	(34,685)	2,570
Restricted contributions, change in fair value of split interest agreements, and realized investment return	(8,499)	(11,199)
Depreciation and amortization	67,786	70,413
Provision for uncollectible accounts	37,541	48,067
Changes in operating assets and liabilities:		
Patient accounts receivable	(77,673)	(71,305)
Due to third-party payors	6,947	16,315
Grants and academic support payable	(358)	3,611
Other operating assets and liabilities	(100,857)	(134,573)
Net cash provided by (used in) operating activities	34,779	(17,247)
Investing activities		
Purchase of trading securities	(921,047)	(227,487)
Sale of trading securities	934,182	217,695
Net unrestricted realized investment return	46,993	29,650
Capital expenditures, net	(136,722)	(80,010)
Net cash used in investing activities	(76,594)	(60,152)
Financing activities		
Payments of long-term debt	(38,089)	(10,035)
Payment of line of credit	(59,750)	—
Proceeds from commercial paper	87,200	—
Restricted contributions, change in fair value of split interest agreements, and realized investment return	8,499	11,199
Net cash (used in) provided by financing activities	(2,140)	1,164
Net decrease in cash and cash equivalents	(43,955)	(76,235)
Cash and cash equivalents, beginning of period	218,163	258,313
Cash and cash equivalents, end of the period	$ 174,208	$ 182,078

See accompanying notes to the interim condensed consolidated financial statements.

As of and for the First Quarter Ended

November 30, 2016

1. Organization and Basis of Presentation

Northwestern Memorial HealthCare (NMHC) is the parent of an integrated nonprofit health care organization, anchored by Northwestern Memorial Hospital (NMH) and Northwestern Medical Group (NMG), that provides health care services to communities in northern Illinois. NMHC partners with Northwestern University's Feinberg School of Medicine (FSM) to form an academic medical center, branded as Northwestern Medicine, that is shaping the future of medicine through outstanding patient care, research and training of resident physicians.

The accompanying condensed consolidated financial statements include the accounts of NMHC and its subsidiaries (collectively referred to herein as Northwestern Memorial). All significant intercompany transactions and balances have been eliminated in consolidation.

These interim financial statements have not been audited; however, in the opinion of management, they include all adjustments necessary for their fair presentation in conformity with U.S. generally accepted accounting principles (U.S. GAAP). These interim statements have been prepared on a basis that is substantially consistent with the accounting principles applied in the audited consolidated financial statements of Northwestern Memorial for the year ended August 31, 2016.

Interim results are not necessarily indicative of results for a full year or any future periods. The information included in these interim financial statements should be read in conjunction with the audited consolidated financial statements for the year ended August 31, 2016, which are available on the Electronic Municipal Market Access ("EMMA") website of the Municipal Securities Rulemaking Board.

2. Reclassifications and Change in Accounting Estimates

Certain reclassifications have been made to the 2016 condensed consolidated financial statements to conform with classifications used in 2017. The reclassifications had no effect on the changes in net assets previously reported.

In 2016, NMHC extended the useful lives of certain assets based on an independent assessment. This resulted in a reduction of depreciation expense of $35,898 for the three months and year ended August 31, 2016, as compared to the depreciation expense computed using former lives. Management estimated there was a reduction of $9,000 of depreciation expense in the three months ended November 30, 2016 compared to the similar period in fiscal year 2016.

3. Adoption of Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 requires an entity to recognize revenue for the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity should disclose sufficient information to enable the financial statement users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued ASU 2015-14, which defers the effective date to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. This ASU allows two alternative methods for application, either retrospectively to each reporting period presented or a modified retrospective approach with a cumulative effect adjustment to net assets at the date of initial application. Northwestern Memorial is evaluating the effect this guidance will have on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. ASU 2015-05 provides explicit guidance on how to account for fees paid in cloud computing arrangements to remove the diversity for accounting for these arrangements. Cloud computing arrangements include software as a service, platform as a service, infrastructure as a service, and other similar hosting arrangements. This ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. This new guidance is effective for fiscal years beginning after December 15, 2015, with early adoption permitted. Northwestern Memorial has adopted this standard in the quarter ended November 2016 noting no impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842),* which will require lessees to put most leases on their balance sheets but recognize expenses on their income statements in a manner similar to existing accounting standards. The guidance also eliminates current real estate-specific provisions for all entities. This new guidance is effective for Northwestern Memorial for the fiscal years and interim periods within those fiscal years beginning after December 15, 2018, with early adoption permitted. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. Full retrospective application is prohibited. Northwestern Memorial is currently evaluating the effect this guidance will have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 will change certain financial statement requirements for not-for-profit (NFP) entities in the scope of Topic 958 in an effort to make the information more meaningful to users and make reporting less complex. NFP entities will no longer be required to distinguish between resources with temporary and permanent restrictions on the face of the financial statements. Additionally, NFP entities will be required to present expenses by their natural and functional classification and present investment returns net of external and direct internal investment expenses. This new guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. This guidance is to be applied retrospectively and early adoption is permitted. Northwestern Memorial is currently evaluating the effect this guidance will have on its consolidated financial statements.

(Unaudited and in thousands)

4. Acquisitions

Affiliation with KishHealth

On December 1, 2015, KishHealth System (KishHealth) became a wholly owned subsidiary of NMHC pursuant to an affiliation agreement between NMHC and KishHealth. This affiliation positions Northwestern Memorial, under the Northwestern Medicine brand, to expand its integrated academic health delivery system to DeKalb County, offering patients access to leading-edge care closer to where they live and work.

The affiliation was effected through a membership substitution with no consideration paid. For accounting purposes, this transaction is considered an acquisition under Accounting Standards Codification (ASC) 958-805, *Not-for-Profit Entities: Business Combinations*, and a contribution was recorded for the fair value of assets, net of liabilities of KishHealth. No goodwill has been recorded as a result of this transaction.

The acquisition-date fair value of identifiable assets and liabilities of KishHealth at December 1, 2015, consisted of the following:

Fair Value of identifiable net assets:	
Cash and cash equivalents	$ 40,535
Other current assets	210,407
Property and equipment	166,399
Other long-term assets	83,812
Current liabilities	(66,218)
Long-term debt	(74,025)
Other long-term liabilities	(11,377)
Noncontrolling interested in unrestricted net assets	(1,141)
Temporarily restricted net assets	(788)
Permanently restricted net assets	(601)
Contribution of unrestricted net assets	$ 347,003

The valuation of property and equipment; other current and long-term assets, including identifiable intangible assets and current and long-term liabilities has been completed. In valuing these assets and liabilities, fair values were based on, but not limited to, independent appraisals, discounted cash flows, replacement costs and actuarially determined values.

Affiliation with Marianjoy

On March 1, 2016, Marianjoy, Inc. (Marianjoy) became a wholly owned subsidiary of NMHC pursuant to a Member Substitution Agreement and Real Estate Purchase Agreement (collectively, the acquisition) between NMHC and Marianjoy's corporate parent, Wheaton Franciscan Services, Inc. (WFSI). This acquisition expands the offerings of Northwestern Memorial, under the Northwestern Medicine brand, to include physical medicine and rehabilitation care in DuPage County and surrounding areas.

(Unaudited and in thousands)

Under these agreements, NMHC transferred $35,412 to WFSI in exchange for Marianjoy's unrestricted net assets at the time of closing less Marianjoy's debt and cash, which were not acquired, and land purchased from WFSI. For accounting purposes, this transaction is considered an acquisition under ASC 958-805.

The acquisition-date fair value of identifiable assets and liabilities of Marianjoy at March 1, 2016, consisted of the following:

Fair Value of identifiable net assets:	
Other current assets	$ 13,385
Property and equipment	68,996
Other long-term assets	3,921
Current liabilities	(4,561)
Temporarily restricted net assets	(3,365)
	78,376
Less consideration paid	(35,412)
Contribution of unrestricted net assets	$ 42,964

The valuation of property and equipment, other current and long-term assets, including identifiable intangible assets, current and long-term liabilities and non-controlling interest has been completed. In valuing these assets and liabilities acquired, fair values were based on, but not limited to independent appraisals, discounted cash flows, replacement costs and actuarially determined values.

Following are the unaudited operating results and changes in net assets attributable to KishHealth and Marianjoy for the three month period ended November 30, 2016 included in the accompanying condensed consolidated statements of operations and changes in net assets:

Total operating revenue	$ 92,913
Excess of revenue over expenses	9,107
Change in unrestricted net assets	11,108
Change in temporarily restricted net assets	217

Following are the unaudited supplemental pro forma operating results of Northwestern Memorial for the three month period ended November 30, 2015 as if the KishHealth and Marianjoy affiliations had occurred on September 1, 2015:

Total operating revenue	$ 1,059,909
Operating income	65,793
Excess of revenue over expenses attributable to NMHC and subsidiaries	51,555

The pro forma information provided should not be construed to be indicative of Northwestern Memorial's results of operations had the acquisition been consummated on September 1, 2015, and is not intended to project Northwestern Memorial's results of operations for any future period.

(Unaudited and in thousands)

5. Investments and Other Financial Instruments

The composition of investments, including assets limited as to use, and cash and cash equivalents and short-term investments, is as follows:

	November 30, 2016	August 31, 2016
Measured at fair value:		
Cash and short-term investments	$ 224,213	$ 351,099
Mutual funds	278,874	415,364
Corporate bonds	259,189	143,740
U.S. government and agency issues	270,843	264,074
Equity securities	248,338	234,344
Other fixed income	16,103	202
	1,297,560	1,408,823
Measured at net asset value as practical expedient:		
Common collective trusts and commingled funds	587,510	703,072
Interest in 103-12 investment entities	242,045	232,998
	829,555	936,070
Accounted for under the equity method:		
Alternative investments	3,172,077	3,023,697
	$ 5,299,192	$ 5,368,590

Investments, including assets limited as to use, and cash and cash equivalents and short-term investments, consist of the following:

	November 30, 2016	August 31, 2016
Assets limited as to use:		
Trustee-held funds	$ 67,057	$ 90,473
Self-insurance programs	577,730	572,661
Board-designated funds	187,462	185,206
Total assets limited as to use	832,249	848,340
Donor-restricted funds	321,722	319,544
Unrestricted, undesignated funds	3,965,314	3,972,069
Total investments, excluding short-term investments	5,119,285	5,139,953
Other financial instruments:		
Cash and cash equivalents and short-term investments	179,907	228,637
	$ 5,299,192	$ 5,368,590

(Unaudited and in thousands)

The composition and presentation of investment returns are as follows:

	Three Months Ended November 30, 2016	Three Months Ended November 30, 2015
Interest and dividend income	$ 5,861	$ 5,955
Investment expenses	(1,355)	(794)
Realized gains on alternative investments, net	28,536	24,969
Realized gains on other investments, net	16,798	1,879
Net change in unrealized (losses) on alternative investments	(655)	(55,995)
Net change in unrealized (losses) gains on other investments	(11,807)	24,230
Change in value of joint ventures	161	466
	$ 37,539	$ 710
Reported as:		
Rental and other revenue	$ (154)	$ 454
Nonoperating investment return	34,301	(3,065)
Temporarily restricted - investment return	3,392	3,321
	$ 37,539	$ 710

Northwestern Memorial's investments measured at fair value include mutual funds; common equities; corporate and US government debt issues; state, municipal and foreign government debt issues; commingled funds; common collective trusts; and 103-12 entities.

Commingled investments, common collective trusts and 103-12 entities are commingled funds formed from the pooling of investments under common management. Unlike a mutual fund, these investments are not registered investment companies and, therefore, are exempt from registering with the Securities and Exchange Commission.

The investment strategy for the mutual funds, commingled funds, common collective trusts and 103-12 entities involves maximizing the overall long-term return by investing in a wide variety of assets, including domestic large cap equities, domestic small cap equities, international developed equities, blended equities, (i.e. a mix of domestic and international equities), natural resources and private investment limited partnerships (LPs).

Northwestern Memorial's non-pension plan investments measured under the equity method of accounting include absolute return hedge funds, equity long/short hedge funds, real estate, natural resources and LPs, collectively referred to as alternative investments. Alternative investments in the pension plan assets are measured at fair value.

Absolute return hedge funds include funds with the ability to opportunistically allocate capital among several strategies. Generally, these funds diversify across strategies in an effort to deliver consistently positive returns regardless of the movement within global markets, exhibit relatively low volatility and are redeemable quarterly with a 60-day notice period. Equity long/short hedge funds include hedge funds that invest both long and short in U.S. and international equities. These funds typically focus on diversifying or hedging across particular sectors, regions or market capitalizations and are generally redeemable quarterly with a 60-day notice period. Absolute return and equity long/short managers are redeemable quarterly or annually with a 45- to 90-day notice period.

Real estate includes LPs that invest in land and buildings and seek to improve property level operations by increasing lease rates, recapitalizing properties, rehabilitating aging/distressed properties, and repositioning properties to maximize revenue. Real estate LPs typically use moderate leverage. Natural resources include a diverse set of LPs that invest in oil and natural gas-related companies, commodity-oriented companies, and timberland. Private equity includes LPs formed to make equity and debt investments in operating companies that are not publicly traded. These LPs typically seek to influence decision-making within the operating companies. Investment strategies in this category may include venture capital, buyouts and distressed debt. These three categories of investments cannot be redeemed with the funds. Distributions from each fund will be received as the underlying assets of the fund are expected to be liquidated periodically over the lives of the LPs, which generally run 10 to 12 years.

Because of the timing of the preparation and delivery of financial statements for limited partnership investments, the use of the most recently available financial statements provided by the general partners results in a quarter delay in the inclusion of the limited partnership results in Northwestern Memorial's statements of operations and changes in net assets. Due to this delay, these financial statements do not yet reflect the market conditions experiences in the last two months of the first quarter of fiscal 2017 for the limited partnerships.

As of November 30, 2016, $2,257,228 of alternative investments is subject to various redemption limits and lockup provisions, of which $1,722,543 expires within one year and $534,685 expires after one year from the balance sheet date.

At November 30, 2016, Northwestern Memorial had commitments to fund approximately an additional $753,000 to alternative investment entities. This funding is expected to occur over the next 12 years.

6. Fair Value Measurements

Northwestern Memorial follows the requirements of ASC 820, *Fair Value Measuremen*t, in regards to measuring the fair value of certain assets and liabilities as well as disclosures about fair value measurements. ASC 820 defines fair value as the price that would be received for an asset or paid for a transfer of a liability in an orderly transaction on the measurement date.

The methodologies used to determine the fair value of assets and liabilities reflect market participant objectives and are based on the application of a three-level valuation hierarchy that prioritizes observable market inputs over unobservable inputs. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Examples of level 2 inputs are quoted prices for similar assets or liabilities in inactive markets or pricing models with inputs that are observable for substantially the full term of the asset or liability.

- Level 3 – Inputs to the valuation methodology are significant to the fair value of the asset or the liability and less observable. These inputs reflect the assumptions market participants would use in the estimation of the fair value of the asset or liability.

Fair Values

A financial instrument's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement.

(Unaudited and in thousands)

The following table presents the financial instruments measured at fair value on a recurring basis at November 30, 2016:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 174,208	$ —	$ —	$ 174,208
Investments:				
Short-term investments:				
Currency	27	—	—	27
Fixed Income	5,672	—	—	5,672
Total short-term investments	5,699	—	—	5,699
Mutual funds:				
Fixed income	111,080	—	—	111,080
U.S. equities	167,794	—	—	167,794
Total mutual funds	278,874	—	—	278,874
Other fixed income	—	16,103	—	16,103
Bonds:				
Corporate bonds	—	259,189	—	259,189
U.S. government and agencies' issues	—	270,843	—	270,843
Total bonds	—	530,032	—	530,032
Equity securities	247,867	471	—	248,338
Cash equivalents in investment accounts	44,306	—	—	44,306
Total investments	576,746	546,606	—	1,123,352
Beneficial interest in trusts	—	13,040	—	13,040
Total assets	$ 750,954	$ 559,646	$ —	$ 1,310,600
Investments recorded at fair value based on NAV				829,555
Total assets measured at fair value				$ 2,140,155
Liabilities:				
Interest rate swaps	$ —	$ 111,475	$ —	$ 111,475

(Unaudited and in thousands)

The following table presents the financial instruments measured at fair value on a recurring basis at August 31, 2016:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 218,163	$ —	$ —	$ 218,163
Investments:				
Short-term investments:				
Currency	27	—	—	27
Fixed Income	10,447	—	—	10,447
Total short-term investments	10,474	—	—	10,474
Mutual funds:				
Fixed income	212,714	—	—	212,714
International equities	9,431	—	—	9,431
U.S. equities	193,219	—	—	193,219
Total mutual funds	415,364	—	—	415,364
Other fixed income	—	202	—	202
Bonds:				
Corporate bonds	—	143,740	—	143,740
U.S. government and agencies' issues	—	264,074	—	264,074
Total bonds	—	407,814	—	407,814
Equity securities	233,927	417	—	234,344
Cash equivalents in investment accounts	122,462	—	—	122,462
Total investments	782,227	408,433	—	1,190,660
Beneficial interest in trusts	—	13,181	—	13,181
Total assets	$ 1,000,390	$ 421,614	$ —	$ 1,422,004
Investments recorded at fair value based on NAV				936,070
Total assets measured at fair value				$ 2,358,074
Liabilities:				
Interest rate swaps	$ —	$ 150,107	$ —	$ 150,107

There were no transfers into or out of Level 1 or Level 2 during the three months ended November 30, 2016 or the year ended August 31, 2016.

(Unaudited and in thousands)

Reconciliation to the Condensed Consolidated Balance Sheets

A reconciliation of the fair value of financial assets to the condensed consolidated balance sheets at November 30, 2016 and August 31, 2016 is as follows:

	November 30, 2016	August 31, 2016
Short-term investments measured at fair value	$ 5,699	$ 10,474
Investments, including assets limited as to use measured at fair value	1,947,208	2,116,256
Total investments at fair value	1,952,907	2,126,730
Alternative investments accounted for under equity method included in investments, including assets limited as to use	3,172,077	3,023,697
Total investments	$ 5,124,984	$ 5,150,427
Other long-term assets:		
Beneficial interests in trusts at fair value	$ 13,040	$ 13,181
Other long-term assets, net	157,167	157,597
Total other long-term assets, net	$ 170,207	$ 170,778

Valuation Techniques and Inputs

Beneficial Interests in Trusts - The fair value of beneficial interests in trusts is based on Northwestern Memorial Foundation's (the Foundation) percentage of the fair value of the trusts' assets adjusted for any outstanding liabilities (discounted using a rate per Internal Revenue Service (IRS) regulations), based on each trust arrangement.

Interest Rate Swaps - The fair value of interest rate swaps is based on generally accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative and quoted prices from dealer counterparties and other independent market sources. The valuation incorporates observable interest rates and yield curves for the full term of the swaps. The valuation is also adjusted to incorporate nonperformance risk for NMHC or the respective counterparty. The adjustment is based on the credit spread for entities with similar credit characteristics as NMHC or market-related data for the respective counterparty. Northwestern Memorial pays various fixed rates and receives cash flows based on rates equal to a percentage of the London Interbank Offered Rate (LIBOR) plus a spread for certain interest rate swaps.

Investments - The fair value of Level 1 investments, which consist of equity securities and mutual funds, is based on quoted market prices that are valued on a daily basis. Level 2 investments consist of U.S. government securities, corporate bonds, commingled funds, common collective trusts, interest in 103-12 entities and fixed income instruments issued by municipalities and foreign government agencies. The fair value of the U.S. government and agency securities and corporate bonds is established based on values obtained from nationally recognized pricing services that value the investments based on similar securities and matrix pricing of similar quality and maturity securities.

The fair values of commingled funds, common collective trusts and 103-12 entities are based on the ownership interest in the net asset value (NAV) per share or its equivalent, of the respective fund.

Northwestern Memorial's investments are exposed to various kinds and levels of risk. Equity securities and equity mutual funds expose Northwestern Memorial to market risk, performance risk and liquidity risk. Market risk is the risk associated with major movements of the equity markets. Performance risk is that risk associated with a company's operating performance. Fixed income securities and fixed income mutual funds expose Northwestern Memorial to interest rate risk, credit risk and liquidity risk. As interest rates change, the value of many fixed income securities is affected, including those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell particular securities. Liquidity risk tends to be higher for equities related to small capitalization companies and certain alternative investments. Due to the volatility in the capital markets, there is a reasonable possibility of subsequent changes in fair value, resulting in additional gains and losses in the near term.

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and other current liabilities and short-term borrowings are reasonable estimates of their fair values due to their short-term nature.

The fair value of the long-term debt portfolio, including the current portion, was $1,435,659 at November 30, 2016 and $1,527,365 at August 31, 2016. The fair value of this Level 2 liability is based on quoted market prices for the same or similar issues and the relationship of those bond yields with various market indices. The market data used to determine yield and calculate fair value represents Aa/AA-rated tax-exempt municipal health care bonds. The effect of third-party credit valuation adjustments, if any, is immaterial.

The fair value of pledges receivable, a Level 2 asset, is based on discounted cash flow analysis and approximates the carrying value of $37,197 and $40,343 at November 30, 2016 and August 31, 2016, respectively.

(Unaudited and in thousands)

7. Long-Term Debt

Long-term debt consists of the following:

	November 30, 2016	August 31, 2016
Revenue Bonds, Series 2015A and 2015B (KishHealth System), payable in monthly installments beginning March 1, 2020 through March 1, 2035 (fixed coupon rate of 2.80%)	$ 11,523	$ 11,642
Revenue Bonds, Series 2013 (NMHC), payable in annual installments beginning August 15, 2031 through August 15, 2043 (fixed coupon rates from 4.00% to 5.00%)	111,235	111,235
Revenue Bonds, Series 2011A and 2011B (CDH), with interest at a variable rate payable in annual installments through November 1, 2038, (weighted average interest rate of 0.76% and 0.55% for the three months ended November 30, 2016 and 2015, respectively)	116,300	117,950
Revenue Bonds, Series 2011C (Delnor), with interest at a variable rate payable in annual installments through November 1, 2038, (weighted average interest rate of 0.74% and 0.66% for the three months ended November 30, 2016 and 2015, respectively)	56,595	57,070
Revenue Bonds, Series 2009A (NMH), payable in annual installments through August 15, 2039 (fixed coupon rates range from 5.00% to 6.00%)	299,220	299,220
Revenue Bonds, Series 2009B (NMH), payable in annual installments through August 15, 2030 (fixed coupon rates range from 5.00% to 5.75%)	39,930	39,930
Revenue Bonds, Series 2009 (CDH) payable in annual installments through November 1, 2039 (fixed coupon rates range from 5.00% to 5.25%)	84,165	86,255
Revenue Bonds, Series 2009B (CDH) payable in annual installments through November 1, 2039 (fixed coupon rates range from 3.30% to 5.75%)	215,330	221,565
Variable Rate Demand Revenue Bonds, Series 2008A (NMH), payable in annual installments beginning August 15, 2017 through August 15, 2038 (weighted average interest rate of 0.57% and 0.01% for the three months ended November 30, 2016 and 2015, respectively)	78,775	78,775
Variable Rate Demand Revenue Bonds, Series 2007A (NMH), payable in annual installments through August 15, 2042 (weighted average interest rate of 0.68% and 0.01% for the three months ended November 30, 2016 and 2015, respectively)	206,000	206,000

(Unaudited and in thousands)

	November 30, 2016	August 31, 2016
Revenue Bonds, Series 2003A–Series 2003C (Delnor) payable in annual installments through November 1, 2033 (fixed coupon rates range from 5.00% - 5.25%)	22,350	22,350
Variable Rate Demand Revenue Bonds, Series 2002C (NMH), payable in annual installments beginning August 15, 2026 through August 15, 2031 (weighted average interest rate was 0.01% for the three months ended November 30, 2015)	—	27,450
Revenue Bonds, Series 2002B–Series 2002D (Delnor) payable in annual installments beginning May 1, 2022 through May 1, 2032 (fixed coupon rate of 5.25%)	35,000	35,000
Delnor medical office building loan, interest fixed at 6.34%, matures September 1, 2017	13,482	13,548
NMHC variable rate note dated October 4, 2016 to a bank, matures October 4, 2019 (weighted average interest rate of 1.02% and 0.78% for the three months ended November 30, 2016 and 2015, respectively)	105,000	105,000
The Midland Surgical Center, LLC line of credit due July 10, 2017, interest payments required monthly at a variable rate not less than 3.75%, and loan with maturity date of December 10, 2018, payable in monthly installments of $2 including interest at a rate of 3.75%	445	449
NMHC line of credit (weighted average interest rate of 1.08% for the twelve months ended August 31, 2016)	—	59,750
NMHC commercial paper (weighted average interest rate of 0.70% for the three months ended November 30, 2016)	87,299	—
	1,482,649	1,493,189
Less:		
Unamortized discount, net and debt issuance costs	7,985	7,899
Current maturities	43,353	29,565
Long-term debt subject to short-term remarketing agreements	—	318,795
Line of credit, included in Accrued expenses and other current liabilities	—	59,750
Commercial paper, included in Short-term debt	87,281	—
	$ 1,344,030	$ 1,077,180

Per the Amended and Restated Master Trust Indenture dated as of May 1, 2004, as supplemented and amended (the NMHC Master Indenture), the Obligated Group includes NMHC, NMH, Northwestern Lake Forest Hospital (NLFH), Central DuPage Hospital (CDH), Cadence, Delnor-Community Hospital (Delnor) and Cadence Physician Group (CPG), the Foundation, Northwestern

(Unaudited and in thousands)

Medical Faculty Foundation d/b/a Northwestern Medical Group (NMG), Northwestern Foundation for Research and Education d/b/a Northwestern Medical Group Management Services (NMGMS), Lake Forest Health and Fitness Institute (HFI), and Wells Fargo Bank, N.A., as master trustee. Supplemental Master Trust Indentures were issued so that all the debt as of November 30, 2014, is either secured or guaranteed by the NMHC Obligated Group.

Effective December 18, 2015, KishHealth, Kishwaukee Community Hospital, Valley West Community Hospital and Kishwaukee Physician Group, Inc. became members of the Obligated Group created under the NMHC Master Indenture. The Series 2015A and Series 2015B Bonds were restructured and secured by direct note obligations within the NMHC Obligated Group. The KishHealth system's Illinois Finance Authority Hospital Revenue Refunding Bonds, Series 2008, were legally defeased by placing sufficient assets in escrow funded by a debt reserve fund and a draw of $59,750 on a Northwestern Memorial line of credit, resulting in a loss on extinguishment of $4,030 for the year ended August 31, 2016.

Effective May 31, 2016, Marianjoy Inc., Marianjoy Rehabilitation Hospital & Clinic, Inc., Rehabilitation Medicine Clinic, Inc. and Marianjoy Foundation, Inc. became members of the Obligated Group created under the NMHC Master Indenture.

Northwestern Memorial had lines of credit of $50,000 and $80,000 that were to expire in May 2019 and September 2018, respectively. At August 31, 2016, Northwestern Memorial had drawn $59,750 on the $80,000 line of credit and restricted $467 of the $50,000 line to secure a letter of credit. The remaining amounts were available for operations. In October 2016, the lines of credit in the amounts of $50,000 and $80,000 were replaced with two $65,000 lines of credit. Northwestern Memorial has the option to borrow at various rates expressed as an adjustment to LIBOR, prime rate or other bank-offered rates. At November 30, 2016, no amounts were borrowed under the lines of credit.

Northwestern Memorial has standby bond purchase agreements (SBPAs) with multiple banks that cover all of its variable rate demand revenue bonds (VRDBs). The short-term credit rating for each series of VRDBs is based on the respective bank's short-term credit rating. The long-term credit rating for each series of VRDBs is based on Northwestern Memorial's long-term credit rating. Changes in credit ratings may impact the interest paid on or remarketing of the VRDBs. As of November 30, 2016, the banks provide liquidity support in the event of a failed remarketing as follows:

	Par Value	Expiration date
Subseries 2007A-1, 2007A-3	$ 103,000	October 2020
Series 2008A	78,775	October 2020
Subseries 2007A-2, 2007A-4	103,000	October 2019

The SBPAs include reporting and financial requirements and other covenants. If an SBPA is not renewed or replaced prior to its expiration, or if some portion, or all, of the related VRDBs are not successfully remarketed (failed remarketing) during the term of the SBPAs, the related VRDBs convert to a term loan at the earlier of the expiration date of the related SBPA or after 90 consecutive days of failed remarketing. The principal payment on the term loan would then be payable over a three-year term. The earliest principal payment on any term loan associated with the bonds is 367 days from the initial failed remarketing date. Therefore the VRDBs, all SBPAs with maturities greater than one year less any current portion, are classified as long-term debt in the accompanying condensed consolidated balance sheets.

In October 2016, the SBPA for the $103,000 Illinois Finance Authority Variable Rate Demand Revenue Bonds, Subseries 2007A-1 and Subseries 2007A-3 (NMH) and for the $78,775 Illinois Finance Authority Variable Rate Demand Revenue Bonds, Series 2008A (NMH) were each extended for four years. The SBPA for the $103,000 Illinois Finance Authority Variable Rate Demand Revenue Bonds, Subseries 2007A-2 and Subseries 2007A-4 was replaced by a new standby bond purchase agreement provider. At August 31, 2016, the expiration date for these SBPAs was less than one year and as such the related debt was classified as short-term.

In October 2016, the Illinois Finance Authority Variable Rate Demand Revenue Bonds, Series 2011A, 2011B, and 2011C (CDH-Delnor Health System) in the aggregate amount of $175,020 were purchased by different banks at variable rates for a period of seven years, five years, and three years respectively. At August 31, 2016, the expiration date for the SBPAs then in effect was less than one year and as such the related debt was classified as short-term.

In October 2016, the existing CDH-Delnor Health System $105,000 variable rate note was replaced with a NMHC $105,000 variable rate note with a different lender and extended to 2019.

In October 2016, NMHC issued commercial paper in the aggregate amount of $87,200. Proceeds were used to redeem all outstanding $27,450 NMH Series 2002C Bonds and pay down a $59,750 NMHC line of credit.

8. Derivatives

Northwestern Memorial's only derivative financial instruments are interest rate swaps approximately equal to its Series 2007A and Series 2011A-C variable rate bonds for the sole purpose of risk management. These bonds expose Northwestern Memorial to variability in interest payments due to changes in interest rates. To manage fluctuations in cash flows resulting from interest rate risk, Northwestern Memorial entered into various interest rate swap agreements. These swaps limit the variable-rate cash flow exposure on the variable rate bonds to synthetically fixed cash flows. By using interest rate swaps to manage the risk of changes in interest rates, Northwestern Memorial exposes itself to credit risk and market risk. Credit risk is the risk that a counterparty will fail to perform under the terms of a derivative contract. When the fair value of a swap is positive, the counterparty owes Northwestern Memorial, which creates credit risk for Northwestern Memorial. When the fair value of a swap is zero or negative, the counterparty does not owe Northwestern Memorial. Northwestern Memorial minimizes the credit risk in its swap contracts by entering into transactions that either require the counterparty to post collateral for the benefit of Northwestern Memorial based on the credit rating of the counterparty and the fair value of the swap contract or whose cash flows are insured by a third party. For certain interest rate swaps, Northwestern Memorial is required to post collateral for the benefit of the counterparty when the negative fair value of the swap exceeds a defined threshold. The aggregate fair value liability of the swaps on the condensed consolidated balance sheets at November 30, 2016 and August 31, 2016, respectively, reflects a reduction of $4,865 and $4,707, respectively, for non-performance risk. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of its swap positions in the context of their total blended cost of capital.

(Unaudited and in thousands)

The following is a summary of the outstanding positions under existing interest rate swap agreements:

Notional Amount: November 30, 2016	Notional Amount: August 31, 2016	Maturity Date	Rate Paid	Rate Received
$ 103,000	$ 103,000	August 2042	3.89%	63% of 1-Month LIBOR + 28 bps
103,000	103,000	August 2042	3.89%	63% of 1-Month LIBOR + 28 bps
61,650	62,175	November 2038	3.82%	67% of 3-Month LIBOR
61,650	62,175	November 2038	3.52%	67% of 3-Month LIBOR
35,000	35,000	May 2032	4.18%	67% of 1-Month LIBOR
22,350	22,350	May 2033	2.89%	67% of 1-Month LIBOR
$ 386,650	$ 387,700			

The fair value of derivative instruments is as follows:

	Derivatives Liabilities		
	Balance Sheet Location	November 30, 2016	August 31, 2016
Derivatives not designated as hedging instruments:			
Interest rate contracts	Interest rate swap liabilities	$ 111,475	$ 150,107

(Unaudited and in thousands)

The effects of derivative instruments on the condensed consolidated statements of operations and changes in net assets are as follows:

	Three Months Ended November 30,	
	2016	**2015**
Derivatives not designated as hedging instruments:		
Operating expense - interest	$ (1,314)	$ (1,782)
Nonoperating - change in fair value of interest rate swaps	38,632	(4,724)

Northwestern Memorial's derivative instruments contain provisions that require Northwestern Memorial's debt to remain above certain credit ratings from Standard and Poor's and Moody's. If Northwestern Memorial's debt were to fall below those levels, it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. Northwestern Memorial has posted collateral of $1,100 and $24,203 as of November 30, 2016 and August 31, 2016, respectively. If the credit-risk-related contingent features underlying these agreements were triggered to the fullest extent on November 30, 2016, Northwestern Memorial would be required to post $115,240 of additional collateral to its counterparties.

In October 2016, three interest rate swaps were novated under the same notional amounts and contract terms to a new counterparty except for the one swap that was subject to a collateral requirement. As a result of this transaction, none of these novated swaps require collateral.

9. Endowments

Northwestern Memorial's endowment consists of individual donor-restricted funds established for a variety of purposes. Net assets associated with endowment funds are classified and reported based on the donor-imposed restrictions.

Northwestern Memorial has interpreted the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), as adopted by the State of Illinois (State), as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment fund absent explicit donor stipulation to the contrary. As a result of this interpretation, Northwestern Memorial classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment, the original value of subsequent gifts to the permanent endowment, and accumulations to the permanent endowment made in accordance with the applicable donor gift instrument. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure consistent with donor intent or, where silent, the standard of prudence prescribed by UPMIFA.

In accordance with UPMIFA, Northwestern Memorial considers the following factors in making a determination to appropriate or accumulate donor-restricted funds:

- The duration and preservation of the fund
- The purposes of Northwestern Memorial and the endowment fund
- General economic conditions
- The possible effects of inflation and deflation
- The expected total return from investment income
- Other resources of Northwestern Memorial
- The investment policies of Northwestern Memorial.

Northwestern Memorial has adopted investment and spending policies for endowment assets designed to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that must be held in perpetuity or for a donor-specified period. Under this policy, endowment assets are allocated a fixed annual return, which is currently set at 6%.

Northwestern Memorial has a policy that limits annual spending from endowment funds to 4% of the endowment fund balance at the midpoint of the preceding fiscal year. In establishing this policy, Northwestern Memorial considered the long-term expected return on its endowment. Accordingly, over the long term, Northwestern Memorial expects the spending policy to allow its endowment to grow at an average annual rate of 2%. This is consistent with its objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specific term, as well as to provide additional real growth through new gifts and investment return.

(Unaudited and in thousands)

The changes in endowment net assets for the three months ended November 30, 2016 and 2015 are summarized below:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, September 1, 2015	$ 55,431	$ 160,775	$ 216,206
Contribution of KishHealth restricted net assets	—	601	601
Contributions	225	1,330	1,555
Change in value of trusts	(23)	(778)	(801)
Investment return	7,812	—	7,812
Appropriation for expenditure	(5,989)	—	(5,989)
Other	(140)	(17)	(157)
Endowment net assets, August 31, 2016	57,316	161,911	219,227
Contributions	(21)	339	318
Change in value of trusts	—	(106)	(106)
Investment return	1,911	—	1,911
Appropriation for expenditure	(825)	—	(825)
Other	(13)	—	(13)
Endowment net assets, November 30, 2016	$ 58,368	$ 162,144	$ 220,512

10. Self-Insurance Programs and Related Insurance Recoverable

Northwestern Memorial's self-insurance liabilities and the related amount recoverable from reinsurers are reported in the condensed consolidated balance sheets at present value based on a discount rate of 1.5% as of November 30, 2016 and August 31, 2016. Provisions for the professional and general liability risks are based on an actuarial estimate of losses using actual loss data adjusted for industry trends and current conditions and an evaluation of claims by Northwestern Memorial's legal counsel. The provision for estimated self-insured claims includes estimates of ultimate costs for both reported claims and claims incurred but not reported.

11. Net Patient Service Revenue

Northwestern Memorial recognizes net patient service revenue associated with services provided to patients who have third-party payment coverage with Medicare, Medicaid, Blue Cross, other managed care programs and other third-party payors on the basis of the contractual rates for the services rendered at the time services are provided. Payment arrangements with those payors include prospectively determined rates per admission or visit, reimbursed costs, discounted charges and per diem rates. Reported costs and/or services provided under certain of the arrangements are subject to retroactive audit and adjustment. Net patient service revenue increased by $2,639 and $727 in the three months ended November 30, 2016 and 2015, respectively, as a result of changes in estimates due to settlements of prior fiscal years' cost reports and the disposition of other payor audits and settlements. Changes in Medicare and Medicaid programs and reduction in funding levels could have an adverse effect on Northwestern Memorial.

Northwestern Memorial also provides care to self-pay patients. Under its Financial Assistance Policy (the Policy), Northwestern Memorial provides medically necessary care to patients in its community with inadequate financial resources at discounts of up to 100% of charges using a sliding scale that is based on patient household income as a percentage (up to 600%) of the federal poverty level guidelines. The Policy also contains a catastrophic financial assistance provision that limits a patient's total financial responsibility to Northwestern Memorial. Since Northwestern Memorial does not pursue collection of these amounts, they are not reported as net patient service revenue. The Policy has not changed in fiscal year 2017 or 2016. Northwestern Memorial implemented presumptive eligibility screening procedures for free care in fiscal year 2014. Northwestern Memorial recognizes net patient service revenue on services provided to these patients at the discounted rate at the time services are rendered.

Net patient service revenue, net of contractual allowances and discounts, is reduced by the provision for uncollectible accounts, and net patient accounts receivable are reduced by an allowance for uncollectible accounts. These amounts are based primarily on management's assessment of historical and expected write-offs and net collections, along with the aging status for each major payor source. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. Based on historical experience, a portion of Northwestern Memorial's self-pay patients who do not qualify for charity care will be unable or unwilling to pay for the services provided. Thus, a provision is recorded for uncollectible accounts in the period services are provided related to these patients. After all reasonable collection efforts have been exhausted in accordance with Northwestern Memorial's policies, accounts receivable are written off and charged against the allowance for uncollectible accounts.

For receivables associated with self-pay patients, Northwestern Memorial records an allowance for uncollectible accounts in the period of service on the basis of past experience. These adjustments are accrued on an estimated basis and are adjusted as needed in future periods.

(Unaudited and in thousands)

Net patient service revenue (including patient co-pays and deductibles), net of contractual allowances and discounts (but before the provision for uncollectible accounts) by primary payor source was as follows:

	Three Months Ended November 30,	
	2016	**2015**
Third-party payors	$ 1,152,311	$ 948,356
Self-pay	11,854	21,386
	$ 1,164,165	$ 969,742

Northwestern Memorial grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. At November 30, 2016 and August 31, 2016, patient accounts receivable, including patient co-pays and deductibles by major primary payor source, before deducting estimated uncollectibles, were as follows:

	November 30, 2016	**August 31, 2016**
Medicare	17%	15%
Medicaid	9	9
Blue Cross	16	16
Other managed care	30	33
Other third-party payors	11	11
Patients	17	16
	100%	100%

The allowance for uncollectible accounts was $173,041 and $174,234, or 21.3% and 22.4% of the related patient accounts receivable, net of contractual adjustments as of November 30, 2016 and August 31, 2016, respectively.

Hospital Assessment Program

In December 2008, the Illinois Hospital Assessment Program was approved by the Federal Centers for Medicare and Medicaid Services (CMS) for the period from July 1, 2008 through June 30, 2013. In July 2012, this program was extended to December 31, 2014, as part of the Save Medicaid Access and Resources Together (SMART) Act. In June 2014, this program was extended to June 30, 2018 as part of the Omnibus Medicaid Bill Senate Bill 741. In October 2013, the Enhanced Illinois Hospital Assessment Program as authorized under Illinois Public Act 97-688 was approved by CMS retroactive to June 10, 2012. Together, these two programs are referred to herein as (HAP). Under HAP, the state receives additional federal Medicaid funds for the State's healthcare system, administered by the Illinois Department of Healthcare and Family Services. HAP includes payments to NMHC hospitals from the state and assessments against NMHC hospitals, which are paid to the state in the same year.

(Unaudited and in thousands)

In June 2014, Omnibus Medicaid Bill Senate Bill 741 authorized a new supplemental program (Access Program) to cover new Medicaid beneficiaries under the Affordable Care Act (ACA), which was approved by CMS in January 2015. In May 2016 the State of Illinois passed HB 4678 (Expanded Access Program) which implemented a framework to increase ACA access funds to Illinois hospitals. The new ACA access funds are attributable to the ACA adults enrolled in managed care products. In September 2016 the Illinois Department of Family and Healthcare Services submitted its certification of the new Medicaid managed care organization rates to CMS. After agreements between managed care organizations and providers were executed, payments for this new program and an adjustment to the assessments began in November 2016 and were retroactive to January 1, 2016.

A summary of the amounts received and paid for the HAP and Access programs is as follows:

	Three Months Ended November 30,	
	2016	**2015**
Net patient service revenue		
HAP	$ 28,210	$ 25,454
Access Program	4,534	5,828
Expanded Access Program	23,557	—
	56,301	31,282
Illinois Hospital Assessment	26,793	19,917
Net excess of HAP and ACA revenue over Illinois assessment	$ 29,508	$ 11,365

The Expanded Access Program Revenue and Illinois Hospital Assessment expense for the three months ended November 30, 2016 includes retroactive portions from January 1, 2016 through August 31, 2016 of $16,728 and $2,004, respectively.

12. Employee Benefit Obligations

Northwestern Memorial's non-contributory, defined-benefit pension plans (Plans) cover certain Northwestern Memorial employees employed prior to January 1, 2013 in NMHC, NMH and NLFH. The Plans were hard frozen as of December 31, 2012, such that no participant will earn any additional or new benefits under the Plans on or after January 1, 2013.

(Unaudited and in thousands)

Net periodic pension benefit cost included in employee benefits expense in the accompanying condensed consolidated statements of operations and changes in net assets is comprised of the following:

	Three Months Ended November 30,	
	2016	**2015**
Plan expenses	$ 352	$ 421
Interest cost on projected benefit obligation	4,783	6,504
Expected return on the Plans' assets	(11,583)	(11,630)
Amortization of net loss	941	346
	$ (5,507)	$ (4,359)

Northwestern Memorial made no contributions for the three month period ended November 30, 2016 and has no current plans to contribute to the Plans during the fiscal year ending August 31, 2017.

13. Commitments and Contingencies

Academic, Programs and Other Support

Consistent with its mission, Northwestern Memorial provides academic, program and other support to other not-for-profit entities. The present value of the total remaining commitments related to this support is $149,332 and $149,690 at November 30, 2016 and August 31, 2016, respectively, which is reported as Grants and academic support payable, current portion and Grants and academic support payable, less current maturities in the accompanying condensed consolidated balance sheets.

Northwestern Memorial will provide continuing funding to Northwestern University in support of the research and education mission of the FSM. This continuing funding is based on the average net patient service revenue and operating results of Northwestern Memorial. The expense incurred of $18,824 and $14,751 for the three months ended November 30, 2016 and 2015, respectively is recorded in Other expense in the accompanying condensed consolidated statements of operations and changes in net assets; and a related liability of $18,876 and $52 is reported in Accrued expenses and other current liabilities in the accompanying condensed consolidated balance sheets as of November 30, 2016 and August 31, 2016, respectively.

Capital Projects

Various capital projects are currently being constructed and are expected to be placed in service over the next three years. The total estimated cost of these projects is approximately $1,468,000. As of November 30, 2016, project commitments totaled $966,000, of which $678,553 has been incurred. These commitments include the construction of a replacement hospital on the Lake Forest Campus as agreed to in the 2010 affiliation agreement with Lake Forest Hospital. All governmental reviews, approvals and building permits have been received. Construction began in February 2015. Building occupancy and hospital opening are planned for the spring of 2018.

Regulatory

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is a reasonable possibility that recorded amounts will change by a material amount in the near term. During the last few years, as a result of nationwide investigations by governmental agencies, various healthcare organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the Medicare and Medicaid programs.

In addition, an increasing number of the operations and practices of not-for-profit healthcare providers has been challenged or questioned to determine if they are consistent with the regulatory requirements for nonprofit tax-exempt organizations. These challenges are broader than concerns about compliance with federal and state statutes and regulations of core business practices of the health care organizations. The laws and regulations regarding these practices are also subject to interpretation and challenge. Areas that have come under examination have included pricing practices, billing and collection practices, charity care, community benefit, executive compensation, exemption of property from real property taxation and others. Northwestern Memorial expects that the level of review and audit to which it and other health care providers are subject will increase. There can be no assurance that regulatory authorities will not challenge Northwestern Memorial's compliance with these laws and regulations or that the laws and regulations themselves will not be subject to challenge, and it is not possible to determine the impact, if any, such claims, penalties or challenges would have on Northwestern Memorial.

Northwestern Memorial is aware of, has investigated, and made disclosure to the United States Department of Health and Human Services Office for Civil Rights (OCR) certain privacy breaches. OCR has requested information for these breaches. NMHC has responded to OCR's requests for information from OCR with respect to one breach related to the theft of a password-protected, unencrypted laptop that contained patient identifiable health information. OCR has also requested information on a separate matter relating to whether a NMHC affiliate had a Business Associate Agreement with a vendor that has been implicated in privacy breaches not involving NMHC records. OCR has been taking a more aggressive enforcement position relating to similar privacy matters by comparable health care organizations, including multiple seven-figure settlements against the disclosing party. NMHC is unable to determine which, if any, fines might be imposed by OCR or other actions that might be taken as result of any privacy breaches or OCR investigations.

Litigation

Northwestern Memorial is a defendant in various other lawsuits arising in the ordinary course of business. Although the outcome of these lawsuits cannot be predicted with certainty, management believes the ultimate disposition of such matters will not have a material effect on Northwestern Memorial's financial condition or operations.

In March 2016, a settlement was reached with various vendors and insurance companies over costs incurred and to be incurred to remediate certain facility issues. Costs incurred related to these issues have been expensed as incurred in operating expenses. The settlement amount of $50,000 is recorded in Rental and other revenue in the condensed consolidated statements of operations and changes in net assets for the three months ended May 31, 2016 and the year ended August 31, 2016.

14. Centegra Letter of Intent

In April 2016, NMHC and Centegra Health System (Centegra) executed a non-binding letter of intent that provides for a period of exclusive discussions regarding a potential affiliation between NMHC and Centegra. NMHC cannot predict whether these discussions will result in an agreement between the two organizations. Any definitive agreement would be subject to both parties' governing bodies and applicable regulatory approvals.

15. Subsequent Events

Northwestern Memorial evaluated events and transactions occurring subsequent to November 30, 2016 through January 13, 2017, the date of issuance of these financial statements. There were no recognized subsequent events and no unrecognized subsequent events requiring disclosure.

Supplementary Information

Northwestern Memorial HealthCare and Subsidiaries
Condensed Consolidating Balance Sheet
November 30, 2016
(Unaudited)
(Dollars in thousands)

	Obligated Group (Note 1)	Non-Obligated Group	Eliminations	Consolidated
Assets				
Current assets:				
Cash and cash equivalents	$ 125,902	$ 48,306	$ —	$ 174,208
Short-term investments	5,699	—	—	5,699
Current portion of investments, including assets limited as to use	59,856	68,265	—	128,121
Patient accounts receivable, net of estimated uncollectible accounts of $173,041 at November 30, 2016	621,517	18,387	—	639,904
Current portion of pledges and grants receivable, net	19,677	264	—	19,941
Current portion of insurance recoverable	79,872	6,341	(74,482)	11,731
Inventories	62,191	179	—	62,370
Other current assets	124,192	77,863	(62,772)	139,283
Due from affiliates	25,805	1,951	(27,756)	—
Total current assets	1,124,711	221,556	(165,010)	1,181,257
Investments, including assets limited as to use, less current portion	4,901,355	107,242	(17,433)	4,991,164
Property and equipment, at cost:				
Land	344,662	4,179	—	348,841
Buildings	3,283,592	74,232	—	3,357,824
Equipment and furniture	983,099	58,346	—	1,041,445
Construction-in-progress	441,831	783	—	442,614
	5,053,184	137,540	—	5,190,724
Less accumulated depreciation	1,866,269	20,782	—	1,887,051
	3,186,915	116,758	—	3,303,673
Prepaid pension cost	48,762	—	—	48,762
Insurance recoverable, less current portion	334,797	64,885	(330,763)	68,919
Other assets, net	302,656	290,345	(422,794)	170,207
Total assets	$ 9,899,196	$ 800,786	$ (936,000)	$ 9,763,982

Northwestern Memorial HealthCare and Subsidiaries
Condensed Consolidating Balance Sheet (continued)
November 30, 2016
(Unaudited)
(Dollars in thousands)

	Obligated Group (Note 1)	Non-Obligated Group	Eliminations	Consolidated
Liabilities and net assets				
Current liabilities:				
Accounts payable	$ 191,197	$ 1,207	$ —	$ 192,404
Accrued salaries and benefits	202,734	5,222	—	207,956
Grants and academic support payable, current portion	50,110	—	—	50,110
Accrued expenses and other current liabilities	127,439	60,254	(48,967)	138,726
Due to third-party payors	408,859	4,272	—	413,131
Current accrued liabilities under self-insurance programs	152,052	68,265	(130,609)	89,708
Current maturities of long-term debt	42,908	445	—	43,353
Short-term debt	87,281	—	—	87,281
Due to affiliates	1,348	26,407	(27,755)	—
Total current liabilities	1,263,928	166,072	(207,331)	1,222,669
Long-term debt, less current maturities	1,344,030	115,122	(115,122)	1,344,030
Accrued liabilities under self-insurance programs, less current portion	726,446	364,877	(581,425)	509,898
Grants and academic support payable, less current portion	99,222	—	—	99,222
Interest rate swaps	111,475	912	(912)	111,475
Due to investment pool participants	17,433	—	(17,433)	—
Other liabilities	136,089	6,528	—	142,617
Total liabilities	3,698,623	653,511	(922,223)	3,429,911
Net assets:				
Unrestricted:				
Undesignated	5,610,716	142,554	(14,363)	5,738,907
Board-designated	223,819	—	—	223,819
Noncontrolling interest in consolidated joint venture	(3,638)	811	624	(2,203)
Total unrestricted	5,830,897	143,365	(13,739)	5,960,523
Temporarily restricted	208,133	3,309	(38)	211,404
Permanently restricted	161,543	601	—	162,144
Total net assets	6,200,573	147,275	(13,777)	6,334,071
Total liabilities and net assets	$ 9,899,196	$ 800,786	$ (936,000)	$ 9,763,982

Northwestern Memorial HealthCare and Subsidiaries
Condensed Consolidating Statement of Revenue and Expense
November 30, 2016
(Unaudited)
(Dollars in thousands)

	Obligated Group (Note 1)	Non-Obligated Group	Eliminations	Consolidated
Revenue				
Net patient service revenue	$ 1,141,625	$ 25,680	$ (3,140)	$ 1,164,165
Provision for uncollectible accounts	34,305	3,236	—	37,541
Net patient service revenue after provision for uncollectible accounts	1,107,320	22,444	(3,140)	1,126,624
Rental and other revenue	57,989	27,814	(22,937)	62,866
Net assets released from donor restrictions and federal and state grants	4,209	914	(212)	4,911
Total revenue	1,169,518	51,172	(26,289)	1,194,401
Expenses				
Salaries	470,416	12,785	—	483,201
Employee benefits	75,714	3,379	(333)	78,760
Supplies	200,652	2,382	(2)	203,032
Purchased services	108,050	8,499	(5,053)	111,496
Depreciation and amortization	65,453	2,333	—	67,786
Insurance	30,169	20,544	(19,593)	31,120
Rent and utilities	21,610	1,828	(998)	22,440
Repairs and maintenance	15,911	1,745	(13)	17,643
Interest	11,737	1,690	(1,689)	11,738
Illinois Hospital Assessment	26,792	—	1	26,793
Other	28,756	938	(300)	29,394
Total expenses	1,055,260	56,123	(27,980)	1,083,403
Operating income (loss)	114,258	(4,951)	1,691	110,998
Nonoperating gains (losses)				
Investment return	38,915	(2,276)	(2,338)	34,301
Change in fair value of interest rate swaps	38,305	327	—	38,632
Loss on extinguishment of long term debt	(82)	—	—	(82)
Grants and academic support provided	(3,437)	—	—	(3,437)
Other	2,063	(20)	—	2,043
Total nonoperating gains (losses), net	75,764	(1,969)	(2,338)	71,457
Excess (deficit) of revenue over expenses	190,022	(6,920)	(647)	182,455
Net (loss) gain attributable to non-controlling interest in subsidiaries	(422)	—	145	(277)
Excess (deficit) of revenue over expenses attributable to NMHC and Subsidiaries	$ 190,444	$ (6,920)	$ (792)	$ 182,732

Obligated Group

Utilization Statistics

(Unaudited)

	Obligated Group	
	Three Months Ended November 30,	
	2016	**2015**
Sources of Net Patient Service Revenue *		
Medicare	22.4%	22.5%
Medicaid	4.7%	5.2%
Charge-based	4.8%	5.1%
Managed Care	68.1%	67.2%
Total	100.0%	100.0%
Utilization of Services		
Admissions (Acute)	21,602	19,432
Observation Cases	9,495	9,897
Equivalent Admissions	49,153	44,534
Average Length of Stay	4.5	4.5
Patient Days	97,186	87,834
Average Occupancy (staffed beds)	66.0%	64.6%
Average Occupancy Incl. Observations	74.8%	74.8%
Deliveries	4,652	4,445
Emergency Room Visits:		
Inpatient	10,313	8,983
Outpatient	61,539	51,985
Total	71,852	60,968
Registrations - Outpatient other than Emergency Room	606,109	481,651
Surgeries:		
Inpatient	5,683	5,467
Outpatient	12,926	10,768
Total	18,609	16,235
Beds, Licensed	1,766	1,562
Beds, Staffed	1,617	1,493
Total Observation Days	12,946	13,790
Medicare Case Mix Index	1.905	1.938
Overall Case Mix Index	1.604	1.613

*Excluding revenue from Hospital Assessment Program and provision for uncollectible accounts.

1. Obligated Group

The supplementary financial information for the Obligated Group is in accordance with the Amended and Restated Master Trust Indenture between NMHC, as the Obligated Group Agent, and Wells Fargo Bank, N.A., as successor Master Trustee to J.P. Morgan Trust Company, National Association, dated as of May 1, 2004 as amended and supplemented by each Supplemental Master Trust Indenture thereto through and including the Twenty-Sixth Supplemental Master Trust Indenture dated as of May 31, 2016.