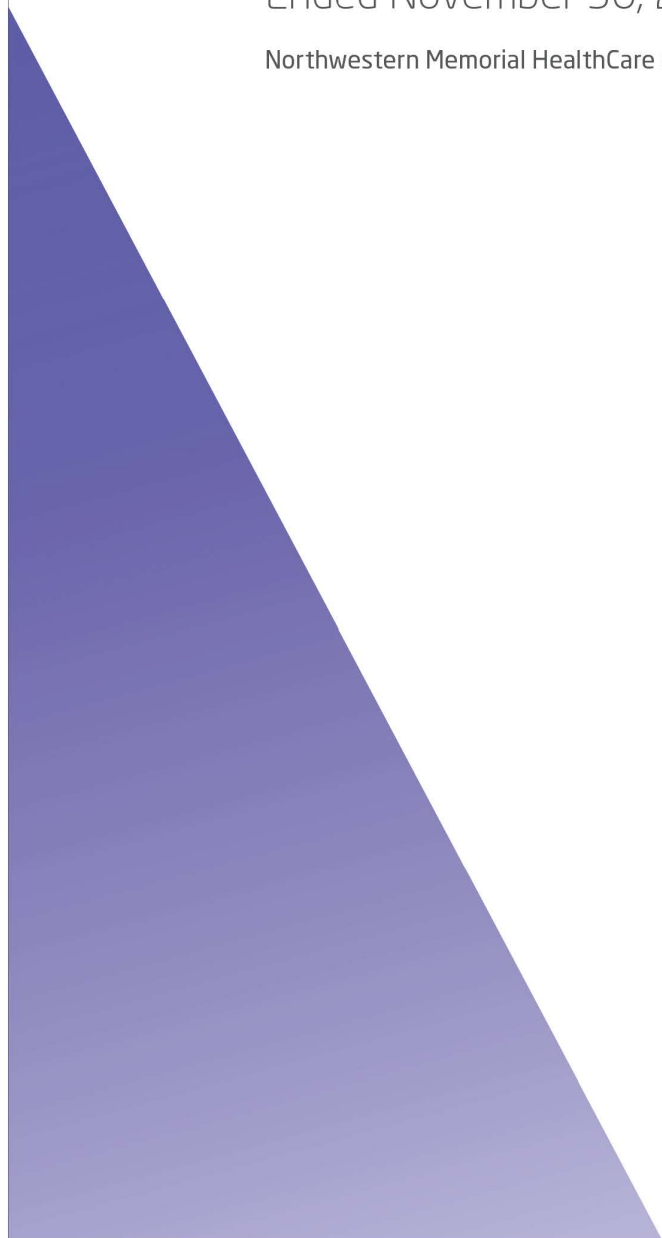




# Quarterly Report

As of and for the First Quarter  
Ended November 30, 2017

Northwestern Memorial HealthCare and Subsidiaries



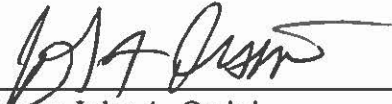
**NORTHWESTERN MEMORIAL HEALTH CARE  
OFFICER'S CERTIFICATE**

Ladies and Gentlemen:

Pursuant to Section 411(A) of the Second Amended and Restated Master Trust Indenture dated December 1, 2017, as supplemented and amended from time to time, by and among Northwestern Memorial HealthCare, certain of its affiliates identified therein and Wells Fargo Bank, 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, 2017, subject to year-end adjustment in the final audited financial statements.

This 12th day of January, 2018.

NORTHWESTERN MEMORIAL HEALTHCARE

By:   
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, 2017**

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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)

	<b>November 30, 2017</b>	<b>August 31, 2017</b>
	<b>(Unaudited)</b>	<b>Note A</b>
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 313,647	\$ 258,463
Short-term investments	21,013	30,685
Current portion of investments, including assets limited as to use	130,830	136,352
Patient accounts receivable, net of estimated allowances for uncollectible accounts of \$237,087 at November 30, 2017 and \$223,411 at August 31, 2017	720,047	716,277
Current portion of pledges and grants receivable, net	17,117	24,561
Current portion of insurance recoverable	14,240	14,186
Inventories	66,036	64,443
Other current assets	139,197	154,752
Total current assets	1,422,127	1,399,719
Investments, including assets limited as to use, less current portion	5,670,715	5,490,526
Property and equipment, at cost:		
Land	347,036	347,036
Buildings	3,538,546	3,465,273
Equipment and furniture	1,191,303	1,166,884
Construction in progress	571,140	539,340
	5,648,025	5,518,533
Less accumulated depreciation	2,126,456	2,059,946
	3,521,569	3,458,587
Prepaid pension cost	125,920	118,562
Insurance recoverable, less current portion	74,477	69,706
Other assets, net	193,973	189,222
<b>Total assets</b>	<b>\$ 11,008,781</b>	<b>\$ 10,726,322</b>

*Continued on next page.*

**Northwestern Memorial HealthCare and Subsidiaries**  
**Condensed Consolidated Balance Sheets (continued)**  
(Dollars in thousands)

	November 30, 2017	August 31, 2017
	(Unaudited)	Note A
<b>Liabilities and net assets:</b>		
Current Liabilities		
Accounts payable	\$ 202,565	\$ 230,588
Accrued salaries and benefits	220,866	314,163
Grants and academic support payable, current portion	39,166	38,753
Accrued expenses and other current liabilities	133,122	115,254
Due to third-party payors	498,501	434,965
Current accrued liabilities under self-insurance programs	94,145	94,256
Current maturities of long-term debt	30,802	30,239
Short-term debt	87,299	87,299
Total current liabilities	1,306,466	1,345,517
Long-term debt, less current maturities	1,313,193	1,324,776
Accrued liabilities under self-insurance programs, less current portion	498,455	495,709
Grants and academic support payable, less current portion	79,713	79,469
Interest rate swaps	99,714	112,586
Other liabilities	144,236	143,428
Total liabilities	3,441,777	3,501,485
Net assets:		
Unrestricted:		
Undesignated	6,927,311	6,602,984
Board-designated	231,925	229,455
Non-controlling interest in consolidated venture	581	(3,599)
Total unrestricted	7,159,817	6,828,840
Temporarily restricted	227,935	220,917
Permanently restricted	179,252	175,080
Total net assets	7,567,004	7,224,837
<b>Total liabilities and net assets</b>	<b>\$ 11,008,781</b>	<b>\$ 10,726,322</b>

*Note A: The August 31, 2017 financial statement information was derived from and should be read in conjunction with the Northwestern Memorial HealthCare and Subsidiaries 2017 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)**

	<b>Three Months Ended November 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>Revenue</b>		
Net patient service revenue	\$ 1,243,437	\$ 1,164,165
Provision for uncollectible accounts	45,426	37,541
Net patient service revenue after provision for uncollectible accounts	1,198,011	1,126,624
Rental and other revenue	73,445	62,866
Net assets released from donor restrictions and federal and state grants	4,831	4,911
Total revenue	1,276,287	1,194,401
<b>Expenses</b>		
Salaries	517,936	483,201
Employee benefits	77,932	78,760
Supplies	235,200	203,032
Purchased services	120,420	111,496
Depreciation and amortization	70,325	67,786
Insurance	31,328	31,120
Rent and utilities	22,931	22,440
Repairs and maintenance	18,336	17,643
Interest	10,519	11,738
Illinois Hospital Assessment	25,713	26,793
Other	36,654	29,394
Total expenses	1,167,294	1,083,403
<b>Operating income</b>	108,993	110,998
<b>Nonoperating gains (losses)</b>		
Investment return	218,377	34,301
Change in fair value of interest rate swaps	12,872	38,632
Loss on extinguishment of long term debt	—	(82)
Grants and academic support provided	(2,925)	(3,437)
Other	120	2,043
Total nonoperating gains, net	228,444	71,457
<b>Excess of revenue over expenses</b>	337,437	182,455
Net (loss) attributable to non-controlling interest in subsidiaries	(62)	(277)
<b>Excess of revenue over expenses attributable to NMHC and Subsidiaries</b>	\$ 337,499	\$ 182,732

*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		
	2017			2016		
	Total	Controlling	Non-controlling	Total	Controlling	Non-controlling
<b>Unrestricted net assets</b>						
Excess (deficiency) of revenue over expenses	\$ 337,437	\$ 337,499	\$ (62)	\$ 182,455	\$ 182,732	\$ (277)
Net assets released from restrictions used for property and equipment additions	—	—	—	1,389	1,389	—
Postretirement-benefit-related changes other than net periodic pension cost	141	141	—	1,351	1,351	—
Distribution to non-controlling interest	(614)		(614)			
Other	(5,988)	(10,844)	4,856	(585)	(903)	318
Increase in unrestricted net assets	330,976	326,796	4,180	184,610	184,569	41
<b>Temporarily restricted net assets</b>						
Contributions	9,478	9,478	—	4,873	4,873	—
Investment return	3,718	3,718	—	3,392	3,392	—
Net assets released from restrictions used for:						
Operating expenses, charity care, research and education	(6,531)	(6,531)	—	(7,031)	(7,031)	—
Property and equipment additions	—	—	—	(1,389)	(1,389)	—
Change in fair value of split-interest agreements	138	138	—	—	—	—
Other	216	216	—	(210)	(210)	—
Increase (decrease) in temporarily restricted net assets	7,019	7,019	—	(365)	(365)	—
<b>Permanently restricted net assets</b>						
Contributions	3,967	3,967	—	339	339	—
Change in fair value of split-interest agreements	205	205	—	(106)	(106)	—
Increase in permanently restricted net assets	4,172	4,172	—	233	233	—
Change in net assets	342,167	337,987	4,180	184,478	184,437	41
Net assets, beginning of period	7,224,837	7,228,436	(3,599)	6,149,593	6,151,837	(2,244)
Net assets, end of period	\$ 7,567,004	\$ 7,566,423	\$ 581	\$ 6,334,071	\$ 6,336,274	\$ (2,203)

*See accompanying notes to the interim condensed consolidated financial statements.*

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

	<b>Three Months Ended November 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>Operating activities</b>		
Change in net assets	\$ 342,167	\$ 184,478
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Postretirement benefit-related changes other than net periodic pension cost	(141)	(1,351)
Change in fair value of interest rate swaps	(12,872)	(38,632)
Loss on extinguishment of long-term debt	—	82
Net unrestricted realized investment return and net change in unrestricted and restricted unrealized investment gains/losses	(218,825)	(34,685)
Restricted contributions, change in fair value of split interest agreements, and realized investment return	(17,058)	(8,499)
Depreciation and amortization	70,325	67,786
Provision for uncollectible accounts	45,426	37,541
Changes in operating assets and liabilities:		
Patient accounts receivable	(49,196)	(77,673)
Due to third-party payors	63,616	6,947
Grants and academic support payable	657	(358)
Other operating assets and liabilities	(90,772)	(100,857)
Net cash provided by operating activities	133,327	34,779
<b>Investing activities</b>		
Purchase of trading securities	(457,717)	(921,047)
Sale of trading securities	476,477	934,182
Net unrestricted realized investment return	35,070	46,993
Capital expenditures, net	(137,880)	(136,722)
Net cash used in investing activities	(84,050)	(76,594)
<b>Financing activities</b>		
Proceeds from commercial paper	—	87,200
Payments of line of credit	—	(59,750)
Payments of long-term debt	(11,151)	(38,089)
Restricted contributions, change in fair value of split interest agreements, and realized investment return	17,058	8,499
Net cash provided by (used in) financing activities	5,907	(2,140)
Net increase (decrease) in cash and cash equivalents	55,184	(43,955)
Cash and cash equivalents, beginning of period	258,463	218,163
Cash and cash equivalents, end of the period	\$ 313,647	\$ 174,208

*See accompanying notes to the interim condensed consolidated financial statements.*



## **As of and for the First Quarter Ended**

**November 30, 2017**

### **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, 2017.

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, 2017, which are available on the Electronic Municipal Market Access ("EMMA") website of the Municipal Securities Rulemaking Board.

### **2. 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 converged and replaced existing revenue recognition guidance, including industry specific guidance, and requires an entity to recognize revenue to depict 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 expects to use the modified retrospective approach. Northwestern Memorial expects substantially all of its current provision for uncollectible accounts to qualify as a price concession under the new guidance and therefore be netted along with charity care and contractual discounts in Net patient service revenue. Northwestern Memorial expects expanded disclosures to

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements** *(continued)*  
*(Unaudited and in thousands)*

also be made. Northwestern Memorial is in the process of evaluating other impacts this guidance may have on its financial statements.

In May 2015, the Financial Accounting Standards Board (FASB) issued new guidance on short-duration insurance contracts (Accounting Standards Update (ASU) 2015-09, *Financial Services - Insurance (Topic 944): Disclosures about Short-Duration Contracts*). The amendments in this new guidance are effective for annual periods beginning after December 15, 2016, and interim periods within annual periods beginning after December 15, 2017. The new guidance should be applied retrospectively by providing comparative disclosures for each period presented, except for those requirements that apply only to the current period. The new guidance requires insurance entities to provide users of financial statements with more transparent information about initial claim estimates and subsequent adjustments to these estimates, including reconciling from the claim development table to the balance sheet liability; methodologies and judgments in estimating claims; and the timing, and frequency of claims. The adoption of this guidance is expected to increase disclosures and is not expected to have a material impact on the 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 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 impact 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 impact this guidance will have on its consolidated financial statements.

In March 2017, the Financial Accounting Standards Board (FASB) issued ASU No. 2017-07, *"Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost"* (ASU 2017-07), which changes the presentation of periodic benefit cost components. Under ASU 2017-07, service costs will continue to be presented within operating expenses but amortization of prior service credits and other components of net periodic benefit cost in Nonoperating gains (losses) in the consolidated statements of operation and changes in net assets. ASU 2017-07 is effective for annual reporting periods beginning after December 15, 2017.

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements** *(continued)*  
*(Unaudited and in thousands)*

**3. 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 decreased by \$3,578 and increased by \$1,649 in the three months ended November 30, 2017 and 2016, 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. Future 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, the discontinued amounts are not reported as net patient service revenue. Northwestern Memorial uses presumptive eligibility screening procedures for free care and recognizes net patient service revenue on services provided to self-pay 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 to these patients. After all reasonable collection efforts have been exhausted in accordance with Northwestern Memorial's policies, patient accounts receivable are written off and charged against the estimated allowances 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.

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(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:

	<b>Three Months Ended November 30,</b>	
	<b>2017</b>	<b>2016</b>
Third-party payors	\$1,219,107	\$1,152,311
Patients	24,331	11,854
	<u>\$1,243,438</u>	<u>\$1,164,165</u>

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, 2017 and August 31, 2017, patient accounts receivable, including patient co-pays and deductibles by major primary payor source, before deducting estimated allowances for uncollectible accounts, were as follows:

	<b>November 30, 2017</b>	<b>August 31, 2017</b>
Medicare	15%	14%
Medicaid	9	11
Blue Cross	22	16
Other managed care	32	32
Other third-party payors	7	8
Patients	15	19
	<u>100%</u>	<u>100%</u>

The allowance for estimated uncollectible accounts was \$237,087 and \$223,411, or 25.2% and 24.3% of the related patient accounts receivable, net of contractual adjustments as of November 30, 2017 and August 31, 2017, respectively.

#### **4. 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.

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

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

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.

The Illinois Hospital Assessment Program ends on June 30, 2018. At the date of issuance of these condensed consolidated financial statements, no extension or new program has been approved and Northwestern Memorial cannot predict whether or when such a new program may be approved.

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

	<b>Three Months Ended November 30,</b>	
	<b>2017</b>	<b>2016</b>
Net patient service revenue		
HAP	\$ 28,208	\$ 28,210
Access Program	5,205	4,534
Expanded Access Program	6,261	23,557
	<u>39,674</u>	<u>56,301</u>
Illinois Hospital Assessment	25,713	26,793
Net excess of HAP and ACA revenue over Illinois assessment	<u>\$ 13,961</u>	<u>\$ 29,508</u>

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

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(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:

	<b>November 30, 2017</b>	<b>August 31, 2017</b>
Measured at fair value:		
Cash and short-term investments	\$ 387,815	\$ 321,507
Mutual funds	231,221	228,599
Corporate bonds	298,598	312,980
U.S. government and agency issues	268,607	268,858
Equity securities	246,877	220,543
Other fixed income	15,753	13,393
	<u>1,448,871</u>	<u>1,365,880</u>
Measured at net asset value as practical expedient:		
Common collective trusts and commingled funds	708,947	685,948
Interest in 103-12 investment entities	310,241	291,304
	<u>1,019,188</u>	<u>977,252</u>
Accounted for under the equity method:		
Alternative investments	3,668,146	3,572,894
	<u>\$ 6,136,205</u>	<u>\$ 5,916,026</u>

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

	<b>November 30, 2017</b>	<b>August 31, 2017</b>
Assets limited as to use:		
Trustee-held funds	\$ 66,756	\$ 67,082
Self-insurance programs	596,855	579,780
Board-designated funds	183,518	181,417
Total assets limited as to use	<u>847,129</u>	<u>828,279</u>
Donor-restricted funds	350,501	337,025
Unrestricted, undesignated funds	4,603,915	4,461,574
Total investments, excluding short-term investments	<u>5,801,545</u>	<u>5,626,878</u>
Other financial instruments:		
Cash and cash equivalents and short-term investments	334,660	289,148
	<u>\$ 6,136,205</u>	<u>\$ 5,916,026</u>

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

The composition and presentation of investment returns are as follows:

	<b>Three Months Ended November 30,</b>	
	<b>2017</b>	<b>2016</b>
Interest and dividend income	\$ 5,529	\$ 5,861
Investment expenses	(594)	(1,355)
Realized gains on alternative investments, net	16,461	28,536
Realized gains on other investments, net	16,772	16,798
Unrealized gains (losses) on alternative investments	107,139	(655)
Unrealized gains (losses) on other investments	76,734	(11,807)
Change in value of joint ventures	171	161
	<u>\$ 222,212</u>	<u>\$ 37,539</u>
Reported as:		
Rental and other revenue	\$ 117	\$ (154)
Nonoperating investment return	218,377	34,301
Temporarily restricted - investment return	3,718	3,392
	<u>\$ 222,212</u>	<u>\$ 37,539</u>

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

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements** *(continued)*  
*(Unaudited and in thousands)*

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 two months delay in the inclusion of the limited partnership results in Northwestern Memorial's consolidated statements of operations and changes in net assets due to results recorded based on September 30 investment statements. Due to this delay, these consolidated financial statements do not yet reflect the market conditions experienced in the last two months of the first quarter of fiscal 2018 or 2017 for the limited partnership investments.

As of November 30, 2017, \$2,782,886 of alternative investments is subject to various redemption limits and lockup provisions, of which \$2,326,352 expires within one year and \$456,534 expires after one year from the balance sheet date.

At November 30, 2017, Northwestern Memorial had commitments to fund approximately an additional \$895,000 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 Measurement*, 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:



**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements** *(continued)*  
*(Unaudited and in thousands)*

- 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.

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

The following table presents the financial instruments measured at fair value on a recurring basis at November 30, 2017:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 313,647	\$ —	\$ —	\$ 313,647
Investments:				
Short-term investments:				
Currency	27	—	—	27
Fixed Income	20,986	—	—	20,986
Total short-term investments	21,013	—	—	21,013
Mutual funds:				
Fixed income	94,744	—	—	94,744
U.S. equities	136,477	—	—	136,477
Total mutual funds	231,221	—	—	231,221
Other fixed income	—	15,753	—	15,753
Bonds:				
Corporate bonds	—	298,598	—	298,598
U.S. government and agencies' issues	—	268,607	—	268,607
Total bonds	—	567,205	—	567,205
Equity securities	246,406	471	—	246,877
Cash equivalents in investment accounts	53,155	—	—	53,155
Total investments	551,795	583,429	—	1,135,224
Beneficial interest in trusts	—	14,546	—	14,546
Total assets	\$ 865,442	\$ 597,975	\$ —	\$ 1,463,417
Investments recorded at fair value based on NAV				1,019,188
Total assets measured at fair value				<u>\$ 2,482,605</u>
Liabilities:				
Interest rate swaps	\$ —	\$ 99,714	\$ —	\$ 99,714

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

The following table presents the financial instruments measured at fair value on a recurring basis at August 31, 2017:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 258,463	\$ —	\$ —	\$ 258,463
Investments:				
Short-term investments:				
Currency	27	—	—	27
Fixed Income	30,658	—	—	30,658
Total short-term investments	30,685	—	—	30,685
Mutual funds:				
Fixed income	98,130	—	—	98,130
U.S. equities	130,469	—	—	130,469
Total mutual funds	228,599	—	—	228,599
Other fixed income	—	13,393	—	13,393
Bonds:				
Corporate bonds	—	312,980	—	312,980
U.S. government and agencies' issues	—	268,858	—	268,858
Total bonds	—	581,838	—	581,838
Equity securities	220,037	506	—	220,543
Cash equivalents in investment accounts	32,359	—	—	32,359
Total investments	511,680	595,737	—	1,107,417
Beneficial interest in trusts	—	14,203	—	14,203
Total assets	<u>\$ 770,143</u>	<u>\$ 609,940</u>	<u>\$ —</u>	<u>\$ 1,380,083</u>
Investments recorded at fair value based on NAV				<u>977,252</u>
Total assets measured at fair value				<u>\$ 2,357,335</u>
Liabilities:				
Interest rate swaps	\$ —	\$ 112,586	\$ —	\$ 112,586

There were no transfers into or out of Level 1 or Level 2 during the three months ended November 30, 2017 or the year ended August 31, 2017.

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(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, 2017 and August 31, 2017 is as follows:

	<b>November 30, 2017</b>	<b>August 31, 2017</b>
Short-term investments measured at fair value	\$ 21,013	\$ 30,685
Investments, including assets limited as to use measured at fair value	2,133,399	2,053,984
Total investments at fair value	2,154,412	2,084,669
Alternative investments accounted for under equity method included in investments, including assets limited as to use	3,668,146	3,572,894
Total investments	<u>\$ 5,822,558</u>	<u>\$ 5,657,563</u>
Other long-term assets:		
Beneficial interests in trusts at fair value	\$ 14,546	\$ 14,203
Other long-term assets, net	179,427	175,019
Total other long-term assets, net	<u>\$ 193,973</u>	<u>\$ 189,222</u>

**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.

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements *(continued)***  
*(Unaudited and in thousands)*

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 \$1,392,615 at November 30, 2017 and \$1,414,681 at August 31, 2017. 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 \$39,941 and \$42,241 at November 30, 2017 and August 31, 2017, respectively.

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

**7. Long-Term Debt**

Long-term debt consists of the following:

	<b>November 30, 2017</b>	<b>August 31, 2017</b>
Revenue Bonds, Series 2015A and 2015B (KishHealth System), payable in monthly installments through March 1, 2035 (fixed coupon rate of 2.80%)	\$ 11,036	\$ 11,158
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 1.25% and 0.76% for the three months ended November 30, 2017 and 2016, respectively)	114,600	116,300
Revenue Bonds, Series 2011C (Delnor), with interest at a variable rate payable in annual installments through November 1, 2038, (weighted average interest rate of 1.19% and 0.74% for the three months ended November 30, 2017 and 2016, respectively)	56,050	56,595
Revenue Bonds, Series 2009A (NMH), payable in annual installments through August 15, 2039 (fixed coupon rates range from 5.00% to 6.00%)	291,760	291,760
Revenue Bonds, Series 2009B (NMH), payable in annual installments through August 15, 2030 (fixed coupon rates range from 5.00% to 5.75%)	37,700	37,700
Revenue Bonds, Series 2009 (CDH) payable in annual installments through November 1, 2039 (fixed coupon rates range from 5.00% to 5.25%)	81,985	84,165
Revenue Bonds, Series 2009B (CDH) payable in annual installments through November 1, 2039 (fixed coupon rates range from 4.00% to 5.75%)	208,730	215,330
Variable Rate Demand Revenue Bonds, Series 2008A (NMH), payable in annual installments through August 15, 2038 (weighted average interest rate of 0.87% and 0.57% for the three months ended November 30, 2017 and 2016, respectively)	74,250	74,250
Variable Rate Demand Revenue Bonds, Series 2007A (NMH), payable in annual installments through August 15, 2042 (weighted average interest rate of 0.90% and 0.68% for the three months ended November 30, 2017 and 2016, respectively)	204,700	204,700

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

	November 30, 2017	August 31, 2017
Revenue Bonds, Series 2003A–Series 2003C (Delnor) payable in annual installments through May 15, 2033 (fixed coupon rates range from 5.00% - 5.25%)	19,950	19,950
Revenue Bonds, Series 2002A–Series 2002D (Delnor) payable in annual installments beginning May 15, 2020 through May 1, 2032 (fixed coupon rate of 5.25%)	35,000	35,000
NMHC variable rate note dated October 4, 2016, matures October 4, 2019 (weighted average interest rate of 1.67% and 1.02 for the three months ended November 30, 2017 and 2016, respectively)	105,000	105,000
The Midland Surgical Center, LLC line of credit due July 10, 2019, interest payments required monthly at a variable rate not less than 3.75%, and loan with maturity date of December 10, 2018.	353	357
NMHC commercial paper dated October 4, 2016 (weighted average interest rate of 1.31 % for the three months ended November 30, 2017 and 0.70% for the two months ended November 30, 2016)	87,299	87,299
	1,439,648	1,450,799
Less:		
Unamortized discount, net and debt issuance costs	8,354	8,485
Current maturities	30,802	30,239
Commercial paper, included in Short-term debt	87,299	87,299
	<u>\$ 1,313,193</u>	<u>\$ 1,324,776</u>

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), Cadence Physician Group (CPG) d/b/a Northwestern Medicine Regional Medical Group (NMRMG), the Foundation, Northwestern 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), and Lake Forest Health and Fitness Institute (HFI), with 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 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 HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

On September 1, 2017, NMHC implemented a number of actions to streamline our organization structure; some of which impacted members of the Obligated Group. LivingWell Cancer Resource Center was merged into CPG; Marianjoy Inc. was merged into NMHC; NMGMS was merged into NMG; Delnor-Community Residential Living, Inc. d/b/a Delnor Glen merged into Delnor; Marianjoy Foundation was dissolved transferring assets to the Foundation; and Tri-Cities Surgery Center, LLC was dissolved transferring assets to Delnor. None of these actions had a material impact on the Obligated Group or any impact on the accompanying consolidated financial statements.

Northwestern Memorial had lines of credit of \$50,000 and \$80,000 that were to expire in May 2019 and September 2018, respectively. 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. At November 30, 2017 and August 31, 2017, Northwestern Memorial had restricted \$1,556 of one of the \$65,000 lines of credit to secure a letter 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, 2017, 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, 2017, the banks provided liquidity support in the event of a failed remarketing as follows:

	<b>Par Value</b>	<b>Expiration date</b>
Subseries 2007A-2, 2007A-4	\$ 102,350	October 2019
Series 2008A	74,250	October 2020
Subseries 2007A-1, 2007A-3	102,350	October 2020

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 SBPAs 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



**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements** *(continued)*  
*(Unaudited and in thousands)*

purchase agreement.

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.

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

In October 2016, NMHC issued commercial paper in the aggregate amount of \$87,299. Proceeds were used to redeem all outstanding \$27,450 NMH Series 2002C Bonds and pay down a \$59,750 NMHC line of credit.

In July 2017, NMHC paid Morton Bank \$13,534 to extinguish the existing Delnor medical office building loan.

In December 2017 and January 2018, the following transactions occurred related to Northwestern Memorial's long- and short-term debt:

Revenue Bonds, Series 2002A-Series 2002D (Delnor); Revenue Bonds, Series 2003A-Series 2003C (Delnor) and Revenue Bonds, Series 2009B (NMH) with principal outstanding of \$35,000, \$19,950 and \$37,700, respectively, were fully legally defeased.

A portion of the Revenue Bonds, Series 2009A (NMH) and Revenue Bonds Series 2009B bonds (CDH) were legally defeased in the amount of \$53,000 and \$28,000, respectively.

The Illinois Finance Authority issued tax-exempt fixed rate bonds, Series 2017A, in the aggregate amount of \$544,520 on behalf of NMHC as the borrower with varying maturities through 2047. The proceeds of these bonds were used to establish an escrow to legally defease the Revenue Bonds, Series 2009 (CDH) of \$81,985 and the remaining principal of the Revenue Bonds, Series 2009A (NMH) and Revenue Bonds, Series 2009B (CDH) in the amount of \$238,760 and \$180,730, respectively. Additionally, \$59,833 outstanding under the NMHC Commercial Paper program was redeemed.

The Illinois Finance Authority issued tax-exempt bonds, Series 2017B, in the aggregate amount of \$162,380 with a nominal maturity of 2057 and an interest rate initially fixed through December 14, 2022. The proceeds of these bonds were used to reimburse NMHC for a portion of the cost of the replacement Northwestern Lake Forest Hospital in Lake Forest, IL.

As a result of the above transactions, Northwestern Memorial will record a \$23,990 Loss on extinguishment of long-term debt in the second quarter of 2018.

NMHC amended and restated its Amended and Restated Master Trust Indenture dated as of May 1, 2004, as supplemented and amended, with the Second Amended and Restated Master Trust

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements** *(continued)*  
*(Unaudited and in thousands)*

Indenture dated as of December 1, 2017 (the “New Master Indenture”) both among NMHC, the other Members of the Obligated Group (as defined in the New Master Indenture) and Wells Fargo Bank, National Association, as master trustee. Certain springing provisions were approved on January 11, 2018.

## **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 reflect a reduction of \$3,349 and \$3,555 for non-performance risk at November 30, 2017 and August 31, 2017, respectively. 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.

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

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

<b>Notional Amount</b>		<b>Maturity Date</b>	<b>Rate Paid</b>	<b>Rate Received</b>
<b>November 30, 2017</b>	<b>August 31, 2017</b>			
\$ 102,350	\$ 102,350	August 2042	3.89%	63% of 1-Month LIBOR + 28 bps
102,350	102,350	August 2042	3.89	63% of 1-Month LIBOR + 28 bps
61,113	61,650	November 2038	3.82	67% of 3-Month LIBOR
61,113	61,650	November 2038	3.52	67% of 3-Month LIBOR
35,000	35,000	May 2032	4.18	67% of 1-Month LIBOR
19,950	19,950	May 2033	2.89	67% of 1-Month LIBOR
<u>\$ 381,876</u>	<u>\$ 382,950</u>			

The fair value of derivative instruments is as follows:

	<b>Derivatives Liabilities</b>		
	<b>Balance Sheet Location</b>	<b>November 30, 2017</b>	<b>August 31, 2017</b>
Derivatives not designated as hedging instruments:			
Interest rate contracts	Interest rate swap liabilities	\$ 99,714	\$ 112,586

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

	<b>Three Months Ended November 30,</b>	
	<b>2017</b>	<b>2016</b>
Derivatives not designated as hedging instruments:		
Operating expense - interest	\$ (1,816)	\$ (1,314)
Nonoperating - change in fair value of interest rate swaps	12,872	38,632

Northwestern Memorial's derivative instruments contain provisions that require its debt to remain above certain credit ratings from Standard & 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 \$0 and \$330 as of November 30, 2017 and August 31, 2017, respectively. If the credit-risk-related contingent features underlying the

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements *(continued)***  
*(Unaudited and in thousands)*

agreement were triggered to the fullest extent on November 30, 2017, Northwestern Memorial would be required to post \$103,063 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 required collateral to be posted.

## **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 HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

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.

The changes in endowment net assets for the three months ended November 30, 2017 and 2016 are summarized below:

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment net assets, September 1, 2016	\$ 57,316	\$ 161,911	\$ 219,227
Contributions	460	5,609	6,069
Investment return	7,353	—	7,353
Appropriation for expenditure	(5,602)	—	(5,602)
Change in value of trusts	—	775	775
Other	(705)	6,785	6,080
Endowment net assets, August 31, 2017	58,822	175,080	233,902
Contributions	49	3,967	4,016
Investment return	2,039	—	2,039
Appropriation for expenditure	(877)	—	(877)
Change in value of trusts	—	205	205
Other	18	—	18
Endowment net assets, November 30, 2017	<u>\$ 60,051</u>	<u>\$ 179,252</u>	<u>\$ 239,303</u>

**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, 2017 and August 31, 2017. 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.

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

**11. 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.

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:

	<b>Three Months Ended November 30,</b>	
	<b>2017</b>	<b>2016</b>
Plan expenses	\$ 386	\$ 352
Interest cost on projected benefit obligation	5,036	4,783
Expected return on the Plans' assets	(12,779)	(11,583)
Amortization of net loss	438	941
	<u>\$ (6,919)</u>	<u>\$ (5,507)</u>

Northwestern Memorial made no contributions for the three month period ended November 30, 2017 and has no current plans to contribute to the Plans during the fiscal year ending August 31, 2018.

At August 31, 2016, Northwestern Memorial changed the discount rate method used to measure the service and interest cost starting in fiscal 2017 to the spot rate approach from the yield curve methodology used historically. This change had no impact on the projected benefit obligated as of November 30, 2017. This method does not apply to the service cost as both plans have been frozen, but results in different discount rates utilized for purposes of measuring the interest cost of the two plans. Northwestern Memorial has made this change to provide a more precise measurement of interest costs by improving the correlation between projected benefit cash flows to the corresponding spot yield curve rates. The future impact of this change is expected to be nominal.

**12. 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 \$118,879 and \$118,222 at November 30, 2017 and August 31, 2017, respectively, which is reported as Grants and academic support payable, current portion and Grants and academic support payable, less current portion in the accompanying condensed consolidated balance sheets.

**Northwestern Memorial HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements (continued)**  
*(Unaudited and in thousands)*

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 \$20,105 and \$18,824 for the three months ended November 30, 2017 and 2016, respectively, is recorded in Other expense in the accompanying condensed consolidated statements of operations and changes in net assets; and a related liability of \$981 and \$452 is reported in Accrued expenses and other current liabilities in the accompanying condensed consolidated balance sheets as of November 30, 2017 and August 31, 2017, 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 \$1,655,000. As of November 30, 2017, project commitments totaled \$1,212,300, of which \$997,687 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 is planned to be staggered in fiscal 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 HealthCare**  
**Notes to Interim Condensed Consolidated Financial Statements** *(continued)*  
*(Unaudited and in thousands)*

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 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.

**13. 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.

**14. Subsequent Events**

Northwestern Memorial evaluated events and transactions occurring subsequent to November 30, 2017 through January 12, 2018, the date of issuance of these condensed consolidated financial statements. During this period, there were no subsequent events requiring recognition in the condensed consolidated financial statements and no unrecognized subsequent events requiring disclosure other than those disclosed in Note 7.



## Supplementary Information

**Northwestern Memorial HealthCare and Subsidiaries**  
**Condensed Consolidating Balance Sheet**  
**November 30, 2017**  
**(Unaudited)**  
**(Dollars in thousands)**

	Obligated Group (Note 1)	Non-Obligated Group	Eliminations	Consolidated
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 298,472	\$ 72,379	\$ (57,204)	\$ 313,647
Short-term investments	21,013	—	—	21,013
Current portion of investments, including assets limited as to use	60,354	70,476	—	130,830
Patient accounts receivable, net of estimated uncollectible accounts	701,415	18,632	—	720,047
Current portion of pledges and grants receivable, net	17,011	106	—	17,117
Current portion of insurance recoverable	82,161	7,225	(75,146)	14,240
Inventories	65,995	41	—	66,036
Other current assets	128,864	72,563	(62,230)	139,197
Due from affiliates	72,842	17,307	(90,149)	—
Total current assets	1,448,127	258,729	(284,729)	1,422,127
Investments, including assets limited as to use, less current portion	5,579,574	101,820	(10,679)	5,670,715
Property and equipment, at cost:				
Land	346,047	989	—	347,036
Buildings	3,479,955	58,591	—	3,538,546
Equipment and furniture	1,133,411	57,892	—	1,191,303
Construction-in-progress	569,422	1,718	—	571,140
	5,528,835	119,190	—	5,648,025
Less accumulated depreciation	2,100,122	26,334	—	2,126,456
	3,428,713	92,856	—	3,521,569
Prepaid pension cost	125,920	—	—	125,920
Insurance recoverable, less current portion	332,062	69,738	(327,323)	74,477
Other assets, net	328,850	295,336	(430,213)	193,973
Total assets	\$ 11,243,246	\$ 818,479	\$ (1,052,944)	\$ 11,008,781

**Northwestern Memorial HealthCare and Subsidiaries**  
**Condensed Consolidating Balance Sheet (continued)**  
**November 30, 2017**  
**(Unaudited)**  
**(Dollars in thousands)**

	Obligated Group (Note 1)	Non-Obligated Group	Eliminations	Consolidated
<b>Liabilities and net assets</b>				
Current liabilities:				
Accounts payable	\$ 202,018	\$ 547	\$ —	\$ 202,565
Accrued salaries and benefits	216,446	4,420	—	220,866
Grants and academic support payable, current portion	39,166	—	—	39,166
Accrued expenses and other current liabilities	119,854	63,273	(50,005)	133,122
Due to third-party payors	494,351	4,150	—	498,501
Current accrued liabilities under self-insurance programs	158,120	70,476	(134,451)	94,145
Due to cash pool	57,204	—	(57,204)	—
Current maturities of long-term debt	30,775	27	—	30,802
Short-term debt	87,299	—	—	87,299
Due to affiliates	17,307	72,842	(90,149)	—
Total current liabilities	1,422,540	215,735	(331,809)	1,306,466
Long-term debt, less current maturities	1,312,867	94,566	(94,240)	1,313,193
Accrued liabilities under self-insurance programs, less current portion	717,780	349,519	(568,844)	498,455
Grants and academic support payable, less current portion	79,713	—	—	79,713
Interest rate swaps	99,714	143	(143)	99,714
Due to investment pool participants	10,679	—	(10,679)	—
Other liabilities	141,967	2,269	—	144,236
Total liabilities	3,785,260	662,232	(1,005,715)	3,441,777
Net assets:				
Unrestricted:				
Undesignated	6,821,598	152,979	(47,266)	6,927,311
Board-designated	231,922	3	—	231,925
Non-controlling interest in consolidated venture	—	544	37	581
Total unrestricted	7,053,520	153,526	(47,229)	7,159,817
Temporarily restricted	225,815	2,120	—	227,935
Permanently restricted	178,651	601	—	179,252
Total net assets	7,457,986	156,247	(47,229)	7,567,004
Total liabilities and net assets	\$ 11,243,246	\$ 818,479	\$ (1,052,944)	\$ 11,008,781

**Northwestern Memorial HealthCare and Subsidiaries**  
**Condensed Consolidating Statement of Revenue and Expense**  
**Three Months Ended November 30, 2017**  
*(Unaudited)*  
*(Dollars in thousands)*

	Obligated Group (Note 1)	Non-Obligated Group	Eliminations	Consolidated
<b>Revenue</b>				
Net patient service revenue	\$ 1,225,989	\$ 23,374	\$ (5,926)	\$ 1,243,437
Provision for uncollectible accounts	44,201	1,225	—	45,426
Net patient service revenue after provision for uncollectible accounts	1,181,788	22,149	(5,926)	1,198,011
Rental and other revenue	68,083	30,592	(25,230)	73,445
Net assets released from donor restrictions and federal and state grants	4,573	258	—	4,831
Total revenue	1,254,444	52,999	(31,156)	1,276,287
<b>Expenses</b>				
Salaries	505,865	12,071	—	517,936
Employee benefits	75,363	3,066	(497)	77,932
Supplies	232,965	2,235	—	235,200
Purchased services	118,442	11,473	(9,495)	120,420
Depreciation and amortization	68,330	1,995	—	70,325
Insurance	30,779	20,516	(19,967)	31,328
Rent and utilities	22,149	1,816	(1,034)	22,931
Repairs and maintenance	16,587	1,749	—	18,336
Interest	10,518	1,709	(1,708)	10,519
Illinois Hospital Assessment	25,713	—	—	25,713
Other	35,887	930	(163)	36,654
Total expenses	1,142,598	57,560	(32,864)	1,167,294
<b>Operating income (loss)</b>	111,846	(4,561)	1,708	108,993
<b>Nonoperating gains (losses)</b>				
Investment return	216,836	4,331	(2,790)	218,377
Change in fair value of interest rate swaps	12,734	138	—	12,872
Grants and academic support provided	(2,925)	—	—	(2,925)
Other	122	(2)	—	120
Total nonoperating gains (losses), net	226,767	4,467	(2,790)	228,444
<b>Excess (deficit) of revenue over expenses</b>	338,613	(94)	(1,082)	337,437
Net (loss) gain attributable to non-controlling interest in subsidiaries	(212)	49	101	(62)
<b>Excess (deficit) of revenue over expenses attributable to NMHC and Subsidiaries</b>	\$ 338,825	\$ (143)	\$ (1,183)	\$ 337,499

**Obligated Group  
Utilization Statistics  
(Unaudited)**

	<b>Obligated Group</b>	
	<b>Three Months Ended November 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>Sources of Net Patient Service Revenue *</b>		
Medicare	25.1%	22.4%
Medicaid	4.2%	4.7%
Charge-based	4.1%	4.8%
Managed Care	66.6%	68.1%
Total	100.0%	100.0%
<b>Utilization of Services</b>		
Admissions (Acute)	22,523	21,602
Observation Cases	9,965	9,495
Equivalent Admissions	54,079	49,153
Average Length of Stay	4.9	4.5
Patient Days	109,703	97,186
Average Occupancy (staffed beds)	68.6%	66.0%
Average Occupancy Incl. Observations	78.3%	74.8%
Deliveries	4,647	4,652
<b>Emergency Room Visits:</b>		
Inpatient	10,444	10,313
Outpatient	61,231	61,539
Total	71,675	71,852
Registrations - Outpatient other than Emergency Room	593,095	606,109
<b>Surgeries:</b>		
Inpatient	5,622	5,683
Outpatient	12,333	12,926
Total	17,955	18,609
Beds, Licensed	1,809	1,766
Beds, Staffed	1,757	1,617
Total Observation Days	15,543	12,946
Medicare Case Mix Index	1.997	1.905
Overall Case Mix Index	1.695	1.604

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

**Northwestern Memorial HealthCare**  
**Note to Supplementary Information**  
*(Unaudited and in thousands)*

**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-Seventh Supplemental Master Trust Indenture dated as of October 1, 2016. In December 2017, NMHC restated its Amended and Restated Master Trust Indenture with the Second Amended and Restated Master Trust Indenture both among NMHC, the other members of the Obligated Group (as defined by the New Master Indenture) and Wells Fargo Bank, National Association, as master trustee.