Consolidated Financial Statements

Banner Health and Subsidiaries
Years Ended December 31, 2021 and 2020
With Report of Independent Auditors

Ernst & Young LLP

Building a better working world

Banner Health and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2021 and 2020

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Report of Independent Auditors

The Board of Directors
Banner Health

Opinion

We have audited the consolidated financial statements of Banner Health and Subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2021 and 2020, and the related consolidated statements of income, changes in net assets and cash flows for the years then ended, and the related notes (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained in sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date that the financial statements are issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Other Information

Management is responsible for the other information. The other information comprises the Management Discussion and Analysis of Results from Operations and Financial Position but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materiality misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Ernst + Young LLP

March 16, 2022

Banner Health and Subsidiaries

Consolidated Balance Sheets

	December 31	
	2021	**2020**
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 1,222,289**	$ 1,145,202
Short-term investments	**616,558**	456,560
Collateral held under securities lending program	**237,613**	317,306
Patient receivables	**1,197,429**	1,118,907
Inventories	**337,656**	308,995
Other receivables	**516,897**	366,786
Other current assets	**132,348**	138,734
Total current assets	**4,260,790**	3,852,490
Property and equipment, net	**4,553,527**	4,539,555
Right-of-use assets – operating	**308,360**	304,264
Right-of-use assets – finance	**255,884**	95,333
Other assets:		
Long-term investments	**6,841,569**	6,291,750
Other	**769,525**	714,617
Total other assets	**7,611,094**	7,006,367
Total assets	**$ 16,989,655**	$ 15,798,009

Banner Health and Subsidiaries

Consolidated Balance Sheets (continued)

	December 31	
	2021	**2020**
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Trade accounts payable	**$ 304,451**	$ 258,063
Current portion of long-term debt	**139,062**	267,320
Debt subject to self liquidity	**400,556**	100,000
Current portion of operating lease obligations	**75,619**	70,661
Current portion of finance lease obligations	**15,534**	8,333
Payable under securities lending program	**237,613**	317,306
Accrued expenses:		
Salaries and benefits	**563,663**	618,814
Medical claims payable	**333,298**	221,580
Other	**940,074**	1,113,303
Total current liabilities	**3,009,870**	2,975,380
Long-term debt, less current portion	**4,320,828**	4,272,368
Finance lease obligations, less current portion	**256,953**	95,592
Operating lease obligations, less current portion	**253,138**	253,372
Estimated self-insurance liabilities, less current portion	**203,896**	210,271
Interest rate swaps	**320,629**	394,565
Other	**327,072**	234,873
Total liabilities	**8,692,386**	8,436,421
Net assets without donor restrictions:		
Attributable to Banner Health	**7,839,269**	7,070,393
Attributable to non-controlling interests	**263,858**	105,893
Net assets without donor restrictions	**8,103,127**	7,176,286
Net assets with donor restrictions	**194,142**	185,302
Total net assets	**8,297,269**	7,361,588
Total liabilities and net assets	**$ 16,989,655**	$ 15,798,009

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Income

	Year Ended December 31	
	2021	**2020**
	(In Thousands)	
Revenues:		
Net patient service revenue	**$ 8,883,653**	$ 7,370,066
Medical insurance premiums	**2,728,495**	2,251,394
Other revenue	**746,723**	775,651
Total revenues	**12,358,871**	10,397,111
Expenses:		
Salaries, benefits, and contract labor	**5,754,704**	4,735,854
Supplies	**1,935,283**	1,643,337
Physician and professional fees	**294,498**	249,382
Medical claims cost, net of Banner claims of $458,349 and $380,836 in 2021 and 2020, respectively	**1,899,988**	1,547,525
Depreciation and amortization	**550,458**	499,880
Interest	**152,574**	146,155
Purchased services	**809,831**	640,387
Other	**834,856**	623,664
Total expenses	**12,232,192**	10,086,184
Operating income	**126,679**	310,927
Other income:		
Investment income – realized	**409,375**	45,378
Investment gain – unrealized	**244,001**	402,988
Investment income, net	**653,376**	448,366
Unrealized gain (loss) on interest rate swaps	**73,709**	(59,533)
Other loss	**(25,360)**	(69,248)
Total other income	**701,725**	319,585
Excess of revenues over expenses	**828,404**	630,512
Less excess of revenues over expenses attributable to non-controlling interests	**78,222**	43,827
Excess of revenues over expenses attributable to Banner Health	**$ 750,182**	$ 586,685

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Changes in Net Assets

	Year Ended December 31	
	2021	**2020**
	(In Thousands)	
Net assets without donor restrictions:		
Excess of revenues over expenses attributable to Banner Health	**$ 750,182**	$ 586,685
Amortization of cumulative loss on interest rate swaps	**227**	227
Changes in pension obligation	**860**	40,505
Contributions for property and equipment acquisitions	**18,689**	49,281
Other changes in net assets	**(1,082)**	–
Increase attributable to Banner Health	**768,876**	676,698
Excess of revenue over expenses attributable to non-controlling interests	**78,222**	43,827
Acquisition of non-controlling interests	**97,267**	–
Net distributions to non-controlling interests	**(17,524)**	(1,146)
Increase attributable to non-controlling interests	**157,965**	42,681
Net assets with donor restrictions:		
Contributions	**74,572**	29,333
Net unrealized gain on investments	**2,017**	3,936
Net assets released from restriction	**(2,189)**	(2,809)
Net assets released from restrictions for operations	**(65,560)**	(38,289)
Increase (decrease) in net assets with donor restrictions	**8,840**	(7,829)
Increase in net assets	**935,681**	711,550
Net assets, beginning of year	**7,361,588**	6,650,038
Net assets, end of year	**$ 8,297,269**	$ 7,361,588

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Cash Flows

	Year Ended December 31 2021	2020
	(In Thousands)	
Operating activities		
Increase in net assets	**$ 935,681**	$ 711,550
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	**550,458**	499,880
Loss on early extinguishment of debt	**14,027**	12,385
Acquisitions of non-controlling interests	**(97,267)**	–
Net increase in investments designated as trading	**(558,568)**	(1,372,786)
Net unrealized (gain) loss on interest rate swaps	**(73,936)**	59,306
Pension-related changes other than net periodic pension costs	**(375)**	5,038
(Gain) loss on sale of assets, net	**(3,132)**	458
Contributions for property and equipment and other	**(18,689)**	(49,281)
Restricted contributions	**(74,572)**	(29,333)
Net distributions to non-controlling interests	**56,350**	31,850
Changes in operating elements:		
Patient receivables	**(78,522)**	(132,222)
Inventories and other current assets	**(114,887)**	4,703
Accounts payable and accrued expenses	**(194,093)**	880,797
Estimated self-insurance liabilities	**(6,375)**	33,883
Other assets and liabilities	**41,099**	(4,192)
Net cash provided by operating activities	**377,199**	652,036
Investing activities		
Net purchases of property and equipment	**(516,630)**	(589,563)
Transfer from project fund	**–**	9,182
Business combinations	**22,548**	(161,114)
Net cash used in investing activities	**(494,082)**	(741,495)
Financing activities		
Proceeds from restricted contributions	**74,572**	29,333
Proceeds from issuance of debt	**801,333**	1,782,873
Payments of finance lease obligations	**(10,052)**	(2,046)
Payments of long-term debt	**(571,022)**	(1,163,059)
Cash distributions to non-controlling interests	**(56,350)**	(31,850)
Net cash provided by financing activities	**238,481**	615,251
Net increase in cash, cash equivalents, and restricted cash	**121,598**	525,792
Cash, cash equivalents, and restricted cash at beginning of year	**1,316,852**	791,060
Cash, cash equivalents, and restricted cash at end of year	**$ 1,438,450**	$ 1,316,852
Supplemental disclosures of cash flow information		
Interest paid, including amounts capitalized	**$ 165,391**	$ 164,192
Taxes paid	**$ 15,912**	$ 7,115

See accompanying notes.

1. Description of Business

Banner Health is a nonprofit corporation exempt from income taxes under Internal Revenue Code Section 501(c)(3) and applicable state income tax codes. Banner Health and its subsidiaries (collectively, Banner) own, control, or lease hospitals, clinics, nursing homes, clinical laboratories, ambulatory surgery centers, urgent care centers, free-standing imaging centers, home health agencies, a captive insurance company, a foundation, an insurance division offering insurance products to Medicare, Medicaid, and commercial subscriber populations, and other health care-related organizations in six western states. Banner also holds controlling interests in several health care-related business ventures (see Note 2) and non-controlling interests in several other entities that are accounted for under the equity method of accounting (see Note 8).

2. Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements reflect the consolidated operations of all owned and leased operating units of Banner and its wholly owned subsidiaries. Banner also holds controlling interests in the following business ventures. The business venture financial results are included within Banner's consolidated financial statements. Banner records the unrelated investor's ownership share of these business ventures as non-controlling interest.

Sonora Quest Laboratories, LLC

The Sonora Quest Laboratories, LLC (SQL) business venture was formed in 1997. Banner holds a 51% controlling interest and Quest Diagnostics of Arizona, Inc. (Quest) holds a 49% non-controlling interest. SQL provides a broad range of laboratory services to Arizona physicians, hospitals, and other health care providers.

BHSM Rehabilitation, LLC

In December 2017, Banner and Select Medical (Select) entered into a business venture that operates Banner's and Select's Arizona inpatient and outpatient rehabilitation services. The business venture, BHSM Rehabilitation, LLC (BHSM), began operations on May 1, 2018. Banner holds a 51% controlling interest in BHSM and Select holds a 49% non-controlling interest.

2. Significant Accounting Policies (continued)

Banner Atlas JV, LLC

In December 2018, Banner and Atlas Healthcare Partners, LLC (Atlas) entered a business venture that operates Banner's ambulatory surgery centers. The business venture is named Banner Atlas JV, LLC, with Banner holding a 75% controlling interest and Atlas holding a 25% non-controlling interest. Atlas manages the ambulatory surgery centers via a management service agreement and works with Banner to develop additional ambulatory surgical facilities in Banner's primary markets. Banner Atlas JV, LLC will always maintain a controlling interest in each surgery center.

Banner Health and Aetna Health Insurance Holding Company LLC

Banner and Aetna, Inc. (Aetna) formed an insurance holding company in 2017, initially owned 49% by Banner and 51% by Aetna. The holding company, Banner|Aetna, became the parent of two Arizona insurance companies that began issuing policies in 2018. Banner established a controlling interest in 2021 by purchasing an additional 1% from Aetna and assuming additional administrative responsibilities. Beginning January 1, 2021, the financial results of the venture are included within Banner's consolidated financial statements.

All significant intercompany accounts and transactions have been eliminated in consolidation.

Subsequent Events

Subsequent events have been evaluated through March 16, 2022, the date the accompanying consolidated financial statements were issued. There were no subsequent events requiring recognition in the consolidated financial statements.

Fair Value of Financial Instruments

The carrying values of financial instruments classified as current assets and current liabilities approximate fair value. The fair values of other financial instruments are disclosed in their respective notes.

Cash, Cash Equivalents, and Restricted Cash

Cash and cash equivalents consist primarily of cash and highly liquid marketable securities with an original maturity of three months or less when purchased by Banner.

2. Significant Accounting Policies (continued)

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the statement of financial position that sum to the total of the same such amounts shown on the statements of cash flows for the years ended December 31:

	2021	2020
	(In Thousands)	
Cash and cash equivalents	**$ 1,222,289**	$ 1,145,202
Investments	**216,161**	171,650
Cash, cash equivalents, and restricted cash	**$ 1,438,450**	$ 1,316,852

Short-Term Investments

Short-term investments include debt securities with maturity dates of one year or less from the balance sheet date and actively traded equity securities that are expected to be used on a short-term basis for working capital needs. These investments are stated at fair value, based on quoted market prices in active markets.

Investments

Banner invests in various investment securities that are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated financial statements.

Banner invests in various commingled funds, which are assets from multiple accounts, primarily equities, blended into a single fund. Commingled funds do not have a readily determinable fair value, despite the nature of the underlying securities; therefore, the net asset value, as reported by the fund manager, is used as a practical expedient for fair value. As such, they are excluded from the fair value hierarchy (see Note 5) and noted as investments measured at net asset value: private commingled funds.

2. Significant Accounting Policies (continued)

Banner invests in alternative investments, mainly hedge funds, through limited partnerships. Banner accounts for its ownership interests in these alternative investments under the equity method of accounting, based on the net asset value per share of the fund held by Banner. The net asset value is determined based on the estimated fair value of each of the underlying investments held in the hedge fund. However, the hedge fund investment holdings may include investments in private investment funds whose values have been estimated by the hedge fund managers in the absence of readily ascertainable fair values. Due to the inherent uncertainty of these estimates, these values may differ from the values that would have been used had a ready market for these investments existed. The investment income recorded is based on Banner's proportionate share of the hedge fund portfolio's change in net asset value during the year. The alternative investment income is primarily recorded within income from alternative investments on the consolidated statement of income, with the remainder recorded as a change to restricted net assets for those funds that have been restricted by the donor.

Certain of Banner's alternative investments are subject to redemption lockup periods or have capital call commitments. As of December 31, 2021, approximately $266,669,000 of Banner's alternative investments were subject to a two-year redemption lockup period. In addition, certain of Banner's alternative investment agreements follow a capital call structure, of which Banner has committed up to approximately $461,750,000. Of that total, Banner has made capital contributions of $235,866,000 as of December 31, 2021, resulting in up to approximately $225,884,000 in uncalled commitments.

Banner uses derivative financial instruments in its investment portfolio to moderate changes in value due to fluctuations in the financial markets. Banner has not designated its derivatives related to marketable securities as hedged financial instruments. Accordingly, the change in the fair value of derivatives is recognized as a component of investment income. Banner's fixed-income manager has executed a master netting arrangement for each of the derivative instruments held by the same counterparty, which are legally offset as the instrument is settled. Banner's derivative contracts in a net loss position were reported on a net basis on the accompanying consolidated balance sheets as of December 31, 2021 and 2020. As of December 31, 2021, approximately $186,249,000 of gross derivative assets and approximately $185,827,000 of gross derivative liabilities were netted together within investments. As of December 31, 2020, approximately $97,276,000 of gross derivative assets and approximately $97,073,000 of gross derivative liabilities were netted together within investments (see Note 5).

2. Significant Accounting Policies (continued)

Investment income, including interest and dividends, realized gains and losses on investments, unrealized gains and losses on investments, and income on alternative investments, is included in excess of revenues over expenses, unless the income or loss is restricted by donor or law.

Securities Lending Program

Banner participates in securities lending transactions through its custodian whereby Banner lends a portion of its investments to various brokers in exchange for collateral for the securities loaned, usually on a short-term basis. Collateral provided by the brokers consists of cash and securities and is maintained at levels approximating 104% of the fair value of the securities on loan, adjusted for market fluctuations. Banner maintains effective control of the loaned securities through its custodian during the term of the arrangement in that the securities may be recalled at any time. Under the terms of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed. The value of collateral held for loaned securities is reported in current assets as collateral held under securities lending program, and a corresponding obligation is reported in current liabilities as a payable under securities lending program on the accompanying consolidated balance sheets. At December 31, 2021 and 2020, the fair value of the collateral provided on behalf of Banner was approximately $237,613,000 and $317,306,000, respectively. At December 31, 2021 and 2020, the fair value of securities on loan was approximately $225,913,000 and $300,585,000, respectively.

Patient Receivables

Net patient accounts receivable and net patient service revenues have been adjusted to the estimated amounts expected to be received based on contractual rates for services rendered, inclusive of an estimated implicit price concession. These estimated amounts are subject to further adjustments upon review by third-party payors.

2. Significant Accounting Policies (continued)

Inventories

Inventories, consisting principally of supplies, are stated at the lower of cost or net realizable value, determined on a first-in, first-out basis.

Property and Equipment

Property and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation and amortization.

Depreciation is provided on a straight-line basis over the estimated useful lives of the property and equipment, which range from 2 to 20 years for major movable equipment and from 5 to 40 years for buildings and fixed equipment. Amortization of leasehold improvements is provided on a straight-line basis over the shorter of the lease period or the estimated useful lives.

Long-Lived Asset Impairment

Banner reviews long-lived assets, other than goodwill, for impairment when events or changes in business conditions indicate that their carrying values may not be recoverable. Banner considers assets to be impaired and writes them down to fair value if expected undiscounted cash flows are less than the carrying amounts. Fair value is the present value of the associated discounted cash flows.

Goodwill

Purchases of acquired businesses are allocated to the assets acquired and liabilities assumed based on the estimated fair values on the respective acquisition dates. Based on these values, the excess purchase price over the fair value of the net assets acquired is allocated to goodwill.

Banner evaluates goodwill for impairment at least annually, and more frequently if indicators of impairment are encountered. Banner completes its annual impairment test during the fourth quarter to determine whether there are events or circumstances that indicate it is more likely than not that the reporting units' fair values are less than their carrying amounts.

2. Significant Accounting Policies (continued)

If indicators of impairment are identified, goodwill is tested at the reporting unit level, defined as an operating segment or one level below an operating segment, with the fair value of the reporting unit being compared with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered to be impaired. Banner did not identify any indicators of impairment, and no impairment was recorded for 2021 or 2020.

Costs of Borrowing

Debt issuance costs are deferred and amortized over the term of the related bond using the straight-line method, which approximates the effective interest method.

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Self-Insurance Programs

In connection with self-insurance programs, accounts have been established for the purpose of accumulating assets based on actuarial determinations. These assets can be used only for the payment of professional liability, general liability, workers' compensation, employment liability, employee group life insurance claims, health plan stop-loss coverage, and related expenses. It is Banner's policy to record the expense and related liability for professional liability, general liability, workers' compensation, employment liability, and employee group life insurance losses based upon undiscounted actuarial estimates.

Net Assets

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor- or grantor-imposed restrictions. Net assets and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions – Net assets available for use in general operations and not subject to donor restrictions.

2. Significant Accounting Policies (continued)

Net Assets With Donor Restrictions – Net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. Net assets with donor restrictions are primarily restricted for capital projects, Alzheimer's research, oncology, and pediatric programs.

Contributions

Banner records contributions upon receipt of an unconditional promise to give. Gifts, bequests, and other promises or receipts restricted by donors as to use or time period are recorded as net assets with donor restriction until used in the manner designated or upon expiration of the time period restriction. Donated property and equipment are recorded at fair value at the date received. Unrestricted contributions received are recorded as other income.

Performance Indicator

Banner's performance indicator is the excess of revenues over expenses, which includes all changes in net assets without donor restrictions other than changes in the amortization of cumulative loss on interest rate swaps, contributions for property and equipment acquisitions, changes in pension funded status, and the cumulative effect of changes in accounting principle.

Net Patient Service Revenue

Net patient service revenue is reported at the amount to which Banner expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and include variable consideration for retroactive revenue adjustments due to settlement of ongoing and future audits, reviews, and investigations.

2. Significant Accounting Policies (continued)

Banner uses a portfolio approach to account for categories of patient contracts as a collective group, rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and major payor classes and types of services provided for outpatient revenue. Based on historical collection trends and other analyses, Banner believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

Banner's initial estimate of the transaction price for services provided to patients is determined by reducing the total standard charges related to the patient services provided by various elements of variable consideration, including contractual adjustments, discounts, implicit price concessions, and other reductions to Banner's standard charges. Banner determines the transaction price associated with services provided to patients who have third-party payor coverage based on the reimbursement terms outlined in contractual agreements, Banner's discount policies, and historical experience. For uninsured and underinsured patients who do not qualify for charity care, Banner determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on Banner's historical collection experience for applicable patient portfolios. Patients who meet Banner's criteria for free care are provided care without charge; such amounts are not reported as revenue. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to net patient service revenue in the period of the change.

Net patient service revenue is recognized as performance obligations are satisfied, even though Banner bills patients and third-party payors several days after the services are performed and/or the patient is discharged. Performance obligations are determined based on the nature of the services provided by Banner. Net patient service revenue for performance obligations satisfied over time is recognized based on actual charges incurred to date in relation to total expected charges. Banner believes that this method provides a reasonable depiction of the transfer of services over the term of the performance obligation based on the services needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services. Banner measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided, and Banner does not believe it is required to provide additional goods or services to the patient.

2. Significant Accounting Policies (continued)

Banner has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by the payors, the lines of business that render services to patients, and the timing of when revenue is recognized and billed. Net patient service revenue for the years ended December 31 by payor is as follows:

	2021	2020
	(In Thousands)	
Commercial and contracted payors	**$ 4,089,065**	$ 3,515,210
Medicare	**2,869,182**	2,558,472
Medicaid	**1,776,110**	1,192,500
Self-pay	**149,296**	103,884
	$ 8,883,653	$ 7,370,066

Deductibles, copayments, and coinsurance under third-party payment programs, which are the patient's responsibility, are included within the primary payor category in the table above.

Net patient service revenue for the years ended December 31 by line of business, is as follows:

	2021	2020
	(In Thousands)	
Hospital	**$ 7,154,541**	$ 6,047,972
Physician services	**768,224**	649,665
Outreach laboratory	**514,341**	385,477
Ambulatory and other	**446,547**	286,952
	$ 8,883,653	$ 7,370,066

2. Significant Accounting Policies (continued)

Medical Insurance Premiums and Claim Liabilities

Banner Health Network (BHN), a wholly owned accountable care organization, has entered into both shared and full risk contracts with CMS and insurance companies. Shared risk gains and losses (net) are included in other operating revenue while full risk plans recognize premium revenue in exchange for being responsible for the enrolled members' claims. For the years ended December 31, 2021 and 2020, BHN recorded premium revenue from insurance companies of approximately $410,833,000 and $398,598,000, respectively. BHN has recorded a medical claim liability, associated with claims incurred but not yet paid, of approximately $57,063,000 and $47,565,000 as of December 31, 2021 and 2020, respectively.

The Banner-University Health Plans (BUHP) include University Care Advantage and University Family Care. BUHP has entered into contracts with AHCCCS and CMS to provide health insurance services for enrolled members. In October 2018, University Family Care was awarded a three-year AHCCCS Complete Care contract, including an option that was exercised to extend up to four years, which is in addition to the AHCCCS long-term care contract that was awarded on October 1, 2017. University Care Advantage's contract with CMS is a calendar year contract, which can be renewed annually. For the years ended December 31, 2021 and 2020, BUHP recorded premium revenue from AHCCCS and CMS of approximately $1,925,162,000 and $1,733,595,000, respectively. BUHP has recorded a medical claim liability, associated with claims incurred but not yet paid and/or received, of approximately $248,533,000 and $188,301,000 as of December 31, 2021 and 2020, respectively.

Banner|Aetna has entered into numerous contracts with employers to provide commercial health insurance coverage in exchange for monthly premiums. For the year ended December 31, 2021, Banner|Aetna recorded premium revenue from employers of approximately $266,724,000. Banner|Aetna has recorded a medical claim liability, associated with claims incurred but not yet paid and/or received, of approximately $45,662,000 as of December 31, 2021.

Banner Medicare Advantage (BMA) plans and employee contributions to medical benefits contributed approximately $125,776,000 and $119,201,000 of premium revenue for the years ended December 31, 2021 and 2020, respectively. BMA has recorded a medical claim liability, associated with claims incurred but not yet paid and/or received, of approximately $7,115,000 and $4,447,000 as of December 31, 2021 and 2020, respectively.

2. Significant Accounting Policies (continued)

Included in medical claim liabilities were amounts owed to Banner Health of approximately $25,075,000 and $18,733,000 for the years ended December 31, 2021, and 2020, respectively, which are eliminated upon consolidation.

Reclassifications

Certain amounts in the 2020 consolidated financial statements have been reclassified to conform to the 2021 presentation.

Use of Estimates

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

3. Charity Care and Services That Benefit the Community

In furtherance of its charitable purpose, Banner provides a broad range of benefits to the communities it serves, including offering various community-based social service programs and several health-related educational programs. These services are designed and provided to improve the general standards of health for the communities.

Included in services to the communities are programs directed at the poor and persons who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured. Non-elective, medically necessary care provided by Banner is rendered, regardless of the patient's ability to pay, and Banner's charity care policy offers various discounts from billed charges based on the patient's family's income.

In addition to providing traditional charity care, Banner assumes the unpaid costs of Medicaid and other indigent public programs; provides services for the community through health promotion and education, health clinics, and screenings, all of which cannot be billed or can be operated only on a deficit basis; assumes the unpaid costs of training health professionals, such as medical residents, nursing students, and students in allied health professions; provides community health

3. Charity Care and Services That Benefit the Community (continued)

research; and provides cash and in-kind donations of equipment, supplies, or staff time made on behalf of the community.

Banner's cost accounting system is used to quantify the estimated charity care costs, which include both direct and indirect costs, for providing patient care at each facility. During 2021 and 2020, costs incurred by Banner in the provision of charity care, the unpaid costs of programs directed at the poor, the education of health professionals, research activities, and the costs of supporting other community programs were approximately $790,229,000 and $775,459,000, respectively. Charity care is reported based on the cost of services provided for which charges are written off in accordance with Banner's charity care policy, but does not include the amount, if any, for which the patient remains responsible.

The following summary of Banner's net community benefit for the years ended December 31 represents services to both the poor and broader community:

	2021	**Percentage of Total Expense**	**2020**	**Percentage of Total Expense**
	(In Thousands)		*(In Thousands)*	
Traditional charity care, at cost	**$ 140,879**	**1.2%**	$ 105,887	1.0%
Unpaid cost of public programs, Medicaid, and other indigent care programs	**485,629**	**4.0**	517,094	5.1
Health professional education	**97,966**	**0.8**	96,370	1.0
Community health services	**10,009**	**0.1**	10,356	0.1
Research activities	**16,670**	**0.1**	16,770	0.2
Community-building activities	**211**	**–**	323	–
Subsidized health services	**35,886**	**0.3**	26,271	0.3
Contributions and in-kind donations	**2,929**	**–**	2,346	–
Community benefit operations	**50**	**–**	42	–
Total cost of community benefit	**790,229**	**6.5**	775,459	7.7
Unpaid cost of Medicare	**230,501**	**1.9**	131,717	1.3
Total cost of community benefit and unpaid cost of Medicare	**$ 1,020,730**	**8.4%**	$ 907,176	9.0%

3. Charity Care and Services That Benefit the Community (continued)

Traditional Charity Care is the cost of services for which reimbursement is not pursued, in accordance with Banner's policy to provide health care services free of charge or on a discounted fee schedule to those who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured.

Unpaid Cost of Public Programs is the shortfall created when Banner receives payments below the cost for patients enrolled in publicly supported programs, such as Medicare and Medicaid.

Health Professional Education includes the unpaid costs of training health professionals, such as medical residents, nursing students, and students in allied health professions.

Community Health Services include costs for health education and related activities designed to improve the health of the community. Community health education programs, community-based clinical services, and health care support services are included. No patient bills are generated for these services.

Research Activities include clinical and community health research, as well as studies on health care delivery.

Community-Building Activities include the costs of programs that develop the community through physical improvements, economic development, support system enhancements, environmental improvements, leadership development, coalition building, community health improvement advocacy, and workforce enhancement.

Subsidized Health Services include costs for billed services that are subsidized by Banner. These include services offered despite a financial loss because they are needed in the community and either other providers are unwilling to provide the services or the services would, otherwise, be unable to meet patient demand.

Contributions and In-Kind Donations include cash donations, grants, and in-kind donations to the community at large and other tax-exempt organizations.

Community Benefit Operations include costs of directly planning, evaluating, and managing community benefit activities.

4. Concentrations of Credit Risk

Banner grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors as of December 31 was as follows:

	2021	2020
Commercial and contracted payors	**46.2%**	42.4%
Medicare	**30.0**	35.1
Medicaid	**18.8**	16.8
Self-pay	**5.0**	5.7
	100.0%	100.0%

5. Fair Value Measurements

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, Banner utilizes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- *Level 1* – Pricing inputs into the determination of fair value are generally observable inputs, such as quoted prices for identical instruments in active markets. Financial assets in Level 1 primarily include listed equities and mutual funds.

- *Level 2* – Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in Level 2 include asset-backed securities, mortgage-backed securities, collateralized mortgage obligations, U.S. Treasury securities, corporate bonds and loans, forward contracts, interest and credit swap agreements, options, and interest rate swap obligations.

5. Fair Value Measurements (continued)

Level 3 – Pricing inputs are generally unobservable and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are, therefore, determined using factors that involve considerable judgment and interpretation, including, but not limited to, private and public comparables, third-party appraisals, discounted cash flow models, and fund manager estimates.

Assets and liabilities measured at fair value are based on one of the following valuation techniques:

(a) *Market approach* – prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities

(b) *Income approach* – techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option pricing, and excess earnings models)

Banner's investment in alternative investments of approximately $1,179,747,000 and $1,264,535,000 as of December 31, 2021 and 2020, respectively, is accounted for using the equity method of accounting. Accordingly, the alternative investments are omitted from the following schedule of financial instruments measured at fair value.

There have not been any changes in any of the investments' fair value level classification between Level 1 and Level 2 in 2021 or 2020. Banner has no Level 3 investments.

Included in short-term and long-term investments are marketable securities that have been designated for use as determined by the Banner Board of Directors consisting of $2,808,267,000 for property and equipment and $492,671,000 for self-insurance funding arrangements, assets held by trustees, and assets held as collateral by counterparties under interest rate swap agreements.

5. Fair Value Measurements (continued)

	December 31, 2021	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b)
Cash and cash equivalents	$ 216,161	$ 216,161	$ –	$ –	a
Collateral held under securities lending (primarily cash and debt securities)	237,613	121,414	116,199	–	a
Mutual funds:					
Mutual funds – U.S. funds	1,778,199	1,778,199	–	–	a
Mutual funds – International	493,484	493,484	–	–	a
Total mutual funds	2,271,683	2,271,683	–	–	
Debt securities:					
U.S. Treasury/government obligations	400,014	–	400,014	–	a
Corporate bonds/non-U.S. government bonds	604,490	–	604,490	–	a
Asset-backed securities	312,883	–	312,883	–	a
Commercial mortgage-backed securities	100,652	–	100,652	–	a
Non-government-backed collateralized mortgages	27,293	–	27,293	–	a
Government mortgage-backed securities	236,347	–	236,347	–	a
Total debt securities	1,681,679	–	1,681,679	–	
Equity securities:					
U.S. equity securities	116,790	116,790	–	–	a
Total equity securities	116,790	116,790	–	–	
Derivative securities:					
Future contracts	121,133	121,133	–	–	a
Forward contracts	64,284	–	64,284	–	a
Option Agreements	69	–	69	–	
Net credit swaps	763	–	763	–	a
Subtotal derivative assets	186,249	121,133	65,116	–	
Future contracts	(121,337)	(121,337)	–	–	a
Forward contracts	(62,829)	–	(62,829)	–	a
Option agreements	(420)	–	(420)	–	a
Net credit swaps	(1,241)	–	(1,241)	–	a
Subtotal derivative liabilities	(185,827)	(121,337)	(64,490)	–	
Total investments in the fair value hierarchy	$ 4,524,348	$ 2,725,844	$ 1,798,504	$ –	
Investments measured at net asset value: private commingled funds	2,105,901				
Total fair value investments	$ 6,630,249				
Short-term investments	$ 474,481				
Collateral held under securities lending agreements	237,613				
Long-term investments	6,983,646				
Other assets – Banner Foundation restricted funds	116,560				
Less alternative investments	1,179,747				
Less split-dollar life insurance	2,304				
Total fair value investments	$ 6,630,249				
Interest rate swaps	$ (320,629)	$ –	$ (320,629)	$ –	b

5. Fair Value Measurements (continued)

	December 31, 2020	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique (a, b)
Cash and cash equivalents	$ 171,650	$ 170,650	$ 1,000	$ –	a
Collateral held under securities lending (primarily cash and debt securities)	317,306	175,355	141,951	–	a
Mutual funds:					
Mutual funds – U.S. funds	1,535,757	1,535,757	–	–	a
Mutual funds – International	506,758	506,758	–	–	a
Total mutual funds	2,042,515	2,042,515	–	–	
Debt securities:					
U.S. Treasury/government obligations	497,250	–	497,250	–	a
Corporate bonds/non-U.S. government bonds	443,385	–	443,385	–	a
Asset-backed securities	308,239	–	308,239	–	a
Commercial mortgage-backed securities	58,629	–	58,629	–	a
Non-government-backed collateralized mortgages	33,164	–	33,164	–	a
Government mortgage-backed securities	181,048	–	181,048	–	a
Government commercial-backed securities	12,615	–	12,615	–	a
Total debt securities	1,534,330	–	1,534,330		
Repurchase agreements	7,294	–	7,294	–	a
Equity securities:					
U.S. equity securities	96,835	96,835	–	–	a
International equity securities	10	10	–	–	a
Total equity securities	96,845	96,845	–	–	
Derivative securities:					
Future contracts	38,928	38,928	–	–	a
Forward contracts	55,802	–	55,802	–	a
Net credit swaps	2,546	–	2,546	–	a
Subtotal derivative assets	97,276	38,928	58,348	–	
Future contracts	(38,239)	(38,239)	–	–	a
Forward contracts	(57,291)	–	(57,291)	–	a
Option agreements	(21)	–	(21)	–	a
Net credit swaps	(1,522)	–	(1,522)	–	a
Subtotal derivative liabilities	(97,073)	(38,239)	(58,834)	–	
Total investments in the fair value hierarchy	$ 4,170,143	$ 2,486,054	$ 1,684,089	$ –	
Investments measured at net asset value: private commingled funds	1,734,906				
Total fair value investments	$ 5,905,049				
Short-term investments	$ 336,985				
Collateral held under securities lending agreements	317,306				
Long-term investments	6,411,325				
Other assets – Banner Foundation restricted funds	106,273				
Less alternative investments	1,264,535				
Less split-dollar life insurance	2,305				
Total fair value investments	$ 5,905,049				
Interest rate swaps	$ (394,565)	$ –	$ (394,565)	$ –	b

5. Fair Value Measurements (continued)

Investment income consisted of the following for the years ended December 31:

	2021	2020
	(In Thousands)	
Interest and dividend income	**$ 132,732**	$ 74,427
Net realized gain (loss) on sales of marketable securities	**146,283**	(14,763)
Realized and unrealized gain from alternative investments, including amount recorded in net assets with donor restriction	**167,060**	72,859
Net realized (loss) gain on derivative instruments	**(2,095)**	1,958
Net unrealized gain on marketable securities	**220,009**	324,072
Net unrealized loss on derivative instruments	**(281)**	(1,214)
	663,708	457,339
Less investment loss credited to other revenue, restricted equity, and capitalized bond project funds	**10,332**	8,973
Investment income, net	**$ 653,376**	$ 448,366

6. Liquidity

Financial assets available for general expenditure within one year of the balance sheet date consist of the following as of December 31:

	2021	2020
	(In Thousands)	
Cash and cash equivalents	**$ 1,222,289**	$ 1,145,202
Patient receivables	**1,197,429**	1,118,907
Other receivables	**516,897**	366,786
Short-term investments	**474,481**	336,985
Long-term investments	**6,493,023**	5,956,009
	$ 9,904,119	$ 8,923,889

6. Liquidity (continued)

Banner has the ability to structure its financial assets to be available as its general expenditures and other obligations come due. Cash in excess of daily requirements is invested in short-term investments. Banner also has access to $600,000,000 in lines of credit to support liquidity needs. As of December 31, 2021, $600,000,000 remained available on the line of credit.

7. Property and Equipment

Property and equipment consisted of the following as of December 31:

	2021	**2020**
	(In Thousands)	
Land and land improvements	**$ 412,430**	$ 404,984
Buildings and fixed equipment	**5,628,455**	5,295,709
Major movable equipment	**3,935,776**	3,709,567
Construction-in-progress	**228,556**	312,336
	10,205,217	9,722,596
Less accumulated depreciation and amortization	**5,651,690**	5,183,041
Property and equipment, net	**$ 4,553,527**	$ 4,539,555

8. Other Non-Current Assets

Non-current assets consisted of the following as of December 31:

	2021	2020
	(In Thousands)	
Restricted assets	**$ 182,106**	$ 185,817
Goodwill	**414,631**	332,130
Investments in unconsolidated affiliates	**9,211**	99,249
Due from Sun Health Services	**15,003**	29,524
Intangible assets, net of accumulated amortization of $27,497,000 and $23,820,000 in 2021 and 2020, respectively	**65,121**	9,753
Other	**83,453**	58,144
Total other non-current assets	**$ 769,525**	$ 714,617

Goodwill increased $41,251,000 related to acquisition and development of numerous ambulatory surgery centers within the Banner Atlas JV, LLC. An additional increase of $31,820,000 resulted from acquiring the controlling interest in Banner|Aetna. The decline in investments in unconsolidated affiliates and increase in intangible assets were also primarily driven by the inclusion of Banner|Aetna financial results within Banner's consolidated financial statements.

Banner and Sun Health Services are parties to a Support and Maintenance Agreement in which Sun Health Services provides an annual contribution to Banner, calculated under the terms of the agreement and, subject to certain contractual limitations and conditions, to support projects at facilities previously owned by Sun Health Corporation (the predecessor of Sun Health Services), or at other future Banner projects in the northwestern section of the Phoenix metropolitan area. Capital project commitments from Sun Health Services as of December 31, 2021 and 2020, were approximately $24,342,000 and $37,208,000, respectively, and are recorded as restricted assets within other non-current assets.

In addition to the capital project commitment, Sun Health Services also funds the Sun Health defined pension plan obligation, which was acquired by Banner and in accordance with the terms outlined in the acquisition agreement. Banner has recorded a receivable from Sun Health Services of approximately $15,003,000 and $29,524,000 as of December 31, 2021 and 2020, respectively, representing the unfunded plan obligation.

9. Long-Term Debt

Long-term debt consisted of the following as of December 31:

	2021	2020
	(In Thousands)	
Taxable Revenue Bonds, Series 2021A, interest 2.48% to 2.91%, due through 2042	**$ 422,100**	$ –
Taxable Revenue Bonds, Series 2021B-1 interest determined weekly, average interest 0.09%, due through 2056	**100,000**	–
Taxable Revenue Bonds, Series 2021B-2 interest determined weekly, average interest 0.08%, due through 2061	**100,000**	–
Commercial paper, interest determined by dealer, average interest 0.14% in 2021	**100,556**	–
Taxable Revenue Bonds, Series 2020A, interest 2.34%, due through 2030	**301,632**	301,632
Taxable Revenue Bonds, Series 2020B, interest 3.18%, due through 2050	**304,322**	304,322
Taxable Revenue Bonds, Series 2020C, interest 1.90% to 2.91%, due through 2051	**603,670**	603,670
Taxable Revenue Bonds, Series 2019, interest 3.76%, due through 2049	**125,000**	125,000
Revenue Bonds, Series 2019A, interest 4.00%, due through 2044	**94,050**	94,050
Floating Rate Bonds, Series 2019B-C, interest determined weekly, average interest 0.43%–0.62% in 2021 and 0.92%–1.11% in 2020, interest due through 2035	**153,110**	157,555
Revenue Bonds, Series 2019D, interest 5.00%, due through 2046	**83,600**	83,600
Revenue Bonds, Series 2019E-F, average interest 3.00% to 4.00% in 2021 and 3.00% to 4.00% in 2020, due through 2049	**188,990**	188,990
Revenue Bonds, Series 2017A, interest 4.00% to 5.00%, due through 2041	**188,985**	188,985
Revenue Bonds, Series 2017B-C, interest 5.00%, due through 2048	**171,890**	171,890
Revenue Bonds, Series 2017D, average interest 3.00% to 4.00% in 2021 and 3.00% to 4.00% in 2020, due through 2048	**91,705**	91,705
Revenue Bonds, Series 2016A, interest 3.13% to 5.00%, due through 2038	**743,775**	763,540
Revenue Bonds, Series 2015A, interest 5.00%, due through 2025	**48,225**	60,860
Floating Rate Bonds, Series 2015B, interest determined weekly, average interest 0.31% in 2021, due through 2046	**100,630**	–
Daily Rate Securities Revenue Bonds, Series 2015B (2020 only) and 2015C, interest determined daily, average interest 0.02% in 2021 and 0.41%–0.46% in 2020, due through 2046	**100,630**	201,260
Taxable loan, interest determined monthly, average interest 0.66% in 2021 and 1.14% in 2020	–	100,556
Commercial paper, interest determined by dealer, average interest 0.16% in 2021 and 0.95% in 2020.	**100,000**	100,000
Revenue Bonds, Series 2014A, interest 4.00% to 5.00%	–	200,600
Taxable Revenue Bonds, Series 2012B, interest 4.16%, due 2030	**67,840**	67,840
Index Rate Bonds, Series 2007B, interest determined quarterly, average interest 0.94% in 2021 and 1.36% in 2020, due through 2037	**400,000**	400,000
Syndicated Line of Credit – Bank of America, N.A., as Administrative Agent	–	200,000
Other	**135,232**	73,732
	4,725,942	4,479,787
Premiums on long-term debt, net	**143,084**	168,856
Less deferred debt issuance costs	**8,580**	8,955
Total long-term debt	**4,860,446**	4,639,688
Less current portion, including debt subject to self-liquidity	**539,618**	367,320
Total long-term debt, less current portion, including debt subject to self-liquidity	**$ 4,320,828**	$ 4,272,368

9. Long-Term Debt (continued)

During 2021, Banner issued $722,656,000 of new debt and, using the proceeds, repaid or advance refunded $501,156,000 of long-term debt.

Scheduled maturities of debt, excluding bond premiums and deferred debt issuance costs not yet amortized, for the years ending December 31 and thereafter are as follows (in thousands):

2022	$ 539,618
2023	48,050
2024	49,285
2025	49,324
2026	50,558
Thereafter	3,989,107
	$ 4,725,942

Total interest incurred was approximately $156,535,000 and $153,891,000 in 2021 and 2020, respectively, of which $3,961,000 and $7,736,000 was capitalized in 2021 and 2020, respectively.

Master Indenture and Bond Indentures

Substantially all of Banner's indebtedness, including its obligations on interest rate swaps, is secured by obligations issued under a master indenture, as supplemented from time to time (the Master Indenture). The Master Indenture provides that all indebtedness secured by obligations issued thereunder is on equal parity with all other such indebtedness. The Master Indenture contains covenants that, among other matters, restrict the transfer of assets and require the maintenance of specified levels of cash on hand and compliance with certain other financial ratios. Pursuant to the Master Indenture, as supplemented, Banner has pledged its gross revenues, including all accounts receivable, to secure all indebtedness and other obligations governed by the Master Indenture. Banner was in compliance with these covenants as of December 31, 2021. Banner Health and its two wholly owned subsidiaries, Banner – University Medical Center Tucson Campus, LLC and Banner – University Medical Center South Campus, LLC, are the only members of the Obligated Group and are responsible for payment of obligations issued under the Master Indenture.

Under the terms of the bond indentures, periodic deposits are made to a trustee-held fund to meet interest and principal payments. Trustee-held funds are included as short-term investments on the accompanying consolidated balance sheets.

9. Long-Term Debt (continued)

Certain of Banner's bonds are subject to a remarketing agreement whereby bondholders have the right to tender their bonds to Banner for repurchase at the end of the interest rate period if the bonds are not resold to a new purchaser. Banner has entered into a direct pay letter of credit agreement with a third-party bank, which will pay for any tendered bonds if they are not resold to a new purchaser. As of December 31, 2021, Banner had entered into a direct pay letter of credit agreement associated with the Revenue Bond Series 2015C. There were no advances outstanding on the direct pay letter of credit agreement as of December 31, 2021. The direct pay letter of credit agreement supports the 2015C Revenue Bond's long-term debt classification.

Interest Rate Swap Agreements

Banner has multiple interest rate swap contracts that effectively convert the variable rate of certain bonds into fixed rates. Banner's obligations under the swap agreements are secured by the Master Indenture.

The interest rate swaps do not qualify for hedge accounting treatment under accounting standards for derivative instruments and hedging activities. The derivative mark-to-market adjustments resulted in unrealized gains (losses) of approximately $73,709,000 and $(59,533,000) for the years ended December 31, 2021 and 2020, respectively, recorded in excess of revenues over expenses. The net realized portion of the interest rate swaps for the years ended December 31, 2021 and 2020, recorded as an increase to interest expense, was approximately $34,766,000 and $37,631,000, respectively.

Each of the interest rate swap agreements has collateral posting thresholds based on the counterparties' bond ratings. At the AA- rating level, Banner and its counterparty must post collateral when the mark-to-market value exceeds $35,000,000–$88,000,000, depending on the counterparty. For two of Banner's counterparties, no collateral is required. At December 31, 2021 and 2020, Banner had approximately $28,589,000 and $38,892,000, respectively, of collateral outstanding with its counterparties. The fair value of the collateral is reported as long-term investments on the accompanying consolidated balance sheets.

As of December 31, 2021, and 2020, the estimated fair value of the interest rate swaps resulted in an imputed obligation of $320,629,000 and $394,565,000, respectively, which is recorded in interest rate swaps on the accompanying consolidated balance sheets. The fair value of the swaps is based on the forward London Interbank Offered Rate curve, with a blended average duration of 7 to 21 years.

9. Long-Term Debt (continued)

On June 29, 2020, partial novations of interest rate swap agreements were completed between Morgan Stanley to Mizuho Capital Markets LLC and between Merrill Lynch Capital Services, Inc. to Bank of New York Mellon. The Mizuho Capital Markets LLC partial novation begins January 1, 2025, and expires July 1, 2029, and the Bank of New York Mellon partial novation begins July 1, 2025, and expires October 1, 2031. Approximately $125,000,000 of collateral was returned as a result of the partial novations. Morgan Stanley and Merrill Lynch swap agreements remain in effect for the balance of the swap terms following expiration of the partial novations, including the collateral posting requirements.

10. Estimated Self-Insurance Liabilities

Banner has obtained insurance through a combination of purchased and self-insurance programs for professional and general liability claims, workers' compensation claims, and several other insurance programs to address claims incurred as part of Banner's ongoing business operations, including directors and officers, auto, environmental, aviation, cybersecurity, property, and certain physicians' prior acts coverage. Banner is self-insured for several of its insurance programs through its wholly owned captive, Banner Indemnity, Ltd. (BIL).

Banner's professional and general liability is self-insured through BIL. Since July 1, 2015, Banner is self-insured, on a claims-made basis, for the first $15,000,000 of each professional liability claim and the first $10,000,000 in aggregate of general liability claims. BIL also provides an excess liability policy with a single limit of $150,000,000 per claim and in the aggregate for the period July 1, 2021, through July 1, 2022. This policy is fully reinsured by reinsurance carriers with an A.M. Best rating of A-VII or better.

Under its self-insured professional and general liability program, Banner contributes actuarially determined amounts to BIL to fund estimated ultimate losses. Banner has accrued estimates for asserted and incurred but not reported claims. The actuarially determined claim liabilities were approximately $204,333,000 and $192,887,000, of which $44,388,000 and $28,765,000 has been recorded as current liabilities on the accompanying consolidated balance sheets as of December 31, 2021 and 2020, respectively. Self-insurance liabilities are undiscounted at December 31, 2021 and 2020.

11. Other Non-Current Liabilities

Other non-current liabilities consisted of the following as of December 31:

	2021	2020
	(In Thousands)	
Non-current employee benefit liabilities	**$ 184,322**	$ 153,564
Sun Health Services pension plan	**15,003**	29,524
Asset retirement obligation	**28,229**	27,232
Other	**99,518**	24,553
Total other non-current liabilities	**$ 327,072**	$ 234,873

12. Retirement Plans

Defined Contribution Plan

Substantially all of Banner's eligible employees may elect to participate in Banner's defined contribution plan. Employees may contribute up to 21% of eligible compensation, subject to plan restrictions. Banner provides a matching contribution equal to the first 4% of eligible compensation contributed for each participant, as defined under the defined contribution plan. Contribution expense was approximately $106,445,000 and $91,639,000 for the years ended December 31, 2021 and 2020, respectively.

Defined Benefit Plans

Banner's Pension and Retirement Committee oversees the investment policy and strategy associated with its defined benefit plans. The expected long-term rate of return on plan assets for both pension plans is based on historical and projected rates of return for current and planned asset categories in the Plan's investment portfolio. Assumed projected rates of return for each asset category were selected after analyzing historical experience and future expectations of the returns and volatility for assets of that category using benchmark rates. Based on the target asset allocation among the asset categories, the overall expected rate of return for the portfolio was developed and adjusted for historical and expected experience of active portfolio management results compared with benchmark returns and for the effect of expenses paid from plan assets.

12. Retirement Plans (continued)

Banner Retirement Income Plan

Banner completed the termination process for a non-contributory defined benefit pension plan (the Plan) during the year ended December 31, 2020. Benefit accruals under the Plan had been frozen since 2002. The Plan's benefit obligation was transferred to a third-party insurance company, which became primarily obligated to fund future benefits to Plan participants. The Plan's assets were used to purchase annuity contracts through the third-party insurance company. As part of the termination, Banner recognized $46,400,000 of accumulated plan losses as pension expense, within other non-operating expense.

Sun Health Pension Plan

Under the terms of the agreement for the purchase of Sun Health Corporation, Banner assumed sponsorship of the Sun Health Pension Plan, a defined benefit plan, and the Sun Health Pension Plan Trust (the Trust). Sun Health Services retained the obligation to fund any required contributions to the Trust to meet the Employee Retirement Income Security Act of 1974 minimum funding requirements, and Sun Health Services retains the right to any excess assets that may exist upon termination of the Sun Health Pension Plan. Benefit accruals under the Sun Health Pension Plan have been frozen since May 2007, except for certain employees whose salary benefits were not frozen until 2014. At December 31, 2021 and 2020, Banner recorded a non-current liability of approximately $15,003,000 and $29,524,000, respectively, representing the unfunded liability under the Sun Health Pension Plan, and a long-term receivable from Sun Health Services in the same amount on the accompanying consolidated balance sheets (see Note 8).

Wyoming Medical Center Pension Plan

Banner acquired the Wyoming Medical Center Pension Plan as the sole member of WMC, Inc. The plan was terminated in 2021. The Plan's benefit obligation was transferred to a third-party insurance company, which became primarily obligated to fund future benefits to Plan participants. The Plan's assets were used to purchase annuity contracts through the third-party insurance company. As part of the termination, Banner recognized $485,000 of accumulated plan losses as pension expense, within other non-operating expense.

13. Income Taxes

Banner's deferred tax assets as of December 31, 2021 and 2020, were $118,581,000 and $117,666,000, respectively, and primarily relate to BHN's net operating loss carryforwards. Banner has established a valuation allowance equal to the deferred tax assets due to uncertainty as to whether the deferred assets will be realized in future periods. As a result, Banner does not recognize any tax benefit until it is in a tax paying position and more likely than not to realize the tax benefit.

There is no time limit on BHN's federal net operating loss carryforwards and net operating loss carryforwards for state purposes begin to expire in the year 2033.

14. Statement of Functional Expenses

The following statement of functional expenses reports Banner's operating expenses, as presented on the consolidated statements of income, by each of Banner's major operating functions for the years ended December 31, 2021 and 2020. Operating expenses that are attributable to more than one operating function have been allocated using a basis representative of the operating expenditure, such as patient volume, full-time equivalent, or facility size.

	Operating Expenses at December 31, 2021				
	Delivery	Insurance Operations	Corporate & Other Services	Eliminations	Banner Health Consolidated
			(In Thousands)		
Expenses:					
Salaries, benefits, and contract labor	$ 4,951,851	$ 107,091	$ 736,196	$ (40,434)	$ 5,754,704
Supplies	1,956,667	392	(2,482)	(19,294)	1,935,283
Physician and professional fees	271,613	32,317	33,353	(42,785)	294,498
Medical claims costs	209	2,358,128	-	(458,349)	1,899,988
Depreciation and amortization	444,727	13,871	94,532	(2,672)	550,458
Interest expense	139,405	3,958	10,451	(1,240)	152,574
Purchased services	524,501	108,412	353,799	(176,881)	809,831
Other	1,028,489	77,215	(266,651)	(4,197)	834,856
Total expenses	$ 9,317,462	$ 2,701,384	$ 959,198	$ (745,852)	$ 12,232,192

14. Statement of Functional Expenses (continued)

	Operating Expenses at December 31, 2020				
	Delivery	Insurance Operations	Corporate & Other Services	Eliminations	Banner Health Consolidated
			(In Thousands)		
Expenses:					
Salaries, benefits, and contract labor	$ 3,996,907	$ 105,919	$ 663,386	$ (30,358)	$ 4,735,854
Supplies	1,637,035	888	24,710	(19,296)	1,643,337
Physician and professional fees	237,832	18,634	31,471	(38,555)	249,382
Medical claims costs	–	1,928,361	–	(380,836)	1,547,525
Depreciation and amortization	404,939	1,890	92,247	804	499,880
Interest expense	127,375	3,331	15,609	(160)	146,155
Purchased services	467,425	29,964	310,603	(167,605)	640,387
Other	811,463	50,503	(235,038)	(3,264)	623,664
Total expenses	$ 7,682,976	$ 2,139,490	$ 902,988	$ (639,270)	$ 10,086,184

15. Commitments and Contingencies

Leases

Banner has operating and finance leases for certain hospitals, corporate offices, physicians' offices, and equipment. These leases have remaining terms ranging from 1 to 25 years, some of which include options to extend lease terms for up to 25 years, and some include options to terminate within the next year. As of December 31, 2021 and 2020, right-of-use assets – finance were $277,530,000 and $98,837,000, respectively, and accumulated depreciation associated with finance leases was $21,646,000 and $3,503,000, respectively.

Leases with an initial term of 12 months or less are not recorded on the balance sheet.

Banner uses a risk-free discount rate commensurate with the lease term to determine the present value of lease payments used to record the right-of-use asset and related lease liability.

15. Commitments and Contingencies (continued)

The table below summarizes the components of lease cost by lease type for the years ended December 31 followed by disclosure of weighted average remaining lease term and weighted average discount rate by type:

	2021	2020
	(In Thousands)	
Finance lease cost:		
Amortization of right-of-use assets	**$ 12,381**	$ 4,512
Interest on lease liabilities	**4,363**	2,519
Operating lease cost	**75,954**	69,626
Short-term lease cost	**17,230**	11,748
Variable lease cost	**11,940**	9,375
Total lease cost	**$ 121,868**	$ 97,780
Weighted average remaining lease term – finance leases (years)	**24.6**	17.6
Weighted average remaining lease term – operating leases (years)	**6.2**	6.1
Weighted average discount rate – finance leases	**2.03%**	2.68%
Weighted average discount rate – operating leases	**2.02%**	2.10%

The following table presents cash paid for amounts included in the measurement of lease liabilities for the years ended December 31:

	2021	2020
	(In Thousands)	
Operating cash flows for operating leases	**$ 74,599**	$ 72,411
Operating cash flows for finance leases	**4,293**	2,123
Financing cash flows for finance leases	**$10,052**	2,046

15. Commitments and Contingencies (continued)

Maturities of Lease Liabilities

The following table reconciles the undiscounted cash flows to the finance lease liabilities and operating lease liabilities recorded on the balance sheet at December 31, 2021 (in thousands):

	Operating Leases	Finance Leases
2022	$ 76,662	$ 16,884
2023	65,893	20,935
2024	55,952	20,887
2025	48,289	18,189
2026	39,799	17,657
Thereafter	76,521	256,458
Total minimum lease payments	$ 363,116	$ 351,010
Less: amount of lease payments representing interest	(34,359)	(78,523)
Present value of future minimum lease payments	328,757	272,487
Less: current obligations under leases	(75,619)	(15,534)
Long-term lease obligations	$ 253,138	$ 256,953

Academic Affiliation Agreement

On February 28, 2015, the University of Arizona Health Network and its wholly owned subsidiary, University Medical Center Corporation, were acquired by Banner. As part of the transaction, Banner and the University of Arizona (UA) entered into a 30-year academic affiliation agreement (the AAA), providing for ongoing support of the UA Colleges of Medicine in Tucson and Phoenix, and for Banner – University Medical Center Phoenix to become the primary teaching affiliate of the UA College of Medicine – Phoenix. Under the terms of the transaction, Banner and UA contributed $300,000,000 to an Academic Enhancement Fund to provide $20,000,000 of annual support for academic enhancements, faculty recruitment, and program development at the UA College of Medicine – Tucson and College of Medicine – Phoenix. In addition, Banner agreed to fund such additional amounts as may be needed to meet the $20,000,000 annual commitment during the 30-year term of the AAA to the extent that the Academic Enhancement Fund, and earnings thereon, is insufficient to do so. Banner must fund a minimum annual amount of $151,300,000

15. Commitments and Contingencies (continued)

for funds flow and mission support. The annual funds flow commitment is subject to adjustment based upon fluctuations in governmental funding for graduate medical education. Banner funded approximately $297,575,000 and $282,988,000 relating to the AAA funds flow and mission support for the years ended December 31, 2021 and 2020, respectively.

Compliance with Laws and Regulations

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Compliance with such laws and regulations can be subject to future review and interpretation, as well as regulatory actions unknown or unasserted at this time.

16. COVID-19

The outbreak of COVID-19, a respiratory disease caused by a novel strain of coronavirus, has and will continue to have significant adverse impacts on the operations and financial condition of health care providers generally. The treatment of this contagious disease at health care facilities has resulted in temporary shutdowns or diversion of patients from those facilities as well as staffing and supply shortages. Elective procedures and other patient care appointments have been and are being deferred and individuals may otherwise avoid medical treatment unrelated to COVID-19, resulting in periods of reduced patient volumes and operating revenues at outpatient facilities.

A variety of federal, state, and local efforts have been initiated in response to the COVID-19 crisis, the largest of which is the Coronavirus Aid, Relief and Economic Security Act (the CARES Act) that was enacted on March 27, 2020. The CARES Act is a federal stimulus package designed to provide emergency assistance to individuals and businesses, including hospitals and other health care providers. Banner has received approximately $477,000,000 in Provider Relief Funds from the CARES Act to cover unreimbursed health-care-related expenses attributable to the public

16. COVID-19 (continued)

health emergency and lost revenues resulting from COVID-19 as of December 31, 2021. Approximately $136,000,000 and $316,000,000 of these funds have been recognized as other operating revenue for the years ended December 31, 2021 and 2020, respectively. Banner follows grant accounting to recognize the stimulus funding as other operating revenue based on guidance from the U.S. Department of Health & Human Services. An additional $24,000,000 was recognized as an increase to unrestricted net assets as reimbursement for emergent capital purchases made in response to the pandemic during 2020. The remaining $1,000,000 is recorded as a current liability and is expected to be used to offset qualifying unreimbursed expenses related to COVID-19 testing and mitigation at rural health clinics in 2022. In addition, Banner received $654,000,000 of Medicare Advance and Accelerated Payments in 2020, recorded as a current liability, to help support liquidity needs in the short term. The recoupment of the advanced payments began in April of 2021 and will continue until fully recouped. As of December 31, 2021, $424,000,000 remained as a currently liability.

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