



**Unaudited Consolidated
Financial Statements and Supplementary Information**

Banner Health and Subsidiaries

March 31, 2021

Banner Health and Subsidiaries
Unaudited Consolidated Financial Statements
March 31, 2021

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Review Report of Independent Auditors

The Board of Directors
Banner Health

We have reviewed the consolidated financial information of Banner Health and Subsidiaries, which comprise the consolidated balance sheet as of March 31, 2021, and the related consolidated statements of income, changes in net assets and cash flows for the three-month periods ended March 31, 2021 and 2020.

Management's Responsibility for the Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in conformity with U.S. generally accepted accounting principles.

Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial information referred to above for it to be in conformity with U.S. generally accepted accounting principles.

Report on Balance Sheet as of December 31, 2020

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of Banner Health and Subsidiaries as of December 31, 2020, and the related consolidated statements of income, changes in net assets and cash flows for the year then ended (not presented herein); and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated March 15, 2021. In our opinion, the accompanying consolidated balance sheet of Banner Health and Subsidiaries as of December 31, 2020, is consistent, in all material respects, with the consolidated balance sheet from which it has been derived.

Ernst & Young LLP

May 27, 2021

Banner Health and Subsidiaries

Consolidated Balance Sheets

(In Thousands)

	Unaudited March 31 2021	December 31 2020
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,211,904	\$ 1,145,202
Short-term investments	431,584	336,985
Collateral held under securities lending program	310,342	317,306
Assets limited as to use	29,773	119,575
Patient receivables	1,098,719	1,118,907
Inventories	317,579	308,995
Other receivables	368,304	366,786
Other current assets	148,727	138,734
Total current assets	3,916,932	3,852,490
Assets limited as to use:		
Funds designated by:		
Board of Directors	2,740,520	2,637,157
Lease agreements	2,051	2,051
Funds held by trustees under:		
Self-insurance funding arrangements	144,420	142,661
Other funds	165,701	193,080
Total assets limited as to use, less current portion	3,052,692	2,974,949
Property and equipment, net	4,519,059	4,539,555
Right-of-use assets – operating	321,048	304,264
Right-of-use assets – finance	192,782	95,333
Other assets:		
Long-term investments	3,378,221	3,316,801
Other	740,458	714,617
Total other assets	4,118,679	4,031,418
Total assets	\$ 16,121,192	\$ 15,798,009

Banner Health and Subsidiaries

Consolidated Balance Sheets

(In Thousands)

	Unaudited March 31 2021	December 31 2020
Liabilities and net assets		
Current liabilities:		
Trade accounts payable	\$ 226,061	\$ 258,063
Current portion of long-term debt	373,435	267,320
Debt subject to self liquidity	100,000	100,000
Current portion of operating lease obligations	70,379	70,661
Current portion of finance lease obligations	10,856	8,333
Payable under securities lending program	310,342	317,306
Accrued expenses:		
Salaries and benefits	645,271	618,814
Medical claims payable	243,735	221,580
Other	1,071,454	1,113,303
Total current liabilities	3,051,533	2,975,380
Long-term debt, less current portion	4,133,295	4,272,368
Operating lease obligations, less current portion	270,839	253,372
Finance lease obligations, less current portion	194,375	95,592
Estimated self-insurance liabilities, less current portion	214,410	210,271
Interest rate swaps	304,539	394,565
Other	241,126	234,873
Total liabilities	8,410,117	8,436,421
Net assets without donor restrictions:		
Attributable to Banner Health	7,389,235	7,070,393
Attributable to non-controlling interests	125,245	105,893
Net assets without donor restrictions	7,514,480	7,176,286
Net assets with donor restrictions	196,595	185,302
Total net assets	7,711,075	7,361,588
Total liabilities and net assets	\$ 16,121,192	\$ 15,798,009

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Income

Unaudited

(In Thousands)

	Three Months Ended March 31	
	2021	2020
Revenues:		
Net patient service revenue	\$ 2,136,129	\$ 1,796,881
Medical insurance premiums	643,475	523,018
Other revenue	252,213	115,305
Total revenues	<u>3,031,817</u>	<u>2,435,204</u>
Expenses:		
Salaries and benefits	1,431,380	1,155,539
Supplies	448,691	382,136
Physician and professional fees	72,026	54,563
Medical claims cost, net of Banner claims of \$113,986 and \$96,352 in 2021 and 2020, respectively	444,890	363,795
Depreciation and amortization	134,467	121,681
Interest	38,695	36,012
Purchased services	198,732	147,160
Other	200,137	143,674
Total expenses	<u>2,969,018</u>	<u>2,404,560</u>
Operating income	62,799	30,644
Other income (loss) :		
Investment income (loss), net	181,879	(573,945)
Unrealized gain (loss) on interest rate swaps	89,969	(133,822)
Other loss	(2,849)	(1,304)
Total other income (loss)	<u>268,999</u>	<u>(709,071)</u>
Excess (deficiency) of revenues over expenses	331,798	(678,427)
Less excess of revenues over expenses attributable to non-controlling interests	17,873	5,026
Excess (deficiency) of revenues over expenses attributable to Banner Health	<u>\$ 313,925</u>	<u>\$ (683,453)</u>

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Changes in Net Assets

Unaudited

(In Thousands)

	Three Months Ended March 31	
	2021	2020
Net assets without donor restrictions:		
Excess (deficiency) of revenues over expenses attributable to Banner Health	\$ 313,925	\$ (683,453)
Contributions for property and equipment acquisitions	4,859	11,413
Other changes in net assets	58	55
Increase (decrease) attributable to Banner Health	\$ 318,842	(671,985)
Excess of revenues over expenses attributable to non-controlling interests	17,873	5,026
Net contributions from non-controlling interests	1,479	8,392
Increase attributable to non-controlling interests	19,352	13,418
Net assets with donor restrictions:		
Contributions	30,487	18,991
Net unrealized gain (loss) on investments	1,954	(3,371)
Net assets released from restriction	(21,148)	(13,256)
Increase in net assets with donor restrictions	11,293	2,364
Increase (decrease) in net assets	349,487	(656,203)
Net assets, beginning of period	7,361,588	6,650,038
Net assets, end of period	\$ 7,711,075	\$ 5,993,835

See accompanying notes.

Banner Health and Subsidiaries

Consolidated Statements of Cash Flows

Unaudited

(In Thousands)

	Three Months Ended March 31	
	2021	2020
Operating activities		
Increase (decrease) in net assets	\$ 349,487	\$ (656,203)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	134,467	121,681
Net (increase) decrease on investments designated as trading	(239,504)	592,474
Net unrealized (gain) loss on interest rate swaps	(89,969)	133,823
Loss (gain) on sale of assets	75	(15)
Contributions for property and equipment and other	(4,859)	(11,413)
Restricted contributions	(30,487)	(18,991)
Cash distributions to non-controlling interests	12,750	-
Changes in operating elements:		
Patient receivables	20,188	(54,887)
Inventories and other current assets	(20,092)	50,941
Accounts payable and accrued expenses	(32,360)	(159,568)
Estimated self-insurance liabilities	4,139	3,425
Other assets and liabilities	15,526	2,012
Net cash provided by operating activities	<u>119,361</u>	<u>3,279</u>
Investing activities:		
Net purchases of property and equipment	(101,281)	(157,848)
Transfer from project fund	-	9,086
Increase in other assets	(33,438)	(14,005)
Net cash used in investing activities	<u>(134,719)</u>	<u>(162,767)</u>
Financing activities:		
Proceeds from restricted contributions	30,487	18,991
Proceeds from issuance of debt	9,525	4,054
Payments on finance leases and leased hospital obligations	(1,911)	(406)
Payments on long-term debt	(38,835)	(61,415)
Cash distributions to non-controlling interests	(12,750)	-
Net cash used in financing activities	<u>(13,484)</u>	<u>(38,776)</u>
Net decrease in cash, cash equivalents, and restricted cash	(28,842)	(198,264)
Cash, cash equivalents, and restricted cash at beginning of year	1,316,852	791,060
Cash, cash equivalents, and restricted cash at end of period	<u>\$ 1,288,010</u>	<u>\$ 592,796</u>
Supplemental disclosure of cash flow information		
Interest paid, including amounts capitalized	\$ 61,952	59,479

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

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, home health agencies, a captive insurance company, a foundation, an accountable health care organization, a Medicaid managed care health plan and related Medicare Advantage health plan, and other health care-related organizations in six western states. Banner also holds controlling interests in several health care-related business ventures and non-controlling interests in several other entities.

2. Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) for interim financial reporting, applied on a basis substantially consistent with that of the 2020 audited financial statements of Banner. They do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2021 are not necessarily indicative of the results to be expected for the year ending December 31, 2021. For more information, refer to the audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2020.

Certain reported amounts in the 2020 interim financial statements have been corrected to conform to the 2020 annual financial statement and 2021 interim financial statement presentations. For the three months ended March 31, 2020, medical insurance premiums and salaries and benefits expense were increased by approximately \$28,000,000 to reflect employee health plan premiums as revenue. Also, medical insurance premiums were increased by approximately \$60,000,000, net patient service revenue was decreased by approximately \$27,000,000 and medical claims expense was increased by approximately \$33,000,000 to reflect the gross up of revenue and expense of an insurance contract and the associated elimination of patient service revenue. These corrections had no impact on the previously reported operating income, net assets or cash flows.

The separate details of the Obligated and Non-Obligated Group financial statements are presented for purposes of additional analysis and are not a required part of the consolidated financial statements.

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 several business ventures, the financial results of which are included in Banner's consolidated financial statements. Banner records the unrelated investor's ownership share of these business ventures as non-controlling interest.

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

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

2. Significant Accounting Policies (continued)

Cash and Cash Equivalents

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. The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the consolidated balance sheet that sum to the total of the same such amounts shown in the consolidated statement of cash flows for the three months ended March 31, 2021:

	March 31, 2021	December 31, 2020
	<i>(In Thousands)</i>	
Cash and cash equivalents	\$ 1,211,904	\$ 1,145,202
Investments	39,709	31,064
Assets limited as to use	36,397	140,586
Cash, cash equivalents, and restricted cash	<u>\$ 1,288,010</u>	<u>\$ 1,316,852</u>

Short-Term Investments

Short-term investments primarily include debt securities with maturity dates of one year or less from the balance sheet date, U.S. Treasury government obligations 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 (see Note 3).

Investments

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

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 3) and noted as investments measured at net asset value: private commingled funds.

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 hedge fund net asset value is provided to Banner by each of the hedge fund managers. 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

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

2. Significant Accounting Policies (continued)

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 (loss) 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. Banner has recorded approximately \$56,101,000 and \$(124,835,000) of alternative investment unrestricted realized and unrealized gains (losses) for the periods ended March 31, 2021 and 2020, respectively. The restricted share of alternative investment realized, and unrealized loss is approximately \$954,000 and \$1,922,000 for the period ended March 31, 2021 and 2020, respectively.

Certain of Banner's alternative investments are subject to redemption lockup periods or have capital call commitments. As of March 31, 2021, approximately \$216,318,000 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 \$411,750,000. Of that total, Banner has made capital contributions with a current market value of \$198,592,000 as of March 31, 2021, resulting in up to approximately \$213,158,000 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 March 31, 2021 and December 31, 2020. As of March 31, 2021, approximately \$105,425,000 of gross derivative assets and approximately \$104,207,000 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 3).

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.

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 Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

2. Significant Accounting Policies (continued)

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 under-insured 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.

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 three months ended March 31, 2021 and 2020, by line of business is as follows:

	2021	2020
	<i>(In Thousands)</i>	
Hospital	\$ 1,720,296	\$ 1,486,581
Physician services	189,831	162,029
Laboratory	112,480	58,914
Ambulatory and other	113,522	89,357
	\$ 2,136,129	\$ 1,796,881

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

2. Significant Accounting Policies (continued)

Use of Estimates

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

3. 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 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.

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.

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 generally based on the market approach, using prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. Interest rate swap liabilities are valued using the income approach, which uses 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 alternative investments, of approximately \$1,291,830,000 and \$1,264,535,000 as of March 31, 2021 and December 31, 2020, respectively, are 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 financial instruments' fair value classification between Level 1 and Level 2 since December 31, 2019. Banner has no Level 3 financial instruments.

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

3. Fair Value Measurements (continued)

	March 31, 2021	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 76,106	\$ 76,106	\$ -	\$ -
Collateral held under securities lending (primarily cash and debt securities)	310,342	182,576	127,766	
Mutual funds:				
Mutual funds – U.S. funds	1,689,962	1,689,962	-	-
Mutual funds – International	541,775	541,775	-	-
Total mutual funds	2,231,737	2,231,737	-	-
Debt securities:				
U.S. Treasury/government obligations	482,869	-	482,869	-
Corporate bonds/non-U.S. government bonds	451,900	-	451,900	-
Asset-backed securities	296,663	-	296,663	-
Commercial mortgage-backed securities	59,501	-	59,501	-
Non-government-backed collateralized mortgages	-	-	-	-
Government mortgage-backed securities	171,233	-	171,233	-
Government commercial-backed securities	43,398	-	43,398	-
Total debt securities	1,505,564	-	1,505,564	-
Equity securities:				
U.S. equity securities	94,876	94,876	-	-
International equity securities	10	10	-	-
Total equity securities	94,886	94,886	-	-
Derivative securities:				
Future contracts	66,836	66,836	-	-
Forward contracts	37,766	-	37,766	-
Options agreements	27	-	27	-
Net credit swaps	850	-	850	-
Subtotal derivative assets	105,479	66,836	38,643	-
Future contracts	(66,642)	(66,642)	-	-
Forward contracts	(37,270)	-	(37,270)	-
Option agreements	-	-	-	-
Net credit swaps	(295)	-	(295)	-
Subtotal derivative liabilities	(104,207)	(66,642)	(37,565)	-
Total investments in the fair value hierarchy	\$ 4,219,907	\$ 2,585,499	\$ 1,634,408	\$ -
Investment measured at net asset value: private commingled fund	1,799,609			
Total fair value investments	<u>\$ 6,019,516</u>			
Short-term investments	\$ 431,584			
Collateral held under securities lending agreements	310,342			
Assets limited as to use	3,082,465			
Long-term investments	3,378,221			
Other assets – Banner Foundation restricted funds	111,037			
Less alternative investments	1,291,829			
Less split-dollar life insurance	2,304			
Total fair value investments	<u>\$ 6,019,516</u>			
Interest rate swaps included in other long-term liabilities	\$ (304,539)	\$ -	\$ (304,539)	\$ -

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

3. 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)
Cash and cash equivalents	\$ 171,650	\$ 170,650	\$ 1,000	\$ –
Collateral held under securities lending (primarily cash and debt securities)	317,306	175,355	141,951	
Mutual funds:				
Mutual funds – U.S. funds	1,535,757	1,535,757	–	–
Mutual funds – International	506,758	506,758	–	–
Total mutual funds	2,042,515	2,042,515	–	–
Debt securities:				
U.S. Treasury/government obligations	497,250	–	497,250	–
Corporate bonds/non-U.S. government bonds	443,385	–	443,385	–
Asset-backed securities	308,239	–	308,239	–
Commercial mortgage-backed securities	58,629	–	58,629	–
Non-government-backed collateralized mortgages	33,164	–	33,164	–
Government mortgage-backed securities	181,048	–	181,048	–
Government commercial-backed securities	12,615	–	12,615	–
Total debt securities	1,534,330	–	1,534,330	–
Repurchase agreements	7,294	–	7,294	–
Equity securities:				
U.S. equity securities	96,835	96,835	–	–
International equity securities	10	10	–	–
Total equity securities	96,845	96,845	–	–
Derivative securities:				
Future contracts	38,928	38,928	–	–
Forward contracts	55,802	–	55,802	–
Interest rate swap agreements	–	–	–	–
Net credit swaps	2,546	–	2,546	–
Subtotal derivative assets	97,276	38,928	58,348	–
Future contracts	(38,239)	(38,239)	–	–
Forward contracts	(57,291)	–	(57,291)	–
Option agreements	(21)	–	(21)	–
Net credit swaps	(1,522)	–	(1,522)	–
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	\$ –
Investment measured at net asset value: private commingled fund	1,734,906			
Total fair value investments	<u>\$ 5,905,049</u>			
Short-term investments	\$ 336,985			
Collateral held under securities lending agreements	317,306			
Assets limited as to use	3,094,524			
Long-term investments	3,316,801			
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	<u>\$ 5,905,049</u>			
Interest rate swaps included in other long-term liabilities	\$ (394,565)	\$ –	\$ (394,565)	\$ –

Banner Health and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
March 31, 2021

3. Fair Value Measurements (continued)

Investment income (loss) consisted of the following for the three months ended March 31:

	2021	2020
	<i>(In Thousands)</i>	
Interest and dividend income	\$ 23,630	\$ 18,919
Net realized gain (loss) on sales of marketable securities	31,686	(1,819)
Realized and unrealized gain (loss) from alternative investments, including amount recorded in net assets with donor restriction	57,056	(122,912)
Net realized gain (loss) on derivative instruments	2,445	(4,197)
Net unrealized gain (loss) on marketable securities	70,480	(460,715)
Net unrealized gain (loss) on derivative instruments	284	(4,232)
	185,581	(574,956)
Less investment gain (loss) credited to other revenue, restricted equity, and capitalized bond project funds	3,702	(1,011)
Investment income (loss), net	\$ 181,879	\$ (573,945)

4. Liquidity

Financial assets available for general expenditure within one year of the balance sheet date, consist of the following as of March 31, 2021 and December 31, 2020:

	2021	2020
	<i>(In Thousands)</i>	
Cash and cash equivalents	\$ 1,211,904	\$ 1,145,202
Patient receivables	1,098,719	1,118,907
Other receivables	368,304	366,786
Short-term investments	431,584	336,985
Funds designated by board of directors and lease agreements	2,742,571	2,639,208
Long-term investments	3,378,221	3,316,801
	\$ 9,231,303	\$ 8,923,889

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 has access to \$550,000,000 in lines of credit to support liquidity needs. As of March 31, 2021, \$350,000,000 remained available on the lines of credit.

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

5. 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 did 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 or (losses) of approximately \$89,969,000 and \$(133,822,000) for the three months ended March 31, 2021 and 2020, respectively, recorded in excess of revenues over expenses. The net realized portion of the interest rate swaps for the three months ended March 31, 2021 and 2020, recorded as an increase to interest expense, was approximately \$8,490,000 and \$7,897,000, 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 counterparties, no collateral is required. At March 31, 2021 and December 31, 2020, Banner had approximately \$7,146,000 and \$38,892,000, respectively, of collateral outstanding with its counterparties. The fair value of the collateral is reported as assets limited as to use – other funds on the accompanying consolidated balance sheets.

As of March 31, 2021, and December 31, 2020, the estimated fair value of the interest rate swaps resulted in an imputed obligation of \$304,539,000 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 LIBOR curve.

6. Leases

The table below summarizes the components of lease cost by lease type for the three months ended March 31, 2021 and 2020, followed by disclosure of weighted average remaining lease term and weighted average discount rate by type:

	2021	2020
	<i>(In Thousands)</i>	
Finance lease cost:		
Amortization of right-of-use assets	\$ 2,460	\$ 1,068
Interest on lease liabilities	746	633
Operating lease cost	18,832	16,941
Short-term lease cost	5,229	2,000
Variable lease cost	2,497	2,323
Total lease cost	\$ 29,764	\$ 22,965
Weighted-average remaining lease term-finance leases (yrs)	22.3	20.5
Weighted-average remaining lease term-operating leases (yrs)	6.3	5.7
Weighted-average discount rate-finance leases	1.73%	2.98%
Weighted-average discount rate-operating leases	2.07%	2.50%

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

6. Leases (continued)

The following table presents cash paid for amounts included in the measurement of lease liabilities for the three months ended March 31:

	2021	2020
	<i>(In Thousands)</i>	
Operating cash flows for operating leases	\$ 19,085	\$ 17,398
Operating cash flows for finance leases	\$ 726	\$ 336
Financing cash flows for finance leases	\$ 1,911	\$ 517

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 March 31, 2021:

	Operating Leases	Finance Leases
	<i>(In Thousands)</i>	
2021	\$ 56,424	\$ 9,149
2022	68,852	12,895
2023	56,538	15,752
2024	48,086	15,444
2025	40,481	13,857
Thereafter	94,007	176,941
Total minimum lease payments	\$ 364,388	\$ 244,038
Less: amount of lease payments representing interest	(23,170)	(38,807)
Present value of future minimum lease payments	341,218	205,231
Less: current obligations under leases	(70,379)	(10,856)
Long-term lease obligations	<u>\$ 270,839</u>	<u>\$ 194,375</u>

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

7. 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 three months ended March 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.

Expenses March 31, 2021

	Delivery	Insurance Operations	Corporate Services	Other/ Eliminations	Banner Health Consolidated
	<i>(In Thousands)</i>				
Expenses:					
Salaries and benefits	\$ 1,242,498	\$ 26,775	\$ 170,834	\$ (8,727)	\$ 1,431,380
Supplies	456,106	164	(2,754)	(4,825)	448,691
Physician and professional fees	66,719	6,769	8,085	(9,547)	72,026
Medical claims costs	-	558,876	-	(113,986)	444,890
Depreciation and amortization	108,263	3,280	22,923	1	134,467
Interest expense	34,531	822	3,490	(148)	38,695
Purchased services	123,022	30,578	88,479	(43,347)	198,732
Other expense	464,921	13,444	(277,935)	(293)	200,137
Total expenses	\$ 2,496,060	\$ 640,708	\$ 13,122	\$ (180,872)	\$ 2,969,018

Expenses March 31, 2020

	Delivery	Insurance Operations	Corporate Services	Other/ Eliminations	Banner Health Consolidated
	<i>(In Thousands)</i>				
Expenses:					
Salaries and benefits	\$ 973,122	\$ 25,785	\$ 161,516	\$ (4,884)	\$ 1,155,539
Supplies	387,234	422	(698)	(4,822)	382,136
Physician and professional fees	55,975	2,833	4,912	(9,157)	54,563
Medical claims costs	-	460,147	-	(96,352)	363,795
Depreciation and amortization	98,913	473	22,295	-	121,681
Interest expense	31,263	721	4,046	(18)	36,012
Purchased services	107,736	7,015	70,554	(38,145)	147,160
Other expense	383,099	7,096	(245,935)	(586)	143,674
Total expenses	\$ 2,037,342	\$ 504,492	\$ 16,690	\$ (153,964)	\$ 2,404,560

Banner Health and Subsidiaries

Notes to Unaudited Consolidated Financial Statements

March 31, 2021

8. Commitments and Contingencies

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.

9. COVID-19

The outbreak of COVID-19, a respiratory disease caused by a novel strain 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 a temporary shutdown or diversion of patients from those facilities and in staffing and supply shortages. Elective procedures and other patient care appointments are being deferred and individuals may otherwise avoid medical treatment unrelated to COVID-19, resulting in 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 \$465,000,000 in stimulus funding to cover unreimbursed health care related expenses attributable to the public health emergency and lost revenues resulting from COVID-19. 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 ("HHS"). Approximately \$97,000,000 of these funds has been recognized as other operating revenue for the three months ended March 31, 2021. In addition, Banner received \$654,000,000 of Medicare Advance and Accelerated Payments, recorded as a current liability, to help support liquidity needs in the short term. The advanced payments will be recouped over 12 to 18 months, beginning in April 2021.

10. Subsequent Events

Subsequent events have been evaluated through May 27, 2021, the date of issuance of the accompanying consolidated financial statements.

Supplementary Information

Banner Health

Balance Sheet - Obligated and Non-Obligated Group Details of Consolidation

March 31, 2021

Unaudited

(In Thousands)

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
Assets				
Current assets:				
Cash and cash equivalents	\$ 685,965	\$ 525,939	\$ -	\$ 1,211,904
Short-term investments	431,558	26	-	431,584
Collateral held under securities lending program	310,342	-	-	310,342
Assets limited as to use	1,008	28,765	-	29,773
Patient receivables	986,950	183,068	(71,299)	1,098,719
Inventories	262,220	55,359	-	317,579
Other receivables	150,045	222,160	(3,901)	368,304
Other current assets	619,631	(470,904)	-	148,727
Total current assets	3,447,719	544,413	(75,200)	3,916,932
Assets limited as to use:				
Funds designated by:				
Board of Directors	2,740,520	-	-	2,740,520
Lease agreements	2,051	-	-	2,051
Funds held by trustees under:				
Self-insurance funding arrangements	(263)	144,683	-	144,420
Other funds	164,699	1,002	-	165,701
Total assets limited as to use, less current portion	2,907,007	145,685	-	3,052,692
Property and equipment, net	4,259,797	259,262	-	4,519,059
Right of use assets - operating leases	116,620	204,428	-	321,048
Right of use assets - finance leases	62,546	130,236	-	192,782
Other assets:				
Long-term investments	3,344,303	33,918	-	3,378,221
Other	430,362	237,477	72,619	740,458
Total other assets	3,774,665	271,395	72,619	4,118,679
Total assets	\$ 14,568,354	\$ 1,555,419	\$ (2,581)	\$ 16,121,192

Banner Health

Balance Sheet - Obligated and Non-Obligated Group Details of Consolidation

March 31, 2021

Unaudited

(In Thousands)

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
Liabilities and net assets				
Current liabilities:				
Trade accounts payable	\$ 184,514	\$ 41,547	\$ -	\$ 226,061
Current portion of long-term debt	338,261	40,544	(5,370)	373,435
Debt subject to self liquidity	100,000	-	-	100,000
Current portion of operating lease obligations	26,156	44,223	-	70,379
Current portion of finance lease obligations	8,406	2,450	-	10,856
Payable under securities lending program	310,342	-	-	310,342
Accrued expenses:				
Salaries and benefits	520,171	141,803	(16,703)	645,271
Medical claims payable	-	301,049	(57,314)	243,735
Other	897,220	175,034	(800)	1,071,454
Total current liabilities	2,385,070	746,650	(80,187)	3,051,533
Long-term debt, less current portion	4,120,661	13,901	(1,267)	4,133,295
Operating lease obligations, less current portion	99,133	171,706	-	270,839
Finance lease obligations, less current portion	54,180	140,195	-	194,375
Estimated self-insurance liabilities, less current portion	72,678	142,114	(382)	214,410
Interest rate swaps	304,539	-	-	304,539
Other	240,003	1,123	-	241,126
Total liabilities	7,276,264	1,215,689	(81,836)	8,410,117
Net assets without donor restrictions:				
Attributable to Banner Health	7,228,566	81,414	79,255	7,389,235
Attributable to non-controlling interests	-	125,245	-	125,245
Total net assets without donor restrictions	7,228,566	206,659	79,255	7,514,480
Net assets with donor restrictions	63,524	133,071	-	196,595
Total net assets	7,292,090	339,730	79,255	7,711,075
Total liabilities and net assets	\$ 14,568,354	\$ 1,555,419	\$ (2,581)	\$ 16,121,192

Banner Health
Statement of Income -
Obligated and Non-Obligated Group Details of Consolidation
Three Months Ended March 31, 2021
Unaudited

(In Thousands)

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
Revenues:				
Net patient service revenue	\$ 1,844,298	\$ 411,920	\$ (120,089)	\$ 2,136,129
Medical insurance premiums	-	615,217	28,258	643,475
Other revenue	158,701	148,539	(55,027)	252,213
Total revenues	2,002,999	1,175,676	(146,858)	3,031,817
Expenses:				
Salaries and benefits	996,221	443,130	(7,971)	1,431,380
Supplies	341,598	111,917	(4,824)	448,691
Physician and professional fees	54,118	27,078	(9,170)	72,026
Medical claims costs	-	533,954	(89,064)	444,890
Depreciation and amortization	121,008	13,459	-	134,467
Interest expense	35,819	3,025	(149)	38,695
Purchased services	166,247	66,519	(34,034)	198,732
Other expenses	177,268	23,163	(294)	200,137
Total expenses	1,892,279	1,222,245	(145,506)	2,969,018
Operating income	110,720	(46,569)	(1,352)	62,799
Other income:				
Investment gain (loss), net	177,607	4,421	(149)	181,879
Unrealized gain on interest rate swaps	89,969	-	-	89,969
Total other (loss) income	(1,463)	(3,272)	1,886	(2,849)
Total other income	266,113	1,149	1,737	268,999
Excess (deficiency) of revenues over expenses	376,833	(45,420)	385	331,798
Less excess of revenues over expenses attributable to non-controlling interests	-	17,873	-	17,873
Excess (deficiency) of revenues over expenses attributable to Banner Health	376,833	(63,293)	385	313,925

Banner Health
Statement of Changes in Net Assets -
Obligated and Non-Obligated Group Details of Consolidation
Three Months Ended March 31, 2021
Unaudited

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
	<i>(In Thousands)</i>			
Net assets without donor restrictions:				
Excess (deficiency) of revenues over expenses attributable to Banner Health	\$ 376,833	\$ (63,293)	\$ 385	\$ 313,925
Contributions for property and equipment acquisitions	5,243	-	(384)	4,859
Other changes in net assets	(10,508)	5,250	5,316	58
Equity transfers	(121,932)	121,932	-	-
Increase in net assets without donor restrictions	<u>\$ 249,636</u>	<u>\$ 63,889</u>	<u>\$ 5,317</u>	<u>\$ 318,842</u>
Non-controlling interests:				
Excess of revenues over expenses attributable to non-controlling interests	-	17,873	-	17,873
Net contributions from non-controlling interests	-	1,479	-	1,479
Increase attributable to non-controlling interests	<u>-</u>	<u>19,352</u>	<u>-</u>	<u>19,352</u>
Net assets with donor restrictions:				
Contributions	26,202	4,285	-	30,487
Net unrealized (loss) gain on investments	(13)	1,967	-	1,954
Net assets released from restriction	(17,396)	(3,752)	-	(21,148)
Increase in net assets with donor restrictions	<u>\$ 8,793</u>	<u>\$ 2,500</u>	<u>\$ -</u>	<u>\$ 11,293</u>
Increase in net assets	258,429	85,741	5,317	349,487
Net assets, beginning of period	7,033,661	253,989	73,938	7,361,588
Net assets, end of period	<u>\$ 7,292,090</u>	<u>\$ 339,730</u>	<u>\$ 79,255</u>	<u>\$ 7,711,075</u>

Banner Health

Statement of Cash Flows -

Obligated and Non-Obligated Group Details of Consolidation

Three Months Ended March 31, 2021

Unaudited

(In Thousands)

	Obligated Group	Non-Obligated Group	Eliminations	Total Consolidated
Operating activities				
Increase in net assets	\$ 258,429	\$ 85,741	\$ 5,317	\$ 349,487
Adjustments to reconcile increase in net assets to net cash provided by operating activities:				
Equity transfers	121,932	(121,932)	-	-
Depreciation and amortization	121,008	13,459	-	134,467
Increase in investments designated as trading	(233,216)	(6,288)	-	(239,504)
Net unrealized loss on interest rate swaps	(89,969)	-	-	(89,969)
Loss on sale of assets	-	75	-	75
Contributions for property and equipment and other	(5,243)	-	384	(4,859)
Restricted contributions	(26,202)	(4,285)	-	(30,487)
Cash distributions to non-controlling interests	12,750	-	-	12,750
Changes in operating elements:				
Patient receivables	22,503	(16,995)	14,680	20,188
Inventories and other current assets	(11,736)	(8,873)	517	(20,092)
Accounts payable and accrued expenses	(114,175)	95,523	(13,708)	(32,360)
Estimated self-insurance liabilities	6,154	(527)	(1,488)	4,139
Other assets and liabilities	10,254	5,272	-	15,526
Net cash provided by operating activities	72,489	41,170	5,702	119,361
Investing activities:				
Net purchases of property and equipment	(76,541)	(24,356)	(384)	(101,281)
Decrease in other assets	(10,416)	(17,704)	(5,318)	(33,438)
Net cash used in investing activities	(86,957)	(42,060)	(5,702)	(134,719)
Financing activities:				
Proceeds from restricted contributions	26,202	4,285	-	30,487
Equity transfers	(32,734)	32,734	-	-
Proceeds from issuance of debt	-	9,525	-	9,525
Payments of finance lease obligations	(1,322)	(589)	-	(1,911)
Payments of long-term debt	(38,013)	(822)	-	(38,835)
Cash distributions to non-controlling interests	(12,750)	-	-	(12,750)
Net cash (used in) provided by financing activities	(58,617)	45,133	-	(13,484)
Net (decrease) increase in cash, cash equivalents, and restricted cash	(73,085)	44,243	-	(28,842)
Cash, cash equivalents, and restricted cash at beginning of year	833,801	483,051	-	1,316,852
Cash, cash equivalents, and restricted cash at end of period	\$ 760,716	\$ 527,294	\$ -	\$ 1,288,010