



Quarterly Report

As of and for the Second Quarter
Ended February 28, 2022

Northwestern Memorial HealthCare and Subsidiaries



**NORTHWESTERN MEMORIAL HEALTHCARE AND
SUBSIDIARIES**
Unaudited Condensed Consolidated Financial Statements
As of and for the Second Quarter Ended February 28, 2022

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Forward-Looking Information:

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

Northwestern Memorial HealthCare and Subsidiaries

Condensed Consolidated Balance Sheets

(Dollars in thousands)

	February 28, 2022	August 31, 2021
	(Unaudited)	Note A
Assets		
Current Assets:		
Cash and cash equivalents	\$ 760,768	\$ 1,229,066
Short-term investments	354,870	15,478
Current portion of investments, including assets limited as to use	245,827	203,658
Patient accounts receivable	830,535	830,724
Current portion of pledges and grants receivable, net	26,561	24,057
Current portion of insurance recoverable	22,234	21,481
Inventories	152,841	152,889
Other current assets	189,560	208,349
Total current assets	2,583,196	2,685,702
Investments, including assets limited as to use, less current portion	9,176,597	9,556,068
Property and equipment, at cost:		
Land	424,227	417,655
Buildings	5,356,555	5,062,945
Equipment and furniture	1,916,303	1,872,931
Construction in progress	230,688	209,387
	7,927,773	7,562,918
Less accumulated depreciation and amortization	3,363,870	3,168,927
	4,563,903	4,393,991
Prepaid pension cost	239,595	220,258
Pledges and grants receivable, less current portion	110,361	90,844
Insurance recoverable, less current portion	159,610	169,460
Operating lease right-of-use assets	180,977	181,820
Other assets, net	307,054	302,934
Total assets	\$ 17,321,293	\$ 17,601,077

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

	February 28, 2022	August 31, 2021
	(Unaudited)	Note A
Liabilities and net assets		
Current Liabilities		
Accounts payable	\$ 256,820	\$ 279,731
Accrued salaries and benefits	417,773	479,971
Grants and academic support payable, current portion	12,320	15,299
Accrued expenses and other current liabilities	207,487	192,702
Due to third-party payors	699,013	768,386
CMS Accelerated Payments	188,745	314,509
Current accrued liabilities under self-insurance programs	212,332	170,184
Current maturities of long-term debt	18,870	18,815
Long-term debt subject to short-term remarketing	288,580	126,200
Short-term debt	77,697	77,697
Total current liabilities	<u>2,379,637</u>	<u>2,443,494</u>
Long-term debt, less current maturities	1,642,849	1,812,325
Accrued liabilities under self-insurance programs, less current portion	859,053	842,041
Grants and academic support payable, less current portion	61,487	60,868
Interest rate swaps	89,431	106,447
Operating lease liabilities, less current portion	162,005	165,146
Other liabilities	343,802	306,446
Total liabilities	<u>5,538,264</u>	<u>5,736,767</u>
Net assets:		
Without donor restrictions:		
Controlling interest	11,069,212	11,214,690
Noncontrolling interest in subsidiaries	82	13
Total net assets without donor restrictions	<u>11,069,294</u>	<u>11,214,703</u>
With donor restrictions	713,735	649,607
Total net assets	<u>11,783,029</u>	<u>11,864,310</u>
Total liabilities and net assets	<u>\$ 17,321,293</u>	<u>\$ 17,601,077</u>

Note A: The August 31, 2021 financial statement information was derived from and should be read in conjunction with the Northwestern Memorial HealthCare and Subsidiaries 2021 audited consolidated financial statements.

See accompanying notes to the interim condensed consolidated financial statements.

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

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Revenue				
Patient service revenue	\$ 1,802,466	\$ 1,637,680	3,677,506	3,232,243
Rental and other revenue	114,040	100,174	225,300	194,438
Net assets released from donor restrictions and federal and state grants	50,786	32,672	57,167	38,770
Total revenue	1,967,292	1,770,526	3,959,973	3,465,451
Expenses				
Salaries	840,072	722,182	1,643,616	1,386,333
Employee benefits	132,537	105,701	237,254	169,076
Supplies	410,775	376,683	840,216	757,250
Purchased services	190,074	180,362	374,660	353,886
Depreciation and amortization	107,998	99,029	216,576	191,979
Insurance	58,609	41,687	104,678	79,893
Rent and utilities	25,776	20,331	51,904	45,555
Repairs and maintenance	34,613	30,390	67,184	56,910
Interest	10,758	14,035	21,422	26,918
Illinois Hospital Assessment	51,888	46,599	100,790	89,871
Other	47,151	42,443	93,117	83,733
Total expenses	1,910,251	1,679,442	3,751,417	3,241,404
Operating income	57,041	91,084	208,556	224,047
Nonoperating (losses) gains				
Investment return	(241,910)	516,707	(375,129)	894,121
Contribution of Palos net assets	—	255,633	—	255,633
Change in fair value of interest rate swaps	10,550	19,003	17,017	22,420
Grants and academic support provided	(10,402)	(8,793)	(22,378)	(19,475)
Other	9,348	4,355	20,620	9,539
Total nonoperating (losses) gains, net	(232,414)	786,905	(359,870)	1,162,238
(Deficiency) excess of revenue over expenses	(175,373)	877,989	(151,314)	1,386,285
Net gain attributable to noncontrolling interest in subsidiaries	200	180	397	283
(Deficiency) excess of revenue over expenses attributable to NMHC and subsidiaries	\$ (175,573)	\$ 877,809	\$ (151,711)	\$ 1,386,002

Continued on next page.

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

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Net assets without donor restrictions, controlling interest				
(Deficiency) excess of revenue over expenses	\$ (175,573)	\$ 877,809	\$ (151,711)	\$ 1,386,002
Net assets released from restrictions used for property and equipment additions	1,838	4,399	5,214	5,861
Postretirement-benefit-related changes other than net periodic pension cost	445	1,921	890	3,842
Other	176	(511)	129	572
(Decrease) increase in net assets without donor restrictions, controlling interest	(173,114)	883,618	(145,478)	1,396,277
Net assets without donor restrictions, noncontrolling interest				
Excess of revenue over expenses	200	180	397	283
Distribution to noncontrolling interest	(229)	(70)	(328)	(351)
Other	—	70	—	(833)
(Decrease) increase in net assets without donor restrictions, noncontrolling interest	(29)	180	69	(901)
Net assets with donor restrictions				
Contributions	34,879	113,736	70,183	121,670
Investment return	7,729	5,721	15,280	11,471
Net assets released from restrictions used for:				
Operating expenses, charity care, and research and education	(7,527)	(9,277)	(15,724)	(14,756)
Property and equipment additions	(1,838)	(4,399)	(5,214)	(5,861)
Change in fair value of split-interest agreements	(315)	1,285	(427)	1,156
Contribution of Palos restricted net assets	—	184	—	184
Other	7	119	30	119
Increase in net assets with donor restrictions	32,935	107,369	64,128	113,983
Change in net assets	(140,208)	991,167	(81,281)	1,509,359
Net assets, beginning of period	11,923,237	9,608,510	11,864,310	9,090,318
Net assets, end of period	\$ 11,783,029	\$ 10,599,677	\$ 11,783,029	\$ 10,599,677

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

	Six Months Ended	
	February 28,	
	2022	2021
Operating activities		
Change in net assets	\$ (81,281)	\$ 1,509,359
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Postretirement benefit-related changes other than net periodic pension cost	(890)	(3,842)
Change in fair value of interest rate swaps	(17,017)	(22,420)
Net unrestricted realized investment return and net change in unrestricted and restricted unrealized investment gains	374,711	(894,688)
Restricted contributions, change in fair value of split interest agreements and realized investment return	(84,616)	(133,914)
Contribution of Palos net assets	—	(255,817)
Depreciation and amortization	216,576	191,979
Changes in operating assets and liabilities:		
Patient accounts receivable	189	(143,071)
Due to third-party payors	(63,359)	(56,948)
Grants and academic support payable	(2,360)	(2,978)
CMS accelerated payments	(125,764)	—
Other operating assets and liabilities	(2,670)	100,058
Net cash provided by operating activities	213,519	287,718
Investing activities		
Purchase of investments	(1,729,893)	(4,938,111)
Sale of investments	1,107,326	4,142,520
Cash received from contribution of Palos	—	46,251
Net unrestricted realized investment return	245,765	179,612
Capital expenditures, net	(387,591)	(236,374)
Net cash used in investing activities	(764,393)	(806,102)
Financing activities		
Payments of long-term debt	(2,040)	(10,628)
Restricted contributions, change in fair value of split interest agreements and realized investment return	84,616	133,914
Net cash provided by financing activities	82,576	123,286
Net decrease in cash and cash equivalents	(468,298)	(395,098)
Cash and cash equivalents, beginning of period	1,229,066	1,336,516
Cash and cash equivalents, end of the period	\$ 760,768	\$ 941,418

See accompanying notes to the interim condensed consolidated financial statements.

As of and for the Second Quarter Ended

February 28, 2022

1. Organization and Basis of Presentation

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

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

These interim financial statements have not been audited; however, in the opinion of management, they include all adjustments necessary for their fair presentation in conformity with U.S. generally accepted accounting principles (U.S. GAAP). These interim statements have been prepared on a basis that is substantially consistent with the accounting principles applied in the audited consolidated financial statements of Northwestern Memorial for the year ended August 31, 2021.

Interim results are not necessarily indicative of results for a full year or any future periods. The information included in these interim financial statements should be read in conjunction with the audited consolidated financial statements for the year ended August 31, 2021, which are available on the Electronic Municipal Market Access ("EMMA") website of the Municipal Securities Rulemaking Board.

2. Adoption of Accounting Standards

In August 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-14, *Compensation - Retirement Benefits - Defined Benefit Plans (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans*. ASU 2018-14 makes minor changes to the disclosure requirements for employers that sponsor defined benefit and other postretirement benefit plans. This guidance is effective for fiscal years beginning after December 15, 2021. This guidance is to be applied retrospectively, and early adoption is permitted. Northwestern Memorial is currently evaluating the impact this guidance will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*. ASU 2018-15 requires customers in a cloud computing agreement that is a service contract to follow the internal use software guidance in ASC 350-40 to determine which implementation costs to capitalize as assets. On September 1, 2021, this standard was adopted by Northwestern Memorial on a retrospective basis, having no material impact to the financial position, results of operations or cash flows.

In September 2020, the FASB issued ASU 2020-07, *Not-for-Profit Entities (Topic 958): Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*. ASU 2020-07 requires presentation of contributed nonfinancial assets as a separate line in the consolidated statement of operations and change in net assets, apart from contributions of cash or other financial assets. On

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

September 1, 2021, this standard was adopted by Northwestern Memorial on a retrospective basis, having no material impact to the financial position, results of operations or cash flows.

3. Reclassification

Certain reclassifications have been made to the 2021 consolidated financial statements to conform with classification used in 2022. The reclassifications had no material effect on total assets, total liabilities, total revenue or excess of revenue over expenses previously reported.

4. Membership Substitution Agreement with Palos Community Hospital

On January 1, 2021, Palos Community Hospital (PCH), and all other affiliated medical-related businesses affiliated with PCH (Palos), became wholly owned direct or indirect subsidiaries of NMHC pursuant to a membership substitution between NMHC and St. George Corporation, which had previously been the parent company of PCH. This affiliation positions Northwestern Memorial, under the Northwestern Medicine brand, to expand its integrated academic health delivery system to the Southwest Chicagoland area, offering patients access to leading-edge care closer to where they live and work.

The affiliation was effected through a membership substitution with no consideration paid. For accounting purposes, this transaction is considered an acquisition under Accounting Standards Codification Topic (ASC) 958-805, "Not-for-Profit Entities: Business Combinations", and a contribution was recorded for the fair value of assets, net of liabilities of Palos. Northwestern Memorial has reflected the results of all third party valuations received in the accompanying condensed consolidated financial statements.

Also effective January 1, 2021, PCH joined the NMHC Obligated Group. A Supplemental Master Trust Indenture was executed to issue obligations pursuant to the NMHC Master Trust Indenture in order to secure all debt that was previously secured by obligations issued pursuant to The St. George Corporation, Palos Community Hospital Master Trust Indenture (PCH MTI) prior to the release of PCH MTI in accordance with its terms.

The acquisition-date fair value of identifiable assets and liabilities of Palos at January 1, 2021 consisted of the following:

Cash and cash equivalents	46,251
Other current assets	54,884
Property and equipment	328,803
Other long-term assets	64,148
Current liabilities	(93,538)
Long-term debt, less current maturities	(279,355)
Other long-term liabilities	(59,543)
Donor restricted net assets	(184)
Contribution of unrestricted net assets	<u>61,466</u>

The above table represents the final acquisition date fair value as of August 31, 2021.

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

5. Patient Service Revenue

Northwestern Memorial recognizes Patient service revenue at the amount that reflects the consideration expected to be paid for providing patient care. Patient service revenue is recognized as performance obligations are satisfied based on the nature of the services provided by Northwestern Memorial. Performance obligations satisfied over time relate to patients in Northwestern Memorial hospitals receiving inpatient acute care services from admission to the point when services are no longer required, which is generally at the time of discharge. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. Outpatient services are performance obligations satisfied at a point in time, and revenue is recognized when goods or services are provided and Northwestern Memorial does not believe it is required to provide additional goods or services. Management believes this method provides a fair depiction of the transfer of services over the term of performance obligations based on the inputs needed to satisfy the obligations.

Northwestern Memorial has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) because all of its performance obligations relate to contracts with a duration of less than one year. Therefore, Northwestern Memorial is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially satisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

Northwestern Memorial 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 the historical collection trends and other analysis, Northwestern Memorial believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

Northwestern Memorial determines the transaction price, which involves significant estimates and judgment, based on standard charges for goods and services provided, reduced by explicit and implicit price concessions, including contractual adjustments provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with policy, and/or implicit price concessions based on the historical collection experience of patient accounts. Northwestern Memorial determines the transaction price associated with services provided to patients who have third-party payor coverage with Medicare, Medicaid, Blue Cross, other managed care programs and other third-party payors based on reimbursement terms per contractual agreements, discount policies and historical experience. Payment arrangements with those payors include prospectively determined rates per admission or visit, reimbursed costs, discounted charges per diem rates and value-based care agreements. Reported costs and/or services provided under certain of the arrangements are subject to retroactive audit and adjustment. Patient service revenue decreased by \$4,135 and increased by \$623 for the three months ended February 28, 2022 and 2021, respectively, and decreased by \$4,880 and \$2,927 for the six months ended February 28, 2022 and 2021, respectively, as a result of changes in estimates due to settlements of prior fiscal years' cost reports and the disposition of other payor audits and settlements. Future changes in Medicare and Medicaid programs and reduction in funding levels could have an adverse effect on Northwestern Memorial. There were no other significant changes to the judgements used to determine the transaction price in prior periods.

Northwestern Memorial also provides care to self-pay patients. Under its Financial Assistance Policy (the Policy), Northwestern Memorial provides medically necessary care to patients in its community with

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

inadequate financial resources at discounts of up to 100% of charges using a sliding scale that is based on patient household income as a percentage (up to 600%) of the federal poverty level guidelines. The Policy also contains a catastrophic financial assistance provision that limits a patient's total financial responsibility to Northwestern Memorial. Since Northwestern Memorial does not pursue collection of these amounts, the values are reported net of price concessions. Northwestern Memorial uses presumptive eligibility screening procedures for free care and recognizes Patient service revenue on services provided to self-pay patients at a reduced transaction price at the time services are rendered.

In certain instances, Northwestern Memorial receives payment in advance of the services provided and considers these amounts to represent contract liabilities. Contract liabilities at February 28, 2022 and 2021 were not material other than as disclosed in Note 17.

Management has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the payors and line of business that renders services to patients. The composition of Patient service revenue by payor was as follows:

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Medicare	\$ 538,381	\$ 470,557	\$ 1,093,836	\$ 902,755
Medicaid	179,275	160,233	361,274	307,545
Blue Cross	701,220	643,352	\$ 1,419,647	1,287,445
Other managed care	332,435	322,607	678,268	655,700
Commercial and other	37,138	38,173	98,358	71,627
Self-pay	14,017	2,758	26,123	7,171
Total	\$ 1,802,466	\$ 1,637,680	\$ 3,677,506	\$ 3,232,243

The composition of the Patient service revenue by service line was as follows:

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Hospitals	\$ 1,385,107	\$ 1,277,547	\$ 2,825,728	\$ 2,507,182
Physician groups	401,477	345,114	822,003	695,358
Other	15,882	15,019	29,775	29,703
Total	\$ 1,802,466	\$ 1,637,680	\$ 3,677,506	\$ 3,232,243

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

Northwestern Memorial grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. At February 28, 2022 and 2021, patient accounts receivable, including patient co-pays and deductibles by major primary payor source, were as follows:

	February 28,	August 31,
	2022	2021
Medicare	29%	26%
Medicaid	10	8
Blue Cross	22	28
Other managed care	25	25
Commercial and other	7	5
Self-pay	7	8
	100%	100%

6. Hospital Assessment Program

In May 2020, the Illinois Hospital Assessment Program (HAP) was redesigned and reauthorized by the Illinois General Assembly via SB 2541, which was subsequently signed into law by the Governor as Illinois Public Law 101-0650. The amendment to Illinois' existing State Medicaid Plan establishing the redesigned HAP has been approved by the Centers for Medicare and Medicaid Services (CMS). The HAP program provides for increased Illinois Medicaid and Illinois Medicaid Managed Care inpatient rates and better recognizes patient volumes as well as acuity.

A summary of the amounts recognized for the HAP program is as follows:

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Patient service revenue - HAP	\$ 64,768	\$ 60,155	\$ 136,845	\$ 116,456
Illinois Hospital Assessment	(51,888)	(46,599)	(100,790)	(89,871)
Net excess of HAP revenue over Illinois assessment	\$ 12,880	\$ 13,556	\$ 36,055	\$ 26,585

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

7. Investments and Other Financial Instruments

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

	February 28, 2022	August 31, 2021
Measured at fair value:		
Cash and cash equivalents and Short-term investments	\$ 1,422,468	\$ 1,579,126
Mutual funds	318,495	401,250
Corporate bonds	410,690	404,728
U.S. government and agency issues	507,405	428,661
Equity securities	169,938	172,220
	<u>2,828,996</u>	<u>2,985,985</u>
Measured at net asset value as practical expedient:		
Common collective trusts and commingled funds	1,720,291	1,799,433
Interest in 103-12 investment entities	304,739	305,526
	<u>2,025,030</u>	<u>2,104,959</u>
Accounted for under the equity method:		
Alternative investments	5,684,036	5,913,326
	<u>\$ 10,538,062</u>	<u>\$ 11,004,270</u>

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

	February 28, 2022	August 31, 2021
Assets limited as to use:		
Trustee-held funds	\$ 392	\$ 3,005
Self-insurance programs	824,291	844,057
Board-designated funds	228,461	226,700
Total assets limited as to use	<u>1,053,144</u>	<u>1,073,762</u>
Donor-restricted funds	571,346	529,855
Unrestricted, undesignated funds	7,797,934	8,156,109
Total investments, excluding short-term investments	<u>9,422,424</u>	<u>9,759,726</u>
Other financial instruments:		
Cash and cash equivalents and short-term investments	1,115,638	1,244,544
	<u>\$ 10,538,062</u>	<u>\$ 11,004,270</u>

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

The composition and presentation of investment returns are as follows:

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Interest and dividend income	\$ 10,684	\$ 6,399	\$ 22,978	\$ 10,426
Investment expenses	(1,512)	(1,383)	(2,981)	(2,706)
Realized gains on alternative investments, net	146,856	110,739	201,455	146,540
Realized gains on other investments, net	27,504	30,751	40,222	36,108
Net change in unrealized gain on alternative investments	(202,327)	270,881	(276,746)	481,688
Net change in unrealized gain on other investments	(214,576)	105,262	(343,731)	233,388
Change in value of joint ventures	(378)	(190)	(556)	229
	<u>\$ (233,749)</u>	<u>\$ 522,459</u>	<u>\$ (359,359)</u>	<u>\$ 905,673</u>
Reported as:				
Rental and other revenue	\$ 432	\$ 31	\$ 490	\$ 81
Nonoperating investment return	(241,910)	516,707	(375,129)	894,121
With donor restriction investment return	7,729	5,721	15,280	11,471
	<u>\$ (233,749)</u>	<u>\$ 522,459</u>	<u>\$ (359,359)</u>	<u>\$ 905,673</u>

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

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

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

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

Absolute return hedge funds include funds with the ability to opportunistically allocate capital among several strategies. Generally, these funds diversify across strategies in an effort to deliver consistently positive returns regardless of the movement within global markets, exhibit relatively low volatility and are redeemable quarterly with a 60-day notice period. Equity long/short hedge funds include hedge funds that

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

invest both long and short in U.S. and international equities. These funds typically focus on diversifying or hedging across particular sectors, regions or market capitalizations and are generally redeemable quarterly with a 60-day notice period. Absolute return and equity long/short managers are redeemable quarterly or annually with a 45- to 90-day notice period.

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

Because of the timing of the preparation and delivery of financial statements for limited partnership investments, the use of the most recently available financial statements provided by the general partners results in a two month delay in the inclusion of the limited partnership results in Northwestern Memorial's condensed consolidated statements of operations and changes in net assets due to results recorded based on December 31 investment statements. Due to this delay, these condensed consolidated financial statements do not yet reflect the market conditions experienced in the last two months of the second quarter of fiscal 2022 or 2021 for the limited partnership investments.

As of February 28, 2022, \$3,959,474 of alternative investments is subject to various redemption limits and lockup provisions, of which \$3,284,699 expires within one year and \$674,775 expires after one year from the balance sheet date.

At February 28, 2022, Northwestern Memorial had commitments to fund approximately an additional \$689,000 to alternative investment entities. This funding is expected to occur over the next 12 years.

8. Fair Value Measurements

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

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

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Examples of Level 2 inputs are quoted prices for similar assets or liabilities in inactive markets or pricing models with inputs that are observable for substantially the full term of the asset or liability.

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

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

Fair Values

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

The following table presents the financial instruments measured at fair value on a recurring basis at February 28, 2022:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 760,768	\$ —	\$ —	\$ 760,768
Investments:				
Short-term investments:				
Currency	15,480	—	—	15,480
Cash equivalents in investment accounts	339,390	—	—	339,390
Total short-term investments	354,870	—	—	354,870
Mutual funds:				
Fixed income	5,888	—	—	5,888
U.S. equities	312,607	—	—	312,607
Total mutual funds	318,495	—	—	318,495
Bonds:				
Corporate bonds	—	410,690	—	410,690
U.S. government and agency issues	—	507,405	—	507,405
Total bonds	—	918,095	—	918,095
Equity securities	169,938	—	—	169,938
Cash equivalents in investment accounts	394,836	—	—	394,836
Due to broker	(88,006)	—	—	(88,006)
Total investments	1,150,133	918,095	—	2,068,228
Beneficial interest in trusts	—	20,641	—	20,641
Total assets	<u>\$ 1,910,901</u>	<u>\$ 938,736</u>	<u>\$ —</u>	<u>2,849,637</u>
Investments recorded at fair value based on NAV				<u>2,025,030</u>
Total assets measured at fair value				<u>\$ 4,874,667</u>
Liabilities:				
Interest rate swaps	\$ —	\$ 89,431	\$ —	\$ 89,431

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

The following table presents the financial instruments measured at fair value on a recurring basis at August 31, 2021:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 1,229,066	\$ —	\$ —	\$ 1,229,066
Investments:				
Short-term investments:				
Currency	15,478	—	—	15,478
Total short-term investments	15,478	—	—	15,478
Mutual funds:				
Fixed income	3,387	—	—	3,387
U.S. equities	397,863	—	—	397,863
Total mutual funds	401,250	—	—	401,250
Bonds:				
Corporate bonds	—	404,728	—	404,728
U.S. government and agency issues	—	428,661	—	428,661
Total bonds	—	833,389	—	833,389
Equity securities	172,220	—	—	172,220
Cash equivalents in investment accounts	373,499	—	—	373,499
Due to broker	(38,917)	—	—	(38,917)
Total investments	923,530	833,389	—	1,756,919
Beneficial interest in trusts	—	21,069	—	21,069
Total assets	<u>\$ 2,152,596</u>	<u>\$ 854,458</u>	<u>\$ —</u>	<u>3,007,054</u>
Investments recorded at fair value based on NAV				<u>2,104,959</u>
Total assets measured at fair value				<u>\$ 5,112,013</u>
Liabilities:				
Interest rate swaps	\$ —	\$ 106,447	\$ —	\$ 106,447

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

Reconciliation to the Condensed Consolidated Balance Sheets

A reconciliation of the fair value of financial assets to the condensed consolidated balance sheets is as follows:

	February 28,	August 31,
	2021	2021
Short-term investments measured at fair value	\$ 354,870	\$ 15,478
Investments, including assets limited as to use measured at fair value	3,738,388	3,846,400
Total investments at fair value	4,093,258	3,861,878
Alternative investments accounted for under equity method included in investments, including assets limited as to use	5,684,036	5,913,326
Total investments	<u>\$ 9,777,294</u>	<u>\$ 9,775,204</u>
Pledges and grants receivable, less current portion:		
Beneficial interests in trusts at fair value	\$ 20,641	\$ 21,069
Pledges and grants receivable, less current portion, net	89,720	69,775
Total pledges and grants receivable, less current portion	<u>\$ 110,361</u>	<u>\$ 90,844</u>

Valuation Techniques and Inputs

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

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

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

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

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

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

The fair value of the long-term debt portfolio, including the current portion, was \$1,941,831 and \$2,020,440 at February 28, 2022 and August 31, 2021, respectively. The fair value of this Level 2 liability is based on quoted market prices for the same or similar issues and the relationship of those bond yields with various market indices. The market data used to determine yield and calculate fair value represents Aa/AA-rated tax-exempt municipal health care bonds. The effect of third-party credit valuation adjustments, if any, is immaterial.

The fair value of pledges receivable, a Level 2 asset, is based on discounted cash flow analysis and approximates the carrying value of \$114,560 and \$91,683 at February 28, 2022 and August 31, 2021, respectively.

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

9. Long-Term Debt

Long-term debt consists of the following:

	February 28, 2022	August 31, 2021
Taxable Revenue Bonds, Series 2021 (NMHC), payable in varying installments beginning July 2030 through July 2051 (fixed coupon rates range from 1.67% to 2.63%)	\$ 519,735	\$ 519,735
Revenue Bonds, Series 2021A (NMHC), payable in varying installments beginning July 2022 through July 2043 (fixed coupon rates range from 3.00% to 5.00%)	213,730	213,730
Revenue Bonds, Series 2017A (NMHC), payable in varying annual installments through July 2047 (fixed coupon rates range from 3.00% to 5.00%)	501,505	501,505
Revenue Bonds, Series 2017B (NMHC), payable in varying annual installments beginning July 2055 through July 2057 (fixed coupon rate of 5.00% through December 15, 2022)	162,380	162,380
Revenue Bonds, Series 2015E (PCH), payable in varying annual installments through May 2037 (fixed coupon rate of 2.32%)	33,880	33,880
Variable Rate Demand Revenue Bonds, Series 2021B (NMHC), payable in varying annual installments beginning July 2052 through July 2055 (weighted average interest rate of 0.03% for the six months ended February 28, 2022)	73,000	73,000
Variable Rate Demand Revenue Bonds, Series 2021C (NMHC), payable in varying annual installments beginning July 2052 through July 2055 (weighted average interest rate of 0.03% for the six months ended February 28, 2022)	73,000	73,000
Variable Rate Demand Revenue Bonds, Series 2021D (NMHC), payable in varying annual installments beginning July 2052 through July 2055 (weighted average interest rate of 0.07% for the six months ended February 28, 2022)	63,100	63,100
Variable Rate Demand Revenue Bonds, Series 2021E (NMHC), payable in varying annual installments beginning July 2052 through July 2055 (weighted average interest rate of 0.06% for the six months ended February 28, 2022)	63,100	63,100
Revenue Bonds, Series 2014B (NMHC), with interest at a variable rate payable with varying installments through September 2044, (weighted average interest rate of 0.50% and 0.54% for the six months ended February 28, 2022 and 2021, respectively)	32,445	32,810
Revenue Bonds, Series 2011A and 2011B (NMHC), with interest at a variable rate payable with varying annual installments through November 2038, (weighted average interest rate of 0.46% and 0.51% for the six months ended February 28, 2022 and 2021, respectively)	107,950	109,625
NMHC fixed rate note dated August 29, 2019, matures September 1, 2024 (fixed rate of 1.98%)	55,000	55,000
NMHC commercial paper dated October 4, 2016 (weighted average interest rate of 0.12% and 0.19% for the six months ended February 28, 2022 and 2021, respectively)	77,697	77,697
	<u>1,976,522</u>	<u>1,978,562</u>

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

	February 28, 2022	August 31, 2021
Less:		
Unamortized premium and debt issuance costs	(51,474)	(56,475)
Long-term debt subject to short-term remarketing agreements	288,580	126,200
Current maturities	18,870	18,815
Commercial paper, included in Short-term debt	77,697	77,697
	\$ 1,642,849	\$ 1,812,325

Northwestern Memorial has lines of credit with multiple banks. Northwestern Memorial has the option to borrow at various rates expressed as an adjustment to LIBOR, prime rate or other bank-offered rates. Additionally, Northwestern Memorial has restricted certain lines of credit to secure letters of credit. The amounts available, outstanding and restricted to secure letters of credit as of February 28, 2022 are as follows:

Available	Outstanding	Restricted
\$ 100,000	\$ —	\$ 556
7,000	—	4,029

Northwestern Memorial has SBPAs with two banks that cover certain variable rate demand revenue bonds (VRDBs). The short-term credit rating for each series of VRDBs is based on the respective bank's short-term credit rating. The long-term credit rating for each series of VRDBs is based on Northwestern Memorial's long-term credit rating. Changes in credit ratings may impact the interest paid, on or remarketing of, the VRDBs. As of February 28, 2022, the banks provided liquidity support in the event of a failed remarketing as follows:

	Par Value	Expiration date
Subseries 2021B	73,000	August 2026
Subseries 2021C	73,000	August 2026

Northwestern Memorial provides self-liquidity on the Series 2021D and Series 2021E Bonds. These bonds are classified as Long-term debt subject to short-term remarketing in the accompanying condensed consolidated balance sheets.

The SBPAs include reporting and financial requirements and other covenants. If an SBPA is not renewed or replaced prior to its expiration, or if some portion, or all of the related VRDBs are not successfully remarketed (i.e., failed remarketing) during the term of the SBPA, the related VRDBs are Purchased Bonds by the SBPA provider under the SBPA. Such Purchased Bonds are required to be redeemed by the Obligated Group over an amortization period pursuant to the SBPA. The earliest redemption associated with the Purchased Bonds is 367 days from the failed remarketing date or the expiration date of the SBPA. Therefore, the VRDBs that are supported by SBPAs are classified as long-term debt in the accompanying condensed consolidated balance sheets.

The Series 2017B Bonds are subject to a Mandatory Tender on December 15, 2022 at which time the bonds are subject to redemption and therefore these bonds are classified as Long-term debt subject to short-term remarketing in the accompanying condensed consolidated balance sheet as of February 28, 2022. The Obligated Group may seek to remarket or refinance the bonds.

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

The Series 2014B Bonds are subject to put options such that the bondholders have agreed to hold the 2014B for initial private placement rate periods ending on July 1, 2024, at which time the bonds are subject to redemption. The Obligated Group may provide written notice to the bondholder no sooner than 18 months and not later than four months prior to the end of the initial private placement rate period of its desire to request the bondholders to extend the initial private placement rate period. The bondholders must provide notice of acceptance of the request within 60 days of such request. In the event the initial private placement rate period is not extended, Northwestern Memorial may be required to redeem the bonds, unless the bonds can be remarketed prior to July 1, 2024.

10. Derivatives

In August 2021, Northwestern Memorial fully redeemed the Illinois Finance Authority Variable Rate Demand Revenue Bonds Series 2007A1-4 (NMH) in aggregate amount of \$199,100. The swaps related to these bonds were not terminated. Northwestern Memorial's interest rate swaps related to the 2011A-B bonds were not impacted. The interest rate swaps will remain in place for the sole purpose of risk management. To manage fluctuations in cash flows resulting from interest rate risk, Northwestern Memorial entered into various interest rate swap agreements. By using interest rate swaps to manage the risk of changes in interest rates, Northwestern Memorial exposes itself to credit risk and market risk. Credit risk is the risk that a counterparty will fail to perform under the terms of a derivative contract. When the fair value of a swap is positive, the counterparty owes Northwestern Memorial, which creates credit risk for Northwestern Memorial. When the fair value of a swap is zero or negative, the counterparty does not owe Northwestern Memorial. Northwestern Memorial minimizes the credit risk in its swap contracts by entering into transactions that either require the counterparty to post collateral for the benefit of Northwestern Memorial based on the credit rating of the counterparty and the fair value of the swap contract or whose cash flows are insured by a third party. For certain interest rate swaps, Northwestern Memorial is required to post collateral for the benefit of the counterparty when the negative fair value of the swap exceeds a defined threshold. The aggregate fair value liability of the swaps on the condensed consolidated balance sheets reflect a reduction of \$2,408 and \$2,404 for nonperformance risk at February 28, 2022 and August 31, 2021, respectively. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of its swap positions in the context of their total blended cost of capital.

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

Notional Amount		Maturity Date	Rate Paid	Rate Received
February 28, 2022	August 31, 2021			
\$ 99,550	\$ 99,550	August 2042	3.89 %	63% of 1-Month LIBOR + 28 bps
99,550	99,550	August 2042	3.89	63% of 1-Month LIBOR + 28 bps
59,150	59,575	November 2038	3.82	67% of 3-Month LIBOR
59,150	59,575	November 2038	3.52	67% of 3-Month LIBOR
\$ 317,400	\$ 318,250			

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

The fair value of derivative instruments is as follows:

	Derivative Liabilities		
	Balance Sheet Location	February 28, 2022	August 31, 2021
Derivatives not designated as hedging instruments:			
Interest rate contracts	Interest rate swap liabilities	\$ 89,431	\$ 106,447

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

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Derivatives not designated as hedging instruments:				
Operating expense - interest	\$ (1,030)	\$ (1,686)	\$ (2,093)	\$ (3,426)
Nonoperating - investment return	(1,721)	—	(3,469)	—
Nonoperating - change in fair value of interest rate swaps	10,550	19,003	17,017	22,420

Northwestern Memorial's derivative instruments contain provisions that require its debt to remain above certain credit ratings from Standard & Poor's and Moody's. If Northwestern Memorial's debt were to fall below those levels, it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. Northwestern Memorial has posted collateral of \$0 and \$2,590 as of February 28, 2022 and August 31, 2021, respectively. If the credit-risk-related contingent features underlying the agreement were triggered to the fullest extent on February 28, 2022, Northwestern Memorial would be required to post \$91,839 of additional collateral to its counterparties.

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

11. Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following purposes as follows:

	February 28,	August 31,
	2022	2021
Subject to expenditure for specified purpose:		
Purchase of property and equipment	\$ 51,153	\$ 34,874
Operating expenses and charity care	265,590	244,072
Research, education and other	170,958	154,841
Total expenditure for specified purpose	<u>487,701</u>	<u>433,787</u>
Subject to passage of time:		
Pledges and trusts	2,819	2,776
Endowments:		
Perpetual in nature:		
Purchase of property and equipment	16,004	16,004
Operating expenses and charity care	94,636	85,310
Research, education and other	112,575	111,730
Total perpetual in nature	<u>223,215</u>	<u>213,044</u>
Total net assets with donor restrictions	<u>\$ 713,735</u>	<u>\$ 649,607</u>

Net assets were released from donor restrictions by incurring expenditures for the following purposes as follows:

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Health care services:				
Purchase of property and equipment	\$ 1,838	\$ 4,399	\$ 5,214	\$ 5,861
Clinical expenses and charity care	3,881	2,794	7,030	5,551
Research, education and other	3,646	6,483	8,694	9,205
	<u>\$ 9,365</u>	<u>\$ 13,676</u>	<u>\$ 20,938</u>	<u>\$ 20,617</u>

Net assets released from donor restrictions reported in the condensed consolidated statements of operations and changes in net assets were recorded as follows:

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Net assets released from donor restrictions and federal and state grants	\$ 6,161	\$ 8,298	\$ 11,655	\$ 12,389
Nonoperating other	1,366	979	4,069	2,367
	<u>\$ 7,527</u>	<u>\$ 9,277</u>	<u>\$ 15,724</u>	<u>\$ 14,756</u>

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

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

Northwestern Memorial has interpreted the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), as adopted by the State of Illinois, as requiring the preservation of the value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Northwestern Memorial classifies as net assets with restrictions the original value of gifts donated to the permanent endowment, the original value of subsequent gifts to the permanent endowment and accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time.

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

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

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

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

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

The changes in endowment net assets for the twelve months ended August 31, 2021 and six months ended February 28, 2022 are summarized below:

	Total
Endowment net assets, August 31, 2020	\$ 270,011
Contributions	7,198
Change in value of trusts	2,420
Investment return	15,563
Appropriation for expenditure	(11,247)
Other	999
Endowment net assets, August 31, 2021	284,944
Contributions	11,743
Change in value of trusts	(139)
Investment return	8,095
Appropriation for expenditure	(2,926)
Other	323
Endowment net assets, February 28, 2022	\$ 302,040

12. Liquidity and Availability

Financial assets available for general expenditure within one year of the balance sheet date comprise the following:

	February 28, 2022	August 31, 2021
Cash and cash equivalents	\$ 760,768	\$ 1,229,066
Patient accounts receivable	830,535	830,724
Pledges receivable	24,840	21,907
Grants receivable	1,721	2,150
Other receivables	89,745	86,005
Investments	8,531,173	8,417,372
Total financial assets available within one year	\$ 10,238,782	\$ 10,587,224

13. Self-Insurance Programs and Related Insurance Recoverable

Northwestern Memorial's self-insurance liabilities and the related amount recoverable from reinsurers are reported in the accompanying condensed consolidated balance sheets at present value based on a discount rate of 2.0% as of February 28, 2022 and August 31, 2021. Provisions for the professional and general liability risks are based on an actuarial estimate of losses using actual loss data adjusted for industry trends and current conditions and an evaluation of claims by Northwestern Memorial's legal counsel. The provision for estimated self-insured claims includes estimates of ultimate costs for both reported claims and claims incurred but not reported.

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

14. Employee Benefit Obligations

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

Net periodic pension benefit cost included in Nonoperating gains (losses) Other in the accompanying condensed consolidated statements of operations and changes in net assets is comprised of the following:

	Three Months Ended		Six Months Ended	
	February 28,		February 28,	
	2022	2021	2022	2021
Plan expenses	\$ (487)	\$ (611)	\$ (974)	\$ (1,222)
Interest cost on projected benefit obligation	(3,528)	(3,434)	(7,056)	(6,868)
Expected return on Plan's assets	13,683	11,469	27,366	22,938
Amortization of net loss	(251)	(1,565)	(502)	(3,130)
	<u>\$ 9,417</u>	<u>\$ 5,859</u>	<u>\$ 18,834</u>	<u>\$ 11,718</u>

Northwestern Memorial made no contributions for the three and six months ended February 28, 2022 and 2021, and has no current plans to contribute to the Plans during the fiscal year ending August 31, 2022.

Northwestern Memorial uses the spot rate approach to measure the service and interest cost. This method does not apply to the service cost as both plans have been frozen, but results in different discount rates utilized for purposes of measuring the interest cost of the two plans.

15. Functional Expenses

Northwestern Memorial provides general health care services primarily to residents within its geographic location and supports research and education programs. Operating expenses directly attributable to a specific functional area are reported as expenses of those functional areas. Expenses other than depreciation expense are directly allocated to functional departments at the time they are incurred. Depreciation expense is allocated on a pro rata basis. General administrative and other expenses primarily include legal, finance, purchasing, human resources, information technology, management and governance.

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

Expenses related to providing these services were as follows for the six months ended:

	February 28, 2022				
	Health Care Services	Research and Education	Fundraising	General, Administrative and Other	Total Expenses
Salaries	\$ 1,344,959	\$ 2,269	\$ 3,522	\$ 292,866	\$ 1,643,616
Employee benefits	191,530	601	481	44,642	237,254
Supplies	828,308	309	181	11,418	840,216
Purchased services	104,359	7,794	202	262,305	374,660
Depreciation and amortization	172,487	3,067	224	40,798	216,576
Insurance	83,840	—	—	20,838	104,678
Rent and utilities	24,194	1	135	27,574	51,904
Repairs and maintenance	45,121	189	95	21,779	67,184
Interest	31	—	—	21,391	21,422
Illinois Hospital Assessment	100,790	—	—	—	100,790
Other	16,344	56,081	78	20,614	93,117
	\$ 2,911,963	\$ 70,311	\$ 4,918	\$ 764,225	\$ 3,751,417
	February 28, 2021				
	Health Care Services	Research and Education	Fundraising	General, Administrative and Other	Total Expenses
Salaries	\$ 1,130,862	\$ 1,972	\$ 3,584	\$ 249,915	\$ 1,386,333
Employee benefits	132,203	376	401	36,096	169,076
Supplies	746,458	400	113	10,279	757,250
Purchased services	84,518	7,468	196	261,704	353,886
Depreciation and amortization	153,020	2,710	245	36,004	191,979
Insurance	66,994	—	—	12,899	79,893
Rent and utilities	22,160	3	184	23,208	45,555
Repairs and maintenance	38,476	4	279	18,151	56,910
Interest	1,592	—	—	25,326	26,918
Illinois Hospital Assessment	89,871	—	—	—	89,871
Other	17,087	49,999	70	16,577	83,733
	\$ 2,483,241	\$ 62,932	\$ 5,072	\$ 690,159	\$ 3,241,404

The research and education costs include \$988 and \$931 for the six months ended February 28, 2022 and 2021, respectively, of expenses supported by federal, state, and corporate grants; and includes \$7,682 and \$8,245 for the six months ended February 28, 2022 and 2021, respectively, of expenses supported by other donor-restricted funds.

Northwestern Memorial HealthCare
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16. Commitments and Contingencies

Academic, Program and Other Support

Consistent with its mission, Northwestern Memorial provides academic, program and other support to other not-for-profit entities. The present value of the total remaining commitments related to this support is \$73,807 and \$76,167 at February 28, 2022 and August 31, 2021, respectively, which is reported as Grants and academic support payable, current portion and Grants and academic support payable, less current portion in the accompanying condensed consolidated balance sheets.

Northwestern Memorial will provide continuing funding to Northwestern University in support of the research and education mission of FSM. This continuing funding is based on the average Patient service revenue and operating results of Northwestern Memorial. The expense incurred of \$26,745 and \$24,701 for the three months ended February 28, 2022 and 2021, and \$55,483 and \$49,937 for the six months ended February 28, 2022 and 2021, respectively, is recorded in Other expense in the accompanying condensed consolidated statements of operations and changes in net assets; a related liability of \$567 and \$5,652, is recorded in Accrued expenses and other current liabilities as of February 28, 2022 and August 31, 2021, respectively.

Capital Projects

Various capital projects are currently being constructed and are expected to be placed in service over the next three years. The total estimated cost of these projects is approximately \$1,944,000. As of February 28, 2022, project commitments totaled \$1,274,000, of which \$864,000 has been incurred.

Regulatory

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

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

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

The United States Department of Health and Human Services Office of Civil Rights (OCR) is responsible for enforcing the Health Insurance Portability and Accountability Act (HIPAA) and the Privacy and Security Rules. OCR has initiated a compliance review of Northwestern Memorial of certain privacy breaches related to inappropriate access of patient information. Northwestern Memorial has complied with the OCR data requests. In addition, Northwestern Memorial is aware of, has investigated, and has made disclosure to OCR with respect to certain other privacy breaches and has responded to requests for information from the OCR. NMHC is unable to determine whether any corrective actions or fines might be imposed by OCR as a result of the compliance review or the disclosures provided to OCR.

Litigation

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

17. COVID-19

In March 2020, the World Health Organization declared the global novel coronavirus disease 2019 (COVID-19) outbreak a pandemic. Northwestern Memorial has developed and implemented an emergency response to the situation. However, COVID-19 could still materially affect Northwestern Memorial's operations and financial condition as the duration of the pandemic is unknown.

On March 27, 2020, the United States President signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which provided economic assistance to a wide array of industries, including health care. As part of this act, CMS expanded its Accelerated and Advance Payment Program which allowed participants to receive expedited payments during periods of national emergencies. Northwestern Memorial received approximately \$412,000 in Medicare advanced payments. To preserve liquidity throughout the uncertain market, Northwestern Memorial retained these funds, which are recorded in Cash and cash equivalents at February 28, 2022 and August 31, 2021. CMS began recouping these advanced payments in April 2021, which was one year subsequent to the issuance of the funds and are based on a percentage of Medicare payments owed to Northwestern Memorial over 17 months with the remaining balance due at the conclusion of that time period.

Northwestern Memorial has received support under the CARES Act and American Rescue Plan Act (ARP). CARES Act support includes Provider Relief Funds (PRF). Northwestern Memorial accounted for the PRF payments and ARP payments as contributions that are recognized as revenue when any related conditions have been substantially met.

The PRF and ARP payments provide funding from the U.S. Department of Health and Human Services (HHS) to healthcare providers to support healthcare-related expenses or lost revenue attributable to COVID-19. Funds received from HHS represent payments to providers and do not need to be repaid as long as Northwestern Memorial complies with certain terms and conditions imposed by HHS, including reporting and compliance requirements. Northwestern Memorial recognized HHS stimulus payments of \$44,000 during the three and six months ended February 28, 2022, respectively, and \$12,000 for the three and six months ended February 28, 2021, respectively.

Northwestern Memorial has elected to defer the deposit and payment of the employer's share of Social Security taxes allowed under the CARES Act. Northwestern Memorial has deferred \$43,716 of such payments recorded in Accrued expenses and other current liabilities as of February 28, 2022 and \$87,432 of

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

such payments with \$43,716 recorded in Accrued expenses and other current liabilities and \$43,716 in Other liabilities as of August 31, 2021.

Management will continue to review any additional impact of the CARES Act.

18. Subsequent Events

Northwestern Memorial evaluated events and transactions occurring subsequent to February 28, 2022 through April 14, 2022, the date of issuance of these condensed consolidated financial statements. During this period, there were no subsequent events requiring recognition in the condensed consolidated financial statements and no unrecognized subsequent events requiring disclosure.