



Quarterly Report

As of and for the Fourth Quarter
Ended August 31, 2020

Northwestern Memorial HealthCare and Subsidiaries



**NORTHWESTERN MEMORIAL HEALTHCARE AND
SUBSIDIARIES**
Unaudited Condensed Consolidated Financial Statements
As of and for the Fourth Quarter Ended August 31, 2020

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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)

	August 31, 2020	August 31, 2019
	(Unaudited)	Note A
Assets		
Current Assets:		
Cash and cash equivalents	\$ 1,336,516	\$ 329,646
Short-term investments	15,474	189,444
Current portion of investments, including assets limited as to use	190,482	171,227
Patient accounts receivable	607,407	791,667
Current portion of pledges and grants receivable, net	17,028	17,393
Current portion of insurance recoverable	28,971	17,433
Inventories	121,999	89,147
Other current assets	172,598	158,763
Total current assets	2,490,475	1,764,720
Investments, including assets limited as to use, less current portion	6,971,079	6,359,161
Property and equipment, at cost:		
Land	392,078	379,989
Buildings	4,564,669	4,406,214
Equipment and furniture	1,705,261	1,515,862
Construction in progress	138,072	150,896
	6,800,080	6,452,961
Less accumulated depreciation	2,825,937	2,487,009
	3,974,143	3,965,952
Prepaid pension cost	81,199	71,872
Pledges and grants receivable, less current portion	44,000	49,179
Insurance recoverable, less current portion	133,573	112,040
Right-of-use assets - leases, net	173,422	—
Other assets, net	236,737	205,207
Total assets	\$ 14,104,628	\$ 12,528,131

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

	August 31, 2020	August 31, 2019
	(Unaudited)	Note A
Liabilities and net assets:		
Current Liabilities		
Accounts payable	\$ 216,410	\$ 264,896
Accrued salaries and benefits	392,710	323,647
Grants and academic support payable, current portion	22,602	28,869
Accrued expenses and other current liabilities	572,764	132,905
Due to third-party payors	655,892	598,020
Current accrued liabilities under self-insurance programs	137,537	116,161
Current maturities of long-term debt	25,471	20,735
Long-term debt subject to short-term remarketing	58,880	73,836
Short-term debt	77,697	77,697
Total current liabilities	2,159,963	1,636,766
Long-term debt, less current maturities	1,611,861	1,636,857
Accrued liabilities under self-insurance programs, less current portion	650,034	586,472
Grants and academic support payable, less current portion	71,871	65,120
Interest rate swaps	128,253	120,755
Lease obligations, less current portion	150,514	—
Other liabilities	241,814	208,114
Total liabilities	5,014,310	4,254,084
Net assets:		
Without donor restrictions:		
Controlling interest	8,615,138	7,819,189
Non-controlling interest in subsidiaries	515	635
Total net assets without donor restrictions	8,615,653	7,819,824
With donor restrictions	474,665	454,223
Total net assets	9,090,318	8,274,047
Total liabilities and net assets	\$ 14,104,628	\$ 12,528,131

Note A: The August 31, 2019 financial statement information was derived from and should be read in conjunction with the Northwestern Memorial HealthCare and Subsidiaries 2019 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		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Revenue				
Patient service revenue	\$ 1,436,912	\$ 1,424,817	5,570,737	5,665,736
Rental and other revenue	83,918	104,473	394,664	355,335
Net assets released from donor restrictions and federal and state grants	139,782	10,217	323,026	30,957
Total revenue	1,660,612	1,539,507	6,288,427	6,052,028
Expenses				
Salaries	648,221	607,571	2,578,215	2,411,575
Employee benefits	76,022	80,954	346,970	350,024
Supplies	355,459	323,761	1,303,575	1,230,830
Purchased services	168,793	185,053	665,600	667,198
Depreciation and amortization	95,150	98,079	370,991	372,310
Insurance	21,272	37,709	132,781	122,764
Rent and utilities	28,857	27,869	105,013	105,078
Repairs and maintenance	40,694	45,701	123,882	131,256
Interest	12,879	15,242	53,346	60,634
Illinois Hospital Assessment	41,691	38,529	157,279	154,117
Other	37,092	43,922	157,775	162,713
Total expenses	1,526,130	1,504,390	5,995,427	5,768,499
Operating income	134,482	35,117	293,000	283,529
Nonoperating gains (losses)				
Investment return	668,384	145,095	576,905	57,836
Contribution of Centegra net assets	—	(1,531)	—	74,555
Change in fair value of interest rate swaps	7,063	(24,756)	(7,498)	(47,405)
Grants and academic support provided	(40,443)	(16,694)	(74,567)	(46,904)
Other	13,390	8,550	26,576	26,133
Total nonoperating gains, net	648,394	110,664	521,416	64,215
Excess of revenue over expenses	782,876	145,781	814,416	347,744
Net gain attributable to non-controlling interest in subsidiaries	120	176	455	1,193
Excess of revenue over expenses attributable to NMHC and Subsidiaries	\$ 782,756	\$ 145,605	\$ 813,961	\$ 346,551

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

	Three Months Ended		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Net assets without donor restrictions, controlling interest				
Excess of revenue over expenses	\$ 782,756	\$ 145,605	\$ 813,961	\$ 346,551
Net assets released from restrictions used for property and equipment additions	810	4,183	5,514	12,567
Postretirement-benefit-related changes other than net periodic pension cost	(23,310)	(147,973)	(18,890)	(146,907)
Other	(223)	237	(4,636)	(317)
Increase in net assets without donor restrictions, controlling interest	760,033	2,052	795,949	211,894
Net assets without donor restrictions, noncontrolling interest				
Excess of revenue over expenses	120	176	455	1,193
Distribution to non-controlling interest	(440)	—	(903)	(1,118)
Other	110	(229)	328	(66)
(Decrease) increase in net assets without donor restrictions, noncontrolling interest	(210)	(53)	(120)	9
Net assets with donor restrictions				
Contributions	13,823	13,884	47,190	57,321
Investment return	3,284	4,327	21,732	16,400
Net assets released from restrictions used for:				
Operating expenses, charity care, and research and education	(16,881)	(16,094)	(42,867)	(36,142)
Property and equipment additions	(810)	(4,183)	(5,514)	(12,567)
Change in fair value of split-interest agreements	911	(617)	367	(245)
Contribution of Centegra net assets with donor restrictions	—	—	—	6,591
Other	(12)	(668)	(466)	(2,363)
Increase (decrease) in net assets with donor restrictions	315	(3,351)	20,442	28,995
Change in net assets	760,138	(1,352)	816,271	240,898
Net assets, beginning of period	8,330,180	8,275,399	8,274,047	8,033,149
Net assets, end of period	\$ 9,090,318	\$ 8,274,047	\$ 9,090,318	\$ 8,274,047

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

	Twelve Months Ended	
	August 31,	
	2020	2019
Operating activities		
Change in net assets	\$ 816,271	\$ 240,898
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Postretirement benefit-related changes other than net periodic pension cost	18,890	146,907
Change in fair value of interest rate swaps	7,498	47,405
Net unrestricted realized investment return and net change in unrestricted and restricted unrealized investment gains/(losses)	(577,626)	(58,821)
Restricted contributions, change in fair value of split interest agreements, and realized investment return	(68,567)	(72,489)
Contribution of Centegra net assets	—	(81,146)
Depreciation and amortization	370,991	372,310
Changes in operating assets and liabilities:		
Patient accounts receivable	184,260	44,127
Due to third-party payors	60,605	(1,745)
Grants and academic support payable	484	(16,897)
CMS accelerated payments	412,358	—
Other operating assets and liabilities	5,461	(52,191)
Net cash provided by operating activities	1,230,625	568,358
Investing activities		
Purchase of investments	(4,806,171)	(2,947,680)
Sale of investments	4,818,980	2,447,463
Cash received from contribution of Centegra	—	12,406
Net unrestricted realized investment return	107,615	188,186
Capital expenditures, net	(387,002)	(386,047)
Net cash used in investing activities	(266,578)	(685,672)
Financing activities		
Proceeds from line of credit	—	50,231
Proceeds from issuance of long-term debt	—	55,000
Payments of long-term debt	(25,744)	(138,009)
Restricted contributions, change in fair value of split interest agreements, and realized investment return	68,567	72,489
Net cash provided by financing activities	42,823	39,711
Net increase (decrease) in cash and cash equivalents	1,006,870	(77,603)
Cash and cash equivalents, beginning of period	329,646	407,249
Cash and cash equivalents, end of the period	\$ 1,336,516	\$ 329,646

See accompanying notes to the interim condensed consolidated financial statements.

As of and for the Fourth Quarter Ended

August 31, 2020

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, 2019.

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, 2019, which are available on the Electronic Municipal Market Access ("EMMA") website of the Municipal Securities Rulemaking Board.

2. Adoption of Accounting Standards

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*, which requires lessees to put most leases on their balance sheets but recognize expenses on their income statements in a manner similar to existing accounting standards. On September 1, 2019, this standard was adopted by Northwestern Memorial on a modified retrospective approach. Northwestern Memorial did not reassess whether any existing or expired agreements contain leases, the lease classification for any expired or existing leases and the initial direct costs for any expired or existing leases through the election of practical expedients. As of August 31, 2020, the impact of adoption on the condensed consolidated financial statements resulted in an increase of \$173,422 in noncurrent assets presented within Right-of-use assets - leases, an increase of \$35,131 in Accrued expenses and other current liabilities, and an increase of \$150,514 in Lease obligation, less current portion to record lease obligations for operating leases. The adoption of this standard had no material impact to the results of operations or cash flows.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 changed certain financial statement requirements for not-for-profit (NFP) entities in the scope of Topic 958 in an effort to make the information more meaningful to users and make reporting less complex. NFP entities no longer distinguish between resources with temporary and permanent restrictions on the face of the financial statements. Additionally, NFP entities are required to present expenses by their natural and functional classification, present investment returns net of

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

external and direct internal investment expenses, and add additional disclosures. On August 31, 2019, this standard was adopted by Northwestern Memorial on a retrospective basis, having no impact to the financial position, results of operations or cash flows.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*. ASU 2018-13 eliminates certain disclosure requirements for fair value measurements for all entities, requires public entities to disclose certain new information and modifies some disclosure requirements. This new guidance is effective for fiscal years beginning after December 15, 2019. 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 2018-14, *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 in 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 Accounting Standards Codification (ASC) 350-40 to determine which implementation costs to capitalize as assets. This guidance is effective in fiscal years beginning after December 15, 2021. This guidance is to be applied prospectively and early adoption is permitted. Northwestern Memorial is currently evaluating the impact this guidance will have on its consolidated financial statements.

3. Reclassification

Certain reclassifications have been made to the 2019 consolidated financial statements to conform with classifications used in 2020. The reclassifications had no material effect on total assets, total liabilities, total revenue or total revenue in excess of expenses previously reported.

4. Affiliation Agreement with Centegra

On September 1, 2018, Centegra Health System (Centegra) became a wholly owned subsidiary of NMHC pursuant to an affiliation agreement between NMHC and Centegra. This affiliation positions Northwestern Memorial, under the Northwestern Medicine brand, to expand its integrated academic health delivery system to McHenry County, offering patients access to leading-edge care closer to where they live and work.

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

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

The acquisition-date fair value of identifiable assets and liabilities of Centegra at September 1, 2018 consisted of the following:

Fair Value of identifiable net assets:	
Cash and cash equivalents	\$ 12,406
Other current assets	114,779
Property and equipment	362,312
Other long-term assets	161,038
Current liabilities	(129,273)
Long-term debt	(397,494)
Other long-term liabilities	(42,622)
Net assets with donor restrictions	<u>(6,591)</u>
Contribution of net assets without donor restrictions	<u>\$ 74,555</u>

The valuation of property and equipment; other current and long-term assets, including identifiable intangible assets and current and long-term liabilities has been completed as of August 31, 2019. In valuing these assets and liabilities, fair values were based on, but not limited to, independent appraisals, discounted cash flows, replacement costs and actuarially determined values.

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

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 \$477 and \$4,081 for the three months ended August 31, 2020 and 2019 respectively, and decreased by \$11,028 and \$9,630 for the twelve months ended August 31, 2020 and 2019, 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 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 August 31, 2020 and 2019, respectively, were not material other than those disclosed in Note 17.

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

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		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Patient service revenue:				
Medicare	\$ 395,738	\$ 407,326	\$ 1,507,994	\$ 1,541,055
Medicaid	148,094	108,093	482,135	458,257
Blue Cross	545,072	554,283	2,194,231	2,224,456
Other managed care	303,938	304,463	1,209,185	1,257,371
Commercial and other	39,979	44,229	137,109	145,827
Self pay	4,091	10,423	40,083	38,770
Total Patient service revenue	\$ 1,436,912	\$ 1,428,817	\$ 5,570,737	\$ 5,665,736

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

	Three Months Ended		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Hospitals	\$ 1,101,065	\$ 1,080,265	\$ 4,316,239	\$ 4,408,719
Physician groups	321,615	333,790	1,201,407	1,188,974
Other	14,232	10,762	53,091	68,043
Total	\$ 1,436,912	\$ 1,424,817	\$ 5,570,737	\$ 5,665,736

Northwestern Memorial grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. At August 31, 2020 and 2019, respectively, patient accounts receivable, including patient co-pays and deductibles by major primary payor source, were as follows:

	August 31,	August 31,
	2020	2019
Medicare	18%	18%
Medicaid	16	11
Blue Cross	15	23
Other managed care	25	22
Commercial and other	8	7
Self pay	18	19
	100%	100%

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

6. Hospital Assessment Program

In June, 2018, the Illinois Hospital Assessment Program (HAP) was redesigned and reauthorized by the Illinois General Assembly via SB 1773, which was subsequently signed into law by the Governor as Illinois Public Law 100-581. The Federal Centers for Medicare and Medicaid Services (CMS) approved the redesigned HAP on June 20, 2018. The HAP was scheduled to expire on June 30, 2020. Supplemental payments for the new HAP program began in July, 2018 and are reflected below. In addition, the HAP program provides for increased Illinois Medicaid and Illinois Medicaid Managed Care inpatient rates.

In May, 2020, the Illinois General Assembly unanimously approved SB 2541, which creates a redesigned HAP for the State of Illinois. On July 7, 2020, Governor Pritzker has signed it into law. An amendment to Illinois' existing State Medicaid Plan establishing the redesigned HAP as per SB 2541 has also been approved by the federal Centers for Medicare and Medicaid Services. In addition to new funding for the program, the redesigned HAP better recognizes patient volumes as well as acuity.

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

	Three Months Ended		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Patient service revenue - HAP	\$ 56,437	\$ 48,337	\$ 204,202	\$ 193,262
Illinois Hospital Assessment	(41,691)	(38,529)	(157,279)	(154,117)
Net excess of HAP revenue over Illinois assessment	\$ 14,746	\$ 9,808	\$ 46,923	\$ 39,145

As part of Coronavirus Aid, Relief and Economic Securities Act (CARES Act), which is discussed further in Note 17, Northwestern Memorial received an additional \$8,116 and \$10,918 in HAP revenue for the three and twelve month periods ended August 31, 2020 respectively.

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:

	August 31, 2020	August 31, 2019
Measured at fair value:		
Cash and cash equivalents and Short-term investments	\$ 1,515,798	\$ 831,630
Mutual funds	353,300	230,611
Corporate bonds	350,101	362,382
U.S. government and agency issues	398,051	293,987
Equity securities	4,545	48,794
Other fixed income	300	12,459
	<u>2,622,095</u>	<u>1,779,863</u>
Measured at net asset value as practical expedient:		
Common collective trusts and commingled funds	1,193,784	786,767
Interest in 103-12 investment entities	286,404	325,607
	<u>1,480,188</u>	<u>1,112,374</u>
Accounted for under the equity method:		
Alternative investments	4,411,268	4,157,241
	<u>\$ 8,513,551</u>	<u>\$ 7,049,478</u>

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

	August 31, 2020	August 31, 2019
Assets limited as to use:		
Trustee-held funds	\$ 26,790	\$ 22,151
Self-insurance programs	628,999	651,177
Board-designated funds	212,252	202,649
Total assets limited as to use	<u>868,041</u>	<u>875,977</u>
Donor-restricted funds	415,310	387,665
Unrestricted, undesignated funds	5,878,210	5,266,746
Total investments, excluding short-term investments	<u>7,161,561</u>	<u>6,530,388</u>
Other financial instruments:		
Cash and cash equivalents and short-term investments	1,351,990	519,090
	<u>\$ 8,513,551</u>	<u>\$ 7,049,478</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		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Interest and dividend income	\$ 9,552	\$ 11,598	\$ 38,873	\$ 46,425
Investment expenses	(1,569)	(1,336)	(4,913)	(4,741)
Realized gains (losses) on alternative investments, net	19,859	15,667	83,683	83,953
Realized (losses) gains on other investments, net	6,881	6,535	15,517	81,238
Net change in unrealized (loss) gain on alternative investments	411,240	111,966	200,819	23,007
Net change in unrealized gain (loss) on other investments	227,606	6,709	269,195	(152,348)
Change in value of joint ventures	(1,734)	359	(1,137)	1,820
	<u>\$ 671,835</u>	<u>\$ 151,498</u>	<u>\$ 602,037</u>	<u>\$ 79,354</u>
Reported as:				
Rental and other revenue	\$ 166	\$ 2,076	\$ 3,400	\$ 5,118
Nonoperating investment return	668,384	145,095	576,905	57,836
With donor restriction investment return	3,285	4,327	21,732	16,400
	<u>\$ 671,835</u>	<u>\$ 151,498</u>	<u>\$ 602,037</u>	<u>\$ 79,354</u>

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

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

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

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

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

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

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 June 30 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 fourth quarter of fiscal 2020 or 2019 for the limited partnership investments.

As of August 31, 2020, \$3,117,111 of alternative investments is subject to various redemption limits and lockup provisions, of which \$2,559,120 expires within one year and \$557,991 expires after one year from the balance sheet date.

At August 31, 2020, Northwestern Memorial had commitments to fund approximately an additional \$784,000 to alternative investment entities. This funding is expected to occur over the next 12 years.

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

8. Fair Value Measurements

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

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

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Examples of Level 2 inputs are quoted prices for similar assets or liabilities in inactive markets or pricing models with inputs that are observable for substantially the full term of the asset or liability.
- Level 3 – Inputs to the valuation methodology are significant to the fair value of the asset or the liability and less observable. These inputs reflect the assumptions market participants would use in the estimation of the fair value of the asset or liability.

Fair Values

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

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

The following table presents the financial instruments measured at fair value on a recurring basis at August 31, 2020:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 1,336,516	\$ —	\$ —	\$ 1,336,516
Investments:				
Short-term investments:				
Currency	15,474	—	—	15,474
Total short-term investments	15,474	—	—	15,474
Mutual funds:				
Fixed income	69,153	—	—	69,153
U.S. equities	284,147	—	—	284,147
Total mutual funds	353,300	—	—	353,300
Other fixed income	—	300	—	300
Bonds:				
Corporate bonds	—	350,101	—	350,101
U.S. government and agency issues	—	398,051	—	398,051
Total bonds	—	748,152	—	748,152
Equity securities	4,545	—	—	4,545
Cash equivalents in investment accounts	256,975	—	—	256,975
Due to broker	(93,167)	—	—	(93,167)
Total investments	537,127	748,452	—	1,285,579
Beneficial interest in trusts	—	17,354	—	17,354
Total assets	<u>\$ 1,873,643</u>	<u>\$ 765,806</u>	<u>\$ —</u>	<u>2,639,449</u>
Investments recorded at fair value based on NAV				<u>1,480,188</u>
Total assets measured at fair value				<u>\$ 4,119,637</u>
Liabilities:				
Interest rate swaps	\$ —	\$ 128,253	\$ —	\$ 128,253

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, 2019:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 329,646	\$ —	\$ —	\$ 329,646
Investments:				
Short-term investments:				
Currency	15,964	—	—	15,964
Fixed Income	173,480	—	—	173,480
Total short-term investments	189,444	—	—	189,444
Mutual funds:				
Fixed income	58,902	—	—	58,902
U.S. equities	171,709	—	—	171,709
Total mutual funds	230,611	—	—	230,611
Other fixed income	—	12,459	—	12,459
Bonds:				
Corporate bonds	—	362,382	—	362,382
U.S. government and agency issues	—	293,987	—	293,987
Total bonds	—	656,369	—	656,369
Equity securities	48,794	—	—	48,794
Cash equivalents in investment accounts	363,000	—	—	363,000
Due to broker	(50,460)	—	—	(50,460)
Total investments	781,389	668,828	—	1,450,217
Beneficial interest in trusts	—	16,987	—	16,987
Total assets	<u>\$ 1,111,035</u>	<u>\$ 685,815</u>	<u>\$ —</u>	<u>1,796,850</u>
Investments recorded at fair value based on NAV				<u>1,112,374</u>
Total assets measured at fair value				<u>\$ 2,909,224</u>
Liabilities:				
Interest rate swaps	\$ —	\$ 120,755	\$ —	\$ 120,755

There were no transfers into or out of Level 1 or Level 2 during the periods ended August 31, 2020 or year ended August 31, 2019.

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

Reconciliation to the Condensed Consolidated Balance Sheets

A reconciliation of the fair value of financial assets to the condensed consolidated balance sheets at August 31, 2020 and 2019, respectively, is as follows:

	<u>August 31, 2020</u>	<u>August 31, 2019</u>
Short-term investments measured at fair value	\$ 15,474	\$ 189,444
Investments, including assets limited as to use measured at fair value	2,750,293	2,373,147
Total investments at fair value	2,765,767	2,562,591
Alternative investments accounted for under equity method included in investments, including assets limited as to use	4,411,268	4,157,241
Total investments	<u>\$ 7,177,035</u>	<u>\$ 6,719,832</u>
Pledges and grants receivable, less current portion:		
Beneficial interests in trusts at fair value	\$ 17,354	\$ 16,987
Pledges and grants receivable, less current portion, net	26,646	32,192
Total pledges and grants receivable, less current portion	<u>\$ 44,000</u>	<u>\$ 49,179</u>

Valuation Techniques and Inputs

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

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

Investments - The fair value of Level 1 investments, which consist of equity securities and mutual funds, is based on quoted market prices that are valued on a daily basis. Level 2 investments consist of U.S. equities, 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 \$1,771,959 and \$1,810,449 at August 31, 2020 and 2019, 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 \$40,782 and \$44,992 at August 31, 2020 and 2019, 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:

	August 31, 2020	August 31, 2019
Revenue Bonds, Series 2017A (NMHC), payable in annual installments through July 15, 2047 (fixed coupon rates range from 3.00% to 5.00%)	\$ 514,575	\$ 523,325
Revenue Bonds, Series 2017B (NMHC), payable in annual installments beginning July 25, 2055 through July 25, 2057 (fixed coupon rate of 5.00% through December 15, 2022)	162,380	162,380
Revenue Bonds, Series 2015A and 2015B (NMHC), payable in monthly installments through March 1, 2035 (fixed interest rates range from 2.18% to 2.27% through March 1, 2023)	9,626	10,150
Revenue Bonds, Series 2014A (Centegra), payable in annual installments through September 1, 2042 (fixed coupon rates range from 4.63% to 5.00%)	132,325	133,545
Revenue Bonds, Series 2013 (NMHC), payable in annual installments beginning August 15, 2031 through August 15, 2043 (fixed coupon rates range from 4.00% to 5.00%)	111,235	111,235
Revenue Bonds, Series 2012 (Centegra), payable in annual installments through September 1, 2038 (fixed coupon rates range from 4.00% to 5.00%)	179,115	184,700
Revenue Bonds, Series 2011A and 2011B (NMHC), with interest at a variable rate payable with annual installments through November 1, 2038, (weighted average interest rate of 1.37% and 2.46% for the twelve months ended August 31, 2020 and 2019, respectively)	111,250	112,900
Revenue Bonds, Series 2011C (Delnor), with interest at a variable rate payable with annual installments through November 1, 2038, (weighted average interest rate of 1.27% and 2.41% for the twelve months ended August 31, 2020 and 2019, respectively)	54,725	55,440
Revenue Bonds, Series 2014B (Centegra), with interest at a variable rate payable with annual installments through September 1, 2044, (weighted average interest rate of 1.40% and 3.97% for the twelve months ended August 31, 2020 and 2019, respectively)	33,160	33,490
Revenue Bonds, Series 2014C (Centegra), with interest at a variable rate payable with annual installments through September 1, 2044 (weighted average interest rate of 1.39% and 4.18% for the twelve months ended August 31, 2020 and 2019, respectively)	24,010	24,250
Variable Rate Demand Revenue Bonds, Series 2008A (NMH), payable in annual installments through August 15, 2038 (weighted average interest rate of 1.06% and 1.72% for the twelve months ended August 31, 2020 and 2019, respectively)	58,880	64,210
Variable Rate Demand Revenue Bonds, Series 2007A (NMH), payable in annual installments through August 15, 2042 (weighted average interest rate of 0.82% and 1.53% for the twelve months ended August 31, 2020 and 2019, respectively)	200,600	202,000

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

	August 31, 2020	August 31, 2019
NMHC fixed rate note dated August 29, 2019, matures September 1, 2024 (fixed rate of 1.98%)	\$ 55,000	\$ 55,000
The Midland Surgical Center, LLC line of credit due October 15, 2020, interest payments required monthly at a variable rate not less than 3.75%	321	321
NMHC commercial paper dated October 4, 2016 (weighted average interest rate of 1.47% and 2.31% for the twelve months ended August 31, 2020 and 2019, respectively)	77,697	77,697
	1,724,899	1,750,643
Less:		
Unamortized premium and debt issuance costs	(49,010)	(58,482)
Long-term debt subject to short-term remarketing agreements	58,880	73,836
Current maturities	25,471	20,735
Commercial paper, included in Short-term debt	77,697	77,697
	\$ 1,611,861	\$ 1,636,857

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 August 31, 2020 are as follows:

Available	Outstanding	Restricted
\$ 100,000	\$ —	\$ 556
15,000	—	—
7,000	—	10

Northwestern Memorial has standby bond purchase agreements (SBPAs) with multiple 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 August 31, 2020, the banks provided liquidity support in the event of a failed remarketing as follows:

	Par Value	Expiration date
Subseries 2007A-2, 2007A-4	\$ 100,300	September 2024
Subseries 2007A-1, 2007A-3	100,300	September 2023

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

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

The Series 2014B and 2014C Bonds are subject to put options, such that the bondholders have agreed to hold the 2014B and 2014C Bonds for initial private placement rate periods ending on July 1, 2024 and September 1, 2021, respectively, 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 and September 1, 2021, respectively.

In August 2019, the following transactions occurred related to Northwestern Memorial's long- and short-term debt:

The SBPA for the \$101,000 Illinois Finance Authority Variable Rate Demand Revenue Bonds, Subseries 2007A-1 and Subseries 2007A-3 (NMH) was extended for four years. The SBPA for the \$101,000 Illinois Finance Authority Variable Rate Demand Revenue Bonds, Subseries 2007A-2 and Subseries 2007A-4 (NMH) was replaced by a new standby bond purchase agreement for five years. The SBPA for the \$64,210 Illinois Finance Authority Variable Rate Demand Revenue Bonds, Series 2008A (NMH) was terminated and the bonds converted to self-liquidity mode and are included in Long-term subject to short-term remarketing in the accompanying consolidated balance sheets.

The Illinois Finance Authority Variable Rate Demand Revenue Bonds, Series 2011A (NMHC) and 2011C (CDH-Delnor Health System) in the aggregate amount of \$111,890 were purchased by different banks at variable rates for a period of seven years and three years, respectively. The Illinois Finance Authority Variable Rate Demand Revenue Bonds, Series 2011B (NMHC) in the amount of \$56,450 were extended with the current bank at a variable rate for a period of five years.

NMHC issued an additional tranche of commercial paper in the amount of \$50,231. The proceeds were used to partially pay off the NMHC variable rate note (Term Loan). The remaining \$55 million of the Term Loan was refinanced with a different bank at a fixed rate for a period of five years.

10. Derivatives

Northwestern Memorial's only derivative financial instruments are interest rate swaps approximately equal to its Series 2007A and Series 2011A-C variable rate bonds for the sole purpose of risk management. These bonds expose Northwestern Memorial to variability in interest payments due to changes in interest rates. To manage fluctuations in cash flows resulting from interest rate risk, Northwestern Memorial entered into various interest rate swap agreements. These swaps limit the variable-rate cash flow exposure on the variable rate bonds to synthetically fixed cash flows. By using interest rate swaps to manage the risk of changes in interest rates, Northwestern Memorial exposes itself to credit risk and market risk. Credit risk is the risk that a counterparty will fail to perform under the terms of a derivative contract. When the fair value

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

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 \$9,484 and \$2,780 for non-performance risk at August 31, 2020 and 2019, 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
August 31, 2020	August 31, 2019			
100,300	\$ 101,000	August 2042	3.89 %	63% of 1-Month LIBOR + 28 bps
100,300	101,000	August 2042	3.89	63% of 1-Month LIBOR + 28 bps
60,050	60,575	November 2038	3.82	67% of 3-Month LIBOR
60,050	60,575	November 2038	3.52	67% of 3-Month LIBOR
<u>\$ 320,700</u>	<u>\$ 323,150</u>			

The fair value of derivative instruments is as follows:

	Derivative Liabilities		
	Balance Sheet Location	August 31, 2020	August 31, 2019
Derivatives not designated as hedging instruments:			
Interest rate contracts	Interest rate swap liabilities	\$ 128,253	\$ 120,755

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

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

	Three Months Ended		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Derivatives not designated as hedging instruments:				
Operating expense - interest	\$ (1,800)	\$ (1,064)	\$ (5,837)	\$ (4,271)
Nonoperating - change in fair value of interest rate swaps	7,063	(24,756)	(7,498)	(47,405)

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 \$11,610 and \$7,130 as of August 31, 2020 and 2019, respectively. If the credit-risk-related contingent features underlying the agreement were triggered to the fullest extent on August 31, 2020, Northwestern Memorial would be required to post \$126,127 of additional collateral to its counterparties.

11. Net Assets with Donor Restrictions

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

	August 31, 2020	August 31, 2019
Subject to expenditure for specified purpose:		
Purchase of property and equipment	\$ 22,152	\$ 22,746
Operating expenses and charity care	99,391	105,226
Research, education, and other	146,502	130,386
Total expenditure for specified purpose	268,045	258,358
Subject to passage of time:		
Pledges and trusts	1,977	2,107
Endowments:		
Perpetual in nature:		
Purchase of property and equipment	15,754	15,454
Operating expenses and charity care	82,018	74,835
Research, education, and other	106,871	103,469
Total perpetual in nature	204,643	193,758
Total net assets with donor restrictions	\$ 474,665	\$ 454,223

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

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

	Three Months Ended		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Health care services:				
Purchase of property and equipment	\$ 810	\$ 4,183	\$ 5,514	\$ 12,567
Clinical expenses and charity care	5,057	5,852	21,362	16,099
Research, education and other	11,824	10,242	21,505	20,043
	<u>\$ 17,691</u>	<u>\$ 20,277</u>	<u>\$ 48,381</u>	<u>\$ 48,709</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		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Net assets released from donor restrictions and federal and state grants	\$ 8,160	\$ 7,704	\$ 25,210	\$ 19,040
Nonoperating other	8,721	8,390	17,657	17,102
	<u>\$ 16,881</u>	<u>\$ 16,094</u>	<u>\$ 42,867</u>	<u>\$ 36,142</u>

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 fair 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 donor 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 HealthCare
Notes to Interim Condensed Consolidated Financial Statements (continued)
(Unaudited and in thousands)

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.

The changes in endowment net assets for the twelve months ended August 31, 2019 and twelve months ended August 31, 2020 are summarized below:

	<u>Total</u>
Endowment net assets, August 31, 2018	\$ 238,435
Contributions	10,961
Change in value of trusts	(421)
Investment return	9,292
Appropriation for expenditure	(7,448)
Other	<u>599</u>
Endowment net assets, August 31, 2019	251,418
Contributions	9,853
Change in value of trusts	424
Investment return	14,713
Appropriation for expenditure	(7,297)
Other	<u>900</u>
Endowment net assets, August 31, 2020	<u><u>\$ 270,011</u></u>

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

12. Liquidity and Availability

Financial assets available for general expenditure within one year of the balance sheet date, comprise the following at August 31:

	2020
Cash and cash equivalents	\$ 1,336,516
Patient accounts receivable	607,407
Promises to give	14,135
Grants receivable	2,893
Other receivables	86,726
Investments	6,203,734
Total financial assets available within one year	\$ 8,251,411

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 condensed consolidated balance sheets at present value based on a discount rate of 2.0% as of August 31, 2020 and 2019, respectively. 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.

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 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.

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

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		Twelve Months Ended	
	August 31,		August 31,	
	2020	2019	2020	2019
Plan expenses	\$ (506)	\$ (330)	\$ (2,024)	\$ (1,323)
Interest cost on projected benefit obligation	(4,737)	(5,766)	(18,945)	(23,067)
Expected return on the Plans' assets	11,018	11,479	44,068	45,913
Amortization of net loss	(1,361)	(154)	(5,441)	(616)
	<u>\$ 4,414</u>	<u>\$ 5,229</u>	<u>\$ 17,658</u>	<u>\$ 20,907</u>

Northwestern Memorial made no contributions for the three and twelve month periods ended August 31, 2020 and has no current plans to contribute to the Plans during the fiscal year ending August 31, 2021.

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

	August 31, 2020				
	Health Care Services	Research and Education	Fundraising	General, Administrative and Other	Total Expenses
Salaries	\$ 2,080,816	\$ 4,351	\$ 7,851	\$ 485,197	\$ 2,578,215
Employee benefits	298,585	1,100	1,023	46,262	346,970
Supplies	1,286,581	369	437	16,188	1,303,575
Purchased services	159,112	14,413	230	491,845	665,600
Depreciation and amortization	289,551	5,480	979	74,981	370,991
Insurance	110,504	—	—	22,277	132,781
Rent and utilities	45,403	5	401	59,204	105,013
Repairs and maintenance	84,311	50	373	39,148	123,882
Interest	169	—	—	53,177	53,346
Illinois Hospital Assessment	157,279	—	—	—	157,279
Other	30,714	92,224	352	34,485	157,775
	\$ 4,543,025	\$ 117,992	\$ 11,646	\$ 1,322,764	\$ 5,995,427

	August 31, 2019				
	Health Care Services	Research and Education	Fundraising	General, Administrative and Other	Total Expenses
Salaries	\$ 1,931,227	\$ 795	\$ 8,157	\$ 471,396	\$ 2,411,575
Employee benefits	279,947	641	1,110	68,326	350,024
Supplies	1,211,298	65	656	18,811	1,230,830
Purchased services	149,467	13,391	555	503,785	667,198
Depreciation and amortization	285,792	5,200	699	80,619	372,310
Insurance	99,893	—	12	22,859	122,764
Rent and utilities	47,741	—	395	56,942	105,078
Repairs and maintenance	95,441	138	467	35,210	131,256
Interest	180	—	—	60,454	60,634
Illinois Hospital Assessment	154,117	—	—	—	154,117
Other	38,604	86,285	748	37,076	162,713
	\$ 4,293,707	\$ 106,515	\$ 12,799	\$ 1,355,478	\$ 5,768,499

The research and education costs include \$614 and \$989 for the three months ended August 31, 2020 and 2019, respectively, and \$2,597 and \$3,382 for the twelve months ended August 31, 2020 and 2019, respectively, of expenses supported by federal, state, and corporate grants; and includes \$10,725 and \$9,209 for the three months ended August 31, 2020 and 2019, respectively and \$18,372 and \$16,560 for the twelve months ended August 31, 2020 and 2019, respectively, of expenses supported by other donor-restricted funds.

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

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 \$94,473 and \$93,989 at August 31, 2020 and 2019, 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 \$22,625 and \$22,807 for the three months ended August 31, 2020 and 2019, respectively, and \$89,213 and \$85,711 for the twelve months ended August 31, 2020 and 2019, respectively, is recorded in Other expense in the accompanying condensed consolidated statements of operations and changes in net assets; and a related receivable of \$1,830, is recorded in Other current assets as of August 31, 2020 and a liability of \$499 is reported in Accrued expenses and other current liabilities in the accompanying condensed consolidated balance sheets as of August 31, 2019, 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 \$1,688,000. As of August 31, 2020, project commitments totaled \$777,000, of which \$573,000 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 healthcare organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the Medicare and Medicaid programs.

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

Northwestern Memorial HealthCare
Notes to Interim Condensed Consolidated Financial Statements (continued)
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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 Hospital 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 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. The Company's operations have been adversely affected in the near term as a result of COVID-19, but the impact to the Company's financial condition, including the effects on its investment portfolio as a result of market volatility, is not known.

On March 27, 2020, the United States President signed into law the Coronavirus Aid, Relief and Economic Securities Act (CARES Act) which will provide economic assistance to a wide array of industries, including health care. As part of this act, CMS has expanded its Accelerated and Advance Payment Program which allows participants to receive expedited payments during periods of national emergencies. Through August 31, 2020, Northwestern Memorial has received approximately \$412,000 in Medicare advanced payments, recorded in Accrued expenses and other liabilities. In September 2020, the Senate passed a bipartisan government funding bill that will delay the recoupment of these funds such that, depending upon usage, would require Northwestern Memorial to record some of these funds as long-term liabilities. Northwestern Memorial expects CMS to begin recouping these advanced payments in March 2021, which is one year subsequent to the issuance of the funds. Northwestern Memorial also received \$289,000 via the US Department of Health & Human Services stimulus payments, recorded in Net assets released from donor restrictions and federal and state grants. To preserve liquidity throughout the uncertain market, Northwestern Memorial has retained these funds which have been recorded in Cash and cash equivalents.

Northwestern Memorial has elected to defer the deposit and payment of the employer's share of Social Security taxes allowed under the CARES Act. Through August 31, 2020, Northwestern Memorial has deferred approximately \$48,000 of such payments with the related liability recorded in Accrued salaries and benefits. Additionally, Northwestern Memorial has recorded approximately \$4,300 from the Employee Retention Credit under the CARES Act as of August 31, 2020 which has been recorded in Rental and other revenue.

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

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

18. Palos Health Letter of Intent

In August 2020, NMHC and Palos Health executed a non-binding letter of intent that provides for a period of exclusive discussions regarding a potential affiliation between NMHC and Palos Health. NMHC cannot predict whether these discussions will result in an agreement between the two organizations. Any definitive agreement would be subject to both parties governing bodies and applicable regulatory approvals.

19. Subsequent Events

Northwestern Memorial evaluated events and transactions occurring subsequent to August 31, 2020 through October 30, 2020, the date of issuance of these condensed consolidated financial statements. During this period, there were no subsequent events requiring recognition in the consolidated financial statements and no unrecognized subsequent events requiring disclosure other than those disclosed in Note 17.