THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Financial Statements

June 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

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KPMG LLP
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200 East Randolph Drive
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Independent Auditors' Report

The Board of Trustees
The University of Chicago Medical Center:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of The University of Chicago Medical Center, which comprise the consolidated balance sheet as of June 30, 2016, and the related consolidated statements of operations, consolidated changes in net assets, and consolidated cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the 2016 consolidated financial statements referred to above present fairly, in all material respects, the financial position of The University of Chicago Medical Center as of June 30, 2016, and the results of their operations and of their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Other Matter

The accompanying consolidated financial statements of The University of Chicago Medical Center as of June 30, 2015 and for the year then ended were audited by other auditors whose report thereon dated October 29, 2015, expressed an unmodified opinion on those financial statements.

KPMG LLP

Chicago, Illinois
October 10, 2016

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Balance Sheets

June 30, 2016 and 2015

(In thousands)

Assets		2016	2015
Current assets:			
Cash and cash equivalents	$	20,335	163,969
Patient accounts receivable, net of estimated uncollectibles of $73,746 in 2016 and $51,737 in 2015		288,401	209,736
Current portion of investments limited to use		36,768	5,033
Current portion of malpractice self-insurance receivable		18,289	20,129
Current portion of pledges receivable		1,661	1,102
Prepaids, inventory and other current assets		62,614	43,148
Total current assets		428,068	443,117
Investments limited to use, less current portion		894,808	1,013,224
Property, plant and equipment, net		1,380,132	1,232,784
Pledges receivable, less current portion		2,489	1,522
Malpractice self-insurance receivable, less current portion		99,121	92,571
Other assets, net		22,040	19,350
Total assets	$	2,826,658	2,802,568
Liabilities and Net Assets			
Current liabilities:			
Accounts payable and accrued expenses	$	166,173	127,477
Current portion of long-term debt		13,255	11,535
Current portion of other long-term liabilities		—	197
Current portion of estimated third-party payor settlements		139,429	98,975
Current portion of malpractice self-insurance liability		18,289	20,129
Due to University of Chicago		22,146	59,437
Total current liabilities		359,292	317,750
Other liabilities:			
Worker’s compensation self-insurance liabilities, less current portion		6,305	8,174
Malpractice self-insurance liability, less current portion		99,121	92,571
Long-term debt, less current portion		850,252	868,008
Interest rate swap liability		165,417	110,447
Other long-term liabilities, less current portion		30,618	44,071
Total liabilities		1,511,005	1,441,021
Net assets:			
Unrestricted		1,225,616	1,267,336
Temporarily restricted		81,925	86,109
Permanently restricted		8,112	8,102
Total net assets		1,315,653	1,361,547
Total liabilities and net assets	$	2,826,658	2,802,568

See accompanying notes to financial statements.

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Statements of Operations

June 30, 2016 and 2015

(In thousands)

		2016	2015
Operating revenues:			
Net patient service revenue	$	1,574,252	1,493,816
Provision for doubtful accounts		84,243	52,166
Net patient service revenue after provision for doubtful accounts		1,490,009	1,441,650
Other operating revenues and net assets released from restrictions used for operating purposes		126,625	101,643
Total operating revenues		1,616,634	1,543,293
Operating expenses:			
Salaries, wages and benefits		698,752	681,909
Supplies and other		427,739	400,536
Physician services from the University of Chicago		215,727	205,461
Insurance		11,324	16,774
Interest		32,940	35,632
Medicaid provider tax		36,110	36,935
Depreciation and amortization		87,603	81,902
Total operating expenses		1,510,195	1,459,149
Operating revenue in excess of expenses		106,439	84,144
Nonoperating gains and losses:			
Investment income (loss) and unrestricted gifts, net		(18,359)	26,788
Derivative ineffectiveness		(2,506)	(567)
Revenue and gains in excess of expenses and losses		85,574	110,365
Other changes in net assets:			
Equity transfers to University of Chicago, net		(72,025)	(70,501)
Net assets released from restriction for capital purchases		—	2,204
Change in accrued pension benefits other than net periodic benefit costs		(4,429)	(8,192)
Effective portion of change in valuation of derivatives		(50,775)	(12,396)
Other, net		(65)	—
Increase (decrease) in unrestricted net assets	$	(41,720)	21,480

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Statements of Changes in Net Assets

June 30, 2016 and 2015

(In thousands)

		2016	2015
Unrestricted net assets:			
Revenue and gains in excess of expenses and losses	$	85,574	110,365
Equity transfers to University of Chicago, net		(72,025)	(70,501)
Net assets released from restriction for capital purchases		—	2,204
Change in accrued pension benefits other than net periodic benefit cost		(4,429)	(8,192)
Effective portion of change in valuation of derivatives		(50,775)	(12,396)
Other, net		(65)	—
Increase (decrease) in unrestricted net assets		(41,720)	21,480
Temporarily restricted net assets:			
Contributions		3,677	2,697
Net assets released from restrictions used for operating purposes		(5,501)	(5,124)
Investment income		(2,425)	2,786
Net assets released from restriction for capital purchases		—	(2,204)
Other, net		65	—
Decrease in temporarily restricted net assets		(4,184)	(1,845)
Permanently restricted net assets:			
Contributions and other		10	10
Change in net assets		(45,894)	19,645
Net assets at beginning of year		1,361,547	1,341,902
Net assets at end of year	$	1,315,653	1,361,547

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Statements of Cash Flows

June 30, 2016 and 2015

		2016	2015
Cash flows from operating activities:			
Change in net assets	$	(45,894)	19,645
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Net change in unrealized gains and losses on investments		35,951	37,631
Equity transfers to University of Chicago		72,025	70,501
Restricted contributions and investment return		(1,262)	(2,697)
Realized gains on investments		(6,451)	(58,351)
Net change in valuation of derivatives		54,970	14,637
Change in accrued pension benefits other than net period benefit cost and other		4,429	8,192
(Gain) loss on disposal of assets		853	(10)
Provision for doubtful accounts		84,243	52,166
Net assets released from restrictions for operations		5,501	—
Depreciation and amortization		87,603	81,902
Changes in assets and liabilities:			
Patient accounts receivable, net		(162,908)	(77,137)
Other assets		(27,551)	(12,678)
Accounts payable and accrued expenses		6,985	8,398
Due to the University of Chicago		(37,291)	43,676
Estimated settlements with third-party payors		23,267	15,931
Self-insurance liabilities		2,841	(67)
Other liabilities		4,133	(4,943)
Net cash provided from operating activities		101,444	196,796
Cash flows from investing activities:			
Purchases of property, plant and equipment		(234,191)	(109,524)
Change in construction payables		26,892	—
Physician practice acquisitions		(1,447)	—
Purchases of investments		(46,138)	(346,607)
Sales of investments		100,894	370,733
Net cash used in investing activities		(153,990)	(85,398)
Cash flows from financing activities			
Proceeds from issuance of long-term debt		—	74,874
Payments on long-term obligations		(14,824)	(36,064)
Equity transfers to the University of Chicago, net		(72,025)	(70,501)
Net assets released from restriction for operations		(5,501)	—
Restricted contributions and investment return		1,262	4,564
Net cash used in financing activities		(91,088)	(27,127)
Net increase (decrease) in cash and cash equivalents		(143,634)	84,271
Cash and cash equivalents:			
Beginning of year		163,969	79,698
End of year	$	20,335	163,969

See accompanying notes to consolidated financial statements.

(1) Organization and Basis of Presentation

The University of Chicago Medical Center (UCMC) is an Illinois not-for-profit corporation. UCMC operates the Center for Care and Discovery, the Bernard Mitchell Hospital, the Chicago Lying-In Hospital, the University of Chicago Comer Children's Hospital, the Duchossois Center for Advanced Medicine, the University of Chicago Medicine Care Network, LLC and various other outpatient clinics and treatment areas.

The University of Chicago (the University), as the sole corporate member of UCMC, elects UCMC's Board of Trustees and approves its By-Laws. The UCMC President reports to the University's Executive Vice President for Medical Affairs. The relationship between UCMC and the University is defined in the Medical Center By-Laws, an Affiliation Agreement, an Operating Agreement, and several Leases. See note 3 for agreements and transactions with the University.

UCMC is a tax-exempt organization under Section 501(c) 3 of the Internal Revenue Code. The University of Chicago Medicine Care Network, LLC is awaiting its approval of tax-exempt status.

(2) Summary of Significant Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements of UCMC have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. All significant intercompany accounts and transactions have been eliminated in consolidation.

(b) New Accounting Pronouncements

During 2015, UCMC adopted the provisions of Accounting Standards Update (ASU) 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. This pronouncement is effective for fiscal years beginning on or after December 15, 2016, and UCMC elected early adoption in 2015. ASU 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. See note 6 for related fair value disclosures.

(c) Use of Estimates

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

(d) Community Benefits

UCMC's policy is to treat patients in immediate need of medical services without regard to their ability to pay for such services, including patients transferred from other hospitals under the provisions of the Emergency Medical Treatment and Active Labor Act (EMTALA). UCMC also accepts patients through the Perinatal and Pediatric Trauma Networks without regard to their ability to pay for services.

UCMC developed a Financial Assistance Policy (the Policy) under which patients are offered discounts of up to 100% of charges on a sliding scale. The Policy is based both on income as a percentage of the Federal Poverty Level guidelines and the charges for services rendered. The Policy also contains provisions that are responsive to those patients subject to catastrophic healthcare expenses. Since UCMC does not pursue collection of these amounts, they are not reported as net patient service revenue. The cost of providing care under this Policy, along with the unreimbursed cost of government sponsored indigent healthcare programs, unreimbursed cost to support education, clinical research and other community programs for the years ended June 30, 2016 and 2015, are reported in note 5.

(e) Fair Value of Financial Instruments

Fair value is defined as the price that UCMC would receive upon selling an asset or pay to settle a liability in an orderly transaction between market participants.

UCMC uses a framework for measuring fair value that includes a hierarchy that categorizes and prioritizes the sources used to measure and disclose fair value. This hierarchy is broken down into three levels based on inputs that market participants would use in valuing the financial instruments based on market data obtained from sources independent of UCMC. Inputs refer broadly to the assumptions that market participants would use in pricing the asset, including assumptions about risk. Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset developed based on the best information available. The three tier hierarchy of inputs is summarized in the three broad levels as follows:

Level 1 – quoted market prices in active markets for identical investments.

Level 2 – inputs other than quoted prices for similar investments in active markets, quoted prices for identical or similar investments in markets that are not active, or inputs other than quoted prices that are observable including model-based valuation techniques.

Level 3 – valuation techniques that use significant inputs that are unobservable because they trade infrequently or not at all.

(f) Cash and Cash Equivalents

Cash equivalents include U.S. Treasury notes, commercial paper, and corporate notes with original maturities of three months or less, excluding investments whose use is limited or restricted.

(g) Inventory

UCMC values inventories at the lower of cost or market, using the first-in, first-out method. During 2016, UCMC changed its non-GAAP policy for recording certain inventory. This change resulted in an $8,200 increase in inventory at June 30, 2016 and a corresponding $8,200 reduction in supplies and other expense in the accompanying 2016 consolidated statement of operations.

(h) Investments

Investments are classified as trading securities. As such, investment income or loss (including realized or unrealized gains and losses on investments, interest, and dividends) is included in excess of revenues and gains over expenses and losses unless the income is restricted by donor or law.

Investments are recorded in the consolidated financial statements at estimated fair value. If an investment is held directly by UCMC and an active market with quoted prices exists, the market price of an identical security is used as reported fair value. Reported fair values for shares in mutual funds are based on share prices reported by the funds as of the last business day of the fiscal year. UCMC's interests in alternative investment funds such as private debt, private equity, real estate, natural resources, and absolute return are generally reported at the net asset value (NAV) reported by the fund managers, which is used as a practical expedient to estimate the fair value, unless it is probable that all or a portion of the investment will be sold for an amount different from NAV. As of June 30, 2016 and 2015, UCMC had no plans to sell investments at amounts different from NAV.

A significant portion of UCMC's investments are part of the University's Total Return Investment Pool (TRIP). UCMC accounts for its investments in TRIP on the fair value method based on its share of the underlying securities and accordingly, records the investment activity as if UCMC owned the investments directly using the fair value option election. The University does not engage directly in unhedged speculative investments; however, the Board of the University of Chicago has authorized the use of derivative investments to adjust market exposure within asset class ranges.

A summary of the inputs used in valuing UCMC's investments as of June 30, 2016 and 2015 is included in note 6.

(i) Endowment Funds with Deficits

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. As of June 30, 2016 and 2015, endowments in deficit positions were $65 and $0, respectively.

(j) Investments limited as to Use

Investments limited as to use primarily include assets held by trustees under debt and other agreements and designated assets set aside by the Board of Trustees for future capital improvements and other specific purposes, over which the Board retains control and may at their discretion subsequently use for other purposes. Investments limited as to use also include investments held under swap collateral posting requirements, investments under the workers' compensation self-insurance trust fund and investments whose use is restricted by donors. Investments limited as to use are reported as unrestricted net assets. Investments whose use is restricted by donors are reported as temporarily restricted or permanently restricted.

(k) Derivative Instruments

UCMC accounts for derivatives and hedging activities in accordance with ASC No. 815, *Derivatives and Hedging*, which requires that all derivative instruments be recorded as either assets or liabilities in the balance sheet at their respective fair values.

For hedging relationships, UCMC formally documents the hedging relationship and its risk management objective and strategy for understanding the hedge, the hedging instrument, the nature of the risk being hedged, how the hedging investment's effectiveness in offsetting the hedged risk will be assessed, and a description of the method for measuring ineffectiveness. This process includes linking all derivatives that are presented as cash flow hedges to specific assets and liabilities in the balance sheet.

(l) Property, Plant and Equipment

Property, plant and equipment are reported on the basis of cost less accumulated depreciation and amortization. Depreciation of property, plant and equipment is calculated by use of the straight-line method at rates intended to depreciate the cost of assets over their estimated useful lives, which generally range from three to eighty years. Interest costs incurred during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets with explicit restrictions by donors that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted contributions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

UCMC periodically assesses the recoverability of long-lived assets (including property, plant, and equipment) when indications of potential impairment, based on estimated, undiscounted future cash flows exist. Management considers factors such as current results, trends, and future prospects, in addition to other economic factors, in determining whether there is an impairment of the asset.

(m) Asset Retirement Obligation

UCMC recognizes a liability for the fair value of a legal obligation to perform asset retirement activities in which the timing or method of settlement are conditional on a future event if the amount can be reasonably estimated. Upon recognition of a liability, the asset retirement cost is recorded as an increase in the carrying value of the related long-lived asset and then depreciated over the life of the asset. The UCMC asset retirement obligations arise primarily from regulations that specify how to dispose of asbestos if facilities are demolished or undergo major renovations or repairs. UCMC's obligation to remove asbestos was estimated using site-specific surveys where available and a per square foot estimate where surveys were unavailable.

(n) Other Assets and Liabilities

Other assets and liabilities, including deferred financing costs, which are amortized over the term of the related obligations, do not differ materially from their estimated fair value.

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(o) Net Assets

Net assets are classified as either permanently or temporarily restricted when the use of the assets is limited by outside parties or as unrestricted net assets when outside parties place no restrictions on the use of the assets or when the assets arise as a result of the operations of UCMC.

Unconditional promises to give cash and other assets to UCMC are reported at fair value at the date the promise is received. Pledges receivable to be collected after one year are discounted using a risk-adjusted interest rate at the time the pledge is made. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limits the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported as operating revenue in the statements of operations if restricted for operating purposes and as an increase to unrestricted net assets if restricted to purchase property, plant, and equipment. Gifts for which donors have not stipulated restrictions, as well as contributions for which donors have not stipulated restrictions, as well as contributions for which donors have stipulated restrictions that are met within the same reporting period, are reported as other operating revenue.

(p) Statement of Operations

All activities of UCMC deemed by management to be ongoing, major and central to the provision of healthcare services are reported as operating revenues and expenses.

The consolidated statement of operations includes revenue and gains in excess of expenses and losses. Changes in unrestricted net assets that are excluded from revenue and gains in excess of expenses and losses include transfers to the University, contributions of long-lived assets released from restrictions (including assets acquired using contributions which by donor restriction were to be used for acquisition of UCMC assets), the effective portion of changes in the valuation of derivatives, and change in accrued pension benefits other than net periodic benefit costs and other.

(q) Net Patient Service Revenue, Accounts Receivable and Allowance for Doubtful Accounts

UCMC maintains agreements with the Centers for Medicare and Medicaid Services under the Medicare Program, Blue Cross and Blue Shield of Illinois, Inc. (Blue Cross), and the State of Illinois under the Medicaid Program and various managed care payors that govern payment to UCMC for services rendered to patients covered by these agreements. The agreements generally provide for per case or per diem rates or payments based on allowable costs, subject to certain limitations, for inpatient care and discounted charges or fee schedules for outpatient care.

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and include estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and UCMC estimates are adjusted in future periods as adjustments become known or as years are no longer subject to UCMC

(Continued)

audits, reviews and investigations. Adjustments to prior year estimates for these items resulted in an increase in net patient service revenues of $3,874 in 2016 and $900 in 2015. Contracts, laws and regulations governing Medicare, Medicaid, and Blue Cross are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. A portion of the accrual for settlements with third-party payors has been classified as long-term because UCMC estimates they will not be paid within one year.

The process for estimating the ultimate collectibility of receivables involves significant assumptions and judgment. UCMC has implemented a standardized approach to this estimation based on the payor classification and age of outstanding receivables. Account balances are written off against the allowance when management feels it is probable the receivable will not be recovered. The use of historical collection experience is an integral part of the estimation of the reserve for doubtful accounts. Revisions in the reserve for doubtful accounts are recorded as adjustments to the provision for doubtful accounts.

(r) Hospital Assessment Program/Medicaid Provider Tax

In December 2008, the State of Illinois, after receiving approval by the federal government, implemented a hospital assessment program. The program assessed hospitals a provider tax based on occupied bed days and provided increases in hospitals' Medicaid payments. In 2016, reimbursement under the assessment programs resulted in a net increase of $29,190 in operating income, which includes $65,300 in Medicaid payments included in net patient service revenue offset by $36,110 in Medicaid provider tax expense. In 2015, reimbursement under the program resulted in a net increase of $28,465 in income from operations, which included $65,400 of incremental Medicaid payments included in net patient service revenue offset by $36,935 in Medicaid provider tax expense.

(s) Affordable Care Act (ACA)

In March 2010, the federal government passed the Affordable Care Act (ACA), which expanded Medicaid coverage to millions of low-income Americans and made improvements to both the Medicaid and the Children's Health Insurance Program. Beginning in 2014, coverage for newly eligible adults would be funded by the federal government for three years. UCMC recognized $14,300 and $16,800 of net patient service revenue in 2016 and 2015, respectively, under this new law. Due to the timing of actual payments, UCMC recorded a receivable of $4,000 as of June 30, 2016.

(t) Income Taxes

UCMC is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The University of Chicago Medicine Care Network, LLC is awaiting its approval of tax-exempt status.

UCMC applies ASC No. 740, Income Taxes (ASC 740), which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements. ASC 740 prescribes a more-likely than-not recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken. Under ASC 740, tax positions are evaluated for recognition, derecognition, and measurement using consistent criteria and provide more information about the uncertainty in income tax assets and liabilities. As of June 30, 2016 and 2015, UCMC and affiliates do not have an asset or liability recorded for unrecognized tax positions.

(u) Reclassifications

Certain 2015 amounts have been reclassified to conform to the 2016 consolidated financial statement presentation.

(v) Subsequent Events

On October 1, 2016, UCMC acquired Ingalls Health System, an independent health system serving Chicago's south suburbs, through an affiliation and member substitution. As a result of this transaction, Ingalls Health System became a wholly owned subsidiary of UCMC through a newly created Community Health and Hospital Division of UCMC. The results of operations for Ingalls Health System will be included in UCMC's consolidated financial statements from the date of acquisition.

UCMC has performed an evaluation of subsequent events through October 10, 2016, which is that date the consolidated financial statements were issued and other than noted above, there were no other items to disclose.

(3) Agreements and Transactions with the University

The Affiliation Agreement with the University provides, among other things, that all members of the medical staff will have academic appointments in the University. The Affiliation Agreement has an initial term of 40 years ending October 1, 2026 unless sooner terminated by mutual consent or as a result of a continuing breach of a material obligation therein or in the Operating Agreement. The Affiliation Agreement automatically renews for additional successive 10-year terms following expiration of the initial term, unless either party provides the other with at least two years' prior written notice of its election not to renew.

The Operating Agreement, as amended, provides, among other things, that the University gives UCMC the right to use and operate certain facilities. The Operating Agreement is coterminous with the Affiliation Agreement.

The Lease Agreements provide, among other things, that UCMC will lease from the University certain of the health care facilities and land that UCMC operates and occupies. The Lease Agreements are coterminous with the Affiliation Agreement.

UCMC purchases various services from the University, including certain employee benefits, utilities, security, telecommunications and insurance. In addition, certain UCMC accounting records are maintained by the University. During the years ended June 30, 2016 and 2015, the University charged UCMC approximately $29,100 and $29,000, respectively, for utilities, security, telecommunications, insurance and overhead.

The University's Division of Biological Sciences (BSD) provides physician services to UCMC. In 2016 and 2015, UCMC recorded $215,727 and $205,461, respectively, in expense related to these services.

UCMC's Board of Trustees adopted a plan of support under which it would provide annual net asset transfers to the University for support of academic programs in biology and medicine. All commitments under this plan are subject to the approval of UCMC's Board of Trustees and do not represent legally binding commitments until that approval. Unpaid portions of commitments approved by the UCMC Board of Trustees are reflected as current liabilities. UCMC recorded net asset transfers of $71,750 in 2016 and 2015 for this support.

(4) Third-Party Reimbursement Programs

UCMC follows the provisions of Accounting Standards Update 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. ASU 2011-07 requires that entities that recognize significant amounts of patient service revenue at the time the services are rendered even though they do not assess the patient's ability to pay must present the provision for bad debts related to patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) on their consolidated statements of operations. In addition, there are enhanced disclosures about the entity's policies for recognizing revenue and assessing bad debts. The ASU also requires disclosures of patient service revenue as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. The provision for doubtful accounts on the accompanying consolidated statements of operations for the years ended June 30, 2016 and 2015 have been presented on a separate line as a deduction from net patient service revenue (net of contractual allowances and discounts) to reflect the application of ASU 2011-07.

UCMC has agreements with third-party payors that provide for reimbursement at amounts different from their established rates. Estimated contractual adjustments arising under third-party reimbursement programs principally represent the differences between UCMC's billings at list price and the amounts reimbursed by Medicare, Blue Cross, and certain other contracted third-party payors; the difference between the UCMC's billings at list price and the allocated cost of services provided to Medicaid patients; and any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements. A summary of the reimbursement methodologies with major third-party payors is as follows:

(a) Medicare

UCMC is paid for various services rendered to Medicare program beneficiaries under prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. The prospectively determined rates are not subject to retroactive adjustment. UCMC's classification of patients under the prospective payment systems and the appropriateness of the patients' admissions are subject to validation reviews.

Other services rendered to Medicare beneficiaries are reimbursed based upon a combination of prospectively determined rates and cost reimbursement methodologies. For the cost reimbursement, UCMC is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by UCMC and audits by the Medicare fiscal intermediary. UCMC's Medicare reimbursement reports through June 30, 2012 have been audited by the Medicare fiscal intermediary.

(b) Medicaid

UCMC is paid for inpatient acute care services rendered to Medicaid program beneficiaries under prospectively determined rates-per-discharge. For inpatient acute care services, payment rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Medicaid outpatient services are reimbursed based on fee schedules. Medicaid reimbursement methodologies may be subject to periodic adjustment, as well as to changes in existing payment levels and rates, based on the amount of funding available to the State of Illinois Medicaid program and any such changes could have a significant effect on UCMC's revenue.

(c) Blue Cross

UCMC also participates as a provider of healthcare services under reimbursement agreements with Blue Cross under its indemnity program. The provisions of the agreements stipulate that services will be reimbursed at a tentative reimbursement rate and that final reimbursement for these services is determined after the submission of an annual cost report by UCMC and a review by Blue Cross. The Blue Cross reimbursement reports for 2015 and prior years have been reviewed by Blue Cross.

(d) Other

UCMC has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements is negotiated by UCMC and includes prospectively determined rates-per-discharge, discounts from established charges, and prospectively determined per diem rates.

Accruals for settlements with third-party payors are made based on estimates of amounts to be received or paid under the terms of the respective contracts and related settlement principles and regulations of the federal Medicare program, the Illinois Medicaid program, and the Blue Cross Plan of Illinois.

Patients' accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectibility of patients' accounts receivable, UCMC analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for uncollectible accounts receivable. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. For receivables associated with services provided to patients who have third-party coverage, UCMC analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for accounts receivable, if necessary. For receivables associated with patient responsibility (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the patients are screened against UCMC's charity care policy. For any remaining patient responsibility balance, UCMC records a provision for uncollectible accounts receivable in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

(Dollars in thousands)

UCMC's allowance for uncollectible accounts, which includes uninsured patients, residual copayments and deductibles for which managed care has already paid, and certain aged Medicaid and Medicaid managed care accounts receivable, increased from 19.8% of accounts receivable at June 30, 2015 to 20.4% of accounts receivable at June 30, 2016. Gross write-offs increased from approximately $128,600 for fiscal year 2015 to $146,200 in fiscal year 2016. UCMC did not have significant write-offs from third-party payors.

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the period from these major payor sources, is as follows:

	2016	2015
Medicare	$ 369,511	337,188
Medicaid	272,302	280,673
Managed care	911,886	860,632
Patients and other	20,553	15,323
Net patient service revenue before provision for doubtful accounts	$ 1,574,252	1,493,816

UCMC grants credit without collateral to their patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors as of June 30, 2016 and 2015 are as follows:

	2016	2015
Medicare	11.1%	11.3%
Medicaid	27.9%	28.1%
Managed care	60.8%	60.4%
Patients and other	0.2%	0.2%
	100.0%	100.0%

A summary of UCMC's utilization percentages based upon gross patient service revenue is as follows:

	2016	2015
Medicare	37.2%	36.3%
Medicaid	23.7%	23.5%
Managed care	37.8%	38.9%
Patients and other	1.3%	1.3%
	100.0%	100.0%

(Continued)

(Dollars in thousands)

(5) Community Benefits

The following is a summary of UCMC's unreimbursed cost of providing care, as defined under their Financial Assistance Policy, along with the unreimbursed cost of government sponsored indigent healthcare programs, unreimbursed cost to support education, clinical research and other community programs for the years ended June 30, 2016 and 2015:

	Year ended June 30	
	2016	**2015**
Uncompensated care:		
Medicaid sponsored indigent healthcare	$ 72,619	56,302
Medicare sponsored indigent healthcare – cost report	94,965	94,872
Medicare sponsored indigent healthcare – physician services	11,145	16,889
Total uncompensated care	178,729	168,063
Charity care	36,230	27,987
	214,959	196,050
Unreimbursed education and research:		
Education	65,632	64,020
Research	48,000	48,000
Total unreimbursed education and research	113,632	112,020
Total community benefits	$ 328,591	308,070

UCMC determines the costs associated with providing charity care by aggregating the applicable direct and indirect costs, including salaries, wages, and benefits, supplies, and other operating expenses, based on data from its costing system to determine a cost-to-charge ratio. The cost to charge ratio is applied to the charity care charge to calculate the charity care amount reported above. UCMC amended their financial assistance policy in 2016 to remain in compliance with federal and state regulations.

(Dollars in thousands)

(6) Investments Limited as to Use

The composition of investments limited as to use is as follows at June 30 2016 and 2015:

	2016				2015
	Endowments				
	Separately invested	TRIP	Other	Total	2015
Investments carried at fair value:					
Cash equivalents	$ 1,183	13,090	119	14,392	23,027
Global public equities	72,891	146,021	—	218,912	236,930
Private debt	—	33,297	—	33,297	31,372
Private equity:					
U.S. Venture capital	1,637	34,745	—	36,382	42,929
U.S. Corporate finance	—	28,994	—	28,994	36,875
International	135	37,216	—	37,351	42,357
Real assets:					
Real estate	—	43,056	—	43,056	50,933
Natural resources	—	42,660	—	42,660	51,676
Absolute return:					
Equity oriented	—	71,437	—	71,437	70,046
Global macro/relative value	—	47,520	—	47,520	56,579
Multistrategy	—	53,981	—	53,981	58,065
Credit-oriented	—	33,928	—	33,928	34,386
Protection-oriented	—	13,036	—	13,036	14,945
Fixed income:					
U.S. Treasuries, including TIPS	—	28,679	—	28,679	56,468
Other fixed income	138,052	38,381	—	176,433	190,216
Funds in trust	—	—	51,518	51,518	21,453
Total investments	$ 213,898	666,041	51,637	931,576	1,018,257

Investments classified as other consist of construction and debt proceeds to pay interest, donor restricted, worker's compensation, self-insurance, and trustee-held funds. Investments limited as to use are classified as current assets to the extend they are available to meet current liabilities. Investments are presented in the consolidated financial statements as follows:

	2016	2015
Current portion of investments limited to use	$ 36,768	5,033
Investments limited to use, less current portion	894,808	1,013,224
Total investments limited to use	$ 931,576	1,018,257

(Dollars in thousands)

A summary of investments limited as to use for the years ended June 30 is as follows:

		2016	2015
Investments limited as to use:			
By the board for capital improvements/restricted by donors	$	214,017	222,434
Funds held by custodian/trustee under indenture agreements		69	3
Funds held by trustee for self-insurance		14,749	16,419
Collateral for interest rate swap		36,700	5,030
TRIP investments		666,041	774,371
Total investments limited as to use	$	931,576	1,018,257

The composition of net investment income is as follows for the years ended June 30:

		2016	2015
Interest and dividend income, net	$	11,141	12,567
Realized gains on sales of securities		6,451	52,460
Unrealized losses on securities		(35,951)	(38,239)
	$	(18,359)	26,788

Outside of TRIP, UCMC also invests in private equity limited partnerships. As of June 30, 2016, UCMC has commitments of $1,700 remaining to fund private equity limited partnerships.

Fair Value of Financial Instruments

The overall investment objective of UCMC is to invest its assets in a prudent manner that will achieve a long-term rate of return sufficient to fund a portion of its annual operating activities and increase investment value after inflation. UCMC diversifies its investments among various asset classes incorporating multiple strategies and external investment managers, including the University Investment Office. Major investment decisions for investments held in TRIP and managed by the University are authorized by the University Board of Trustee's Investment Committee, which oversees the University's investment program in accordance with established guidelines.

The carrying amount reported in the consolidated statements of financial position for the following approximates fair value because of the short maturities of these instruments: cash and cash equivalents, accounts payable and accrued expenses, and estimated payables under third-party reimbursement programs. Cash equivalent investments include cash equivalents and fixed-income investments, with maturities of less than one year, which are valued based on quoted market prices in active markets. The majority of these investments are held in U.S. money market accounts. Global public equity investments consist of separate accounts, commingled funds with liquidity ranging from daily to monthly, and limited partnerships. Securities held in separate accounts and daily traded commingled funds are generally valued based on quoted market prices in active markets. Commingled funds with monthly liquidity are valued based on independently determined NAV. Limited partnership interests in equity-oriented funds are valued based upon NAV provided by external fund managers.

Investments in private debt, private equity, real estate, and natural resources are in the form of limited partnership interests, which typically invest in private securities for which there is no readily determinable market value. In these cases, market value is determined by external managers based on a combination of discounted cash flow analysis, industry comparables, and outside appraisals. Where private equity, real estate, and natural resources managers hold publicly traded securities, these securities are generally valued based on market prices. The value of the limited partnership interests are held at the manager's reported NAV, unless information becomes available indicating the reported NAV may require adjustment. The methods used by managers to assess the NAV of these external investments vary by asset class. The University's Investment Office on behalf of UCMC monitors the valuation methodologies and practices of managers.

The absolute return portfolio comprises investments of limited partnership interests in hedge funds and drawdown private equity style partnerships whose managers have the authority to invest in various asset classes at their discretion, including the ability to invest long and short. The majority of the underlying holdings are marketable securities. The remainder of the underlying holdings is held in marketable securities that trade infrequently or in private investments, which are valued by the manager on the basis of an appraised value, discounted cash flow, industry comparables, or some other method. Most hedge funds that hold illiquid investments designate them in special side pockets, which are subject to special restrictions on redemption.

Fixed-income investments consist of directly held actively traded treasuries, separately managed accounts, commingled funds, and bond mutual funds that hold securities, the majority of which have maturities greater than one year. These are valued based on quoted market prices in active markets.

Funds in trust investments consist primarily of project construction funds and worker's compensation trust funds. Funds in trust comprise 72% cash and cash equivalents, 16% fixed income investments and 12% equity investments at June 30, 2016 and comprised 26% cash and cash equivalents, 44% fixed income securities and 30% equity investments at June 30, 2015.

(Dollars in thousands)

UCMC believes that the reported amount of its investments is a reasonable estimate of fair value as of June 30, 2016 and 2015. Because of the inherent uncertainties of valuation, these estimated fair values may differ significantly from values that would have been used had a ready market existed. Assets and liabilities recorded at fair value as of June 30, 2016 and 2015 were as follows:

Assets		**Quoted prices in Active Markets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**2016 Total fair value**
Cash and cash equivalents	$	20,335	—	—	20,335
Investments:					
Cash equivalents		14,392	—	—	14,392
Global public equities		96,930	4,104	—	101,034
Real assets:					
Real estate		3,163	—	—	3,163
Absolute return:					
Equity oriented		—	4,702	—	4,702
Global macro/relative value		7,979	2,417	—	10,396
Fixed income:					
U.S. Treasuries, including TIPS	$	28,679	—	—	28,679
Other fixed income		165,294	—	—	165,294
Funds in trust		51,518	—	—	51,518
Investments measured at net asset value [1]			—	—	552,398
Total investments at fair value		388,290	11,223	—	951,911
Other assets		5,850	—	—	5,850
Total assets at fair value	$	394,140	11,223	—	957,761
Liabilities					
Interest rate swap payable	$	—	165,417	—	165,417
Total liabilities at fair value	$	—	165,417	—	165,417

(Dollars in thousands)

Assets		Quoted prices in Active Markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2015 Total fair value
Cash and cash equivalents	$	163,969	—	—	163,969
Investments:					
Cash equivalents		23,027	—	—	23,027
Global public equities		112,815	3,579	—	116,394
Real assets:					
Real estate		2,123	—	—	2,123
Natural resources		3,300	—	—	3,300
Absolute return:					
Equity oriented [2]		—	9,245	—	9,245
Global macro/relative value		10,074	—	—	10,074
Fixed income:					
U.S. Treasuries, including TIPS	$	56,468	—	—	56,468
Other fixed income		176,136	—	—	176,136
Funds in trust		21,453	—	—	21,453
Investments measured at net asset value [1]		—	—	—	600,037
Total investments at fair value		569,365	12,824	—	1,182,226
Other assets		5,216	—	—	5,216
Total assets at fair value	$	574,581	12,824	—	1,187,442
Liabilities					
Interest rate swap payable	$	—	110,447	—	110,447
Total liabilities at fair value	$	—	110,447	—	110,447

[1] Certain investments that are measured at fair value using the NAV per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the balance sheets.

[2] UCMC re-evaluated the application of the definition of readily determinable fair value in accordance with ASU 2015-10, *Technical Corrections and Improvements*, and has corrected the classification of an investment totaling $9,245 previously shown as investments held at NAV. These investments are now classified as level 2 investments in the 2015 table. Management assessed the effect of the correction on the 2015 financial statements, and determined it to be immaterial.

During 2016, there were no transfers between investment Levels 1 and 2 or between Levels 2 and 3. The interest rate swap arrangement has inputs, which can generally be corroborated by market data and is therefore classified within Level 2.

In addition, investment securities are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of UCMC's investments could occur in the next term and that such changes could materially affect the amounts reporting in the consolidated financial statements. The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while UCMC believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The significant unobservable inputs used in the fair value measurement of UCMC's long-lived partnership investments include a combination of cost, discounted cash flow analysis, industry comparables and outside appraisals. Significant changes in any inputs used by investment managers in determining net asset values in isolation would result in a significant changes in fair value measurement.

(Continued)

UCMC has made investments in various long-lived partnerships and, in other cases, has entered into contractual agreements that may limit its ability to initiate redemptions due to notice periods, lockups and gates. Details on typical redemption terms by asset class and type of investment are provided below:

	Remaining life	Redemption terms	Redemption restrictions and terms
Cash	N/A	Daily	None
Global public equities:			
Commingled funds	N/A	Daily to triennial with notice periods of 2 to 180 days	Lock-up provisions for up to 3 years, some investments have a portion of capital held in side pockets with no redemptions permitted
Partnerships	N/A	Monthly to biennial with notice periods of 7 to 90 days	Lock-up provisions for up to 4 years, some investments have a portion of capital held in side pockets with no redemptions permitted
Separate accounts	N/A	Daily with notice periods of 1 to 7 days	Lock-up provisions ranging for up to 1 year
Private debt:			
Drawdown partnerships	1 to 11 years	Redemptions not permitted	N/A
Partnerships	N/A	Redemptions not permitted	Capital held in side pockets with no redemption permitted
Private equity:			
Drawdown partnerships	1 to 21 years	Redemptions not permitted	N/A
Separate accounts	N/A	Daily with notice period of 1 day	None
Partnerships	N/A	Semi-annual with notice period of 90 days	A portion of capital is held in side pockets with no redemption permitted
Real estate:			
Drawdown partnerships	1 to 16 years	Redemption not permitted	N/A
Separate accounts	N/A	Daily with notice period of 5 days	None
Natural resources:			
Drawdown partnerships	1 to 17 years	Redemption not permitted	N/A
Commingled funds	N/A	Daily with notice period of 1 day	None

	Remaining life	Redemption terms	Redemption restrictions and terms
Absolute return:			
Commingled funds	N/A	Daily to triennial with notice periods of 1 to 122 days	Lock-up provisions for up to 3 years, some investments have a portion of capital held in side pockets with no redemptions permitted
Drawdown partnerships	1 to 4 years	Redemptions not permitted	N/A
Partnerships	N/A	Quarterly to triennial with notice periods of 45 to 180 days	Lock-up provisions for up to 5 years, some investments have a portion of capital held in side pockets with no redemptions permitted
Fixed income:			
Commingled funds	N/A	Weekly to monthly with notice periods of 5 to 10 days	None
Separate accounts	N/A	Daily to monthly with notice periods of 1 to 30 days	None
Funds in Trust	N/A	Daily	None

(7) Endowments

UCMC's endowments consists of individual donor restricted endowment funds and board-designated endowment funds for a variety of purposes plus the following where the assets have been designated for endowment: pledges receivable, split interest agreements, and other net assets. The endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. The net assets associated with endowment funds including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Illinois is governed by the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA). The Board of Trustees of UCMC has interpreted UPMIFA as sustaining the preservation 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, UCMC classifies as permanently restricted net assets, (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by UCMC in a manner consistent with the standard of prudence prescribed by UPMIFA.

(Dollars in thousands)

UCMC has the following donor-restricted endowment activities during the years ended June 30, 2016 and 2015 delineated by net asset class:

		Unrestricted Funds functioning	Temporarily restricted	Permanently restricted	2016 Total
Endowment net assets, beginning of year	$	914,479	73,568	8,092	996,139
Investment return:					
Investment income		16,383	737	0	17,120
Net appreciation (realized and unrealized)		(34,742)	(3,162)	0	(37,904)
Total investment return		(18,359)	(2,425)	0	(20,784)
Gifts and other additions		0	0	10	10
Appropriation of endowment assets for expenditure		(44,622)	(4,229)	0	(48,851)
Appropriation of endowment assets for capital		(50,000)	0	0	(50,000)
Other		2,939	487	—	3,426
Endowment net assets, end of year	$	804,437	67,401	8,102	879,940

		Unrestricted Funds functioning	Temporarily restricted	Permanently restricted	2015 Total
Endowment net assets, beginning of year	$	921,696	74,468	8,082	1,004,246
Investment return:					
Investment income		40,491	907	0	41,398
Net appreciation (realized and unrealized)		(13,703)	1,879	0	(11,824)
Total investment return		26,788	2,786	0	29,574
Gifts and other additions		32,000	0	10	32,010
Appropriation of endowment assets for expenditure		(43,486)	(4,095)	0	(47,581)
Appropriation of endowment assets for capital		(24,808)	0	0	(24,808)
Other		2,289	409	0	2,698
Endowment net assets, end of year	$	914,479	73,568	8,092	996,139

(Dollars in thousands)

Description of amounts classified as permanently restricted net assets and temporarily restricted net assets (Endowments only) as of June 30, 2016 and 2015:

		Perpetual	Time-restricted by donor	Time-restricted by law	2016 Total
Restricted for pediatric healthcare	$	1,865	—	15,760	17,625
Restricted for adult healthcare		1,925	—	49,412	51,337
Restricted for educational and scientific programs		4,312	—	2,229	6,541
	$	8,102	—	67,401	75,503

		Perpetual	Time-restricted by donor	Time-restricted by law	2015 Total
Restricted for pediatric healthcare	$	1,855	—	17,409	19,264
Restricted for adult healthcare		1,926	—	53,481	55,407
Restricted for educational and scientific programs		4,311	—	2,678	6,989
	$	8,092	—	73,568	81,660

Investment and Spending Policies

UCMC has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. UCMC expects its endowment funds over time, to provide an average rate of return of approximately 6% annually. To achieve its long-term rate of return objectives, UCMC relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). Actual returns in any given year may vary from this amount.

For endowments invested in TRIP, the Board of Trustees of UCMC has adopted the University’s method to be used to appropriate endowment funds for expenditure, including following the University’s payout formula. The University utilizes the total return concept in allocating endowment income. In accordance with the University’s total return objective, between 4.5% and 5.5% of a 12-quarter moving average of the fair value of endowment investments, lagged by one year, is available each year for expenditure in the form of endowment payout. The exact payout percentage, which is set each year by the Board of Trustees with the objective of a 5% average payout over time, was 5.5% for the fiscal years ended June 30, 2016 and 2015. If endowment income received is not sufficient to support the total return objective, the balance is provided from capital gains. If income received is in excess of the objective, the balance is reinvested in the endowment.

(Dollars in thousands)

For endowments invested apart from TRIP, UCMC calculates a payout of 4% annually on a rolling 24-month average market value. In establishing this policy, the Board considered the expected long term rate of return on its endowment.

(8) Property, Plant and Equipment

The components of property, plant and equipment as of June 30 are as follows:

	2016	2015
Land and land rights	$ 36,008	36,008
Buildings and improvements	1,417,450	1,385,018
Equipment	524,676	512,531
Construction in progress	197,346	55,238
	2,175,480	1,988,795
Less accumulated depreciation	(795,348)	(756,011)
Total property, plant and equipment, net	$ 1,380,132	1,232,784

UCMC's net property, plant and equipment cost includes $9,200 and $9,700 at June 30, 2016 and 2015 representing assets under capital leases with the University. The cost of buildings that are jointly used by the University and UCMC is allocated based on the lease provisions. In addition, land and land rights includes $15,000 and $16,400 for 2016 and 2015, respectively, which represents the unamortized portion of initial lease payments made to the University.

A new parking garage was placed into service in 2015 with a total cost of $79,500; approximately $47,200 was spent in 2015 related to the structure. Capitalized interest costs in 2016 and 2015 were $3,200 and $300, respectively. Construction in progress consists primarily of the Center for Care and Discovery expansion, the Orland Park Ambulatory Center construction, and various other renovation projects. As of June 30, 2016, UCMC had total contractual commitments associated with ongoing capital projects of approximately $51,600.

(Dollars in thousands)

(9) Long-Term Debt

Long-term debt as of June 30 consists of the following:

	Final fiscal year maturity	Interest rate	2016	2015
Fixed rate:				
Illinois finance authority:				
Series 2009A and B	2027	5.0	$ 138,915	148,480
Series 2009C	2037	4.7	60,900	60,900
Series 2009D-1 and 2 (synthetically fixed rate)	2044	3.9	70,000	70,000
Series 2009E-1 and 2 (synthetically fixed rate)	2044	3.9	70,000	70,000
Series 2010 A and B (synthetically fixed rate)	2045	3.9	92,500	92,500
Series 2011 A and B (synthetically fixed rate)	2045	3.9	92,500	92,500
Series 2011C	2042	5.5	90,000	90,000
Series 2012A	2037	4.7	66,565	68,535
Series 2015A	2029	5.0	21,895	21,895
Unamortized premium			10,804	12,016
Total fixed rate			714,079	726,826
Variable rate:				
Series 2013A	2020	0.9	73,757	75,000
Illinois Educational Facilities Authority (IEFA)	2038	0.5	75,671	77,717
Total variable rate			149,428	152,717
Total notes and bonds payable			863,507	879,543
Less current portion of long-term debt			(13,255)	(11,535)
Long-term portion of debt			$ 850,252	868,008

The fair value of long-term debt is based on the pricing of fixed-rate bonds of market participants, including assumptions about the present value of current market interest rates, and loans of comparable quality and maturity. The fair value of long-term debt would be a Level 2 hierarchy. The carrying value of long-term debt is below the estimated fair value of the debt by $44,500 and $27,400 as of June 30, 2016 and June 30, 2015, respectively, based on the quoted market prices for the same or similar issues.

(Dollars in thousands)

Scheduled annual repayments for the next five years and thereafter are as follows at June 30:

		Amount
Year:		
2017	$	13,255
2018		13,868
2019		14,513
2020		15,208
2021		15,940
Thereafter		790,723
	$	863,507

Under its various indebtedness agreements, UCMC is subject to certain financial covenants, including maintaining a minimum debt service coverage ratio, maintaining minimum levels of days cash on hand, maintaining debt to capitalization at certain levels; limitations on selling, leasing, or otherwise disposing of UCMC property; and certain other nonfinancial covenants. Each of the bond Series is collateralized by unrestricted receivables under a Master Trust Indenture and subject to certain restrictions.

Recent Financing Activity

In March 2015, the IFA issued $21,895 of Series 2015A Revenue Refunding Bonds, allocated to UCMC for the purpose of refunding a portion of the Illinois Health Facilities Authority Revenue Bonds, Series 2009C. The Series 2015A Bonds are secured by a Direct Note Obligation, Series 2015A of UCMC issued pursuant to the Master Trust Indenture. The extinguishment of the Series 2009C bonds resulted in a loss of $700, the majority of which was recorded to supplies and other expense in 2015.

Letters of Credit

Payment on each of the variable rate demand revenue bonds is also collateralized by a letter of credit. The letter of credit that support the Series 2009D bonds expires in June 2017. The letter of credit that supports the 2009E bonds expires in December 2018. The letters of credit that support the Series 2010A and Series 2010B bonds expire in November 2020 and November 2018, respectively, and the letters of credit that support the Series 2011A and Series 2011B bonds expire in May 2021. The letters of credit are subject to certain restrictions, which include financial ratio requirements and consent to future indebtedness. The most restrictive financial ratio is to maintain a debt service coverage ratio of 1:25:1. Payment on each of the IEFA bonds is collateralized by a letter of credit maturing November 2017. The letter of credit is subject to certain restrictions, which include financial ratio requirements. The most restrictive financial ratio is to maintain a debt service coverage ratio of 1.75:1. UCMC was in compliance with all applicable debt covenants at June 30, 2016.

(Dollars in thousands)

Included in UCMC's debt is $75,671 of commercial paper revenue notes and $325,000 of variable rate demand bonds. In the event that UCMC's remarketing agents are unable to remarket the bonds, the trustee of the bonds will tender them under the letters of credit. Scheduled repayments under the letters of credit are between 1 and 3 years, beginning after a grace period of at least one year from the event, and bear interest rates different from those associated with the original bond issue. Any bonds tendered are still eligible to be remarketed. Bonds subsequently remarketed would be subject to the original bond repayment schedules.

Scheduled principal repayments on long-term debt based on the variable rate demand notes being put back to UCMC and a corresponding draw being made on the underlying credit facility, if available, are as follows:

Year ending June 30:		
2017	$	22,785
2018		139,962
2019		155,098
2020		112,159
2021		36,657
Thereafter		396,846
	$	863,507

UCMC paid interest, net of capitalized interest, of approximately $32,700 and $33,600 in 2016 and 2015, respectively.

UCMC has a $40,000 line of credit from a commercial bank, which expires September 29, 2017. As of June 30, 2016 and 2015, no amount was outstanding under this line.

(10) Derivative Instruments

In August 2006, UCMC entered into a forward starting swap transaction against contemplated variable rate borrowing for the Center for Care and Discovery. This is a cash flow hedge against interest on the variable rate debt. The fair value of these swap agreements is the estimated amount that UCMC would have to pay or receive to terminate the agreements as of the consolidated balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparty. The swap values are based on the London Interbank Rate (LIBOR). The inputs to the fair value estimate are considered Level 2 in the fair value hierarchy. The effective date of the swap was August 2011. In July 2011, UCMC novated the original swap agreement to divide the original notional amount in two equal parts between financial institutions. The fair value of the terminated portion of the hedge on the date of the novation was recorded in net assets in the amount of $35,123 and is being amortized into interest expense over the life of the related debt, commencing on February 23, 2013, the date the Center for Care and Discovery was placed into service. The new agreement is being accounted for as a hedge. The combined notional amount of the swap is $325,000 and the effective start date was August 2011. Management has determined that the interest rate swaps are effective, and have qualified for hedge accounting. Management has recognized ineffectiveness of approximately $2,506 in 2016 and an ineffectiveness of approximately $567 in 2015. This movement reflects the spread between tax-exempt interest rates and LIBOR during the period. The effective portion of these swaps is included in other changes in unrestricted net assets. The interest rate swaps terminate on February 1,

(Dollars in thousands)

2044. Cash settlement payments related to the swaps were accumulated in net assets while the Center for Care and Discovery was under construction, and are being amortized into depreciation expense over the life of the building. Amortization commenced on February 23, 2013, the date the Center for Care and Discovery was placed into service. Cash settlement payments after the Center for Care and Discovery was placed into service are recorded in interest expense.

UCMC is required to provide collateral on one of the interest rate swap agreements when the liability of that swap exceeds $50,000. At June 30, 2016 and 2015, $36,700 and $5,030 was held as collateral, respectively, and recorded in current portion of investments limited to use. If UCMC's credit rating were to be downgraded one level; collateral would need to be provided under the swap with JP Morgan when the liability of that swap exceeds $40,000 and under the Wells Fargo swap when the liability of that swap exceeds $60,000. Upon further downgrade, the collateral requirements increase.

The following summarizes the general terms of each of UCMC's swap agreements:

Effective date	Associated debt series	Original Term		Current notional amount	UCMC pays	UCMC receives
8/9/2011	2009 D/E, 2010 A/B, 2011 A/B	32.5 years	$	162,500,000	3.89 %	68% of LIBOR
8/9/2011	2009 D/E, 2010 A/B, 2011 A/B	32.5 years	$	162,500,000	3.97 %	68% of LIBOR

The fair value of each swap is the estimated amount UCMC would receive or pay to terminate the swap agreement at the reporting date, taking into account current interest rates and the current creditworthiness of the swap counterparties. The fair value is included in interest rate swap liability on the consolidated balance sheets, while the change in fair value is recorded in unrestricted net assets for the effective portion of the change and in nonoperating gains and losses for the ineffective portion of the change.

(11) Commitments

Leases

UCMC has capital and noncancelable operating leases for certain buildings and equipment. Future minimum payments required under noncancelable operating leases as of June 30 are as follows:

		Operating
2017	$	2,520
2018		2,180
2019		2,155
2020		2,046
2021 and thereafter		11,303
Total minimum lease payments	$	20,204

(Dollars in thousands)

The amount of total assets capitalized under these leases at both June 30, 2016 and June 30, 2015 is $0 and $2,300 with related accumulated depreciation of $0 and $2,300, respectively. Rental expense was approximately $6,100 and $5,600 for the years ended June 30, 2016 and 2015, respectively.

(12) Insurance

UCMC is included under certain of the University's insurance programs. Since 1977, UCMC, in conjunction with the University, has maintained a self-insurance program for its medical malpractice liability. This program is supplemented with commercial excess insurance above the University's self-insurance retention, which for the years ended June 30, 2016 and 2015 was $5,000 per claim and unlimited in the aggregate. Claims in excess of $5,000 are subject to an additional self-insurance retention limited to $12,500 per claim and $22,500 in aggregate. There are no assurances that the University will be able to renew existing policies or procure coverage on similar terms in the future.

The estimated liability for medical malpractice self-insurance is actuarially determined based upon estimated claim reserves and various assumptions, and represents the estimated present value of self-insurance claims that will be settled in the future. It considers anticipated payout patterns as well as interest to be earned on available assets prior to payment. The discount rate used to value the self-insurance liability is a rate commensurate with the duration of anticipated payments.

A comparison of the estimated liability for incurred malpractice claims (filed and not filed) and assets available for claims for the combined University and UCMC self-insurance program as of June 30, 2016 and 2015, is presented below:

		2016	2015
Actuarial present value of self-insurance liability for medical malpractice	$	238,213	250,444
Total assets available for claims		300,352	351,528

If the present-value method were not used, the ultimate liability for medical malpractice self-insurance claims would be approximately $33,100 higher at June 30, 2016. The interest rate assumed in determining the present value was 3.5% and 4.25% for 2016 and 2015, respectively. UCMC has recorded its pro-rata share of the malpractice self-insurance liability as required under ASU 2010-24 in the amount of $117,410 and $112,700 at June 30, 2016 and June 30, 2015, respectively, with an offsetting receivable from the malpractice trust to cover any related claims. The malpractice self-insurance trust assets consist primarily of funds held in TRIP.

UCMC recognizes as malpractice expense its negotiated pro-rata share of the actuarially determined normal contribution, with gains and losses amortized over five years, with no retroactive adjustments, as provided in the operating agreement. For fiscal year 2017, UCMC's expense is estimated to be approximately $8,500 related to malpractice insurance.

UCMC designated $14,700 and $16,400 as of June 30, 2016 and 2015, respectively, as a workers' compensation self-insurance reserve trust fund, which is included within investments limited as to use within the consolidated balance sheets. The self-insurance program investments consist of approximately 60% bonds and 40% marketable equities. The specifically identified claim requirements and actuarially determined reserve requirements for unreported workers' compensation claims were approximately $6,300 and $8,200 as of June 30, 2016 and 2015, respectively. The University also charges UCMC for its portion of other commercial insurance and self-insurance costs.

(Dollars in thousands)

(13) Pension Plans

Active Plans

A majority of UCMC's personnel participate in the University's defined benefit and contribution pension plan, which are considered multi-employer pension plans. Under the defined benefit portion of this plan, benefits are based on years of service and the employee's compensation for the five highest paid consecutive years within the last ten years of employment. UCMC and the University make annual contributions to this portion of the plan at a rate necessary to maintain plan funding based on the guidelines set forth by the Employee Retirement Income Security Act of 1974, on an actuarially determined basis. UCMC recognizes its share of net periodic pension cost as expense and any difference in the contribution amount as a transfer of unrestricted net assets. The adjustment to net assets was a decrease of $300 for 2016 and an increase of $1,000 for 2015. Contributions of $32,500 were made in the fiscal years ended June 30, 2016 and 2015. UCMC expects to make contributions not to exceed $10,000 for the fiscal year ended June 30, 2017 that will be entirely expensed as net periodic pension costs.

Under the defined contribution portion of the plan, UCMC and plan participants make contributions that accrue to the benefit of the participants at retirement. UCMC's contributions, which are based on a percentage of each covered employee's salary, totaled approximately $7,800 and $7,400 for the years ended June 30, 2016 and 2015, respectively.

UCMC's contributions to the University's defined benefit plans included in the University's financial statements for the year ended June 30, 2016 and 2015 are as follows:

Plan name	EIN	Contributions of UCMC 2016	Contributions of UCMC 2015
University of Chicago Retirement Income Plan for Employees	36-2177139-002	$ 4,000	—
University of Chicago Pension Plan for Staff Employees	36-2177139-003	28,500	32,500
		$ 32,500	32,500

(Continued)

(Dollars in thousands)

The benefit obligation, fair value of plan assets and funded status for the University's defined benefit plan included in the University's financial statements as of June 30, are shown below:

		2016	2015
Projected benefit obligation	$	1,017,137	954,886
Fair value of plan assets		741,696	695,869
Deficit of plan assets over benefit obligation	$	(275,441)	(259,017)

The weighted-average assumptions used in the accounting for the plan are shown below:

	2016	2015
Discount rate	3.6%	4.5%
Expected return on plan assets	6.5	6.5
Rate of compensation increase	3.5	3.5

The weighted average asset allocation for the plan is as follows:

	2016	2015
Domestic equities	26%	27%
International equity	20	19
Fixed income	54	54
	100%	100%

The pension and other postretirement benefit obligation considers anticipated payout patterns as well as investment returns on available assets prior to payment. The discount rate used to value the pension and other postretirement benefit obligation is a risk-adjusted rate commensurate with the duration of anticipated payments. These inputs to the fair value estimate are considered Level 2 in the fair value hierarchy.

Total benefits and plan expenses paid by the plan were $47,500 and $40,100 for the fiscal years ended June 30, 2016 and 2015, respectively.

Expected future benefit payments excluding plan expenses are as follows:

Fiscal year:		
2017	$	75,031
2018		50,388
2019		51,536
2020		53,248
2021		56,378
2022–2025		296,796

(Dollars in thousands)

Certain UCMC personnel participate in a contributory pension plan. Under this plan, UCMC and plan participants make annual contributions to purchase annuities equivalent to retirement benefits earned. UCMC's pension expense for this plan was $5,300 and $5,200 for the years ended June 30, 2016 and 2015, respectively.

Curtailed and Frozen Plan

In June 2002, UCMC assumed sponsorship of the Louis A. Weiss Memorial Hospital Pension Plan (Employer Identification Number 36-3488183, Plan Number 003), which covers employees of a former affiliate. Participation and benefit accruals are frozen. All benefit accruals are fully vested.

Components of net periodic pension cost and other amounts recognized in unrestricted net assets include the following:

	Years ended June 30,	
	2016	**2015**
Net periodic pension cost:		
Interest cost	$ 2,513	2,293
Expected return on plan assets	(3,009)	(3,080)
Amortization of unrecognized net actuarial loss	926	617
Net periodic pension cost	430	(170)
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:		
Liability for pension benefits	(4,429)	(8,192)
Total recognized in net periodic pension cost and unrestricted net assets	$ 4,859	8,022

(Dollars in thousands)

The following tables set forth additional required pension disclosure information for this plan:

	Years ended June 30, 2016	Years ended June 30, 2015
Change in projected benefit obligation:		
Benefit obligation at beginning of year	$ 60,318	56,410
Interest cost	2,513	2,293
Net actuarial loss (gain)	4,236	5,382
Benefits paid	(3,556)	(3,767)
	63,511	60,318
Change in plan assets:		
Fair value of plan assets at beginning of year	52,037	53,151
Actual return on plan assets	1,890	(347)
Employer contribution	—	3,000
Benefits paid	(3,556)	(3,767)
	50,371	52,037
Funded status at end of year	$ (13,140)	(8,281)

Amounts recognized in the consolidated balance sheet are included in noncurrent liabilities.

Accumulated plan benefits equal projected plan benefits. Assumptions used in the accounting for the net periodic pension cost were as follows:

	2016	2015
Discount rate	3.5%	4.3%
Expected return on plan assets	6.0	6.0
Rate of compensation increase	N/A	N/A

Weighted average asset allocations for plan assets are as follows:

	2016	2015
Cash	3%	3%
Fixed income	60	58
Domestic equities	27	29
International equities	10	10
	100%	100%

(Dollars in thousands)

All plan assets are valued using level 1 inputs in 2016 and 2015. The target asset allocation is 40% equities and 60% fixed income. The expected return on plan assets is based on historical investment returns for similar investment portfolios.

UCMC expects to make contributions of $2,300 to the plan in the fiscal year ending June 30, 2017.

Expected future benefit payments are:

Fiscal year:		
2017	$	3,861
2018		3,858
2019		3,837
2020		3,861
2021		3,833
2022–2025		19,189

(14) Pledges

Pledges receivable at June 30 are comprised of:

		2016	2015
Unconditional promises expected to be collected in:			
Less than one year	$	1,661	1,102
One year to five years		2,602	1,522
More than five years		—	—
		4,263	2,624
Less unamortized discount (discount rate 5.5%)		(113)	—
Total	$	4,150	2,624

(15) Restricted Net Assets

Temporarily restricted net assets are available for the following purposes as of June 30:

		2016	2015
Pediatric healthcare	$	18,064	19,414
Adult healthcare		52,285	55,728
Educational and scientific programs		5,254	5,059
Capital and other purposes		6,322	5,908
Total	$	81,925	86,109

(Dollars in thousands)

Income from permanently restricted net assets is restricted for:

		2016	2015
Pediatric healthcare	$	1,865	1,855
Adult healthcare		1,935	1,935
Educational and scientific programs		4,312	4,312
Total	$	8,112	8,102

(16) Functional Expenses

Total operating expenses by function are as follows for the years ended June 30:

		2016	2015
Healthcare services	$	1,403,939	1,359,252
General and administrative		106,256	99,897
Total	$	1,510,195	1,459,149

(17) Contingencies

UCMC is subject to complaints, claims and litigation, which have risen in the normal course of business. In addition, UCMC is subject to reviews by various federal and state government agencies to assure compliance with applicable laws, some of which are subject to different interpretations. While the outcome of these suits cannot be determined at this time, management, based on advice from legal counsel, believes that any loss which may arise from these actions will not have a material adverse effect on the financial position or results of operations of UCMC.

(a) Medicare and Medicaid Reimbursement

For the years ended June 30, 2016 and 2015, UCMC recognized approximately 24% of net patient service revenue from services provided to Medicare beneficiaries. Recently enacted healthcare reform and other Medicare legislation may have an adverse effect on UCMC's net patient service revenue. Medicaid-payment methodologies and rates may be subject to modification based on the amount of funding available to the State of Illinois Medicaid Program.

UCMC has received and expects to receive future notices from the Medicare program requiring that they provide Medicare with documentation for claims to carry out the Recovery Audit Contract (RAC) program. UCMC is responding to these requests. Review of claims through the RAC program may result in a liability to the Medicare program and could have an adverse impact on UCMC's net patient service revenue.

(b) The Patient Protection and Affordable Care Act and Other Enacted Legislation

In March 2010, the Patient Protection and Affordable Care Act of 2010 (the Affordable Care Act) was enacted. Some of the provisions of the Affordable Care Act took effect immediately, while others will take effect or will be phased in over time, ranging from a few months to ten years following approval. The Affordable Care Act was designed to make available, or subsidize the premium costs of, healthcare insurance for some of the millions of currently uninsured or underinsured consumers below certain income levels. An increase in utilization of healthcare services by those who are currently avoiding or rationing their healthcare was expected. Although bad debt expenses and/or charity care provided were expected to be reduced, increased utilization would be associated with increased variable and fixed costs of providing healthcare services, which may or may not be offset by increased revenues.

The Affordable Care Act contains more than 32 Sections related to healthcare fraud and abuse and program integrity. The potential for increased legal exposure related to the Affordable Care Act's enhanced compliance and regulatory requirements could increase operating expenses.

UCMC continues to analyze the Affordable Care Act to assess its effects on current and projected operations, financial performance, and financial condition.

(c) Regulatory Investigations

The U.S. Department of Justice (DOJ) and other federal agencies routinely conduct regulatory investigations and compliance audits of healthcare providers. UCMC is subject to these regulatory efforts. Additionally, the laws and regulations governing the Medicare, Medicaid, and other government healthcare programs are extremely complex and subject to interpretation, making compliance an ongoing challenge for UCMC and other healthcare organizations. Recently the federal government has increased its enforcement activity, including audits and investigations related to billing practices, clinical documentation, and related matters. UCMC maintains a compliance program and conducts audits and other activities to identify potential compliance issues, including overpayments to governmental payors.

(d) Tax Exemption for Sales Tax and Property Tax

Effective June 14, 2012, the Governor of Illinois signed into law, Public Act 97-0688, which creates new standards for state income tax and property tax exemptions in Illinois. The law establishes new standards for the issuance of charitable exemptions, including requirements for a nonprofit hospital to certify annually that in the prior year, it provided an amount of qualified services and activities to low-income and underserved individuals with a value at least equal to the hospital's estimated property tax liability. UCMC has not recorded a liability for related property taxes based upon management's current determination of qualified services provided.

Effective June 14, 2012, the Governor of Illinois signed into law, Public Act 97-0688, which created an additional method for state sales tax and property tax exemptions to be granted to hospitals in Illinois. The law established new standards for the issuance of charitable exemptions, including requirements for a nonprofit hospital to certify annually that in the prior year, it provided an amount of qualified services and activities to low-income and underserved individuals with a value at least equal to the hospital's estimated property tax liability. This law applies only to those properties, which applied for new property tax exemption after the law's enactment. On January 5, 2016, the Fourth District of Illinois Appellate Court ruled that Public Act 97-0688 was unconstitutional under the Illinois Constitution. UCMC expects this case will ultimately be taken by the parties to the Illinois Supreme Court. Meanwhile UCMC's hospitals and certain affiliated corporations' property tax exemptions under the law remain intact. UCMC has not accrued any liability for property taxes and maintains the position that its hospitals and certain affiliated corporations are exempt from property taxes.