THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Financial Statements

June 30, 2018 and 2017

(With Independent Auditors' Report Thereon)

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

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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 sheets as of June 30, 2018 and 2017, and the related consolidated statements of operations and changes in unrestricted net assets, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated 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 audits. We conducted our audits 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of The University of Chicago Medical Center as of June 30, 2018 and 2017, and the results of its consolidated operations and of its consolidated cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The 2018 supplementary information included in schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Chicago, Illinois
November 7, 2018

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Balance Sheets

June 30, 2018 and 2017

(In thousands)

Assets		**2018**	**2017**
Current assets:			
Cash and cash equivalents	$	211,751	37,446
Patient accounts receivable, net of estimated uncollectibles of $160,307 in 2018 and $140,878 in 2017		347,870	432,100
Current portion of investments limited to use		8,872	20,608
Current portion of malpractice self-insurance receivable		17,491	21,141
Current portion of pledges receivable		1,052	1,256
Prepaids, inventory, and other current assets		111,563	85,921
Total current assets		698,599	598,472
Investments limited to use, less current portion		1,200,413	1,202,972
Property, plant, and equipment, net		1,602,751	1,625,205
Pledges receivable, less current portion		1,435	2,363
Malpractice self-insurance receivable, less current portion		86,319	99,798
Other assets, net		52,542	38,654
Total assets	$	3,642,059	3,567,464
Liabilities and Net Assets			
Current liabilities:			
Accounts payable and accrued expenses	$	251,424	222,595
Current portion of long-term debt		17,323	19,418
Current portion of other long-term liabilities		208	198
Estimated third-party payor settlements		214,184	178,181
Current portion of malpractice self-insurance liability		17,491	21,141
Due to University of Chicago		36,807	28,725
Total current liabilities		537,437	470,258
Other liabilities:			
Workers’ compensation self-insurance liabilities, less current portion		5,782	5,980
Malpractice self-insurance liability, less current portion		127,154	131,535
Long-term debt, less current portion		1,011,129	1,014,827
Interest rate swap liability		104,412	129,450
Other long-term liabilities, less current portion		35,878	44,469
Total liabilities		1,821,792	1,796,519
Net assets:			
Unrestricted		1,708,799	1,663,039
Temporarily restricted		93,981	90,461
Permanently restricted		17,487	17,445
Total net assets		1,820,267	1,770,945
Total liabilities and net assets	$	3,642,059	3,567,464

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Statements of Operations and Changes in Unrestricted Net Assets

Years ended June 30, 2018 and 2017

(In thousands)

		2018	2017
Operating revenues:			
Net patient service revenue	$	2,183,011	2,009,559
Provision for doubtful accounts		182,894	152,888
Net patient service revenue after provision for doubtful accounts		2,000,117	1,856,671
Other operating revenues and net assets released from restrictions used for operating purposes		211,898	148,790
Total operating revenues		2,212,015	2,005,461
Operating expenses:			
Salaries, wages, and benefits		943,550	859,641
Supplies and other		679,490	583,644
Physician services		280,780	251,492
Insurance		46,690	17,794
Interest		43,924	39,416
Medicaid provider tax		59,773	53,824
Depreciation and amortization		125,032	117,275
Total operating expenses		2,179,239	1,923,086
Operating revenue in excess of expenses		32,776	82,375
Nonoperating gains and losses:			
Investment income, net		65,503	89,154
Loss on extinguishment of debt		—	(27,028)
Contribution of CHHD unrestricted net assets		—	309,740
Change in fair value of nonhedged derivative instruments		2,356	3,561
Derivative ineffectiveness on hedged derivative instruments		(62)	2,095
Distributions and other, net		604	2,496
Revenue and gains in excess of expenses and losses		101,177	462,393
Other changes in net assets:			
Equity transfers to University of Chicago, net		(71,750)	(71,750)
Change in accrued pension benefits other than net periodic benefit costs		(7,853)	2,266
Effective portion of change in valuation of derivatives		24,635	44,863
Distributions and other, net		(449)	(349)
Increase in unrestricted net assets	$	45,760	437,423

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2018 and 2017

(In thousands)

		2018	2017
Unrestricted net assets:			
Revenue and gains in excess of expenses and losses	$	101,177	462,393
Equity transfers to the University of Chicago, net		(71,750)	(71,750)
Change in accrued pension benefits other than net periodic benefit cost		(7,853)	2,266
Effective portion of change in valuation of derivatives		24,635	44,863
Distributions and other, net		(449)	(349)
Increase in unrestricted net assets		45,760	437,423
Temporarily restricted net assets:			
Contributions		5,048	3,437
Net assets released from restrictions used for operating purposes		(7,295)	(6,518)
Investment income		5,767	7,582
Contribution of CHHD temporarily restricted net assets		—	4,035
Increase in temporarily restricted net assets		3,520	8,536
Permanently restricted net assets:			
Contribution of CHHD permanently restricted net assets		—	9,087
Contributions and other		42	246
Increase in permanently restricted net assets		42	9,333
Change in net assets		49,322	455,292
Net assets at beginning of year		1,770,945	1,315,653
Net assets at end of year	$	1,820,267	1,770,945

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidated Statements of Cash Flows

Years ended June 30, 2018 and 2017

		2018	2017
Cash flows from operating activities:			
Change in net assets	$	49,322	455,292
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Net change in unrealized gains and losses on investments		544	(18,303)
Equity transfers to the University of Chicago		71,750	71,750
Restricted contributions and investment return		(10,857)	(11,265)
Realized gains on investments		(52,157)	(56,460)
Net change in valuation of derivatives		(25,038)	(48,820)
Contribution of CHHD net assets		—	(322,862)
Change in accrued pension benefits other than net period benefit cost and other		7,853	(2,266)
(Gain) loss on disposal of assets		(122)	91
Provision for doubtful accounts		182,824	152,888
Loss on extinguishment of debt		—	27,028
Net assets released from restrictions for operations		7,295	6,518
Depreciation and amortization		125,032	117,275
Changes in assets and liabilities:			
Patient accounts receivable, net		(98,594)	(264,110)
Other assets		(21,269)	(25,472)
Accounts payable and accrued expenses		33,972	35,105
Due to the University of Chicago		8,082	6,579
Estimated settlements with third-party payors		36,003	16,750
Self-insurance liabilities		(8,229)	(1,732)
Other liabilities		(16,434)	4,651
Net cash provided by operating activities		289,977	142,637
Cash flows from investing activities:			
Purchases of property, plant, and equipment		(100,203)	(170,135)
Change in construction payables		(5,143)	(39,109)
Purchases of investments		(451,471)	(402,496)
Sales of investments		517,379	488,139
Cash received from contribution of CHHD		—	28,003
Net cash used in investing activities		(39,438)	(95,598)
Cash flows from financing activities			
Proceeds from issuance of long-term debt, including bond premium		61,220	256,396
Payments on long-term obligations		(65,917)	(220,069)
(Payments) draws on revolving credit facility		(3,000)	3,000
Payments for bond issuance costs		(349)	(2,252)
Equity transfers to the University of Chicago, net		(71,750)	(71,750)
Net assets released from restriction for operations		(7,295)	(6,518)
Restricted contributions and investment return		10,857	11,265
Net cash used in financing activities		(76,234)	(29,928)
Net increase in cash and cash equivalents		174,305	17,111
Cash and cash equivalents:			
Beginning of year		37,446	20,335
End of year	$	211,751	37,446

See accompanying notes to consolidated financial statements.

(1) Organization and Basis of Presentation

The accompanying consolidated financial statements represent the accounts of The University of Chicago Medical Center and its affiliates (the System). The University of Chicago Medical Center (UCMC) is the parent of an integrated nonprofit health care organization, partnering with the University of Chicago Biological Sciences Division, the University of Chicago Pritzker School of Medicine, and the University of Chicago Physicians Group to provide world-class medical care in an academic setting. 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, the UCM Community Health and Hospital Division, Inc. (CHHD), and various other outpatient clinics and treatment areas. Additional affiliated entities include the University of Chicago Medicine Care Network, which provides support and healthcare services in the greater Chicago region to support the healthcare needs to the community and the UCMC Title Holding Corporation and UCMC Title Holding Corporation II NFP, which cooperatively invest in facilities and equipment for the advancement of patient care. In May 2018, UCMC opened its Level 1 Trauma Center to serve the South Side of Chicago and surrounding community.

On October 1, 2016, UCMC acquired Ingalls Health System (IHS) through an affiliation and member substitution. As a result of this transaction, IHS became a wholly owned subsidiary of UCMC through the newly created CHHD of UCMC. Accordingly, the 2017 consolidated system statement of operations and changes in unrestricted net assets includes the operating activity of IHS for the nine-month period from October 1, 2016 through June 30, 2017.

The University of Chicago (the University), as the sole corporate member of UCMC, elects UCMC's Board of Trustees and approves its bylaws. 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 bylaws, an affiliation agreement, an operating agreement, and several leases. See note 4 for agreements and transactions with the University.

(2) Summary of Significant Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements of the System 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 2017, the System adopted Accounting Standards Update (ASU) No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This guidance requires the service cost component of net periodic benefit cost for pension and other postretirement benefit costs be presented as a component part of employee benefit expense. The other components of net periodic benefit cost, such as interest, expected return on plan assets, and amortization of other actuarially determined amounts, are required to be presented as a nonoperating change in unrestricted net assets. The System adopted the changes for the year ended June 30, 2017.

In August 2016, Financial Accounting Standards Board (FASB) issued ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 represents phase 1 of FASB's not-for-profit financial reporting project, and results reduce the number of net asset classes, require expense presentation by functional and natural classification, require quantitative and qualitative information in liquidity, retain the option to present the cash flow statement on a direct or indirect method, as well as include various other additional disclosure requirements. The requirements of this statement are effective for the System for the year ending June 30, 2019. The System is assessing the impacts on financial statement presentation and disclosures for this ASU.

In May 2014, FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. Particularly, that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The requirements of this statement are effective for the System for the year ending June 30, 2019. The System will record a decrease in net patient service revenue and a corresponding decrease in the provision for uncollectible accounts upon adoption of the standard.

In February 2016, FASB issues ASU No. 2016-02, *Leases*. ASU No. 2016-02 requires entities to recognize all leased assets as assets on the balance sheet with a corresponding liability resulting in a gross up of the balance sheet. Entities will also be required to present additional disclosures as to the nature and extent of leasing activities. ASU No. 2016-02 is effective for nonpublic business entities for the annual reporting period beginning after December 31, 2018. The requirements of this statement are effective for the System for the year ending June 30, 2020. The System has not evaluated the impact of this statement.

(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

The System'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. UCMC also accepts patients through the Perinatal and Pediatric Trauma Networks without regard to their ability to pay for services.

The System 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 the System 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, 2018 and 2017, are reported in note 6.

(e) Fair Value of Financial Instruments

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

The System 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 the System. 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

The System values inventories at the lower of cost or market using the first-in, first-out method.

(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 revenue 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 an entity 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. The System'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, 2018 and 2017, the System had no plans to sell investments at amounts different from NAV.

A significant portion of the System's investments are part of the University's Total Return Investment Pool (TRIP). The System 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 the System 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 has authorized the use of derivative investments to adjust market exposure within asset class ranges.

A summary of the inputs used in valuing the System's investments as of June 30, 2018 and 2017 is included in note 7.

(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, 2018 and 2017, there were no endowments in deficit positions.

(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 (the Board) for future capital improvements and other specific purposes, over which the Board retains control and may at its 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 funds, 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

The System accounts for derivatives and hedging activities in accordance with Accounting Standards Codification (ASC) Topic 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, the System 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.

The System 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

The System 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 System’s asset retirement obligations arise primarily from regulations that specify how to dispose of asbestos if facilities are demolished or undergo major renovations or repairs. The System’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

Goodwill and intangible assets principally relate to physician practice acquisitions. Intangible assets are being amortized over a period, generally not to exceed five years. Intangible assets were $438 and $703 for the years ended June 30, 2018 and 2017, respectively, and are included within other assets, net in the consolidated balance sheets. The System follows the provisions of ASC Subtopic 958-805, *Not-for-Profit Entities – Business* Combinations, which discontinued the amortization of goodwill. Under ASC Subtopic 958-805, goodwill is to be reviewed for impairment at least annually using a two-step test. Goodwill at June 30, 2018 and 2017 was $2,412 and $1,392, respectively, and is included in other assets, net within the consolidated balance sheets. No goodwill impairment was recorded by the System in 2018 and 2017.

(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 the System.

Unconditional promises to give cash and other assets to the System 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 limit 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 and changes in unrestricted net assets 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 the System deemed by management to be ongoing, major, and central to the provision of healthcare services are reported as operating revenue and expenses.

The consolidated statement of operations and changes in unrestricted net assets 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 System assets), the effective portion of changes in the valuation of derivatives, change in accrued pension benefits other than net periodic benefit costs, and distributions and other, net.

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

The System 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 the System 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 the System's estimates are adjusted in future periods as adjustments become known or as years are no longer subject to the System's audits, reviews, and investigations. Adjustments to prior year estimates for these items resulted in an increase in net patient service revenue of $3,506 in 2018 and $8,058 in 2017. 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.

The process for estimating the ultimate collectibility of receivables involves significant assumptions and judgment. The System 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 2018, reimbursement under the assessment programs resulted in a net increase of $33,685 in operating income, which includes $83,641 in Medicaid payments included in net patient service revenue offset by $49,956 in Medicaid provider tax expense. In 2017, reimbursement under the assessment programs resulted in a net increase of $32,560 in operating income, which includes $79,054 in Medicaid payments included in net patient service revenue offset by $46,494 in Medicaid provider tax expense.

(s) Affordable Care Act (ACA)

In March 2010, the federal government passed the 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. The System recognized $20,797 and $16,239 of net patient service revenue in 2018 and 2017, respectively, under this new law. Due to the timing of actual payments, UCMC recorded a receivable of $2,920 and $4,440 as of June 30, 2018 and 2017, respectively.

Beginning in 2016, coverage for newly eligible adults was expanded to include adults covered by an authorized Medicaid managed care organization, which would be funded by the federal government. For the years ended June 30, 2018 and June 30, 2017, the System recognized as reimbursement under the new legislation a net increase of $9,956 and $19,904 in operating income, which includes $19,773 and $27,234 in Medicaid payments included in net patient service revenue offset by $9,817 and $7,330 in Medicaid provider tax expenses, respectively.

(t) Income Taxes

The System applies ASC Topic 740, *Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements. ASC Topic 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 Topic 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, 2018 and 2017, the System does not have an asset or liability recorded for unrecognized tax positions.

UCMC and a substantial number of its subsidiaries are not-for-profit corporations 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 and several entities within CHHD, including Ingalls Captive Insurance, Ltd (ICI), Medcentrix, Inc. (MCX), and Ingalls Provider Group (IPG) are taxable entities under applicable sections of the Code.

Deferred income taxes on taxable entities are recognized for the tax consequences of “temporary differences” by applying enacted statutory tax rates applicable to future years to differences between the consolidated financial statement carrying amounts and the tax bases of existing assets and liabilities. As of June 30, 2018, ICI has a deferred tax asset primarily relating to net operating losses (NOL) of $398, which is recorded within prepaids, inventory, and other current assets in the consolidated balance sheets. A net valuation allowance of $1,521 against the gross ICI deferred tax asset of $1,919 was considered necessary, as management believed that it was not more likely than not that the results of future operations would generate sufficient taxable income to realize a portion of the deferred tax assets. IPG has an NOL of $153 at June 30, 2018; however, it has a full valuation allowance as future realization of the NOL is not likely. As of June 30, 2018, MCX has an NOL of $15,206; however, it has a full valuation allowance as future realization of the NOL is not likely. Income tax expense for the year ended June 30, 2018 was $43 and is related to ICI. This amount is recorded within supplies and other on the consolidated statement of operations and changes in unrestricted net assets.

(u) Reclassifications

Certain 2017 amounts have been reclassified to conform to the 2018 consolidated financial statement presentation.

(v) Subsequent Events

In connection with the preparation of the consolidated financial statements and in accordance with ASC Topic 855, *Subsequent Events*, the System evaluated events and transactions through November 7, 2018, the date the consolidated financial statements were issued noting no subsequent events requiring recording or disclosure in the consolidated financial statements or related notes to the consolidated financial statements other than the item note above.

(3) Acquisition

On October 1, 2016, UCMC acquired IHS through an affiliation and member substitution agreement. As a result of this transaction, IHS became a wholly owned subsidiary of UCMC through the newly created CHHD of UCMC. This affiliation positions the System, under the University of Chicago Medicine brand, to expand its integrated academic health delivery system to the South and Southwest Suburbs of Chicago, providing patients access to care at the forefront of medicine where patients live and work.

(Dollars in thousands)

The affiliation was effected through a member substitution with no consideration paid. For accounting purposes, this transaction is considered an acquisition under ASC Subtopic 958-805, and a contribution was recorded for the fair value of assets, net of liabilities of IHS in the consolidated statement of operations and changes in unrestricted net assets. No goodwill has been recorded as a result of this transaction.

The acquisition-date fair value of identifiable assets and liabilities of IHS at October 1, 2016 consisted of the following:

Fair value of identifiable net assets:		
Cash and cash equivalents	$	28,003
Other current assets		58,527
Property and equipment		187,641
Investments		289,888
Other long-term assets		2,720
Restricted assets – investments		9,087
Current liabilities		(82,428)
Long-term debt		(111,990)
Other long-term liabilities		(58,586)
Contribution of net assets	$	322,862

The valuation of the fair value of identifiable assets and liabilities has been completed. In valuing these assets and liabilities, fair values were based on, but were not limited to, independent appraisals, discounted cash flows, replacement costs, and actuarially determined values.

Operating expenses for the year ended June 30, 2017 include costs related to the integration of IHS into the System, including support services, operating programs with other health practitioners, as well as costs of valuation and integration consulting.

Operating results and changes in net assets attributable to IHS since the date of acquisition included in the accompanying consolidated statement of operations and changes in unrestricted net assets and statement of changes in net assets for the years ended 2017 is as follows:

		2017
Total operating revenue	$	263,549
Excess of revenue over expense		20,195
Change in net assets		1,642

(Dollars in thousands)

The unaudited supplemental pro forma operating results of UCMC as if the IHS affiliation had occurred on July 1, 2016 are as follows:

		Year ended June 30, 2017 (Unaudited)
Total operating revenue	$	2,092,155
Operating income		76,793
Excess of revenue over expenses attributable to UCMC and affiliates		149,622

The pro forma information provided should not be construed to be indicative of UCMC's results of operations had the acquisition been consummated on July 1, 2016, and is not intended to project UCMC's results of operations for any future period.

(4) 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 healthcare 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, 2018 and 2017, the University charged UCMC $28,706 and $30,014, respectively, for utilities, security, telecommunications, insurance, and overhead.

The University's Division of Biological Sciences provides physician services to UCMC. In 2018 and 2017, UCMC recorded $252,587 and $229,863, 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 2018 and 2017 for this support.

(5) Third-Party Reimbursement Programs

The System follows the provisions of ASU No. 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 No. 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 and changes in unrestricted net assets. 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 and changes in unrestricted net assets for the years ended June 30, 2018 and 2017 has 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 No. 2011-07.

The System 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 the System's billings at list price and the amounts reimbursed by Medicare, Blue Cross, and certain other contracted third-party payors; the difference between the System'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

The System 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. The System'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 on a combination of prospectively determined rates and cost reimbursement methodologies. For the cost reimbursement, the System is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits by the Medicare fiscal intermediary. UCMC's Medicare reimbursement reports through June 30, 2012 have been audited by the Medicare fiscal intermediary. CHHD's Medicare reimbursement reports through September 30, 2015 have been audited by the Medicare fiscal intermediary.

(b) Medicaid

The System 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 the System's revenue.

(c) Blue Cross

The System 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 the System and a review by Blue Cross. UCMC's Blue Cross reimbursement reports for 2016 and prior years have been reviewed by Blue Cross. CHHD's Blue Cross reimbursement reports for September 30, 2015, and prior years have been reviewed by Blue Cross.

(d) Other

The System 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 the System 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, the System 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, the System 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 the System's charity care policy. For any remaining patient responsibility balance, the System 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)

The System'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 24.6% of accounts receivable at June 30, 2017 to 28.0% of accounts receivable at June 30, 2018. Gross write-offs increased from approximately $210,841 in fiscal year 2017 to $249,734 in fiscal year 2018.

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 are as follows:

		2018	2017
Medicare	$	563,088	493,691
Medicaid		386,001	391,528
Managed care		1,146,309	1,082,368
Patients and other		87,613	41,972
Net patient service revenue before provision for doubtful accounts	$	2,183,011	2,009,559

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors as of June 30, 2018 and 2017 are as follows:

	2018	2017
Medicare	18.2 %	17.7 %
Medicaid	28.5	30.0
Managed care	50.5	48.4
Patients and other	2.8	3.9
	100.0 %	100.0 %

(Dollars in thousands)

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

	2018	2017
Medicare	39.0 %	38.3 %
Medicaid	23.1	23.5
Managed care	35.4	36.5
Patients and other	2.5	1.7
	100.0 %	100.0 %

(6) Community Benefits

The following is a summary of the System's unreimbursed cost of providing care, as defined under its 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, 2018 and 2017:

	Year ended June 30	
	2018	2017
Uncompensated care:		
Medicaid sponsored indigent healthcare	$ 100,417	72,905
Medicare sponsored indigent healthcare – cost report	150,818	118,486
Medicare sponsored indigent healthcare – physician services	2,703	37,323
Total uncompensated care	253,938	228,714
Charity care	26,967	27,199
	280,905	255,913
Unreimbursed education and research:		
Education (unaudited)	70,983	71,044
Research (unaudited)	48,000	48,000
Total unreimbursed education and research	118,983	119,044
Total community benefits	$ 399,888	374,957

The System 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. The System has not amended its financial assistance policies in 2018.

(Continued)

(Dollars in thousands)

(7) Investments Limited as to Use

The composition of investments limited as to use is as follows at June 30 2018 and 2017:

	2018				
	Separately invested	**TRIP**	**Other**	**Total**	**2017**
Investments carried at fair value:					
Cash equivalents	$ 984	11,446	498	12,928	46,740
Global public equities	107,869	238,400	—	346,269	307,755
Private debt	—	41,107	—	41,107	37,896
Private equity:					
U.S. venture capital	6,451	48,056	—	54,507	132,113
U.S. corporate finance	—	31,321	—	31,321	30,516
International	114	54,214	—	54,328	44,776
Real assets:					
Real estate	—	55,485	—	55,485	61,884
Natural resources	—	67,378	—	67,378	57,826
Absolute return:					
Equity oriented	—	90,477	—	90,477	76,486
Global macro/relative value	—	52,934	—	52,934	51,259
Multistrategy	—	67,111	—	67,111	60,244
Credit-oriented	—	50,245	—	50,245	43,409
Protection-oriented	—	16,816	—	16,816	14,041
Fixed income:					
U.S. Treasuries, including TIPS	—	55,883	—	55,883	47,810
Other fixed income	164,949	—	—	164,949	155,781
Beneficial interests in trust	—	—	9,316	9,316	9,284
Funds in trust	—	—	38,231	38,231	45,760
Total investments	$ 280,367	880,873	48,045	1,209,285	1,223,580

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

	2018	**2017**
Current portion of investments limited to use	$ 8,872	20,608
Investments limited to use, less current portion	1,200,413	1,202,972
Total investments limited to use	$ 1,209,285	1,223,580

(Dollars in thousands)

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

		2018			
		UCMC	**CHHD**	**Total**	**2017**
Investments limited as to use:					
By the board for capital improvements/restrictions by donors	$	218,382	77,453	295,835	415,271
Funds held by custodian/trustee under indenture agreements		164	—	164	2,428
Funds held by trustee for self-insurance		7,468	24,945	32,413	21,647
Collateral for interest rate swap		—	—	—	14,200
TRIP investments		687,795	193,078	880,873	770,034
Total investments limited to use	$	913,809	295,476	1,209,285	1,223,580

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

		2018			
		UCMC	**CHHD**	**Total**	**2017**
Interest and dividend income, net	$	10,748	3,142	13,890	14,391
Realized gains on sales of securities, net		32,047	20,110	52,157	56,460
Unrealized gains (losses) on securities, net		5,917	(6,461)	(544)	18,303
	$	48,712	16,791	65,503	89,154

Outside of TRIP, UCMC also invests in private equity limited partnerships. As of June 30, 2018, UCMC has commitments of $34,200 remaining to fund private equity limited partnerships.

Fair Value of Financial Instruments

The overall investment objective of the System 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. The System 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 is 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 monitors the valuation methodologies and practices of managers on behalf of the System.

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.

Beneficial interests in trusts represent restricted investments that are assets held by third-party trustees for beneficial interests in perpetual trusts, comprising equities, fixed-income securities, and money market funds.

Funds in trust investments consist primarily of project construction funds and workers’ compensation trust funds. Funds in trust comprise 4% cash and cash equivalents, 88% fixed income investments and 8% equity investments at June 30, 2018 and comprised 4% cash and cash equivalents, 62% fixed income investments, and 34% equity investments at June 30, 2017.

(Continued)

(Dollars in thousands)

The System believes that the reported amount of its investments is a reasonable estimate of fair value as of June 30, 2018 and 2017. 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, 2018 and 2017 were as follows:

Assets	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2018 Total fair value
Cash and cash equivalents	$ 211,751	—	—	211,751
Investments:				
Cash equivalents	12,928	—	—	12,928
Global public equities	173,926	13,549	—	187,475
Private equity – U.S.				
Venture Capital	5,613	—	—	5,613
Real assets:				
Real estate	14,533	—	—	14,533
Natural resources	9,326	—	—	9,326
Absolute return:				
Global macro/relative value	9,239	2,997	—	12,236
Fixed income:				
U.S. Treasuries, including TIPS	55,883	—	—	55,883
Other fixed income	164,949	—	—	164,949
Restricted investments	—	—	9,316	9,316
Funds in trust	7,632	30,599	—	38,231
Investments measured at net asset value[1]	—	—	—	698,795
Total investments at fair value	665,780	47,145	9,316	1,421,036
Other assets	6,590	—	—	6,590
Total assets at fair value	$ 672,370	47,145	9,316	1,427,626
Liabilities				
Interest rate swap payable	$ —	104,412	—	104,412
Total liabilities at fair value	$ —	104,412	—	104,412

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(Dollars in thousands)

Assets		Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	2017 Total fair value
Cash and cash equivalents	$	37,446	—	—	37,446
Investments:					
Cash equivalents		46,742	—	—	46,742
Global public equities		130,742	4,470	—	135,212
Private equity – U.S. Venture Capital		—	—	—	—
Real assets:					
Real estate		8,419	—	—	8,419
Natural resources		4,861	—	—	4,861
Absolute return:					
Equity oriented		—	—	—	—
Global macro/relative value		8,312	2,760	—	11,072
Fixed income:					
U.S. Treasuries, including TIPS		47,810	—	—	47,810
Other fixed income		119,634	—	—	119,634
Restricted investments		—	—	9,284	9,284
Funds in trust		25,390	20,370	—	45,760
Investments measured at net asset value[1]		—	—	—	794,786
Total investments at fair value		429,356	27,600	9,284	1,261,026
Other assets		6,587	—	—	6,587
Total assets at fair value	$	435,943	27,600	9,284	1,267,613
Liabilities					
Interest rate swap payable	$	—	129,450	—	129,450
Total liabilities at fair value	$	—	129,450	—	129,450

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.

During 2018, 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.

The following table presents activity for the year ended June 30, 2018 for assets measured at fair value using unobservable inputs classified in Level 3:

		Level 3 rollforward
Beginning fair value	$	9,284
Change in unrealized gains and losses, net		32
Ending fair value	$	9,316

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 the System's investments could occur in the next term and that such changes could materially affect the amounts reported 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 the System 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 the System'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 NAVs in isolation would result in a significant changes in fair value measurement.

(Continued)

(Dollars in thousands)

The System 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 redemptions permitted
Mutual bond and equity funds	N/A	Daily to monthly with notice periods of 1 to 30 days	None
Real estate funds	N/A	Quarterly with notice periods of 45 to 90 days	None
Funds of funds	N/A	Monthly to quarterly with notice periods of 15 to 185 days	None

	Remaining life	Redemption terms	Redemption restrictions and terms
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 redemptions permitted
Real estate:			
Drawdown partnerships	1 to 16 years	Redemptions not permitted	N/A
Separate accounts	N/A	Daily with notice period of 5 days	None
Natural resources:			
Drawdown partnerships	1 to 17 years	Redemptions not permitted	N/A
Commingled funds	N/A	Daily with notice period of 1 day	None

(Continued)

	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

(8) Endowments

The System’s endowment 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, the System 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 the System in a manner consistent with the standard of prudence prescribed by UPMIFA.

The System has beneficial interests in trusts. The System has recorded its share of the principal of the trusts as permanently restricted net assets. Distributions from the trusts are recorded within unrestricted net assets if unrestricted; otherwise, they are classified as temporarily restricted net assets until appropriated for expenditure. In some instances the historical costs basis of the funds is not available as the System received the shares in 1929. The fair value of assets associated with individual donor-restricted endowment funds may fall below the amount of the original donation as a result of unfavorable market conditions. There were no such deficiencies at June 30, 2018 and 2017, respectively.

(Dollars in thousands)

The System has the following donor-restricted endowment activities during the years ended June 30, 2018 and 2017 delineated by net asset class:

		Unrestricted Funds functioning [1]	Temporarily restricted	Permanently restricted	2018 Total
Endowment net assets, beginning of year	$	813,993	75,207	17,445	906,645
Investment return:					
Investment income		10,748	719	—	11,467
Net appreciation (realized and unrealized)		37,964	5,049	32	43,045
Total investment return		48,712	5,768	32	54,512
Gifts and other additions		—	1,224	10	1,234
Appropriation of endowment assets for expenditure		(41,431)	(4,819)	—	(46,250)
Appropriation of endowment assets for capital		—	—	—	—
Other		3,333	—	—	3,333
Endowment net assets, end of year	$	824,607	77,380	17,487	919,474

[1] Funds functioning relate to UCMC only as CHHD does not have such funds at June 30, 2018.

		Unrestricted Funds functioning [1]	Temporarily restricted	Permanently restricted	2017 Total
Endowment net assets, beginning of year	$	804,437	67,401	8,112	879,950
Investment return:					
Investment income		29,989	804	197	30,990
Net appreciation (realized and unrealized)		42,567	6,843	—	49,410
Total investment return		72,556	7,647	197	80,400
Gifts and other additions		—	750	49	799
Contributions – CHHD net assets		—	4,035	9,087	13,122
Appropriation of endowment assets for expenditure		(40,953)	(4,997)	—	(45,950)
Appropriation of endowment assets for capital		(25,000)	—	—	(25,000)
Other		2,953	371	—	3,324
Endowment net assets, end of year	$	813,993	75,207	17,445	906,645

[1] Funds functioning relate to UCMC only as CHHD does not have such funds at June 30, 2017.

(Continued)

(Dollars in thousands)

The description of amounts classified as permanently restricted net assets and temporarily restricted net assets (endowments only) as of June 30, 2018 and 2017 is as follows:

		Perpetual	Time-restricted by donor	Time-restricted by law	2018 Total
Restricted for pediatric healthcare	$	3,951	—	17,478	21,429
Restricted for adult healthcare		4,320	—	57,114	61,434
Restricted for educational and scientific programs		9,216	—	2,788	12,004
	$	17,487	—	77,380	94,867

		Perpetual	Time-restricted by donor	Time-restricted by law	2018 Total
Restricted for pediatric healthcare	$	1,865	—	16,143	18,008
Restricted for adult healthcare		11,220	—	56,560	67,780
Restricted for educational and scientific programs		4,360	—	2,504	6,864
	$	17,445	—	75,207	92,652

Investment and Spending Policies

The System 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. The System expects its endowment funds to provide an average rate of return of approximately 6% annually. To achieve its long-term rate of return objectives, the System 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 the System 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, 2018 and 2017. 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, the System 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.

(9) Property, Plant, and Equipment

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

		2018	2017
Land and land rights	$	55,587	54,505
Buildings and improvements		1,824,214	1,765,121
Equipment		686,998	667,388
Construction in progress		33,295	38,456
		2,600,094	2,525,470
Less accumulated depreciation		(997,343)	(900,265)
Total property, plant and equipment, net	$	1,602,751	1,625,205

UCMC's net property, plant, and equipment cost includes $8,300 and $8,700 at June 30, 2018 and 2017 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 include $20,700 and $22,500 for 2018 and 2017, respectively, which represents the unamortized portion of initial lease payments made to the University.

A new adult Emergency Department and Level 1 Trauma Center were placed into service in 2018. Capitalized interest costs in 2018 and 2017 were approximately $1,100 and $2,800, respectively. Construction in progress consists of various routine capital improvements and renovation projects. As of June 30, 2018, the System had total contractual commitments associated with ongoing capital projects of approximately $39,100.

(10) Long-Term Debt

The UCMC Obligated Group's long-term debt is issued pursuant to the UCMC Amended and Restated Master Trust Indenture (MTI) dated as of November 1, 1998, as subsequently amended and supplemented. UCMC is the only member of the Obligated Group. UCM Care Network, Title Holding Corporation, and CHHD are not members of the UCMC Obligated Group. Each series of bonds is collateralized by the unrestricted receivables of UCMC and subject to certain restrictions under the MTI.

The CHHD Obligated Group's long-term debt is issued pursuant to the CHHD Amended and Restated Master Trust Indenture dated as of December 15, 2017. The CHHD Obligated Group consists of CHHD, Ingalls Memorial Hospital, Ingalls Home Care, and Ingalls Development Foundation.

(Dollars in thousands)

Long-term debt at June 30, 2018 and 2017 consists of the following:

	Fiscal year maturity	Interest rate	2018	2017
University of Chicago Medical Center:				
Fixed rate:				
Illinois Finance Authority:				
Series 2009A and 2009B, 2009B partially legally defeased in 2017	2027	5.0 %	$ 94,630	105,160
Series 2009D1 and 2009D2 (Synthetically fixed rate)	2044	3.9	70,000	70,000
Series 2009E1 and 2009E2 (Synthetically fixed rate)	2044	3.9	70,000	70,000
Series 2010A and 2010B (Synthetically fixed rate)	2045	3.9	92,500	92,500
Series 2011A and 2011B (Synthetically fixed rate)	2045	3.9	92,500	92,500
Series 2012A	2037	4.7	62,595	64,615
Series 2015A	2029	5.0	21,895	21,895
Series 2016A	2027	4.5	22,830	22,830
Series 2016B	2042	4.5	164,490	164,490
Teachers Insurance and Annuity Association of America (TIAA)				
Series 2017A	2047	4.4	30,000	30,000
Unamortized premium			26,265	28,412
Total fixed rate			747,705	762,402
Variable rate:				
Series 2013A	2020	2.2	71,159	72,477
Illinois Educational Facilities Authority (IEFA)	2038	1.2	69,353	72,567
Total variable rate			140,512	145,044
Unamortized debt issuance costs			(6,630)	(7,108)
Less current portion of long-term debt			(14,513)	(13,868)
Total UCMC long-term portion of debt, less current portion			$ 867,074	886,470

(Dollars in thousands)

	Fiscal year maturity	Interest rate	2018	2017
UCMC Title Holding Corporation:				
Fixed rate:				
Brownfield Revitalization 40 – Promissory note A	2024	1.5 %	$ 4,850	4,850
Urban Development Fund XLVI – Promissory note A	2024	1.5	4,850	4,850
Urban Development Fund LI – Promissory note A	2024	1.8	6,500	6,500
Citi NMTC – QLICI	2032	1.2	3,476	3,476
Citi NMTC – QLICI	2032	1.2	1,620	1,620
URP QLICI – Loan A	2047	1.0	7,334	—
URP QLICI – Loan B	2047	1.0	2,666	—
SCORE QLICI – Loan A	2047	1.0	4,176	—
SCORE QLICI – Loan B	2047	1.0	1,704	—
CNI QLICI – Loan A	2047	1.0	3,455	—
CNI QLICI – Loan B	2047	1.0	1,545	—
Total UCMC Title Holding Corporation debt			$ 42,176	21,296
Community Health and Hospital Division:				
Fixed Rate: Series 2013	2043	3.5–5.0%	$ 60,915	61,565
Variable Rate: Series 2004	2034	Varies	—	43,925
Variable Rate: Series 2017			40,340	—
Revolving credit agreement		LIBOR + 1.25%	—	3,000
Unamortized debt fair value adjustment as part of acquisition			4,367	4,739
Unamortized debt issuance costs			(933)	(618)
Total debt and unamortized premiums (discount)			104,689	112,611
Less current portion of long-term debt			(2,810)	(5,550)
Total CHHD debt, excluding current portion			$ 101,879	107,061
Total notes and bonds payable			$ 1,028,452	1,034,245
Less current portion			(17,323)	(19,418)
Long-term debt, excluding current portion			$ 1,011,129	1,014,827

(Dollars in thousands)

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

		Amount
Year:		
2019	$	17,323
2020		18,098
2021		19,230
2022		21,510
2023		8,628
Thereafter		946,859
	$	1,031,648

(a) UCMC Obligated Group

Under its various credit 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.

(i) Recent Financing Activity

In November 2016, the Illinois Finance Authority issued $22,830 and $164,490 of Series 2016A and Series 2016B Revenue Refunding Bonds, respectively, allocated to UCMC with Series 2016A bonds refunding a portion of the 2009B bonds and the Series 2016B bonds refunding all of Series 2009C and Series 2011C bonds via a legal defeasance. The Series 2016A and 2016B bonds are secured by a Direct Note Obligation and were issued pursuant to the MTI. The extinguishment of the Series 2009C and 2011C bonds resulted in a loss on extinguishment of debt of $27,028 recorded as a nonoperating loss in 2017 within the consolidated statements of operations and changes in unrestricted net assets.

In February 2017, UCMC secured a taxable private placement loan through the Teachers Insurance and Annuity Association of America in the amount of $30,000 with interest fixed at 4.4% annually. The proceeds from the financing are utilized for projects, such as the relocation of the adult emergency department, the addition of an adult trauma center, and other capital projects at the medical center campus.

During 2017, UCMC entered into New Market Tax Credit (NMTC) financing agreements with various entities for the purposes of financing various projects at UCMC that would benefit the surrounding community. The NMTC program was established in 2000 by the United States Congress and is administered by the Department of Treasury to encourage private investment in qualifying low-income communities. Pursuant to Section 45(D) of the Internal Revenue Code, UCMC's NMTC structure consists of an NMTC investor (Investor) who provided qualified equity investments to a community development entity (CDE) who in turn provided debt financing to a separate not for profit tax exempt entity, which is a qualified active low income community business (QALICB).

In July 2016, UCMC was a lender in the NMTC structure for the financing of certain equipment. Because UCMC has the power to appoint all board members of UCMC Title Holding Corporation, the QALICB has been consolidated in the financial statements. The Investor made qualifying equity investments into various CDE funds, including Twain Investment Fund 177, LLC and USBCDC Investment Fund 147, LLC (the CDE Funds), which in turn provided debt financing of $16,200 to UCMC Title Holding Corporation to fund qualified costs of equipment, as required under the terms of the agreement. Management anticipates that the NMTC structure will stay in effect through July 2023 when the NMTC tax compliance period expires. At that time, management believes the Investor will exercise its Put Option in the Put and Call Agreement, allowing UCMC to acquire a 100% equity interest in the investment fund for $1. If the Put Option is not exercised, UCMC has the right to call for the purchase of a 100% equity interest in the investment fund at a fair market value. In either case, once the option is exercised, UCMC's loan to the Investment Fund would be extinguished, the investment fund and the CDE Funds would be dissolved, and the loans from the CDE Funds to UCMC Title Holding Corporation would be extinguished.

In June 2017, UCMC was a lender in the NMTC structure for the construction of a new emergency department and adult trauma center. Because UCMC has the power to appoint all board members of UCMC Title Holding Corporation II NFP, the QALICB has been consolidated in the financial statements. The Investor made qualifying equity investments into various CDE funds, including UCMC Trauma Center NMTC Investment Fund, LLC (the CDE Funds), which in turn provided debt financing of $5,096 to UCMC Title Holding Corporation to fund qualified construction costs and equipment, as required under the terms of the agreement. Management anticipates that the NMTC structure will stay in effect through July 2024 when the NMTC tax compliance period expires. At that time, management believes the Investor will exercise its Put Option in the Put and Call Agreement, allowing UCMC to acquire a 100% equity interest in the investment fund for $5. If the Put Option is not exercised, UCMC has the right to call for the purchase of a 100% equity interest in the investment fund at a fair market value. In either case, once the option is exercised, UCMC's loan to the investment fund would be extinguished, the investment fund and the CDE Funds would be dissolved, and the loans from the CDE Funds to UCMC Title Holding Corporation II NFP would be extinguished.

In August 2017, UCMC was a lender in the NMTC structure for the construction of a new emergency department and adult trauma center. Because UCMC has the power to appoint all board members of UCMC Title Holding Corporation II NFP, the QALICB has been consolidated in the financial statements. The Investor made qualifying equity investments into various CDE funds, including UCMC Trauma Center NMTC Investment Fund, LLC (the CDE Funds), which in turn provided debt financing of $20,880 to UCMC Title Holding Corporation to fund qualified construction costs and equipment, as required under the terms of the agreement. Management anticipates that the NMTC structure will stay in effect through July 2025 when the NMTC tax compliance period expires. At that time, management believes the Investor will exercise its Put Option in the Put and Call Agreement, allowing UCMC to acquire a 100% equity interest in the investment fund. If the Put Option is not exercised, UCMC has the right to call for the purchase of a

100% equity interest in the investment fund at a fair market value. In either case, once the option is exercised, UCMC's loan to the investment fund would be extinguished, the investment fund and the CDE Funds would be dissolved, and the loans from the CDE Funds to UCMC Title Holding Corporation II NFP would be extinguished.

(ii) 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 supports the Series 2009D bonds expires in June 2019. The letter of credit that supports the 2009E bonds expires in July 2021. The letters of credit that support the Series 2010A and Series 2010B bonds expire in November 2020 and July 2021, 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 2019. 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.

Included in UCMC's debt is $69,353 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 zero and three 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.

(b) Community Health and Hospital Division

(i) Recent Financing Activity

In December 2017, CHHD issued variable rate bonds, Series 2017, in the amount of $40,340, bearing interest at a variable rate at June 30, 2018. The Series 2017 bonds were issued pursuant to the MTI, were initially sold to JPMorgan Chase Bank and are subject to mandatory redemption on July 3, 2020. The Series 2017 bonds are equally and ratably secured by a security interest in the unrestricted receivables of the members of CHHD's Obligated Group. Proceeds from the Series 2017 issuance were used to redeem the $43,974 outstanding on the Series 2004 bonds. There was no gain or loss recorded on the redemption.

On January 17, 2013, CHHD issued fixed rate revenue bonds, Series 2013, in the amount of $61,860 through the Illinois Finance Authority. The Series 2013 bonds were issued pursuant to the MTI and are subject to mandatory, optional, and extraordinary redemption prior to maturity. Mandatory redemption or payment at maturity will occur, without premium, on May 15 of each year, beginning in 2018 and continuing through 2043. The Series 2013 Obligation will be equally and ratably secured by a security interest in the unrestricted receivables of the members of the CHHD's Obligated Group.

(Dollars in thousands)

(c) Lines of Credit

As of June 30, 2018, UCMC has a $100,000 line of credit from a commercial bank. In September 2018, the line was extended through September 2019 and the line was reduced to $50,000. As of June 30, 2018 and 2017, no amount was outstanding under this line. CHHD has a revolving credit agreement of $10,000, which expires on October 31, 2019. As of June 30, 2018 and 2017, there was $0 and $3,000, respectively, of outstanding borrowings under this agreement. Interest is paid on draws at LIBOR + 1.25%, which was 2.26% as of June 30, 2017.

(i) Other Debt Related Items

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

Year ending June 30:		
2019	$	27,489
2020		144,221
2021		159,609
2022		139,065
2023		7,343
Thereafter		553,921
	$	1,031,648

The System paid interest, net of capitalized interest, of approximately $36,975 and $32,170 in 2018 and 2017, respectively.

(11) Derivative Instruments

The System has interest rate related derivative instruments to manage its exposure on debt instruments. By using derivative financial instruments to manage the risk of changes in interest rates, the System exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes the System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty, and therefore, it does not possess credit risk; however, the System is required to post collateral to the counterparty when certain thresholds as defined in the derivative agreements are met. 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. System management also mitigates risk through periodic reviews of their derivative positions in the context of their total blended cost of capital.

(Dollars in thousands)

The System is required to post collateral under the specific terms and conditions for the various interest rate swap agreements as described below. At June 30, 2018 and 2017, $0 and $14,200 was held as collateral, respectively, and was recorded in current portion of investments limited to use. Collateral postings are primarily driven by the value of the swap as measured at the reset date. Collateral requirements increase if credit ratings were to be downgraded.

University of Chicago Medical Center Interest Rate Swap Agreement

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 $(62) in 2018 and an ineffectiveness of $(2,095) in 2017. 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, 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.

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
August 9, 2011	2009 D/E, 2010 A/B, 2011 A/B	32.5 Years	$ 162,500,000	3.89 %	68% of LIBOR
August 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.

(Dollars in thousands)

Community Health and Hospital Division

(a) 2004 Interest Rate Swap Agreement

CHHD entered into an interest rate swap agreement on June 28, 2004 to lock in long-term fixed rates on the Series 2004 variable-rate debt issuance, with a notional amount of $42,025 and a maturity date of May 15, 2034. This agreement was amended on March 1, 2013. Under the amended agreement, the notional amount and maturity did not change, and CHHD receives, on a monthly basis, 67.00% of one-month LIBOR plus 47.5 basis points and makes payments on a monthly basis, an annualized fixed rate of 4.61%.

The swap is not designated as a hedging instrument, and therefore, the change in fair value of the 2004 interest rate swap agreement was recognized as a component of interest rate swap valuation nonoperating gains in the accompanying consolidated statement of operations and unrestricted in net assets. The fair value of the Series 2004 interest rate swap agreement liability of $7,114 at June 30, 2018 is included as a component of other long-term liabilities in the accompanying consolidated balance sheet. The change in the fair value of the Series 2004 interest rate swap agreement of $(2,356) for the year ended June 30, 2018 has been included as a component of interest rate swap valuation nonoperating gains. The differential to be paid or received under the Series 2004 interest rate swap agreement is recognized monthly and amounted to $(1,253) of net payments during the year ended June 30, 2018, which have been included as a component of interest expense in the accompanying consolidated statement of operations and changes in unrestricted net assets.

(b) CMS Basis Swap Agreement

CHHD previously held CMS basis swap agreements which were not designated as hedging instruments. In December 2017 the CMS Basis Swap agreements were terminated. CHHD received a cash payment upon termination of $159, which was included as a component of interest expense in the accompanying consolidated statement of operations and changes in unrestricted net assets.

A summary of outstanding positions under the interest rate swap agreements for CHHD at June 30, 2018 is as follows:

Series		Notional amount	Maturity date	Rate received	Rate paid
2004 Interest rate swap Agreement:	$	42,025	May 15, 2034	% of LIBOR *	Fixed 4.61%

* Rate received is 67.00% of one-month LIBOR plus 47.5 basis points.

(Dollars in thousands)

(12) Commitments

Leases

The System leases office space and equipment under leases that are classified as operating leases. Future minimum payments required under noncancelable leases as of June 30 are as follows:

	Operating	Capital
2019	$ 5,211	1,491
2020	4,941	1,442
2021	4,733	807
2022	4,570	770
2023 and thereafter	15,553	13,979
	$ 35,008	18,489
Less amount representing interest		8,379
Present value of net minimum capital lease payments		$ 10,110

The amount of total assets capitalized under these leases at both June 30, 2018 and June 30, 2017 is $11,257 and $11,405 with related accumulated depreciation of $1,218 and $714, respectively. Rental expense was approximately $9,400 and $7,700 for the years ended June 30, 2018 and 2017, respectively.

(13) Insurance

Professional and General Liability

The System maintains separate self-insurance programs for UCMC and CHHD. 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, 2018 and 2017 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.

CHHD maintains a self-insurance program for professional and general liability. Coverage from commercial insurance carriers is maintained for claims in excess of self-insured retentions at various levels by policy year. CHHD established a trust fund with an independent trustee for the administration of assets funded under the malpractice and general liability self-insurance program.

The System has engaged professional consultants for calculating an estimated liability for medical malpractice self-insurance and 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.

(Dollars in thousands)

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, 2018 and 2017 is presented below:

		2018	2017
Actuarial present value of self-insurance liability for medical malpractice	$	201,440	236,770
Total assets available for claims		269,378	297,788

If the present-value method were not used, the ultimate liability for medical malpractice self-insurance claims would be approximately $32,000 higher at June 30, 2018. The interest rate assumed in determining the present value was 4% and 3.75% for 2018 and 2017, respectively. UCMC has recorded its pro-rata share of the malpractice self-insurance liability in the amount of $90,648 and $120,939 at June 30, 2018 and June 30, 2017, 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 2019, UCMC’s expense is estimated to be approximately $9,900 related to malpractice insurance.

CHHD estimated the total liability for self-insured malpractice and general claims at $48,240 at June 30, 2018. Accruals for CHHD professional and general liabilities are recorded on an undiscounted basis.

(14) Pension Plans

Active Plans

A majority of UCMC’s personnel participate in the University’s defined benefit and contribution pension plans, 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 $(7,853) and $2,266 for the years ended June 30, 2018 and 2017. No contributions were made in the fiscal years ended June 30, 2018 and 2017. UCMC expects to make contributions not to exceed $7,500 for the fiscal year ending June 30, 2019.

(Dollars in thousands)

Effective January 1, 2017, the 401(a) defined benefit pension plan was frozen for UCMC employees participating in the plan and was replaced with an enhanced defined contribution plan. This curtailment resulted in a current year reduction in the defined benefit pension obligation and a curtailment credit, whereas UCMC's expense for the plans was $12,650 for the year ended June 30, 2017. 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 $22,300 and $16,400 for the years ended June 30, 2018 and 2017, respectively.

UCMC's expense related the multiemployer University's defined benefit plans included in the University's financial statements for the years ended June 30, 2018 and 2017 is as follows:

Plan name	EIN	Contribution of UCMC 2018	Contribution of UCMC 2017
University of Chicago Retirement Income Plan for Employees	36-2177139-002	$ —	—
University of Chicago Pension Plan for Staff Employees	36-2177139-003	—	—
		$ —	—

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.

	2018	2017
Projected benefit obligation	$ 921,794	967,817
Fair value of plan assets	745,768	772,032
Deficit of plan assets over benefit obligation	$ (176,026)	(195,785)

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

	2018	2017
Discount rate	4.2 %	3.7 %
Expected return on plan assets	6.5	6.5
Rate of compensation increase	3.5	3.5

(Dollars in thousands)

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

	2018	2017
Domestic equities	24 %	26 %
International equity	26	21
Fixed income	50	53
	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.

Expected future benefit payments excluding plan expenses are as follows:

Fiscal year:	
2019	$ 103,523
2020	59,953
2021	60,651
2022	59,989
2023	57,812
2024–2028	272,824

UCMC and CHHD also maintain additional defined contribution retirement plans for employees. The System’s pension expense under these distinct defined contribution retirement plans was $10,100 for UCMC and $8,200 for the years ended June 30, 2018 and 2017, 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.

(Dollars in thousands)

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

		Year ended June 30	
		2018	2017
Net periodic pension cost:			
Service cost	$	—	—
Net periodic pension cost	$	—	—
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Interest cost	$	2,187	2,155
Expected return on plan assets		(3,001)	(2,976)
Amortization of unrecognized net actuarial loss		1,097	1,181
Liability for pension benefits		(8,362)	2,918
Total recognized in net periodic pension cost and unrestricted net assets	$	8,645	(2,558)

The following table sets forth additional required pension disclosure information for this plan:

		Year ended June 30	
		2018	2017
Changes in projected benefit obligation:			
Benefit obligation at beginning of year	$	61,105	63,511
Interest cost		2,187	2,155
Net actuarial loss (gain)		(3,965)	(1,001)
Settlements		(8,769)	—
Benefits paid		(3,603)	(3,560)
		46,955	61,105
Changes in plan assets:			
Fair value of plan assets at beginning of year		50,522	50,371
Actual return on plan assets		867	3,711
Employer contribution		6,000	—
Settlements		(8,769)	—
Benefits paid		(3,603)	(3,560)
		45,017	50,522
Funded status at end of year	$	(1,938)	(10,583)

(Continued)

(Dollars in thousands)

Amounts recognized in the consolidated balance sheets are included in other noncurrent liabilities.

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

	2018	2017
Discount rate	4.2 %	3.7 %
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:

	2018	2017
Cash	1 %	1 %
Fixed income	61	60
Domestic equities	28	27
International equities	10	12
	100 %	100 %

All plan assets are valued using Level 1 inputs in 2018 and 2017. 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 $3,000 to the plan in the fiscal year ended June 30, 2019.

Expected future benefit payments are as follows:

Fiscal year:	
2019	$ 3,809
2020	3,763
2021	3,690
2022	3,618
2023	3,546
2024–2028	16,416

(Dollars in thousands)

(15) Pledges

Pledges receivable at June 30 comprise:

		2018	2017
Unconditional promises expected to be collected in:			
Less than one year	$	1,052	1,256
One year to five years		1,570	2,440
More than five years		—	—
		2,622	3,696
Less unamortized discount (discount rate 4.14%)		(135)	(77)
Total	$	2,487	3,619

(16) Restricted Net Assets

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

		2018	2017
Pediatric healthcare	$	21,204	20,220
Adult healthcare		59,575	57,890
Educational and scientific programs		6,062	6,071
Capital and other purposes		7,140	6,280
Total	$	93,981	90,461

Income from permanently restricted net assets is restricted for:

		2018	2017
Pediatric healthcare	$	3,951	3,941
Adult healthcare		4,320	4,287
Educational and scientific programs		9,216	9,217
Total	$	17,487	17,445

(Continued)

(Dollars in thousands)

(17) Functional Expenses

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

		2018	2017
Healthcare services	$	1,958,258	1,765,085
General and administrative		220,981	158,001
Total	$	2,179,239	1,923,086

(18) Contingencies

(a) Litigation

The System is subject to various legal proceedings and claims that are incidental to its normal business activities. In the opinion of the System, the amount of ultimate liability with respect to these actions will not materially affect the consolidated operations or net assets of the System.

(b) Regulatory Investigation and Other

The U.S. Department of Justice and other federal agencies routinely conduct regulatory investigations and compliance audits of healthcare providers. The System 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 the System 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. The System maintains a system wide compliance program and conducts audits and other activities to identify potential compliance issues, including overpayments by governmental payors. Compliance reviews may result in liabilities to government healthcare program, which could have an adverse impact on the System’s net patient service revenue.

Schedule 1

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidating Balance Sheet Information

June 30, 2018

(Dollars in thousands)

Assets		The University of Chicago Medical Center	The University of Chicago Medicine Care Network	UCMC Title Holding Corporation	Community Health and Hospital Division	Eliminations	Consolidated total
Current assets:							
Cash and cash equivalents	$	181,251	238	3,318	26,944	—	211,751
Patient accounts receivable, net of estimated uncollectibles of $160,307		306,872	280	—	40,718	—	347,870
Current portion of investments limited to use		164	—	—	8,708	—	8,872
Current portion of malpractice self-insurance receivable		17,491	—	—	—	—	17,491
Current portion of pledges receivable		1,052	—	—	—	—	1,052
Due from affiliates		26,265	—	—	—	(26,265)	—
Prepaids, inventory, and other current assets		88,463	1,760	2,129	20,235	(1,024)	111,563
Total current assets		621,558	2,278	5,447	96,605	(27,289)	698,599
Investments, limited as to use, less current portion		913,645	—	—	286,768	—	1,200,413
Property, plant, and equipment, net		1,404,889	1,389	—	196,473	—	1,602,751
Pledges receivable, less current portion		1,435	—	—	—	—	1,435
Malpractice self-insurance receivable, less current portion		86,319	—	—	—	—	86,319
Other assets, net		369,874	1,351	39,881	5,738	(364,302)	52,542
Total assets	$	3,397,720	5,018	45,328	585,584	(391,591)	3,642,059
Liabilities and Net Assets							
Current liabilities:							
Accounts payable and accrued expenses	$	167,335	1,456	926	81,707	—	251,424
Current portion of long-term debt		14,513	—	—	2,810	—	17,323
Current portion of other long-term liabilities		1,232	—	—	—	(1,024)	208
Estimated third-party payor settlements		192,305	—	—	21,879	—	214,184
Current portion of malpractice self-insurance liability		17,491	—	—	—	—	17,491
Due to affiliates		—	25,201	482	582	(26,265)	—
Due to the University of Chicago		36,807	—	—	—	—	36,807
Total current liabilities		429,683	26,657	1,408	106,978	(27,289)	537,437
Workers' compensation self-insurance liability, less current portion		5,782	—	—	—	—	5,782
Malpractice self insurance liability, less current portion		86,319	—	—	40,835	—	127,154
Long-term debt, excluding current installments		867,074	—	42,176	101,879	—	1,011,129
Interest rate swap liability		97,298	—	—	7,114	—	104,412
Other long-term liabilities, less current portion		63,811	—	1,560	11,947	(41,440)	35,878
Total liabilities		1,549,967	26,657	45,144	268,753	(68,729)	1,821,792
Net assets (deficit):							
Unrestricted		1,736,958	(21,639)	184	303,036	(309,740)	1,708,799
Temporarily restricted		93,537	—	—	4,479	(4,035)	93,981
Permanently restricted		17,258	—	—	9,316	(9,087)	17,487
Total net assets		1,847,753	(21,639)	184	316,831	(322,862)	1,820,267
Total liabilities and net assets	$	3,397,720	5,018	45,328	585,584	(391,591)	3,642,059

See accompanying independent auditors' report.

Schedule 2

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidating Statement of Operations and Changes in Unrestricted Net Assets Information

Year ended June 30, 2018

(Dollars in thousands)

	The University of Chicago Medical Center	The University of Chicago Medicine Care Network	UCMC Title Holding Corporation	Community Health and Hospital Division	Eliminations	Consolidated total
Revenue:						
Net patient service revenue	$ 1,824,474	4,922	—	353,615	—	2,183,011
Provision for doubtful accounts	141,107	—	—	41,787	—	182,894
Net patient service revenue less provision for doubtful accounts	1,683,367	4,922	—	311,828	—	2,000,117
Other operating revenue and net assets released from restrictions	175,245	3,327	1,583	36,697	(4,954)	211,898
Total operating revenues	1,858,612	8,249	1,583	348,525	(4,954)	2,212,015
Operating expenses:						
Salaries, wages, and benefits	771,596	13,437	—	158,517	—	943,550
Supplies and other	540,942	2,553	472	135,523	—	679,490
Physician services	254,781	1,181	—	28,193	(3,375)	280,780
Insurance	10,501	1,122	—	35,067	—	46,690
Interest	39,747	—	869	4,887	(1,579)	43,924
Medicaid provider tax	43,205	—	—	16,568	—	59,773
Depreciation and amortization	108,634	489	—	15,909	—	125,032
Total operating expenses	1,769,406	18,782	1,341	394,664	(4,954)	2,179,239
Operating revenue in excess (deficit) of expenses	89,206	(10,533)	242	(46,139)	—	32,776
Nonoperating gains (losses), net:						
Investment income, net	48,712	—	—	16,791	—	65,503
Change in fair value of nonhedged derivative instruments	—	—	—	2,356	—	2,356
Derivative ineffectiveness on hedged derivative instruments	(62)	—	—	—	—	(62)
Distributions and other, net	—	(287)	—	891	—	604
Net nonoperating gains (losses)	48,650	(287)	—	20,038	—	68,401
Revenue and gains in excess (deficient) of expenses and losses	137,856	(10,820)	242	(26,101)	—	101,177
Other changes in net assets:						
Equity transfers to University of Chicago, net	(71,750)	—	—	—	—	(71,750)
Change in accrued pension benefits other than net periodic benefit costs	(7,853)	—	—	—	—	(7,853)
Effective portion of change in valuation of derivatives	24,635	—	—	—	—	24,635
Other, net	—	—	—	(449)	—	(449)
Increase (decrease) in unrestricted assets	$ 82,888	(10,820)	242	(26,550)	—	45,760

See accompanying independent auditors' report.

Schedule 3

THE UNIVERSITY OF CHICAGO MEDICAL CENTER

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2018

(Dollars in thousands)

		The University of Chicago Medical Center	The University of Chicago Medicine Care Network	UCMC Title Holding Corporation	Community Health and Hospital Division	Eliminations	Consolidated total
Unrestricted net assets:							
Revenue and gains in excess of expenses and losses	$	137,856	(10,820)	242	(26,101)	—	101,177
Equity transfers to University of Chicago, net		(71,750)	—	—	—	—	(71,750)
Change in accrued pension benefits other than net periodic benefit cost		(7,853)	—	—	—	—	(7,853)
Effective portion of change in valuation of derivatives		24,635	—	—	—	—	24,635
Other, net		—	—	—	(449)	—	(449)
Increase (decrease) in unrestricted net assets		82,888	(10,820)	242	(26,550)	—	45,760
Temporarily restricted net assets:							
Contributions		3,824	—	—	1,224	—	5,048
Net assets released from restrictions used for operating purposes		(6,403)	—	—	(892)	—	(7,295)
Investment income		5,767	—	—	—	—	5,767
Increase in temporarily restricted net assets		3,188	—	—	332	—	3,520
Permanently restricted net assets:							
Contributions and other		10	—	—	32	—	42
Change in net assets		86,086	(10,820)	242	(26,186)	—	49,322
Net assets at beginning of year		1,761,667	(10,819)	(58)	343,017	(322,862)	1,770,945
Net assets at end of year	$	1,847,753	(21,639)	184	316,831	(322,862)	1,820,267

See accompanying independent auditors’ report.