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E-013-16

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HEALTH FACILITIES & SERVICES REVIEW BOARD

ILLINOIS HEALTH FACILITIES AND SERVICES REVIEW BOARD
APPLICATION FOR EXEMPTION FOR THE
CHANGE OF OWNERSHIP FOR AN EXISTING HEALTH CARE FACILITY

1. INFORMATION FOR EXISTING FACILITY

Current Facility Name Tri-Cities Surgery Center
Address 345 Delnor Drive
City Geneva Zip Code 60134 County Kane
Name of current licensed entity for the facility Tri-Cities Surgery Center, LLC
Does the current licensee: own this facility ____ OR lease this facility X (if leased, check if sublease ☐)
Type of ownership of the current licensed entity (check one of the following:) ____ Sole Proprietorship
____ Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental
X Limited Liability Company ____ Other, specify ____
Illinois State Senator for the district where the facility is located: Sen. Jim Oberweis
State Senate District Number 25 Mailing address of the State Senator
959 Oak Street, North Aurora, IL 60542
Illinois State Representative for the district where the facility is located: Rep. Kay Hatcher
State Representative District Number 50 Mailing address of the State Representative
608 East Veterans Parkway, Yorkville, IL 60560

2. OUTSTANDING PERMITS. Does the facility have any projects for which the State Board issued a permit that will not be completed (refer to 1130.140 "Completion or Project Completion" for a definition of project completion) by the time of the proposed ownership change? Yes ☐ No ☒. If yes, refer to Section 1130.520(f), and indicate the projects by Project # ____

3. NAME OF APPLICANT (complete this information for each co-applicant and insert after this page).
Exact Legal Name of Applicant See Attachment Response 3
Address ____
City, State & Zip Code ____
Type of ownership of the current licensed entity (check one of the following:) ____ Sole Proprietorship
____ Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental
____ Limited Liability Company ____ Other, specify ____

4. NAME OF LEGAL ENTITY THAT WILL BE THE LICENSEE/OPERATING ENTITY OF THE FACILITY NAMED IN THE APPLICATION AS A RESULT OF THIS TRANSACTION.

Exact Legal Name of Entity to be Licensed Tri-Cities Surgery Center, LLC
Address 345 Delnor Drive
City, State & Zip Code Geneva, IL 60134
Type of ownership of the current licensed entity (check one of the following:) ____ Sole Proprietorship
____ Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental
X Limited Liability Company ____ Other, specify ____

5. BUILDING/SITE OWNERSHIP. NAME OF LEGAL ENTITY THAT WILL OWN THE "BRICKS AND MORTAR" (BUILDING) OF THE FACILITY NAMED IN THIS APPLICATION IF DIFFERENT FROM THE OPERATING/LICENSED ENTITY

Exact Legal Name of Entity That Will Own the Site Delnor-Community Hospital
Address 300 Randall Road
City, State & Zip Code Geneva, IL 60134
Type of ownership of the current licensed entity (check one of the following:) ____ Sole Proprietorship
X Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental
____ Limited Liability Company ____ Other, specify ____

6. **TRANSACTION TYPE. CHECK THE FOLLOWING THAT APPLY TO THE TRANSACTION:**
   - o Purchase resulting in the issuance of a license to an entity different from current licensee;
   - o Lease resulting in the issuance of a license to an entity different from current licensee;
   - o Stock transfer resulting in the issuance of a license to a different entity from current licensee;
   - o Stock transfer resulting in no change from current licensee;
   - o Assignment or transfer of assets resulting in the issuance of a license to an entity different from the current licensee;
   - o Assignment or transfer of assets not resulting in the issuance of a license to an entity different from the current licensee;
   - o Change in membership or sponsorship of a not-for-profit corporation that is the licensed entity;
   - o Change of 50% or more of the voting members of a not-for-profit corporation's board of directors that controls a health care facility's operations, license, certification or physical plant and assets;
   - o Change in the sponsorship or control of the person who is licensed, certified or owns the physical plant and assets of a governmental health care facility;
   - o Sale or transfer of the physical plant and related assets of a health care facility not resulting in a change of current licensee;
   - ✓ Any other transaction that results in a person obtaining control of a health care facility's operation or physical plant and assets, and explain in "Attachment 3 Narrative Description"

7. **APPLICATION FEE.** Submit the application fee in the form of a check or money order for $2,500 payable to the Illinois Department of Public Health and append as **ATTACHMENT #1.**

8. **FUNDING.** Indicate the type and source of funds which will be used to acquire the facility (e.g., mortgage through Health Facilities Authority; cash gift from parent company, etc.) and append as **ATTACHMENT #2.**

9. **ANTICIPATED ACQUISITION PRICE: $** See Attachment Response 9

10. **FAIR MARKET VALUE OF THE FACILITY: $** See Attachment Response 10
    (to determine fair market value, refer to 77 IAC 1130.140)

11. **DATE OF PROPOSED TRANSACTION:** before June 1, 2016

12. **NARRATIVE DESCRIPTION.** Provide a narrative description explaining the transaction, and append it to the application as **ATTACHMENT #3.**

13. **BACKGROUND OF APPLICANT** (co-applicants must also provide this information). Corporations and Limited Liability Companies must provide a current Certificate of Good Standing from the Illinois Secretary of State. Limited Liability Companies and Partnerships must provide the name and address of each partner/ member and specify the percentage of ownership of each. Append this information to the application as **ATTACHMENT #4.**

14. **TRANSACTION DOCUMENTS.** Provide a copy of the complete transaction document(s) including schedules and exhibits which detail the terms and conditions of the proposed transaction (purchase, lease, stock transfer, etc). Applicants should note that the document(s) submitted should reflect the applicant's (and co-applicant's, if applicable) involvement in the transaction. The document must be signed by both parties and contain language stating that the transaction is contingent upon approval of the Illinois Health Facilities and Services Review Board. Append this document(s) to the application as **ATTACHMENT #5.**

15. FINANCIAL STATEMENTS. (Co-applicants must also provide this information) Provide a copy of the applicants latest audited financial statements, and append it to this application as ATTACHMENT #6. If the applicant is a newly formed entity and financial statements are not available, please indicate by checking YES ____, and indicate the date the entity was formed ______

16. **PRIMARY CONTACT PERSON**. Individual representing the applicant to whom all correspondence and inquiries pertaining to this application are to be directed. (Note: other persons representing the applicant not named below will need written authorization from the applicant stating that such persons are also authorized to represent the applicant in relationship to this application).

Name: Bridget Orth
Address: 211 East Ontario Street, Suite 1750
City, State & Zip Code: Chicago, IL 60611
Telephone ( ) Ext. 312-926-8650

17. **ADDITIONAL CONTACT PERSON. Consultant, attorney, other individual who is also authorized to discuss this** application and act on behalf of the applicant.

Name: James Dechene
Address: 211 East Ontario Street, Suite 1800
City, State & Zip Code: Chicago, IL 60611
Telephone ( ) Ext. 312-926-2236

18. **CERTIFICATION**

I certify that the above information and all attached information are true and correct to the best of my knowledge and belief. I certify that the number of beds within the facility will not change as part of this transaction. I certify that no adverse action has been taken against the applicant(s) by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois. I certify that I am fully aware that a change in ownership will void any permits for projects that have not been completed unless such projects will be completed or altered pursuant to the requirements in 77 IAC 1130.520(f) prior to the effective date of the proposed ownership change. I also certify that the applicant has not already acquired the facility named in this application or entered into an agreement to acquire the facility named in the application unless the contract contains a clause that the transaction is contingent upon approval by the State Board.

Signature of Authorized Officer See Attachment Reponse 18

Typed or Printed Name of Authorized Officer ______

Title of Authorized Officer: ______

Address: ______

City, State & Zip Code: ______

Telephone (____)______ Date: ______

NOTE: complete a separate signature page for each co-applicant and insert following this page.

3a. NAME OF APPLICANT

Exact Legal Name of Applicant Northwestern Memorial HealthCare

Address 251 East Huron Street

City, State & Zip Code Chicago, IL 60611

Type of ownership of the current licensed entity (check one of the following:) _____ Sole Proprietorship
__X__ Not-for-Profit Corporation _____ For Profit Corporation _____ Partnership _____
Governmental _____ Limited Liability Company _____ Other, specify _____

3b. NAME OF APPLICANT

Exact Legal Name of Applicant CDH-Delnor Health System

Address 25 North Winfield Road.

City, State & Zip Code Winfield, IL 60190

Type of ownership of the current licensed entity (check one of the following:) _____ Sole Proprietorship
__X__ Not-for-Profit Corporation _____ For Profit Corporation _____ Partnership _____
Governmental _____ Limited Liability Company _____ Other, specify _____

3c. NAME OF APPLICANT

Exact Legal Name of Applicant Delnor-Community Hospital

Address 300 Randall Road.

City, State & Zip Code Geneva, IL 60134

Type of ownership of the current licensed entity (check one of the following:) _____ Sole Proprietorship
__X__ Not-for-Profit Corporation _____ For Profit Corporation _____ Partnership _____
Governmental _____ Limited Liability Company _____ Other, specify _____

3d. NAME OF APPLICANT

Exact Legal Name of Applicant DelCom Corporation.

Address 3755 East Main Street #120.

City, State & Zip Code St. Charles, IL 60174

Type of ownership of the current licensed entity (check one of the following:) _____ Sole Proprietorship
_____ Not-for-Profit Corporation __X__ For Profit Corporation _____ Partnership _____
Governmental _____ Limited Liability Company _____ Other, specify _____

3e. NAME OF APPLICANT

Exact Legal Name of Applicant Tri-Cities Surgery Center, LLC.

Address 345 Delnor Drive.

City, State & Zip Code Geneva, IL 60134

Type of ownership of the current licensed entity (check one of the following:) ____ Sole Proprietorship ____ Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental __X__ Limited Liability Company ____ Other, specify ____

3f. NAME OF APPLICANT

Exact Legal Name of Applicant Tri-Cities Physician Group, LLC.

Address 345 Delnor Drive.

City, State & Zip Code Geneva, IL 60134

Type of ownership of the current licensed entity (check one of the following:) ____ Sole Proprietorship ____ Not-for-Profit Corporation ____ For Profit Corporation ____ Partnership ____ Governmental __X__ Limited Liability Company ____ Other, specify ____

6. TRANSACTION TYPE.

In the proposed transaction, Delnor Community Hospital will be acquiring 100% of the membership interest in Tri-Cities Surgery Center, LLC: purchase of 50% membership interest from DelCom Corporation (a wholly-owned subsidiary of CDH-Delnor Health System) and purchase of 50% membership interest from Tri-Cities Physician Group, LLC.

8. **FUNDING.** Indicate the type and source of funds which will be used to acquire the facility (e.g., mortgage through Health Facilities Authority; cash gift from parent company, etc.).

The purchase of Tri-Cities Surgery Center will be funded by cash.

ATTACHMENT #2
Attachment Response 8

9. ANTICIPATED ACQUISITION PRICE

The anticipated acquisition price for 100% of Tri-Cities Surgery Center, LLC is $13,175,000. The payment to Tri-Cities Physician Group, LLC is anticipated to be $6,587,500 and the payment to DelCom Corporation is anticipated to be $6,587,500.

10. FAIR MARKET VALUE OF THE FACILITY.

In December, 2015, NMHC engaged Principle Valuation, LLC (Principle) to conduct a fair market valuation of the stockholders' equity of Tri-Cities Surgery Center, LLC. A fair market value range was determined for Tri-Cities Surgery Center, LLC. using three valuation methodologies: 1) Income Approach – Discounted Cash Flow Method, 2) Market Approach – Public Comparables Analysis and Acquisition Comparables Analysis, and 3) Asset-Based Approach – Net Asset Value Analysis. The fair market value of Tri-Cities Surgery Center, LLC was concluded to be in the range of $13.12 million to $14.75 million. Fifty percent (50%) interest in the stockholders' equity of Tri-Cities Surgery Center, LLC was concluded to be in the range of $6.56 million to $7.375 million.

PV15.1770

LETTER UPDATE

STOCKHOLDERS' EQUITY VALUE OF TRI-CITIES SURGERY CENTER, LLC

345 DELNOR DRIVE
GENEVA, ILLINOIS 60134

SUBMITTED TO:
NORTHWESTERN MEMORIAL HEALTHCARE
ATTENTION: MR. BRETT D. TANDE
VICE PRESIDENT, FINANCE AND WEST REGION CFO
25 NORTH WINFIELD ROAD
WINFIELD, ILLINOIS 60190

Attachment Response 10

Principle Valuation, LLC
PEOPLE AND VALUES YOU CAN TRUST

January 19, 2016

Northwestern Memorial Healthcare
25 North Winfield Road
Winfield, Illinois 60190

Attention: Mr. Brett D. Tande
Vice President, Finance and West Region CFO

Re: Stockholders' Equity Value of Tri-Cities Surgery Center, LLC

Ladies and Gentleman:

Principle Valuation provided Northwestern Memorial Healthcare ("Northwestern") an Appraisal Report dated January 8, 2016 which estimated the fair market value of the stockholders' equity of Tri-Cities Surgery Center, LLC ("Tri-Cities Surgery" or the "Center"). The date of our value for this analysis was December 1, 2015 and concluded a fair market value of 100% of the stockholders' equity, on a majority interest basis to be in the range of $15,280,000 to $16,270,000. The value of the 50% interest in the stockholders' equity was valued at $7,640,000 to $8,135,000.

This analysis is considered an addendum to our original analysis, supersedes the prior valuation, and is conditional on the following set of circumstances discussed below.

It was our original understanding that Northwestern is interested in purchasing the 50% interest owned by Tri-Cities Physicians, which would result in Northwestern being the 100% owner. The valuation dated January 8, 2016 assumed all the selling physicians would be signing a non-compete agreement as part of the transaction

Subsequent to the valuation we were informed that not all of the selling physicians will be signing a non-compete agreement. We have revised our analysis assuming that seven of the physicians will not be signing the non-compete agreement and would then be able to actively compete with the Center. We have revised our Income and Market Approaches to adjust for the additional risk associated with not having non-compete agreements from all of the selling physicians.

Based upon the results of our revised analysis, the adjusted fair market value of a 50% interest in the stockholders' equity of Tri-Cities Surgery Center, LLC, on a majority interest basis, as of December 1, 2015, is reasonably represented in the range of:

$6,560,000 to $7,375,000

The valuation assumes that a working capital balance of $1,372,224 is present and available. Should this balance significantly fall or increase an overall adjustment to our estimates may be warranted.

BACKGROUND

The seven physicians considering not signing the non-compete agreement and their related case load for 2014 and for the 11 months ended November 30, 2015 are highlighted in green in the table below.

Physician	FY 2014	YTD 2015
Dr. Carlos A. Rodriguez	933	478
Dr. Jeff Victor	861	671
Dr. Heliodoro Medina	690	584
Dr. Sharif Zubair	651	579
Dr. Niraj Ajmere	631	572
Dr. Yogesh Patel	585	489
Dr. Darran R. Moxon	462	366
Dr. Donald Hoscheit	322	240
Dr. Arvin Bhatia	308	210
Dr. Anjali S. Hawkins	304	283
Dr. Kevin M. King	240	215
Dr. Harold Mozwecz	190	99
Dr. Katherine Brito	181	210
Dr. John P. Plante	109	90
Dr. Eric L. Lenting	86	72
Dr. Michael A. Rashid	74	81
Dr. John G. Christensen	58	42
Dr. Katherine Jelinek	56	160
Dr. Michael G. Larry	42	35
Dr. John H. White	39	17
Dr. Kenya Williams	37	75
Dr. Abraham H. Steinberg	28	6
Dr. George Bardouniotis	26	19
Dr. Faisal Khan	21	65
Dr. Andrew J. Kramer	17	22
Dr. David J. Aguiar	15	26
Dr. Ronald Simone	13	-
Dr. Dean P. Shoener	11	-
Dr. Arkadiush Byskosh	4	-
Dr. D. James Lee	3	-
Dr. Irene Wu	3	2
Dr. Glen K. Lochmueller	2	5
Dr. Jennifer L. Lew	1	-
Dr. Michele Slogoff	-	2
Totals:	7,003	5,715

Attachment Response 10

With this knowledge in hand we adjusted our Income and Market based valuation approaches taking in the added risk associated with ownership in the Center because of the competitive threats and risks associated with the reduced physician core.

INCOME APPROACH

The Income Approach determines the value of the business by projecting income and expenses over a period and discounting the free cash flows and the terminal value to a present value at a rate commensurate with the risks of the investment.

The Income Approach forecast was adjusted to show potential lost volume of 1,000 cases in Year 1 of the forecast. As management is able to rebuild the cases, the lost cases was reduced over the following three year period. Overall, revenue was forecast in Year 1 at $5,175,000, increasing to $7,997,124 in Year 5. EBITDA was forecast at $962,363, or 18.6% of revenues, increasing to $2,467,249, or 30.9% of revenues, in Year 5.

In addition, due to the additional risk of meeting the forecast, the discount rate was increased from 11.0% to 12.0% as shown in the following table.

DEVELOPMENT OF WACC - TRI-CITIES SURGERY CENTER			Cost of Capital	% in Capital Structure	Weighted Cost
Debt			3.21%	50%	1.61%
Equity			21.55%	50%	10.78%
Weighted Average Cost of Capital					12.38%
Concluded WACC					**12.00%**
Cost of Equity					
Risk Free Rate of Return		2.55%			
Plus Equity Risk Premium					
Market Risk Premium[1]	5.00%				
Times Beta	0.70				
Adjusted Market Risk Premium		3.50%			
Plus Size Premium[2]		7.50%			
Plus Company Specific Risk Premium		8.0%			
Indicated Cost of Equity		**21.55%**			
Cost of Debt					
Concluded Pre-Tax Cost of Debt	5.36%				
Income Tax Rate	40.04%				
Concluded After-Tax Cost of Debt		**3.21%**			
Selected Yields and Interest Rates					
Rates as of 12/01/2015					
Prime Rate			3.25%		
5-Year Treasury Rates			1.59%		
10-Year Treasury Rates			2.15%		
20-year Treasury Rates			2.55%		
Moody's Aaa			3.92%		
Baa			5.36%		

(1) Long-horizon expected equity risk premium recommended by Duff & Phelps 2015 Valuation Handbook
(2)Estimated based on Duff & Phelps 2015 Valuation Handbook - Guide to Cost of Capital

The revised discounted cash flow model for the subject is detailed in the following schedules.

Discounted Cash Flow Tri-Cities Surgery Center

		Year 1 Budget	Year 2 Projected	Year 3 Projected	Year 4 Projected	Year 5 Projected	Reversion
Projected Case Volume		6,000	6,300	6,900	7,000	7,000	7,000
Less: Lost Volume		(1,000)	(800)	(500)	(200)		
Case Volume		5,000	5,500	6,400	6,800	7,000	7,000
Average Collection per Procedure		$ 1,035	$ 1,061	$ 1,087	$ 1,115	$ 1,142	$ 1,171
Growth		-6.9%	2.5%	2.5%	2.5%	2.5%	2.5%
Net revenue		$ 5,175,000	$ 5,834,813	$ 6,959,340	$ 7,579,156	$ 7,997,124	$ 8,197,053
Growth		-33.2%	12.8%	19.3%	8.9%	5.5%	2.5%
OPERATING EXPENSES							
Salaries &Wages	v	$ 1,656,000	$ 1,808,792	$ 1,948,615	$ 2,122,164	$ 2,239,195	$ 2,295,175
Materials & Supplies	v	879,750	991,918	1,183,088	1,288,457	1,359,511	1,393,499
Employee Benefits	v	182,160	198,967	214,348	233,438	246,311	252,469
Utilities	f	297,057	304,483	312,096	319,898	327,895	336,093
Outside Services	f	186,392	191,052	195,828	200,724	205,742	210,885
Payroll Taxes	v	140,760	153,747	165,632	180,384	190,332	195,090
Professional Fees	f	194,534	199,397	204,382	209,492	214,729	220,097
Equipment Rental (GI Labs)	f	180,000	184,500	189,113	193,840	198,686	203,653
Insurance	f	102,344	104,903	107,525	110,213	112,969	115,793
Repairs & Maintenance	f	100,901	103,424	106,009	108,659	111,376	114,160
Real Estate Taxes	f	66,389	68,049	69,750	71,494	73,281	75,113
Rent (land lease)	f	30,161	30,915	31,688	32,480	33,292	34,124
Other Expenses	f	196,189	201,094	206,121	211,274	216,556	221,970
Subtotal		4,212,637	4,541,241	4,934,195	5,282,517	5,529,875	5,668,122
Depreciation/Amortization	f	117,215	120,145	123,149	126,228	129,383	132,618
Interest Expense		-	-	-	-	-	-
Total Operating Expense		$ 4,329,852	$ 4,661,386	$ 5,057,344	$ 5,408,744	$ 5,659,259	$ 5,800,740
Gain/(Loss) from Operations		$ 845,148	$ 1,173,427	$ 1,901,996	$ 2,170,412	$ 2,337,866	$ 2,396,312
Total Non-Operating Income		-	-	-	-	-	-
Excess of revenue over expenses		$ 845,148	$ 1,173,427	$ 1,901,996	$ 2,170,412	$ 2,337,866	$ 2,396,312
Operating EBITDA		$ 962,363	$ 1,293,572	$ 2,025,145	$ 2,296,640	$ 2,467,249	$ 2,528,930
Operating EBITDA Margin		*18.6%*	*22.2%*	*29.1%*	*30.3%*	*30.9%*	*30.9%*
EBIT		$ 845,148	$ 1,173,427	$ 1,901,996	$ 2,170,412	$ 2,337,866	$ 2,396,312

Discounted Cash Flow Tri-Cities Surgery Center						
Discount Rate	12.00%					
Effective Corporate Tax Rate in U.S, IL	40.04%					
Normal Debt Free Net Working Capital as % of Revenues	11.00%					
Perpetuity Growth Rate	2.50%					
	Year 1 Budget	Year 2 Projected	Year 3 Projected	Year 4 Projected	Year 5 Projected	Reversion
NET INCOME FOR DISCOUNTING (EBIT)	$ 845,148	$ 1,173,427	$ 1,901,996	$ 2,170,412	$ 2,337,866	$ 2,396,312
ESTIMATED INCOME TAXES	338,397	469,840	761,559	869,033	936,081	959,483
NET INCOME	**$ 506,751**	**$ 703,587**	**$ 1,140,437**	**$ 1,301,379**	**$ 1,401,784**	**$ 1,436,829**
Less Incremental Working Capital	$ 287,461	$ (72,579)	$ (123,698)	$ (68,180)	$ (45,976)	$ (21,992)
Less Capital Expenditures	(117,215)	(120,145)	(123,149)	(126,228)	(129,383)	(132,618)
Plus Depreciation	117,215	120,145	123,149	126,228	129,383	132,618
Cash Flow to Discount	$ 794,211	$ 631,007	$ 1,016,739	$ 1,233,199	$ 1,355,808	$ 1,414,837
Discount Periods	0.50	1.50	2.50	3.50	4.50	
Present Value Factor	0.9449	0.8437	0.7533	0.6726	0.6005	
Present Value of Periodic Cash Flows	$ 750,459	$ 532,362	$ 765,887	$ 829,412	$ 814,174	
Sum of PV Periodic Cash Flows		$ 3,692,293				
Perpetuity Value	$ 14,893,019					
PV of Perpetuity Value		$ 8,943,379				
Business Enterprise Value Before Adjustments		**$ 12,635,673**				
Adjustments to Value:						
Less: Market Required Working Capital Balance		$ (851,591)				
Add: Actual Net Working Capital Balance		1,372,224				
Excess/(Deficit) Working Capital		$ 520,633				
Business Enterprise Value After Adjustments		**$ 13,156,306**				
Rounded Value		**$ 13,160,000**				

Based on the above analysis, the Income Approach results in a revised concluded business enterprise value of $13,160,000.

MARKET APPROACH

Guideline Company Method

The guideline company method of the market approach provides an indication of value for the appraised Company by relating the equity or invested capital (debt plus equity) of guideline companies to various measures of their earnings and cash flow, then applying such multiples to the businesses being appraised.

In the guideline company method we selected six publicly traded companies and reviewed the revenue and EBITDA multiples to select appropriate multiples to apply to the subject company. Our original analysis applied the discounted multiples to the Subject's fiscal 2014 revenue and EBITDA data. Due to the additional risk associated with not receiving non-compete agreements from seven physicians, the lower revenue and EBITDA Subject financial data for the twelve months ended September 30, 2015 was determined to be more appropriate to apply to the multiples.

Based on the revised earnings levels, the overall value for the Subject would be equal to $15,160,000 (rounded), based on the revised guideline company approach.

Our conclusions are shown in the following table.

Company Name	Share Price 12/1/2015	Adjusted Equity Value[1]	Adjusted Enterprise Value	% Debt	Revenues	EBITDA	Debt Free NWC	% Debt Free NWC	Beta	EBITDA Margin	Revenue Multiple	EBITDA Multiple
Universal Health Services Inc. (UHS)	$ 125.33	13,714,611,240	17,134,423,240	20.84%	8,764,741,000	1,653,704,000	585,241,000	6.68%	0.90	18.87%	1.95	10.36
Tenet Healthcare Corp. (THC)	$ 34.94	4,178,963,760	19,148,963,760	79.96%	18,085,000,000	1,946,000,000	2,315,000,000	12.80%	10.88	10.76%	1.06	9.84
Community Health Systems, Inc. (CYH)	$ 29.80	4,226,474,400	22,042,474,400	79.14%	19,557,000,000	2,841,000,000	2,638,000,000	13.49%	0.18	14.53%	1.13	7.76
HCA Holdings, Inc. (HCA)	$ 71.16	34,811,756,640	66,045,756,640	49.39%	39,065,000,000	7,727,000,000	4,285,000,000	10.97%	0.53	19.78%	1.69	8.55
LifePoint Health, Inc. (LPNT)	$ 73.50	3,839,346,000	6,264,846,000	39.22%	5,106,500,000	654,000,000	715,500,000	14.01%	0.77	12.81%	1.23	9.58
AmSurg Corp. (AMSG)	$ 82.14	5,318,729,280	8,682,192,280	28.87%	2,444,433,000	658,981,000	221,904,000	9.08%	0.39	26.96%	3.55	13.18
HIGH:			$66,045,756,640	79.96%	$39,065,000,000			14.01%	10.88	26.96%	3.55	13.18
LOW:			$6,264,846,000	20.84%	$2,444,433,000			6.68%	0.18	10.76%	1.06	7.76
AVERAGE:				49.57%				11.17%	2.28	17.28%	1.77	9.88
MEDIAN:				44.30%				11.88%	0.65	16.70%	1.46	9.71

(1) Adjusted upward 20% to account for a control premium

Qualitative Comparisons (Subject Compared to Market Comparables as a Group | Tri-Cities Surgery Center | 29.64%

Unit of Comparison	Status	Adjustment
Size of Company	Inferior	Downward
Diversity of Market Served	Inferior	Downward
EBITDA Margin	Superior	Upward
Overall Adjustment	**Downward**	

Tri-Cities Surgery Center		
Description	Revenues	EBITDA
Adjustment	-20%	-30%
Adjusted Multiple*	1.415	6.914
Subject Comparable Units	$ 7,741,737	$ 2,294,428
Value Indication	$ 10,952,152	$ 15,863,436
Weighting	25%	75%
Total Asset Value as Unencumbered and assuming market based working capital (Rounded)	$14,640,000	
Market Required Working Capital Balance	$ (851,591)	
Actual Working Capital Balance	$ 1,372,224	
Less Deficient (Excess) Working Capital	$ 520,633	
Overall Value Rounded	$15,160,000	

Guideline Transactions Method

The guideline transaction method of the market approach provides an indication of value for the appraised entities by relating the value of the invested capital (equity and interest-bearing debt) of guideline companies, based on market transactions, to various measures of their earnings and revenues, then applying such multiples to the businesses being appraised.

We relied on data supplied in the *Health Care Acquisition Report, Eighteen through Twenty-First Editions; 2012-2015;* published by Irving Levin Associates, Inc. Our report concluded a revenue multiple of 1.40 and an EBITDA multiple of 6.0. In our original analysis, as with the guideline company approach, we applied the multiples to earnings from fiscal 2014. We adjusted the Subject earnings levels to the earnings for the trailing twelve months ended September 30, 2015.

The adjusted guideline transaction market approach is shown in the following table and concluded a business enterprise value of $13,670,000.

Transactions	Revenue Multiple	EBITDA Multiple	EBITDA Margin	Revenue
Low	1.38	5.10	17.3%	$12,000,000
High	1.93	14.00	41.7%	$155,000,000
Mean	1.57	8.08	30.9%	$76,433,000
Median	1.39	6.62	32.2%	$69,366,000

Tri-Cities Surgery Center, LLC

	Revenue	EBITDA	EBITDA Margin
TTM September 30, 2015	$ 7,741,737	$ 2,294,428	29.6%
Selected Multiple	1.40	6.0	
Indications	$ 10,838,432	$ 13,766,568	
Weights	50.0%	50.0%	
Weighted Conclusion	**$ 12,302,500**		
Indicated Value			**$ 12,302,500**
Debt-free Net Working Capital			$ 1,372,224
Overall Value (Rounded)			**$ 13,670,000**

Market Approach Conclusion

Giving consideration to both the Guideline Company and Guideline Transaction approach yields a value range from $13,670,000 to $15,160,000. Since limited information is provided about the overall assets transferred in the Guideline Transaction approach, in particular working capital assets, we tend to place primary reliance upon the Guideline Company Approach (weighted 75%) and accordingly have estimated the operating value of the enterprise under the revised market approach at $14,787,500.

RECONCILIATION OF VALUE

The concluded enterprise value is in a range determined by the Income & Market Approaches to value. The overall conclusion for the Subject's business enterprise value is reasonably represented in the rounded amount of:

$13,160,000 to $14,787,500

The long-term debt of the Subject property was equal to $41,515 as of September 30, 2015. After subtracting the debt, the total equity value on a marketable control basis is reasonably represented in the rounded amount of $13,120,000 to $14,750,000 as shown in the table below:

Tri-Cities Surgery Center, LLC Summary and Conclusion			
Discounted Cash Flow Approach			$13,160,000
Market Based Approaches			$14,787,500
Public Company Approach	$15,160,000		
Transaction Approach	$13,670,000		
Total Business Enterprise Value (Rounded)	**$13,160,000**	**to**	**$14,787,500**
Less: Debt/Other Liabilities	**$41,515**		**$41,515**
Majority Stockholders' Equity Value (100%)	**$13,120,000**	**to**	**$14,750,000**
50% Interest (based off of the majority value)	**$6,560,000**	**to**	**$7,375,000**

Based upon the results of our analysis, the adjusted fair market value of 100% of the stockholders' equity of Tri-Cities Surgery Center, LLC, on a majority interest basis, as of December 1, 2015, is reasonably represented in the range of:

$13,120,000 to $14,750,000

Based upon the results of our analysis, the adjusted fair market value of a 50% interest in the stockholders' equity of Tri-Cities Surgery Center, LLC, on a majority interest basis, as of December 1, 2015, is reasonably represented in the range of:

$6,560,000 to $7,375,000

The valuation assumes that a working capital balance of $1,372,224 is present and available. Should this balance significantly fall or increase an overall adjustment to our estimates may be warranted.

It is our practice to adhere to our understanding of the Uniform Standards of Professional Appraisal Practice adopted by the Appraisal Standards Board of the Appraisal Foundation.

A copy of this report and the field data supporting it will remain in our files for review on request.

Respectfully Submitted,

PRINCIPLE VALUATION, LLC

PRELIMINARY AND TENTATIVE
FOR DISCUSSION PURPOSES ONLY

PV15.1770

APPENDICES

ASSUMPTIONS AND LIMITING CONDITIONS

We strive to clearly and accurately disclose the assumptions, and limiting conditions that directly affect a valuation analysis, opinion, or conclusion. The appraisal report will be made with the following general assumptions and limiting conditions:

No opinion is expressed for matters that require legal expertise, specialized investigation or knowledge beyond that customarily employed by valuation industry standard. No investigation has been made of, and no responsibility is assumed for, the legal description or legal matters related to the asset(s) being valued, including title or encumbrances. Title to the asset(s) is assumed to be good and marketable unless otherwise stated. The asset(s) is (are) assumed to be free and clear of any liens, easements or encumbrances unless otherwise stated.

Information furnished by others, upon which all or portions of this appraisal are based, is believed to be reliable, but has not been verified in all cases. No warranty is given as to the accuracy of such information.

Use of the valuation report for another purpose other than that which has been defined in the report could result in inaccurate or inappropriate conclusions.

Neither this report nor any portions thereof including, without limitations, any conclusions as to value, the identity of Principle Valuation or any individuals signing or associated with this report, or the professional associations or organizations with which they are affiliated shall be disseminated to third parties by any means or included or referred to in any Securities and Exchange Commission filing or other public document without the prior written consent and approval of Principle Valuation.

Any forecasts of income and expenses are not predictions of the future. Rather, they are our best estimates of current market and management thinking on future income and expenses. We make no warranty or representation that these forecasts will materialize. In addition, it is understood that through this valuation, you accept and take responsibility for any such projections as being realistic and reflective of market conditions as of the valuation date. Additionally, it is understood that such projections represent your realistic projections. The real estate and healthcare markets are constantly fluctuating and changing. It is not our task to predict or in any way warrant the conditions of a future market; we can only reflect what the investment community, as of the date of the engagement, envisions for the future in terms of rates, expenses, and supply and demand.

The valuation estimates are based on the status of the local business economy and the purchasing power of the dollar as of the date of the valuation report, unless otherwise stated in the report.

Valuation assignments are accepted with the understanding that there is no obligation to furnish services after completion of the original assignment. If the need for subsequent services related to a valuation assignment is contemplated, special arrangements acceptable to Principle Valuation can be made under separate agreement.

We are not required to give testimony in court with reference to the valuation or the report, unless otherwise previously arranged. If required to give such testimony or produce documents for the court on matters related to this engagement, you agree to reasonably compensate us for such services. These services and other additional services provided beyond the scope of the engagement letter will be billed separately.

We reserve the right to make adjustments to the analyses, opinions and conclusions set forth in this report as it may deem necessary by consideration of additional or more reliable data that may become available.

However, we have no responsibility to update the report for events and circumstances occurring after the report date.

It is assumed that all required licenses, certificates of occupancy, consents, or other legislative or administrative authority from any local, state, or national, government or private entity or organization have been, or can readily be, obtained or renewed for any use on which the value estimate contained in this report is based.

Full compliance with all applicable federal, state and local zoning, use, environmental and similar laws and regulations is assumed, unless otherwise stated.

Responsible ownership and competent property management are assumed.

Unless otherwise stated in the report, we have no knowledge of the existence of hazardous material on, or in, the property; however, we are not qualified to detect such substances. The presence of potentially hazardous substances such as asbestos, urea-formaldehyde foam insulation, or industrial wastes may affect the value of the property. The value estimate herein is predicated on the assumption that there is no such material on, in, or near the property that would cause a loss in value. No responsibility is assumed for any such conditions or for any expertise or engineering knowledge required to discover them. The client should retain an expert in this field if further information is desired.

Unless otherwise stated in the report, compliance with the requirements of the Americans with Disabilities Act of 1990 (ADA) has not been considered in arriving at the opinion of value. Failure to comply with the requirements of the ADA may adversely affect the valuation. You may wish to obtain an expert in this field.

Our description and valuation of the improvements, including, but not limited to the heating, plumbing, and electrical systems is based on the assumption that they will be in normal working condition; no liability is assumed for the soundness of any structural member.

This is an Appraisal Report. All supporting documentation concerning the data, reasoning, and analyses is retained in the appraiser's file. The information contained in this report is specific to the needs of the client and for the intended use stated in this report.

CERTIFICATION

We certify to the best of our knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest with respect to the parties involved.
- I have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.
- My engagement in this assignment was not contingent upon development or reporting predetermined results.
- My compensation for completing this assignment is not contingent upon the development or reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal.
- My analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the *Uniform Standards of Professional Appraisal Practice*.
- I have not made a personal inspection of the property that is the subject of this report.
- I have appraised the property as of March 31, 2013 for internal planning and the potential sale of a 50% interest. This is the only appraisal prepared by Principle Valuation of the property in the past three years, prior to the January 8, 2015 report valued as of December 1, 2015.

PRELIMINARY AND TENTATIVE FOR DISCUSSION PURPOSES ONLY

Patrick J. Simers
Executive Vice President
Florida Certified General Real Estate Appraiser License #RZ3581

PRELIMINARY AND TENTATIVE FOR DISCUSSION PURPOSES ONLY

Sally Domijan

PATRICK J. SIMERS
EXECUTIVE VICE PRESIDENT

EXPERIENCE

Mr. Simers has extensive experience in serving the valuation needs of the health-care industry. He has valued all tangible and intangible assets associated with health-care enterprises, including the capital stock of majority and minority share holdings; medical specialty and physician joint ventures; fee simple, leased fee, and leasehold interests in real estate for hospital systems, stand-alone hospital campuses, and medical office buildings; major and minor movable equipment; certificates of need; contractual agreements; and preferred provider arrangements.

Specific healthcare enterprises appraised include acute care hospital facilities, LTACH hospitals, psychiatric hospitals, rehab hospital facilities, single physician practices, multi-specialty practices, cath labs, diagnostic centers, cardiac care practices, home health agencies, nursing homes, assisted living facilities, and medical office buildings.

Mr. Simers has performed fair market value studies for purchase, sale, or financing; merger and acquisition consulting; negotiation of purchase price; fairness opinions; purchase price allocations; financial reporting; SEC reporting; Medicare regulatory requirements; Safe Harbor requirements; and 501(c)(3) private placement offerings.

PROFESSIONAL HISTORY

Mr. Simers began his appraisal career with Valuation Counselors in 1982 and held various consulting, business development, and management roles, including four years as president of Valuation Counselors, leading up to its merger with CBIZ Inc. Most recently, Mr. Simers has served as the National Director for Healthcare services for American Appraisal Associates where he spear-headed the development of healthcare services for this international appraisal firm.

Patrick J. Simers is Executive Vice President for Principle Valuation. He is responsible for the development and overall business plan for Principle's consulting and appraisal services to for-profit, nonprofit, and public health-care providers. Mr. Simers is located in Principle Valuation's Atlanta office.

PROFESSIONAL AFFILIATIONS

- American Health Lawyers Association
- Healthcare Financial Management Association

EDUCATION LICENSES, AND DESIGNATIONS

- Graduate of Northern Illinois University with a Bachelor of Science in Finance and Economics
- Graduate of Moraine Valley College with an Associate in Arts in Business Administration
- Certified General Real Estate Appraiser in Georgia
- Certified General Real Estate Appraiser in Florida (#RZ3581)

SALLY M. DOMIJAN

EXPERIENCE

Ms. Domijan has experience in the valuation of business enterprises, majority and minority capital stock interests in privately held companies, intangible assets, preferred stock, restricted stock, and options. In addition she has completed valuations for acquisitions, corporate planning, financial accounting, employee stock ownership plans, fairness opinions, divorce litigation, possible sale, and estate planning purposes.

She has experience valuing a variety of business assets including: trade names, assembled workforce, computer software, medical records, Certificates of Need, noncompete agreements, and specific technologies. She has specialized experience in performing healthcare valuations, including those for hospital systems, ambulatory surgical centers, diagnostic imaging centers, physician practices, clinical labs, healthcare information systems, inpatient and outpatient rehabilitation centers, dialysis centers, home health agencies, medical device companies, HMOs/PPOs, and medical supply companies.

PROFESSIONAL HISTORY

Ms. Domijan is in the Financial Valuation department for Principle Valuation. She has over 20 years in the valuation industry, formerly as a Director of Financial Valuations with American Appraisal, as Director of Financial Valuations with L.T. Annum Appraisal Services, Inc., and a Manager at CBIZ Valuation Group (formerly Valuation Counselors). Prior to that she was a financial analyst in the savings and loan industry.

PROFESSIONAL AFFILIATIONS

- CFA Institute
- CFA Society, Chicago

EDUCATION LICENSES, AND DESIGNATIONS

- University of Illinois at Chicago, Master of Business Administration with a specialization in finance and economics
- Miami University, Oxford, Ohio, Bachelor of Science with a concentration in accounting and finance
- Chartered Financial Analyst

TESTIMONY

- Ms. Domijan has presented testimony as an expert witness in Divorce Court in Cook County. Ms. Domijan has been deposed on valuation matters.

PV15.1770

APPRAISAL REPORT

STOCKHOLDERS' EQUITY VALUE OF TRI-CITIES SURGERY CENTER, LLC

345 DELNOR DRIVE
GENEVA, ILLINOIS 60134

SUBMITTED TO:
NORTHWESTERN MEMORIAL HEALTHCARE
ATTENTION: MR. BRETT D. TANDE
VICE PRESIDENT, FINANCE AND WEST REGION CFO
25 NORTH WINFIELD ROAD
WINFIELD, ILLINOIS 60190

Attachment Response 10

Principle Valuation, LLC

PEOPLE AND VALUES YOU CAN TRUST

January 8, 2016

Northwestern Memorial Healthcare
25 North Winfield Road
Winfield, Illinois 60190

Attention: Mr. Brett D. Tande
Vice President, Finance and West Region CFO

Re: Stockholders' Equity Value of Tri-Cities Surgery Center, LLC

Ladies and Gentleman:

At your request, the following Appraisal Report estimates the fair market value of the stockholders' equity of Tri-Cities Surgery Center, LLC ("Tri-Cities Surgery" or the "Center"). The date of value for this analysis is December 1, 2015.

Tri-Cities Surgery Center, LLC is an ambulatory surgery center specializing in gastroscopy and endoscopy procedures. The Center also performs ophthalmology, urology, general surgery, and gynecology surgical services. The Center is located at 345 Delnor Drive, Geneva, Illinois and the real estate is owned by the Center. The facility has three GI surgery rooms and two general operating rooms.

We further understand that the Center is a joint venture consisting of two shares in which Northwestern Memorial Healthcare ("Northwestern"), formerly Cadence Health, owns one share (50%) and Tri-Cities Physician Group, LLC ("Tri-Cities Physicians") owns one share (50%). Tri-Cities Physicians consists of 29 physician owners.

It is our understanding that Northwestern is interested in purchasing the 50% interest owned by Tri-Cities Physicians, which would result in Northwestern being the 100% owner. We have prepared this appraisal for management planning purposes. We have presented the valuation of 100% of the stockholders' equity on a control basis.

The purpose of this appraisal is to express our opinion of the current fair market value of the Center's stockholders' equity; and in accordance with the Uniform Standards of Professional Appraisal Practice, subject to the definitions of value, assumptions and limiting conditions, and certifications in the attached report.

Fair Market Value, as defined by Revenue Ruling 59-60, is:

> *The price at which the property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy and the latter*

> *is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts.* [1]

Based upon the results of our analysis, the fair market value of 100% of the stockholders' equity of Tri-Cities Surgery Center, LLC, on a majority interest basis, as of December 1, 2015, is reasonably represented in the range of:

FIFTEEN MILLION TWO HUNDRED EIGHTY THOUSAND DOLLARS
TO
SIXTEEN MILLION TWO HUNDRED SEVENTY THOUSAND DOLLARS

$15,280,000 to $16,270,000

Based upon the results of our analysis, the fair market value of a 50% interest in the stockholders' equity of Tri-Cities Surgery Center, LLC, on a majority interest basis, as of December 1, 2015, is reasonably represented in the range of:

SEVEN MILLION SIX HUNDRED FORTY THOUSAND DOLLARS
TO
EIGHT MILLION ONE HUNDRED THIRTY-FIVE THOUSAND DOLLARS

$7,640,000 to $8,135,000

The valuation assumes that a working capital balance of $1,372,224 is present and available. Should this balance significantly fall or increase an overall adjustment to our estimates may be warranted.

It is our practice to adhere to our understanding of the Uniform Standards of Professional Appraisal Practice adopted by the Appraisal Standards Board of the Appraisal Foundation.

A copy of this report and the field data supporting it will remain in our files for review on request.

Respectfully Submitted,

PRINCIPLE VALUATION, LLC

Principle Valuation LLC

PV15.1770

[1] Revenue Ruling 59-60, 1959-1, C.B. 237 – IRC § 2031

TABLE OF CONTENTS

SECTION 1. INTRODUCTION

SUMMARY OF IMPORTANT DATA

Name & Location of Target:	Tri-Cities Surgery Center, LLC 345 Delnor Drive Geneva, Illinois 60134
State of Incorporation:	Illinois
Business Type:	Ambulatory Surgery Center
Interest Appraised:	Stockholders' Equity
Effective Date of Valuation:	December 1, 2015
Standard of Value:	Fair Market Value
Purpose and Intended Use of Valuation:	Internal Planning, Potential purchase of 50% equity interest

PURPOSE OF THE APPRAISAL

The purpose of this appraisal is to express our opinion of the current fair market value of the stockholders' equity in the Center; and in accordance with the Uniform Standards of Professional Appraisal Practice, subject to the definitions of value, assumptions and limiting conditions, and certifications in the attached report.

INTENDED USE OF THE APPRAISAL

These valuation services are intended to assist Northwestern Memorial Healthcare ("Northwestern") in its internal assessment of the overall stockholders' equity value of Tri-Cities Surgery Center ("Tri-Cities Surgery"). Northwestern owns 50% of Tri-Cities Surgery and is interested in buying the remaining 50% interest owned by Tri-Cities Physician Group, LLC ("Tri-Cities Physicians"). Our work is not intended to establish specific recommendations; rather, it is designed to provide you with relevant data that will allow you to make an informed decision. Its use for any other purpose or valuation date may invalidate the appraisal.

INTENDED USER OF THE APPRAISAL

The intended user of this report is Northwestern and Tri-Cities Surgery. The use of this report by any other user may invalidate the appraisal.

COMPETENCY STATEMENT

Principle Valuation, LLC, specializes in the valuation of healthcare and senior living businesses. We have appraised ambulatory surgery centers, diagnostic imaging centers, laboratory services, physician practices, skilled nursing facilities, assisted living residences, independent living communities, acute-care and behavioral health (psychiatric) hospitals, as delineated in the professional qualifications provided in this report.

SCOPE OF THE APPRAISAL

The scope of the appraisal included an analysis of industry data and trends, and an analysis of the Center's financial statements for the fiscal years-ended December 31, 2012 through 2014 and for the nine months ended September 30, 2015. We also reviewed procedural statistics for the same time period. Additionally, we have reviewed other viable data relative to the valuation. The accumulated data have been summarized in this report, resulting in a value conclusion. A physical inspection of the property was not performed.

The appraisal has been completed under the assumptions, limiting conditions and certifications presented in this report.

STANDARD OF VALUE

The standard of value used in this appraisal report is fair market value. Fair market value is defined in the Treasury Regulations as:

> *The price at which the property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts.* [2]

PREMISE OF VALUE

The premise of value utilized in our valuation is of a going concern.

SOURCES OF INFORMATION

Sources of information used in this valuation include:

1. Compiled financial statements for the fiscal years ending December 31, 2012, 2013, and 2014 and for the nine months ended September 30, 2015;
2. Balance sheet as of September 30, 2015;
3. Budget for 2016;
4. Procedure statistics detailing the number of cases for each of the financial periods analyzed;
5. Interviews with officers/management;
6. Ground Lease Agreement with Delnor-Community Health System (now owned by Northwestern;
7. Duff & Phelps *2015 Valuation Handbook – Guide to Cost of Capital;*
8. Federal Reserve Statistical Release published by the Federal Reserve System;
9. Public company data provided by Yahoo Finance, CapitalIQ, and company SEC documents;
10. Irving Levin Associates, Inc. *The Health Care Services Acquisition Report.*

[2] Revenue Ruling 59-60, 1959-1, C.B. 237 – IRC § 2031

SECTION 2. SUBJECT PROFILE

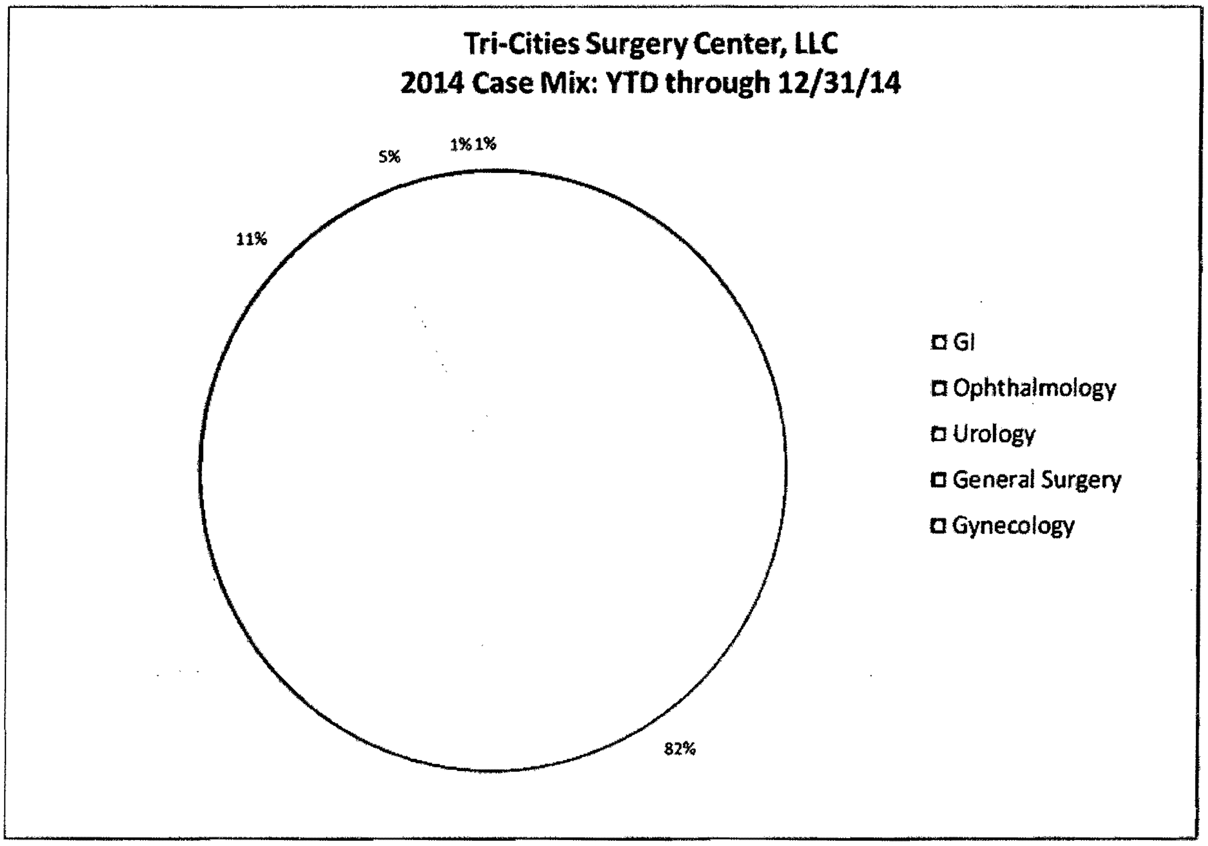
OVERVIEW OF THE SUBJECT BUSINESS

Tri-Cities Surgery is an ambulatory surgery center specializing in gastroscopy and endoscopy procedures. The Center also performs ophthalmology, urology, general surgery, and gynecology surgical services.

The Center is a Joint Venture consisting of two shares in which Northwestern, formerly Cadence Health, owns one share (50%) and Tri-Cities Physicians owns one share (50%). The Joint Venture was formed in October 2004. Tri-Cities Physicians consists of 29 physician owners as shown in the following table with the percentage ownership by individual physician.

Number	Shareholder	Investment %
1	Aguiar	1.04%
2	Ajmere	5.18%
3	Bardouniotis	1.55%
4	Belani	0.52%
5	Bhatia	4.66%
6	Brito	2.07%
7	Christensen	2.59%
8	Hawkins	5.18%
9	Helm	0.52%
10	Hewell	1.55%
11	Hoscheit	1.04%
12	Hunter	1.04%
13	Jelinek	1.55%
14	Khan	1.55%
15	King	4.15%
16	Kramer	5.18%
17	Larry	4.15%
18	Lenting	3.63%
19	Medina	5.18%
20	Moxon	4.66%
21	Mozwecz	1.04%
22	Patel	5.18%
23	Plante	11.92%
24	Powell	11.92%
25	Rashid	1.55%
26	Staudacher, Tim	1.04%
27	Victor	2.07%
28	White	3.11%
29	Zubair	5.18%
	Total	**100.00%**

The case mix is shown in the following table and shows that over 80% of the cases at the Center relate to gastroenterology.



The surgeons utilizing the Center and the number of cases in 2014 and year-to-date ended November 30, 2015 are shown in the following table. In fiscal 2014, the top 15 physicians represented 93.6% of cases at the Center. For the fiscal year to date period ended November 30, 2015, the top 15 physicians represented 91.8% of the cases at the Center.

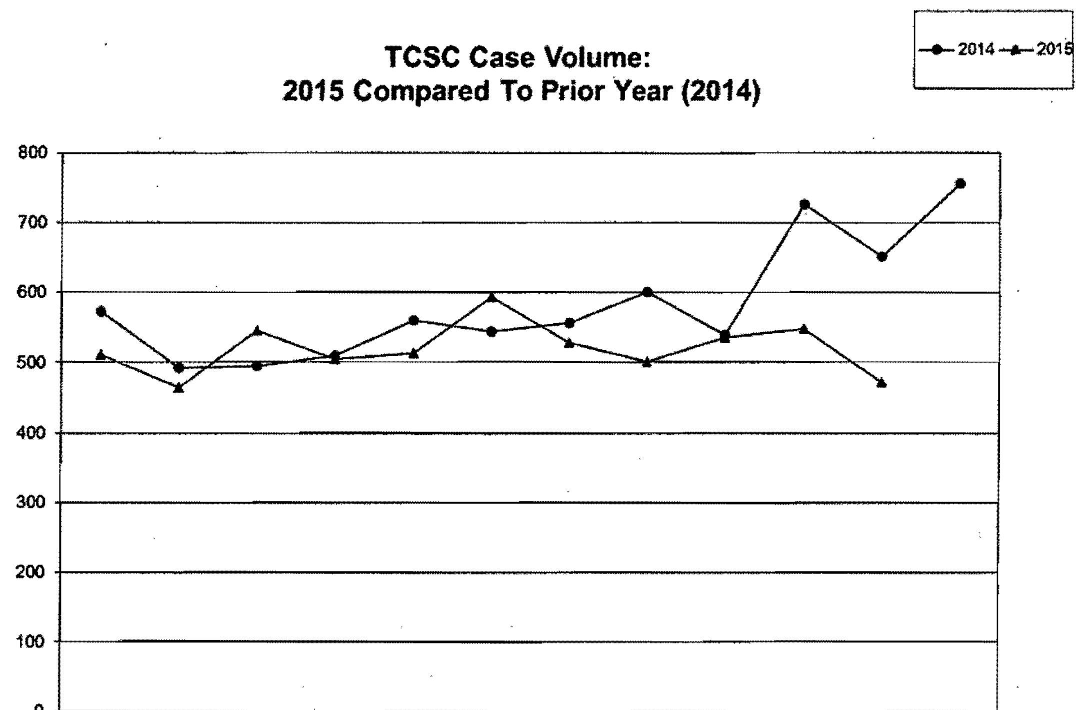
Physician	FY 2014	YTD 2015
Dr. Carlos A. Rodriguez	933	478
Dr. Jeff Victor	861	671
Dr. Heliodoro Medina	690	584
Dr. Sharif Zubair	651	579
Dr. Niraj Ajmere	631	572
Dr. Yogesh Patel	585	489
Dr. Darran R. Moxon	462	366
Dr. Donald Hoscheit	322	240
Dr. Arvin Bhatia	308	210
Dr. Anjali S. Hawkins	304	283
Dr. Kevin M. King	240	215
Dr. Harold Mozwecz	190	99
Dr. Katherine Brito	181	210
Dr. John P. Plante	109	90
Dr. Eric L. Lenting	86	72
Dr. Michael A. Rashid	74	81
Dr. John G. Christensen	58	42
Dr. Katherine Jelinek	56	160
Dr. Michael G. Larry	42	35
Dr. John H. White	39	17
Dr. Kenya Williams	37	75
Dr. Abraham H. Steinberg	28	6
Dr. George Bardouniotis	26	19
Dr. Faisal Khan	21	65
Dr. Andrew J. Kramer	17	22
Dr. David J. Aguiar	15	26
Dr. Ronald Simone	13	-
Dr. Dean P. Shoener	11	-
Dr. Arkadiush Byskosh	4	-
Dr. D. James Lee	3	-
Dr. Irene Wu	3	2
Dr. Glen K. Lochmueller	2	5
Dr. Jennifer L. Lew	1	-
Dr. Michele Slogoff	-	2
Totals:	7,003	5,715

Attachment Response 10

As shown above Dr. Rodriguez had the largest amount of cases at the Center in fiscal 2014. As of September 25, 2015, Dr. Rodriguez moved out of state and will not be utilizing the Center in the future. His partners have tried to cover his cases, but management expects a decline in cases in fiscal 2016 due to losing Dr. Rodriguez. Dr. Rodriguez's former partners are also trying to recruit a surgeon to replace Dr. Rodriguez, but management at the Center are unsure how long it will take and whether a new surgeon will be able to fully replace the number of procedures performed by Dr. Rodriguez.

In addition, a gastroenterology group with three surgeons utilizing the Center was acquired by Northwestern and has started performing more of its cases at the hospital instead of at the Center. As a result of losing Dr. Rodriguez and losing procedures to the hospital, the Center has seen a decline in procedures in recent months as shown in the graph below comparing the number of procedures on a monthly basis from 2015 to 2014.

TCSC Case Volume:
2015 Compared To Prior Year (2014)



	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14
2014	572	493	495	510	560	544	556	601	539	726	651	756
2015	511	464	545	505	513	593	528	501	535	548	472	

The Center is located at 345 Delnor Drive, Geneva, Illinois and the real estate is owned by the Center. The facility is located on the Northwestern Medicine Delnor Hospital Campus. The building is subject to a land lease with Delnor-Community Health System (now Northwestern) to lease approximately 16,000 square feet of land. The lease which is dated August 1, 2006 is

Attachment Response 10

initially for 55 years plus two ten year renewal options. The initial rent was $27,000 per year and increases every five years by CPI. Rent expense for fiscal 2014 was $30,831.

The building is 13,800 square feet and consists of three GI surgery rooms and two general operating rooms.

LITIGATION

According to management, the Center does not have any material adverse legal or other proceedings pending or threatened that would have a material impact upon the Center's operations or value.

SECTION 3. BUSINESS ENVIRONMENT

NATIONAL ECONOMIC CONDITIONS

The value of the Subject is influenced by potential returns available from alternative investments and the overall economic environment. In assessing the overall economic environment, we considered data contained in the U.S. Department of Commerce Bureau of Economic Analysis; The Federal Reserve Bank of Philadelphia, *Third Quarter 2015 Survey of Professional Forecasters*; the "The Economy in 2014, December 23, 2014" published by The Council of Economic Advisers and prepared for the Joint Economic Committee and Standard & Poor's Capital IQ Trends and Projections *Outlook 2015: A Seventh-Year Stretch* dated December 8, 2014. These reports included the following data:

After one of the worst recessions in U.S. history, the U.S. economy shows generally steady growth and continued to grow through the fourth quarter of 2014 and into 2015.

The 5.0% annualized growth rate in real GDP in the third quarter of 2014 is the highest in any quarter since 2003. The growth in real GDP mostly reflects a pickup in consumer spending, a continued solid pace of growth in business investment, and reduced fiscal drag at the state and local levels. Federal fiscal drag rose as a result of the sequester in 2013, but has eased in 2014.

Real GDP increased at an annual rate of 1.5% in the third quarter of 2015, according to the "advance" estimate released by the Bureau of Economic Analysis. In the second quarter, real GDP increased 3.9%. The increase in real GDP in the third quarter primarily reflected positive contributions from personal consumption expenditures, state and local government spending, nonresidential fixed investment, exports, and residential fixed investment that were partly offset by negative contributions from private inventory investment.

According to the Federal Reserve Bank of Philadelphia, *Third Quarter 2015 Survey of Professional Forecasters (the "Forecasters")*, real GDP will grow 2.3% in 2015, 2.8% in 2016, 2.6% in 2017, and 2.4% in 2018.

The federal government deficit has been cut by two-thirds since fiscal year 2009, now below its average since 1970.

The pace of job growth has picked up to 241,000 per month in 2014, up from 194,000 per month in 2013, and the most in any year since the 1990s. The economy is adding jobs at a rate of about 2% per year, also on pace for the largest percentage increase in any calendar year since the late 1990s. Last year, forecasters expected that the unemployment rate would remain above 6% into 2017, yet it declined to 5.8% in November 2014.

Employment figures continue to improve. The Forecasters predict the unemployment rate will be an annual average of 5.3% in 2015, before falling to 5.0% in 2016, 4.8% in 2017, and 4.7% in 2018. The Forecasters' projections for the annual average level of nonfarm payroll employment suggest job gains at a monthly rate of 244,200 in 2015, and 200,500 in 2016.

In the recovery, business investment has grown at an average annualized rate of more than 5.0%. Corporate balance sheets are healthier than any time in the last decade.

Consumer sentiment recently reached the highest level since January 2007. This year's gains in consumer sentiment likely reflect improving income and employment expectations, the decline in gasoline prices, and the fiscal certainty secured for much of the year by the late-2013 Ryan-Murray budget agreement.

S&P expects the U.S. economy should grow 3.0%. Following sub-3% growth rates in every calendar year since the Great Recession ended in 2009, S&P Economics projects the U.S. economy to grow 3.0% in 2015, as crude oil averages $80 per barrel, consumer spending increases 2.9%, capital expenditures rise 7.7%, and residential construction jumps 12.8%. S&P sees headline CPI rising by only 1.9% on a year-over-year basis.

S&P Economics expects economic momentum will continue through 2015. In all, they forecast the economy to expand by 3% for all of 2015 from solid gains in companies' capital expenditures, and as private-sector strength continues to offset government austerity. The aforementioned data indicates that the U.S. Economy continues to show steady, gradual growth.

INDUSTRY OVERVIEW

Below is an industry overview containing excerpts from several publicly traded companies' 10-K filings, Irving Levin Associates "The Health Care Services Acquisition Report", Standard & Poor's Industry Surveys Healthcare: Facilities and various other sources:

> *In July, 2015, the Centers for Medicare and Medicaid Services, or CMS, estimated that national healthcare expenditures grew by 5.5% in 2014 and are expected to grow 5.3% in 2015 as individual (including Medicaid eligibility expansion) and small-group coverage expansion experience sustained growth going forward. From 2014 to 2024, healthcare spending is projected to grow at an average rate of 5.8% annually, driven by Affordable Care Act (ACA) coverage expansion, faster projected economic growth, and the end of the sequester.*
>
> *Health spending has grown at historically low levels since 2008, and this is likely due to the recession, slow recovery, and structural changes to the U.S. health system, such as higher patient cost sharing. CMS projects health spending growth to pick up and average 4.9% annually on a per capita basis from 2014 to 2024. Although the Henry J. Kaiser Family Foundation (KFF) expects the annual growth rate in health spending to increase as the economy recovers, health care costs are not likely to spin out of control; neither is the ACA likely to fuel an increase in health costs.*
>
> *The number of hospital visits increased in 2013, particularly by patients who were commercially insured and who received outpatient treatments, according to an IMS Health report dated April 2014. CMS reported in September 2015 that total hospital*

spending grew 4.4% to $978.3 billion in 2014, almost unchanged from the 4.3% growth in 2013. The CMS projected that growth would reaccelerate to 5.4% in 2015, bolstered by continued spending among the newly insured under the ACA, offset by slower Medicare hospital spending updates. Looking ahead, the CMS projects average annual growth of 6.1% per year in hospital spending from 2016 to 2024, reflecting the aging population, and assuming improved economic conditions.

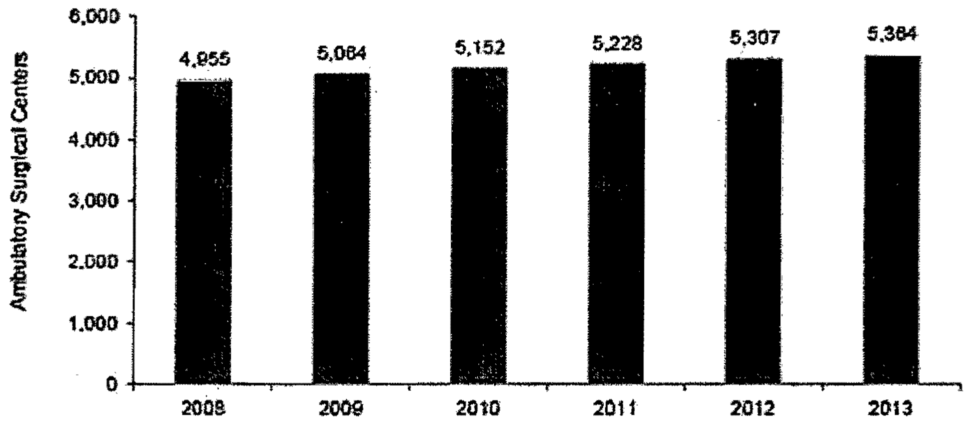
The competitive focus of hospitals on cutting-edge technology, niche specialty services, and amenities to attract physicians and patients have led to targeted geographic expansion into new markets. These hospitals were expanding beyond traditional markets to seek well-insured patients, according to a study by the Center for Studying Health System Change (HSC) published in April 2012 Health Affairs. They entered new regions by building full-service hospitals, establishing freestanding emergency departments and other outpatient services, acquiring physician practices, and operating medical transport systems to shore up their referral bases and increase inpatient admissions. However, by placing more people on health insurance rolls, the Health Care Reform law should also help reduce the level of uncompensated care and, hence, bad debt expense. Even so, some dominant hospital systems and large physician groups are still capable of wrestling higher payments from insurers, resulting in higher health care costs. The higher payments may also result from the offering of a unique service or access in a particular geographic area.

Health reforms are likely driving physicians and hospitals to align closely and share resources, as reforms lead to the transition from a fee-for-service (FFS) reimbursement system to one that focuses more on quality outcomes and containing costs. A successful collaboration would require hospitals to invest in people and processes. Hospitals will have to align compensation and reward performance, and alter the practicing pattern to emphasize quality and efficiency rather than just volume, in S&P Capital IQ's view.

AMBULATORY SURGERY CENTERS

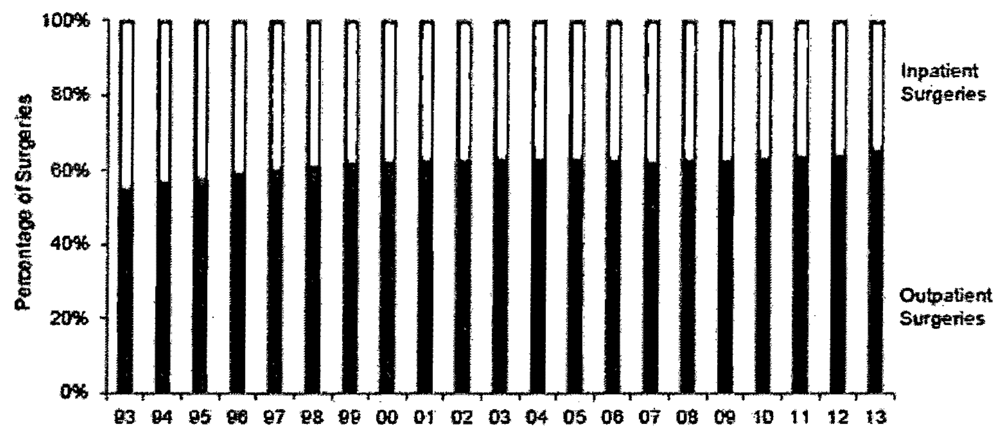
The most common ASC procedures are cataract removal with lens insertion, upper gastrointestinal endoscopy, colonoscopy, and nerve procedures. Total Medicare payments for ASC services increased by 4.2% per year, on average, from 2007 through 2014. Payments per fee-for-service beneficiary grew by 3.9% per year during this period. Between 2013 and 2014, total payments rose by 4.3% and payments per beneficiary grew by 4.0%.

According to A Data Book: Health Care Spending and the Medicare Program, issued in June 2015, there were 5,347 Medicare-certified ambulatory surgical centers in 2014, up from 2012 levels with 5,287 centers.



Source: Medicare Payment Advisory Commission. (March 2015). *Report to Congress: Medicare Payment Policy.*
Link: http://www.medpac.gov/documents/reports/Mar15_EntireReport.pdf.

Of all the surgery cased performed in the United States in 2013, over 60% were performed in the outpatient setting. Outpatient surgery as a percentage of total surgery has increased gradually from 1993 to 2003 and then began to flatten out with a slight uptick in the past couple of years. The increase in surgical procedures performed in outpatient settings is primarily linked to both the rise of ASCs as well as technological and surgical procedure innovation which has expanded the types of procedures suitable for an outpatient setting.[3]



Source: Avalere Health analysis of American Hospital Association Annual Survey data, 2013, for community hospitals.
Previously Chart 3.14 in 2013 and earlier years' Chartbooks.

[3] Trendwatch Chartbook 2013 as provided by AHA and Avelere Health

The number of Medicare certified ASCs grew at an average annual rate of 2% from 2007 through 2014. Each year from 2007 through 2014, an average of 212 new facilities entered the market, while an average of 92 closed or merged with other facilities. The slower growth in the number of ASCs from 2009 through 2014 may reflect the substantially higher rates that Medicare pays for ambulatory surgical services in hospital outpatient departments than in ASCs, the very slow growth of national health care spending and Medicare spending, and the significant increase in hospital employment of physicians.

The industry is highly fragmented, composed of several large, publicly and privately owned companies and many smaller, independent operators. Of the approximately 5,400 freestanding ASCs operating in the United States, approximately 1,312 facilities, or 22.3%, are owned or managed by multi-facility chains.

Multifacility Surgery Center Chain	Centers
AmSurg	208
United Surgical Partners International	191
Surgical Care Affiliates	145
HCA	98
Nueterra	90
Symbion	54
SurgCenter Development	56
NovaMed	49
Community Health Systems	34
Ambulatory Surgical Centers of America	33
ASD Management	27
Health Inventures	26
National Surgical Hospitals	25
Healthmark Partners	19
Titan Health	17
Physicians Endoscopy	17
Surgery Center Partners	16
Regent Surgical Health	14
Foundation Surgery Affiliates	14
Surgem	13
Constitution Surgery Partners	12
Surgery Partners Holdings	11
Surgery Partners Holdings	11
Practice Partners in Healthcare	11
Blue Chip Surgical Center Partners	10
Meridian Surgical Partners	10
Cirrus Health	10
Surgical Management Professionals, LLC	10
Prexus Health Partners	9
Ortmann Healthcare Consultants	9
Global Surgical Partners	8
Neospine	8
Sovereign Healthcare	8
Pinnacle III	8
Community Care	6
Interventional Management Services	6
Medical Consulting Group	6
Covenant Surgical Partners	6
Northstar Healthcare	4
Orion Medical Services	4
Universal Health Services	3
RMC MedStone Capital	3
Medical Facilities Corp	2
Elite Surgical Affiliates	2
TOTAL	1,312

As of June 2011, Tracked by Company Profiles

<u>HEALTH CARE REFORM</u>

The federal government passed the Patient Protection and Affordable Care Act (PPACA or ACA), more commonly known as the Health Care Reform law, in March 2010, to set regulations that will govern the health care industry and strengthen the overall U.S. health care system. The U.S. Supreme Court's decision in June 2012 to uphold the individual mandate provision of the law, while also giving states the choice to opt out of the Medicaid expansion plan, has removed the cloud of uncertainty surrounding the legality of the Health Care Reform law.

The Health Care Reform affects all health care stakeholders. In spite of the numerous concessions and additional fees and taxes imposed on the health care sector, the addition of potentially up to 26 to 28 million insured patients estimated by 2019 will likely be a net benefit for the industry.

The central tenet of the Health Care Reform law is to expand health care insurance coverage to virtually all U.S. citizens and legal residents. On January 1, 2014, the individual mandate component of the law became effective. The individual mandate, arguably the most contentious component of the law, requires most U.S. citizens and legal residents to have qualifying health insurance coverage. Those without coverage will have to pay a tax penalty, which gradually increases each year (to be indexed to the rate of inflation after 2016).

Under the law, individuals and families can purchase coverage through a health care exchange established by an individual state or by the federal government. Among the country's marketplace exchanges, as of September 2015, 14 were state-based, three were federal supported, 7 were state partnerships and 27 were federal facilitated.

In addition to the establishment of health insurance exchanges, the ACA expanded Medicare to include all non-Medicare-eligible individuals under age 65 (children, pregnant women, parents and adults without dependent children) with incomes up to 133% of the Federal Poverty Level (FPL) based on modified adjusted gross income. Undocumented immigrants are not eligible for Medicaid. As mentioned above, the Supreme Court decision in June 2012 allowed for states to opt out of the Medicaid expansion plan. As of September 2015, only 31 states and the District of Columbia had elected to expand Medicaid, but several more states will likely expand Medicaid over the next several years. One state has planned discussions for the possible expansion of Medicaid.

Approximately 89.6% of the U.S. population had some form of health insurance in 2014, according to the U.S. Census Bureau. Approximately 66.0% of the population had coverage through a private plan, including managed health care, while approximately 36.5% of the population had coverage provided by a government program including Medicare or Medicaid. Around 10.4% of the population, or about 33.0 million, were uninsured in 2014. (The estimate of coverage type is not mutually exclusive and people can be covered by more than one type of health insurance during the year, resulting in percentages that total more than 100%). In 2010, 16.3% of the population, or 49.9 million, were uninsured. However, the number of insured has gradually declined since the passage of the ACA in 2010, as various components of the law have been implemented throughout the years. S&P Capital IQ thinks that the ability of individuals aged 26 years and below to remain under their parents' insurance coverage contributed significantly to the decline of the uninsured, as this part of the law became effective in 2010.

In 2014, approximately eight million people obtained health insurance through the health care exchanges, while an additional 8.7 million people enrolled for Medicaid and/or the Children's Health Insurance Program (CHIP). Approximately 11.7 million people signed up for health insurance through the healthcare exchanges during the enrollment in early 2015, according to the Department of Health and Human Services (HHS). Further, since October 2013, more than 10.8 million new enrollees enrolled in Medicaid.

As of January 2015, 70 million people were enrolled in the Medicaid and Children Health Insurance Program (CHIP), and this increased 19.3% over the pre-Health Care Reform enrollment of 58.7 million. CHIP is a state-based program that provides low-cost health coverage to children in families that earn more than the qualified income for Medicaid.

The health care providers and services industry has benefited from the growth in insured patients utilizing health care services. The proportion of physician visits by uninsured patients in the states that expanded Medicaid fell to 2.8% from 4.6%, a decrease of 39%, according to a study conducted by AthenaHealth and the Robert Wood Johnson Foundation. However, in non-expansion states, visits by uninsured patients declined to 6.2% from 7.0%, a decrease of only 11%.

Health care facilities benefited from more insured patients coming through their doors, driving up both inpatient and outpatient services and resulting in lower uncompensated care, charity care, and bad debt.

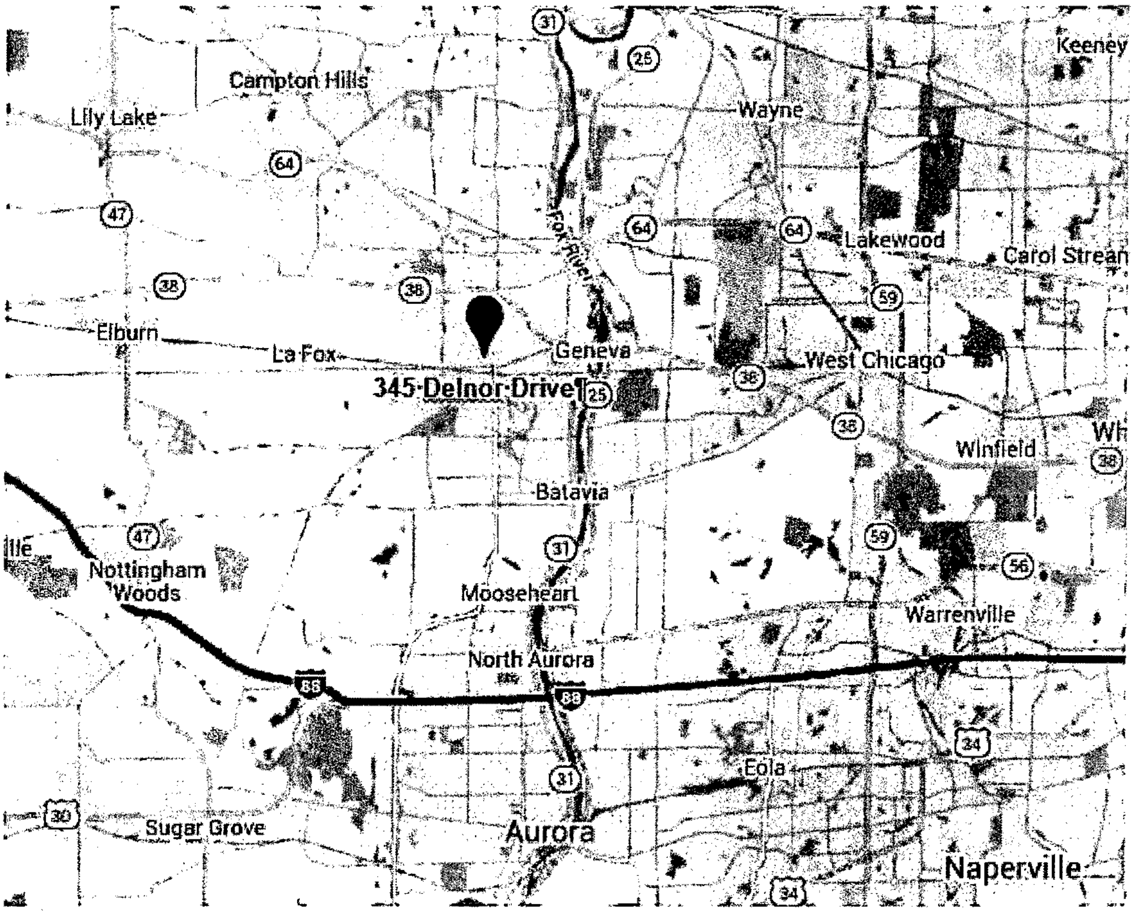
<u>DEMOGRAPHICS</u>

Over the long term, a shift in demographics toward an older population is likely driving higher levels of utilization and overall health care services. The average lifespan increased to 78 years in 2010 and is expected to increase to 79 years in 2015, while the median age increased from 35 years in 2000 to 37 years in 2010, and is expected to increase to 38 by 2020, according to the U.S. Census Bureau. Further, the proportion of the U.S. population older than age 65 is projected to grow from 12.6% in 2007 to 14.5% in 2015 and to 18.2% in 2025. On the other hand, rising costs and potential changes in reimbursement rates could pressure providers, despite the rising demand.

SERVICE AREA AND DEMOGRAPHICS

AREA MAP

The subject property is located at 345 Delnor Dive in the City of Geneva, IL in Kane County.



SERVICE AREA AND DEMOGRAPHICS

The Subject generates the majority of its business from patients within the City of Geneva and the tri-cities area which includes St. Charles and Batavia. This is a very high growth region, benefiting from the urban reach of Chicago spreading west. Geneva is a city in and the county seat of Kane County, Illinois. As of July 2013 official U.S. Census Bureau estimate, Geneva had a total population of 21,694 persons, a 9% increase from the 19,515 persons in 2000. According to the 2010 census, Kane County had a population of 523,643 persons, a 32% increase from 404,119 in 2000.

The population density was 2,151.73 people per square mile (895.9/km²). There are 6,895 housing units at an average density of 820.2/sq. mi (316.5/km²). The racial makeup of the city was 94.77% White; 0.51% African American; 0.08% Native (American Indian, Alaska Native, Hawaiian Native, etc.); and 1.25% from two or more races.

There were 7,865 households out of which 63.78% were married couples living together, 20.84% are 1 person households, 79.16% 2 or more person households, and 24.64% are non-families. In the city the majority of the population was between the ages of 18 to 64 years with 7.61% under the age of 4; 24.18% between the ages of 5 and 17 years; 59.31% between the ages of 18 to 64 years; and 8.90% 65 and over. The median age is 43.5 years.

The median income for a household in the city as of 2013 is $95,542, and the median income for a family is $104,965. The per capita income for the city as of 2013 is $45,501.

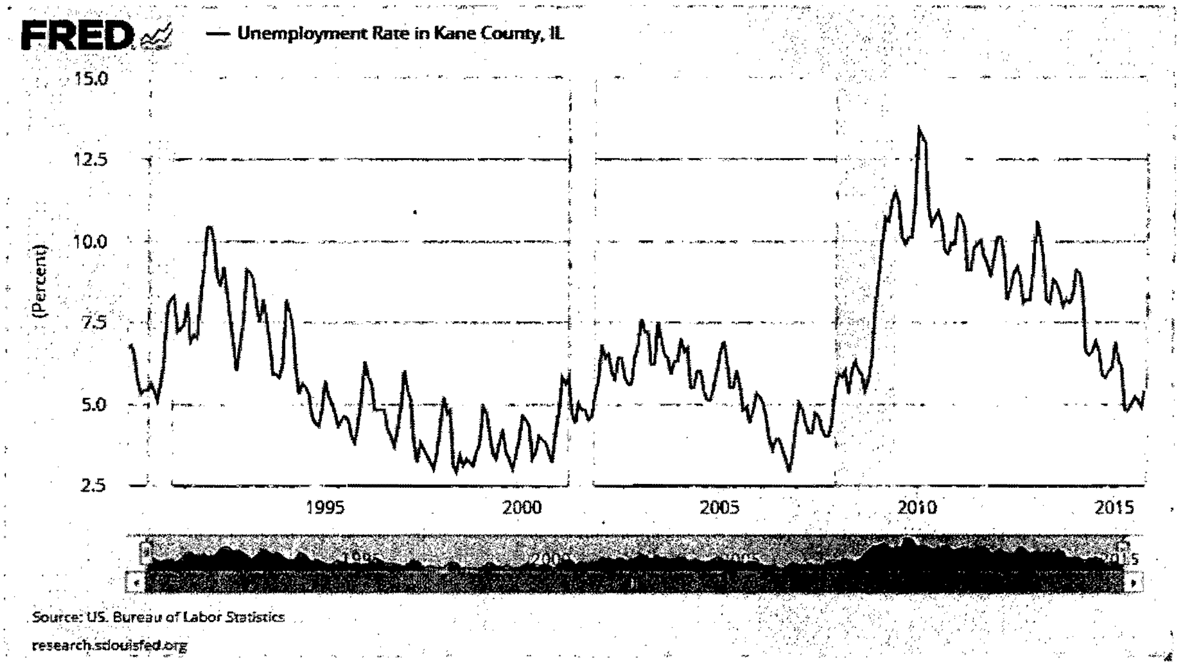
AREA ECONOMY

Geneva, Illinois major industries include, but is not limited to, construction, manufacturing, wholesale trade, retail trade, transportation and warehousing, information, finance, insurance and real estate.

Geneva's top employers are listed in the chart below.

Employer	Number of Employees
Kane County	1,260
Cadence Health/Delnor	869
Geneva School District	654
Kane County Cougars	370
Peacock Engineering	350

The unemployment rate in Geneva, IL is currently 7.4%.



LOCAL AREA SURGICAL CENTERS (COMPETITION)

The nearest major standalone surgical centers to Tri-Cities Surgery Center, LLC are:

Facility Name	Distance from Subject (Mi.)
Valley Ambulatory Surgery Center	3.0
Dreyer Ambulatory Surgery Center	6.7
The Center for Surgery	11.5
Naperville Surgical Centre	12.5
Midwest Endoscopy Center	12.5

There is a high level of local competition to the Subject. The Subject is currently affiliated with Northwestern/Cadence Health (Central DuPage Hospital and Delnor Hospital) which provides an advantage over competitors who are unaffiliated. Valley Ambulatory Surgery Center is the only competitor that is directly located in the Subject's primary service area, with the other four located outside of Kane County. A brief profile of the five standalone facilities identified is outlined below:

Dreyer Ambulatory Surgery Center: The Dreyer Ambulatory Surgery Center, a joint venture with Provena Mercy Medical Center, was established in 1993. The 16,300-square-foot facility is located on the lower level of the Clinic's Highland site. It is licensed, staffed, and equipped to perform dozens of types of outpatient surgeries, from arthroscopic procedures to endoscopies. The center is accredited by the Accreditation Association for Ambulatory Health Care (AAAHC/Accreditation Association).

Midwest Endoscopy Center: Midwest Endoscopy Center is an ambulatory surgery center dedicated exclusively to colonoscopy, endoscopy screenings, digestive health and treating liver disease. It is Medicare approved, and the only state licensed endoscopy center in DuPage County, IL. The center is accredited by the Accreditation Association for Ambulatory Health Care (AAAHC/Accreditation Association).

Naperville Surgical Center: Naperville Surgical Centre, a freestanding ambulatory surgery facility, is a joint-venture between Advocate Network Services (an affiliate of Advocate Health Care) and a group of surgeon investors. The center began providing outpatient surgical services on October 25, 1993.

Featured in the nearly 15,000 square foot facility are four, large, modern operating rooms with state-of-the-science equipment, fully private pre-operative and recovery rooms and separate pediatric recovery area, as well as a pediatric play room in the waiting area. Nearly 75 surgeons in the specialties of orthopedics, general surgery, gynecology, otorhinolaryngology (ENT), ophthalmology, plastic surgery, pain management, podiatry, urology, and anesthesiology utilize the Centre. Anesthesia services are provided by the anesthesiologists affiliated with Good Samaritan Hospital. NSC has a transfer agreement with Edward Hospital to accommodate patients who require overnight observation.

Naperville Surgical Centre is licensed by the Illinois Department of Public Health, is a provider in the Medicare Program, and is accredited by the Joint Commission on Accreditation of Healthcare Organizations.

The Center for Surgery: The Center for Surgery, located west of Chicago in Naperville, Illinois, is affiliated with Edward Hospital (Naperville) and Central DuPage Hospital (Winfield). The center performs the following surgical procedures: Anesthesia, Gastroenterology, General Surgery, Gynecology, Laser Vision Correction, Neurosurgery, Ophthalmology, Oral/Maxillofacial, Orthopaedics, Otolaryngology, Pain Management, Plastic Surgery, Podiatry, Thoracic Vascular Surgery, and Urology/Lithotripsy.

Valley Ambulatory Surgery Center: Valley Ambulatory Surgery Center (VASC) has been providing outpatient surgical care in the Fox Valley area since 1987. More than 750 different types of surgical procedures are routinely performed at VASC. VASC offers the following services: Allergies and Immunology, Anesthesiology, Cardiology, Dentistry (General), Dentistry (Pediatric), Dermatology, Ear, Nose & Throat, Endocrinology, Family Practice, Gastroenterology, General Surgery, Gynecology, Gynecology/Fertility, Infectious Disease, Internal Medicine, Nephrology, Neurology, Ophthalmology, Oral Surgery, Orthopedics, Pain Management, Pediatrics, Plastic Surgery, Podiatry, Pulmonary Disease, Rheumatology, Spinal Surgery, and Urology.

SECTION 4. FINANCIAL ANALYSIS

Principle Valuation was provided with the Center's financial statements for the fiscal years ended December 31, 2012 through December 31, 2014, and for the nine months ended September 30, 2015. The financial statements were accepted as accurately portraying the financial condition and operating performance of the Subject. Principle Valuation assumes no responsibility for the accuracy or completeness of any such information.

INCOME STATEMENT ANALYSIS

Below are income statements for Tri-Cities Surgery for the fiscal years ended December 31, 2012, 2013, and 2014 and for the trailing 12 months (TTM) ended September 30, 2015.

Tri-Cities Surgery Center, LLC					
		FY 2012	FY 2013	FY 2014	TTM 9/30/2015
Case Volume		6,455	7,249	7,003	6,828
Average Collection per Procedure		$ 1,037	$ 1,071	$ 1,112	$ 1,134
Growth			3.2%	3.8%	2.0%
Net revenue		$ 6,696,754	$ 7,764,452	$ 7,788,278	$ 7,741,737
Growth			15.9%	0.3%	-0.6%
OPERATING EXPENSES					
Salaries &Wages	v	$ 1,819,584	$ 2,047,826	$ 2,150,462	$ 2,149,880
Materials & Supplies	v	883,086	1,144,386	1,101,156	1,210,792
Employee Benefits	v	188,607	223,802	233,282	295,569
Utilities	f	247,649	300,542	371,701	400,385
Outside Services	f	229,668	253,190	200,313	212,779
Payroll Taxes	v	153,382	171,930	180,966	173,429
Professional Fees	f	108,374	134,459	175,911	191,767
Equipment Rental (GI Labs)	f	20,577	191,972	267,115	366,506
Insurance	f	77,069	88,522	95,866	99,265
Repairs & Maintenance	f	59,036	63,869	81,539	11,342
Real Estate Taxes	f	55,223	58,264	54,000	73,804
Rent (land lease)	f	29,107	27,911	30,831	30,429
Other Expenses	f	181,582	193,909	225,406	231,362
Subtotal		4,052,944	4,900,582	5,168,548	5,447,309
Depreciation/Amortization	f	218,819	157,141	269,013	253,988
Interest Expense		289	-	2,170	1,736
Total Operating Expense		$ 4,272,052	$ 5,057,723	$ 5,439,731	$ 5,703,033
Gain/(Loss) from Operations		$ 2,424,702	$ 2,706,729	$ 2,348,547	$ 2,038,704
Non-Operating Income:					
Interest Income/Gain on Sale/Other Income		49,424	36,633	19,895	34,950
Total Non-Operating Income		49,424	36,633	19,895	34,950
Excess of revenue over expenses		$ 2,474,126	$ 2,743,362	$ 2,368,442	$ 2,073,654
Operating EBITDA		$ 2,643,810	$ 2,863,870	$ 2,619,730	$ 2,294,428
Operating EBITDA Margin		*39.5%*	*36.9%*	*33.6%*	*29.6%*
EBIT		$ 2,424,991	$ 2,706,729	$ 2,350,717	$ 2,040,440

REVENUE: Revenues grew from $6.7 million in fiscal 2012 to $7.8 million in fiscal 2013, mainly as a result of an increase in cases from 6,455 cases in fiscal 2012 to 7,249 cases in fiscal 2013. Revenues remained fairly flat in fiscal 2014 at $7.8 million, even with total cases declining to 7,003. For the trailing 12 months ended September 30, 2015 cases declined to 6,828 and revenue was $7.7 million. The average collection per case was $1,112 in fiscal 2014 and $1,134 in the trailing twelve month period.

EXPENSES: Operating expenses, before depreciation and interest expense, totaled $5.2 million, or 66.4% of revenues, in fiscal 2014 and $5.4 million, or 70.4% of revenues, in the trailing 12 month period. As a percent of revenues, operating expenses before depreciation and interest fluctuated from a low of 60.5% of revenues in fiscal 2012 to a high of 70.4% of revenues in the trailing 12 month period. The increase in expenses is mainly a result of 1) an increase in materials and supplies expense as a result of price increases and a change in the ophthalmology case mix, and 2) an increase in equipment rental. The increase in the equipment rental was a result of potentially opening a fourth GI lab and purchasing the equipment, but it was never opened. As a result, management has reviewed this expense and expects it to decline in the future.

NET OPERATING INCOME (EBITDA): EBITDA was $2.6 million, or 33.6% of revenues, in fiscal 2014 and declined to $2.3 million, or 29.6% of revenues, in the trailing 12 month period. EBITDA as a percent of revenues declined over the periods reviewed from 39.5% of revenues in fiscal 2012 to 29.6% of revenues in the trailing 12 months ended September 30, 2015.

BALANCE SHEET

The Center's balance sheet data as of September 30, 2015 is summarized on the following table.

Tri-Cities Surgery Center, LLC
Consolidated Balance Sheet
As of September 30, 2015

Assets			**Liabilities and Net Assets**		
Current Assets:			Current liabilities:		
Cash	$	3,055,507	Note Payable	$	30,980
Accounts Receivable		548,582	Accounts Payable		101,412
Inventory		251,003	Accrued Blue Cross		2,296,103
Employee Advance		824	Accrued Payroll and Payroll Taxes		83,105
Prepaid Insurance		37,132	Other Accrued Expenses		315
Prepaid Expenses		22,071	Total Current Liabilities		2,511,915
Total Current Assets		3,915,119			
			Long-Term Liabilities		
Property & Equipment			Note Payable, net of current		10,535
Building and Improvements		3,905,599			
Furniture and Fixtures		103,835	**Total Liabilities**	**$**	**2,522,450**
Medical Equipment		1,632,248			
Office Equipment		161,157	**Total Members' Equity**	**$**	**4,473,600**
Software		51,804			
Total		5,854,643	**Total Liabilities and Members' Equity**	**$**	**6,996,050**
Less: Accumulated Depreciation		(2,776,345)			
Property & Equipment, Net		3,078,298			
Other Assets:					
Other Long-Term Assets		2,633			
Total Other Assets		2,633			
Total assets	**$**	**6,996,050**			

WORKING CAPITAL

Based on the above balance sheet, the debt-free net working capital of the Center as of September 30, 2015 was $1,372,224. This represents 17.7% of trailing twelve months revenue and is above the market based upon a review of publicly traded guideline companies which had a range of working capital of 6.7% to 14.0%. A normalized level of working capital of 11.0% was utilized for the analysis.

SECTION 5. VALUATION ANALYSIS

VALUATION METHODOLOGIES

Three valuation methods are commonly utilized to determine the fair market value of a business enterprise.

Income Approach: Value equals the present value of the unlevered free cash flows plus a projected terminal value. The terminal value is an estimate of the value beyond the forecast period. Two approaches are used to determine the terminal value, the EBITDA multiple approach and a perpetuity growth approach (the Gordon Growth Method).

Market Approach: Value is correlated to the values of prior comparable acquisitions and the values of comparable public companies. The two approaches utilized within the Market Approach are the Public Comparables Analysis and the Acquisition Comparables Analysis. In this analysis we have focused on the Public Company Analysis.

Asset-Based Approach: Value equals the value of the tangible and identified intangible assets of the business and the associated liabilities.

The weight given to each approach in the final value is determined on a case by case basis. Due to the going concern nature of the business and the limited amount of assets, the Asset-Based Approach was not utilized in the valuation.

VALUATION CONSIDERATIONS

Valuations must comply with additional laws and regulations including Stark Laws and Anti-Kickback Provisions. Accordingly, Fair Market Value is defined as the value to a hypothetical purchaser, which the Internal Revenue Code prescribes as a C Corporation, and cannot take into account synergies, management improvements, reimbursement differentials, and the tax status of the purchaser amongst other factors.

Principle Valuation's analysis incorporates, but is not limited to, the criteria laid out in Revenue Ruling 59-60.[4]

- The nature of the business and the history of the enterprise from its inception;
- The economic outlook in general and the condition and outlook of the specific industry in particular;
- The book value of the stock and the financial condition of the enterprise;

[4] Revenue Ruling 59-60, 1959-1 CB 237 – IRC § 2031

- The earning capacity of the enterprise;
- The dividend paying capacity;
- Whether or not the enterprise has goodwill or other intangible value;
- Sales of the stock and the size of the block of stock to be valued; and
- The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over the counter.

INCOME APPROACH

The Income Approach determines the value of the business by projecting income and expenses over a period and discounting the free cash flows and the terminal value to a present value at a rate commensurate with the risks of the investment. It is assumed that an investor will pay no more for a business than for an alternative investment that produces an equivalent return with equivalent risk. The discount rate applied represents the risks inherent with the business and takes into consideration competitive alternative investments.

Cash Flow Projections

In estimating our revenue projections we primarily relied upon discussions with management; management's 2016 budget for Year 1; as well as historical financial data. The following assumptions were made to estimate the cash flows over the forecast period.

- The number of procedures was forecast at 6,000 in Year 1, a decline from the 2015 period due to the loss of Dr. Rodriguez and the increased use of the hospital's GI facilities instead of the Center by some of the surgeons. The number of procedures is expected to increase as Dr. Rodriguez is replaced. The number of procedures was increased to 6,300 in Year 2 and further to 6,900 in Year 3 and 7,000 in Year 4. The number of procedures was stabilized at this level throughout the remainder of the forecast.
- The average collection per procedure was forecast at $1,035 in Year 1 and increased at an inflationary level thereafter.
- Total revenue was projected at $6.2 million in Year 1 and increased to $8.0 million in Year 5 of the projection.
- Variable expenses were projected based upon historical levels as a percent of revenue.
- Fixed costs were increased at an annual rate of 2.5% per year.
- Salaries and wages were maintained at a higher level as a percent of revenues than historical levels in Years 1 and 2 due to the decline in revenues and the need to maintain a stable workforce. After Year 2, salaries and wages were forecast at

a percent of revenues based on historical levels. Employee benefits and payroll taxes were forecast based on a percent of salaries and wages.

- Working capital increases were set at the differential to hold working capital balances at 11.0% of anticipated revenues.
- Capital expenditures were estimated based on historical levels and discussions with management relating to routine capital spending on equipment. Capital expenditures were set equal to depreciation throughout he forecast.
- Depreciation was based on historical levels and the new capital purchases that are anticipated.
- The cash flow projections developed estimate an EBITDA margin of 23.0% in Year 1, increasing to 25.2% in Year 2, and stabilizing in Year 4 at 30.9%. This is at the low range of historical EBITDA margins reviewed which had levels ranging from 29.6% to 39.5%.

Weighted Average Cost of Capital

The net cash flows for the period analyzed were discounted to present value based upon the weighted average cost of capital ("WACC"). The WACC developed for the subject property takes into consideration the general market's requirements for investment returns, the historical rate of return variances from fixed income and equity investments, current market forces, and economic conditions. In addition, the rate takes into consideration the specific risk associated with the company achieving its specific predicted performance and projections against historical achievements. All other things being equal investors that accept higher rates of risk demand higher return requirements.

The discount rate was developed in a process that incorporated aspects of economic theory, capital budgeting techniques, and the capital asset pricing mode ("CAPM").

A company's cost of capital can be considered the discount rate applied to the debt-free cash flows, reflecting the opportunity cost to all capital providers weighted by their relative contribution to the total capital of the company. An investor's cost of capital is the opportunity cost to an investor, equal to the rate of return the investor could expect to earn on other investments of equivalent risk.

Capital Structure

The first step in arriving the company's cost of capital is to estimate what percentage of the company will be financed with debt and what portion will be financed with equity capital. In estimating the capital structure (Debt/Equity) for the subject property we reviewed comparable company debt structures on the public markets, considered the asset compliment of the subject property, and our knowledge of similar enterprises. The debt structure of the comparable companies in the market approach that follows ranges from a low of 20.84% to a high of 79.96% with an average of 49.57% and a median of 44.30%. We believe that an overall debt/equity structure for the subject business would be similar to the guideline public companies. As such, we estimate the debt ratio at 50% debt and 50% equity.

Cost of Debt

We then must establish the Subject's cost of debt based upon a review of comparable debt placements in the market place. Historically, financing for properties similar to the subject property would be at rates 2% to 3% above the prime rate and or rates near Baa bonds. Baa bonds were yielding 5.36% and the prime rate was 3.25%. Based upon this data we believe that the pre-tax cost of debt for the subject property would be 5.36%.

The current effective tax rate for the organization would be 40.04%. This is based upon an effective Federal tax rate of 35% and an Illinois State tax rate of 7.75%. The calculation is shown below.

$$35.00\% + (7.75\% \times (1\text{-}35.0\%) = 40.04\%$$

The after-tax cost of debt would be equal to 3.21%. This is calculated as follows:

$$5.36\% \times (1 - 40.04\%) = 3.21\%$$

Cost of Equity

The third step is to establish required return on equity appropriate for the Subject. The CAPM model applied in our analysis is presented below:

$Re_i = R_f + [\beta_p (R_m - R_f)] + SSP \pm RP_i$

Where

Re_i = Required long-term return on equity for the subject company

β_p = The market-value-weighted average beta of the comparative company stocks (companies of all sizes)

SSP = Small stock premium, or the additional return required by an investor in small capitalization stocks

RP_i = An additional positive or negative increment to the total return for systematic risk factors specific to the subject company that are not already captured in the beta for the comparative companies as a whole and in the SSP risk premium. This increment might include, but would not be limited to, future growth rate, local market considerations, trends, competitive nature of the industry, risk of achieving and sustaining the projected levels of revenues and profitability margins, percent of total ownership being valued, and any other company-specific factors.

The formula generally indicates that an investors rate of return is established by achieving the risk-free rate of return plus a risk premium associated with the risk associated with the market volatility associated with the subject's line of business, a risk premium associated with the companies size and a risk premium associated with the specific lines of business and the forecast developed for the subject.

The risk free rate of return for the subject property was established as the yield rate associated with 20-year Treasury Bonds, 2.55%.

The general equity risk premium was based upon consideration of historical and forward looking evidence of investor's expectations and on Data published by Duff & Phelps in the 2015 Valuation Handbook Guide to Cost of Capital. We have concluded that an equity risk premium of 5.0% as recommended by this handbook is considered reasonable.

To this data we applied a beta adjustment to reflect the volatility associated with comparable healthcare stocks in comparison to the general market place. A beta for the subject property was based upon a comparison to the Betas found for the guideline companies utilized in the Market Approach. As shown in the Market Approach the overall Beta's for the guideline companies ranged from 0.18 to 10.88 with an overall average of 2.28 and a median of 0.65. The Beta source utilized was Capital IQ, a Standard and Poor's Company, contained on Yahoo Finance current web pages. We have estimated that an overall beta of 0.70 is appropriate for the subject company based upon a consideration of the data for the guideline companies and other healthcare enterprises in the market.

To the general equity risk premium we have added a small company risk premium. We relied upon the Duff and Phelps 2015 Valuation Handbook – Guide to Cost of Capital that reflect size premium for the subject property of 7.50% as shown in the following table.

Risk Premia Over CAPM ("Size Premia"), RP_s

				Using Guideline Portfolios	Using Regression Equations		
Size Study: Exhibits B-1 through B-8	Size Measure	Subject Company Value ($Millions)	Indicated Guideline Portfolio	Smoothed Risk Premium Over CAPM ("Size Premia"), RP_s	Regression Equation = Constant + (Coefficient x Log(Size Measure))		Smoothed Risk Premia Over CAPM ("Size Premia"), RP_s
Exhibit B-1	Market Value of Equity	NA	NA	NA	NA	=	NA
Exhibit B-2	Book Value of Equity	$4.47	25	5.57%	8.469% + (-1.599% x 0.6507)	=	7.43%
Exhibit B-3	5-Year Average Net Incom	NA	NA	NA	NA	=	NA
Exhibit B-4	MVIC	NA	NA	NA	NA	=	NA
Exhibit B-5	Total Assets	$7.00	25	6.01%	9.690% + (-1.736% x 0.8449)	=	8.22%
Exhibit B-6	5-Year Average EBITDA	NA	NA	NA	NA	=	NA
Exhibit B-7	Sales	$7.74	25	5.74%	8.662% + (-1.405% x 0.8888)	=	7.41%
Exhibit B-8	Number of Employees	NA	NA	NA	NA	=	NA

Mean and Median Risk Premia Over CAPM ("Size Premia"), RP_s

	Mean RP_s	Median RP_s		
Guideline Portfolio Method	5.77%	5.74%		
Regression Equation Method	7.69%	7.43%	Conclude	7.50%

Attachment Response 10

Finally we applied a company specific risk factor of 5.0% to the subject property which is associated with the specific lines of business the company operates in and the forecasts developed. Specific risk factors considered in establishing this rate for the Center included:

- The company operates from a specific geographic location that hinders its ability to broadly diversify its earning base.
- The enterprise is dependent upon Federal and State Funded reimbursement programs that may be revamped or reduced over the foreseeable future.
- The cash flows developed, the assumptions utilized in our forecasts, and the provided forecasts are considered moderate to conservative.
- The Subject is currently cash flow positive and is anticipated to remain so into the foreseeable future.
- The Center has a diverse physician base with no single physician accounting for more than 14% of total volume.
- The Subject is anticipating a decline in cases and anticipates recovering the lost cases in the future.

Conclusion Weighted Average Cost of Capital

The final step in determining the appropriate discount rate is to blend the two components of debt and equity capital to arrive at the discount rate utilized for the subject property, 11.0%.

The blending of the rates and the overall development of the WACC is presented on the following chart:

DEVELOPMENT OF WACC - TRI-CITIES SURGERY CENTER					
			Cost of Capital	% in Capital Structure	Weighted Cost
Debt			3.21%	50%	1.61%
Equity			18.55%	50%	9.28%
Weighted Average Cost of Capital					10.88%
Concluded WACC					**11.00%**
Cost of Equity					
Risk Free Rate of Return		2.55%			
Plus Equity Risk Premium					
Market Risk Premium[1]	5.00%				
Times Beta	0.70				
Adjusted Market Risk Premium		3.50%			
Plus Size Premium[2]		7.50%			
Plus Company Specific Risk Premium		5.0%			
Indicated Cost of Equity		**18.55%**			
Cost of Debt					
Concluded Pre-Tax Cost of Debt	5.36%				
Income Tax Rate	40.04%				
Concluded After-Tax Cost of Debt		**3.21%**			
Selected Yields and Interest Rates					
Rates as of 12/01/2015					
Prime Rate			3.25%		
5-Year Treasury Rates			1.59%		
10-Year Treasury Rates			2.15%		
20-year Treasury Rates			2.55%		
Moody's Aaa			3.92%		
Baa			5.36%		

(1) Long-horizon expected equity risk premium recommended by Duff & Phelps 2015 Valuation Handbook
(2)Estimated based on Duff & Phelps 2015 Valuation Handbook - Guide to Cost of Capital

Reversionary Capitalization Rate

To estimate the value of the cash flows beyond the forecast period (the terminal value), the Gordon-Shapiro growth model was applied. This model incorporates a capitalization rate equivalent to the WACC less the anticipated growth rate into perpetuity. The following formula is applied:

Terminal Value = Terminal Year Cash Flow ÷ (WACC - Perpetual Growth Rate)

For the subject property we applied a 2.5% perpetual growth rate. This rate gave consideration to management's expectations of the long-term, market conditions, demographics, inflations, and demand for services, technological changes, and real growth prospects in the industry.

Present Value of Cash Flows and Value

Gross cash flow is equal to debt-free net income plus depreciation. Net cash flow is the difference between gross cash flow and reinvestment in fixed assets and incremental net working capital, and represents the amount of cash available to service debt and to provide a return on a willing buyer's investment. Net cash flows for the five-year projection period were discounted to present value based on the indicated discount rate. The present worth factors were calculated on a midterm basis to reflect the receipt of funds throughout the course of each year of the projection. The sum of the present worth of the net cash flows over the projected period represents the interim value of the business enterprise. Because the Subject will continue to generate earnings beyond the projected period a terminal value was calculated. The terminal stabilized net cash flows were discounted to present worth and capitalized at a growth-adjusted rate of return.

The discounted cash flow model for the subject property is detailed on the following page:

Discounted Cash Flow Tri-Cities Surgery Center							
		Year 1 Budget	Year 2 Projected	Year 3 Projected	Year 4 Projected	Year 5 Projected	Reversion
Case Volume		6,000	6,300	6,900	7,000	7,000	7,000
Average Collection per Procedure		$ 1,035	$ 1,061	$ 1,087	$ 1,115	$ 1,142	$ 1,171
Growth		-6.9%	2.5%	2.5%	2.5%	2.5%	2.5%
Net revenue		$ 6,210,000	$ 6,683,513	$ 7,503,038	$ 7,802,073	$ 7,997,124	$ 8,197,053
Growth		-19.8%	7.6%	12.3%	4.0%	2.5%	2.5%
OPERATING EXPENSES							
Salaries &Wages	v	$ 1,987,200	$ 2,071,889	$ 2,100,851	$ 2,184,580	$ 2,239,195	$ 2,295,175
Materials & Supplies	v	1,055,700	1,136,197	1,275,517	1,326,352	1,359,511	1,393,499
Employee Benefits	v	218,592	227,908	231,094	240,304	246,311	252,469
Utilities	f	297,057	304,483	312,096	319,898	327,895	336,093
Outside Services	f	186,392	191,052	195,828	200,724	205,742	210,885
Payroll Taxes	v	168,912	176,111	178,572	185,689	190,332	195,090
Professional Fees	f	194,534	199,397	204,382	209,492	214,729	220,097
Equipment Rental (GI Labs)	f	180,000	184,500	189,113	193,840	198,686	203,653
Insurance	f	102,344	104,903	107,525	110,213	112,969	115,793
Repairs & Maintenance	f	100,901	103,424	106,009	108,659	111,376	114,160
Real Estate Taxes	f	66,389	68,049	69,750	71,494	73,281	75,113
Rent (land lease)	f	30,161	30,915	31,688	32,480	33,292	34,124
Other Expenses	f	196,189	201,094	206,121	211,274	216,556	221,970
Subtotal		4,784,371	4,999,921	5,208,545	5,395,000	5,529,875	5,668,122
Depreciation/Amortization	f	117,215	120,145	123,149	126,228	129,383	132,618
Interest Expense		-	-	-	-	-	-
Total Operating Expense		$ 4,901,586	$ 5,120,066	$ 5,331,694	$ 5,521,228	$ 5,659,259	$ 5,800,740
Gain/(Loss) from Operations		$ 1,308,414	$ 1,563,447	$ 2,171,345	$ 2,280,845	$ 2,337,866	$ 2,396,312
Total Non-Operating Income		-	-	-	-	-	-
Excess of revenue over expenses		$ 1,308,414	$ 1,563,447	$ 2,171,345	$ 2,280,845	$ 2,337,866	$ 2,396,312
Operating EBITDA		$ 1,425,629	$ 1,683,592	$ 2,294,494	$ 2,407,072	$ 2,467,249	$ 2,528,930
Operating EBITDA Margin		*23.0%*	*25.2%*	*30.6%*	*30.9%*	*30.9%*	*30.9%*
EBIT		$ 1,308,414	$ 1,563,447	$ 2,171,345	$ 2,280,845	$ 2,337,866	$ 2,396,312

Discounted Cash Flow Tri-Cities Surgery Center

Discount Rate	11.00%					
Effective Corporate Tax Rate in U.S, IL	40.04%					
Normal Debt Free Net Working Capital as % of Reve	11.00%					
Perpetuity Growth Rate	2.50%					
	Year 1 Budget	Year 2 Projected	Year 3 Projected	Year 4 Projected	Year 5 Projected	Reversion
NET INCOME FOR DISCOUNTING (EBIT)	$ 1,308,414	$ 1,563,447	$ 2,171,345	$ 2,280,845	$ 2,337,866	$ 2,396,312
ESTIMATED INCOME TAXES	523,889	626,004	869,406	913,250	936,081	959,483
NET INCOME	**$ 784,525**	**$ 937,443**	**$ 1,301,938**	**$ 1,367,594**	**$ 1,401,784**	**$ 1,436,829**
Less Incremental Working Capital	$ 173,611	$ (52,086)	$ (90,148)	$ (32,894)	$ (21,456)	$ (21,992)
Less Capital Expenditures	(117,215)	(120,145)	(123,149)	(126,228)	(129,383)	(132,618)
Plus Depreciation	117,215	120,145	123,149	126,228	129,383	132,618
Cash Flow to Discount	$ 958,136	$ 885,356	$ 1,211,790	$ 1,334,701	$ 1,380,329	$ 1,414,837
Discount Periods	0.50	1.50	2.50	3.50	4.50	
Present Value Factor	0.9492	0.8551	0.7704	0.6940	0.6252	
Present Value of Periodic Cash Flows	$ 909,422	$ 757,066	$ 933,512	$ 926,304	$ 863,036	
Sum of PV Periodic Cash Flows		$ 4,389,340				
Perpetuity Value	$ 16,645,139					
PV of Perpetuity Value		$ 10,407,203				
Business Enterprise Value Before Adjustments		**$ 14,796,543**				
Adjustments to Value:						
Less: Market Required Working Capital Balance		$ (851,591)				
Add: Actual Net Working Capital Balance		1,372,224				
Excess/(Deficit) Working Capital		$ 520,633				
Business Enterprise Value After Adjustments		**$ 15,317,176**				
Rounded Value		**$ 15,320,000**				

Income Approach Conclusion

Based upon the above analysis, the Income Approach results in a concluded business enterprise value of $15,320,000.

MARKET APPROACH

Guideline Company Method

The guideline company method of the market approach provides an indication of value for the appraised Company by relating the equity or invested capital (debt plus equity) of guideline companies to various measures of their earnings and cash flow, then applying such multiples to the businesses being appraised.

The guideline company method is based upon a comparison of the subject property with financial results with those of similar enterprises. The guideline company method to value uses the near-term and current relationships of the market prices of the publicly-traded securities of guideline companies to the various measures of their earning power. In other words, the guideline company method makes use of market price data of stocks of corporations engaged in the same or a similar line of business as those of the subject companies. Stocks of these corporations are actively traded in a public, free, and open market, either on an exchange or over the counter.

In estimating the value for the subject property we deemed three publicly-traded companies as being in similar lines of business as Independent Surgery: Universal Health Services (UHS); Tenet Healthcare Corp (THC); Community Health Systems, Inc. (CYH); HCA Holdings, Inc. (HCA); Lifepoint Hospitals Inc. (LPNT), and AmSurg Corp. (AMSG). The guideline companies' overall adjusted market capitalization value including long-term debt ranged from a low of $6.3 billion to $66.0 billion. Total revenues of the organizations ranged from a low of $2.4 billion to $39.1 billion.

Although no two companies are entirely alike, the six companies chosen are in similar lines of business as the subject property. Though these companies were chosen because of the business lines served additional consideration is given to the relative size of the companies, the diversities of the markets served, the historical and predicted growth patterns of the organizations and other factors that have an effect on value. AmSurg Corp. is the most similar to the subject because it has more of a focus on surgery centers rather than whole hospital systems.

In using the data abstracted from the market place adjustments have to be made to the data to be comparable to the subject property. The stock prices reported for publicly traded companies are based upon prices paid for minority share holdings in a business. Therefore a control premium was incorporated into the valuations to reflect the value based upon a marketable, majority basis. The control premium is the amount that a buyer is willing to pay above the current market price for a controlling interest in the company. The premium reflects the buyer's ability to set policies, direct operations, and otherwise manage a business. The control premium is industry specific and typically amounts to 20% to 40% of the market capitalization. However, control premium studies report transactional price premiums rather than actual ownership control premiums. The transaction premiums, in addition to reflecting the control premium, reflect other variables such as anticipated synergies and perceptions regarding price to earnings ratios in the market place. Therefore, the control premium utilized in the current analysis is at the lower end of the range and equals 20%.

The chart at the end of this section summarizes our analysis with respect to this approach. The chart demonstrates that the average Revenue multiple (Enterprise Value/Revenue) for the guideline companies was equal to 1.77 and the median was 1.46. The chart demonstrates that the average EBITDA multiple of the guideline companies (Enterprise Value/EBITDA) was equal to 9.88 and the median multiple was 9.71. The Subject had an EBITDA margin of 33.64% which is above the range of the guideline companies with EBITDA margins ranging from 10.76% to 29.96% with an average of 17.28% and a median of 16.70%. The Subject's EBITDA margin is most similar to that of AmSurg Corp which had an EBITDA margin of 26.96%.

Though there are significant differences in many aspects of the companies chosen to compare to the subject, prudent investors contemplating the purchase of the subject's business lines would consider all or some of these companies as alternative investment opportunities. Adjustments to the guideline company multiples based on a comparison to the subject would be made on a number of factors. We believe that some of the primary criteria that would impact the value of the subject in comparison to the group of guideline companies studied would be the size of the companies, the diversity of the markets served, and the relative EBITDA margins of the entities. Though we do not believe, due to the limited size of the sample, that direct quantitative adjustments can be derived, we believe that based upon a consideration of the overall qualitative factors that an overall adjustment can be made to the guideline companies to arrive at a reasonable fair market value for the subject property. Based on the overall size of the Subject in comparison to the guideline companies and the expected decline in revenue and EBITDA, a 30% adjustment was made to the average multiples. Due to the higher margin of the Subject in comparison to the guideline companies, the revenue multiple was only adjusted by 20%.

A market level of working capital was subtracted and the actual working capital balance was added to the results.

Based upon a consideration of these factors, the overall value for the Subject would be equal to $16,860,000 (rounded), based on the guideline company approach.

Our conclusions are shown in the tables on the following page.

Company Name	Share Price 12/1/2015	Adjusted Equity Value[1]	Adjusted Enterprise Value	% Debt	Revenues	EBITDA	Debt Free NWC	% Debt Free NWC	Beta	EBITDA Margin	Revenue Multiple	EBITDA Multiple
Universal Health Services Inc. (UHS)	$ 125.33	13,714,611,240	17,134,423,240	20.84%	8,764,741,000	1,653,704,000	585,241,000	6.68%	0.90	18.87%	1.95	10.36
Tenet Healthcare Corp. (THC)	$ 34.94	4,178,963,760	19,148,963,760	79.96%	18,085,000,000	1,946,000,000	2,315,000,000	12.80%	10.88	10.76%	1.06	9.84
Community Health Systems, Inc. (CYH)	$ 29.80	4,226,474,400	22,042,474,400	79.14%	19,557,000,000	2,841,000,000	2,638,000,000	13.49%	0.18	14.53%	1.13	7.76
HCA Holdings, Inc. (HCA)	$ 71.16	34,811,756,640	66,045,756,640	49.39%	39,065,000,000	7,727,000,000	4,285,000,000	10.97%	0.53	19.78%	1.69	8.55
LifePoint Health, Inc. (LPNT)	$ 73.50	3,839,346,000	6,264,846,000	39.22%	5,106,500,000	654,000,000	715,500,000	14.01%	0.77	12.81%	1.23	9.58
AmSurg Corp. (AMSG)	$ 82.14	5,318,729,280	8,682,192,280	28.87%	2,444,433,000	658,981,000	221,904,000	9.08%	0.39	26.96%	3.55	13.18
HIGH:			$66,045,756,640	79.96%	$39,065,000,000			14.01%	10.88	26.96%	3.55	13.18
LOW:			$6,264,846,000	20.84%	$2,444,433,000			6.68%	0.18	10.76%	1.06	7.76
AVERAGE:				49.57%				11.17%	2.28	17.28%	1.77	9.88
MEDIAN:				44.30%				11.88%	0.65	16.70%	1.46	9.71

(1) Adjusted upward 20% to account for a control premium

Qualitative Comparisons (Subject Compared to Market Comparables as a Group

Tri-Cities Surgery Center 33.64%

Unit of Comparison	Status	Adjustment
Size of Company	Inferior	Downward
Diversity of Market Served	Inferior	Downward
EBITDA Margin	Superior	Upward
Overall Adjustment	**Downward**	

Tri-Cities Surgery Center

Description	Revenues	EBITDA
Adjustment	**-20%**	**-30%**
Adjusted Multiple*	**1.415**	**6.914**
Subject Comparable Units	**$ 7,788,278**	**$ 2,619,730**
Value Indication	**$ 11,017,993**	**$ 18,112,540**
Weighting	25%	75%
Total Asset Value as Unencumbered and assuming market based working capital (Rounded)	**$16,340,000**	
Market Required Working Capital Balance	$ (851,591)	
Actual Working Capital Balance	$ 1,372,224	
Less Deficient (Excess) Working Capital	**$ 520,633**	
Overall Value Rounded	**$16,860,000**	

Guideline Transactions Method

The guideline transaction method of the market approach provides an indication of value for the appraised entities by relating the value of the invested capital (equity and interest-bearing debt) of guideline companies, based on market transactions, to various measures of their earnings and revenues, then applying such multiples to the businesses being appraised.

The guideline transaction method is a useful indication of value involving actual acquisitions of individual surgery centers in the public market. The basic methodology of the guideline transaction method is deriving market multiples from the prices at which entire companies are being acquired in the marketplace.

In researching transaction data we primarily relied upon data contained in the *Health Care Acquisition Report, Eighteen through Twenty-First Editions; 2012-2015;* published by Irving Levin Associates, Inc. Irving Levin Associates has been charting and gathering data on healthcare transactions for the past twenty years. The data is based upon both announced and closed transaction data. It should be noted that the actual purchase considerations paid often do not match up directly against the published data. We find, though, that this data does represent a good general indication of prices found in the marketplace.

Based upon our knowledge of the published sales we generally find that the data found in the report does not reflect consideration for working capital assets or excess assets associated with a sale of a business.

The data is summarized in the following chart.

Announcement Date	Seller	State	Consideration	Revenue Multiple	EBITDA Multiple	Revenue	EBITDA	EBITDA Margin
03/07/12	Outpatient surgery center	Texas				$12,000,000	$5,000,000	41.7%
01/20/11	Constitution Eye Surgery Center, LLC.	Connecticut	$27,500,000	1.93	5.17	$14,232,000	$5,322,000	37.4%
01/21/11	NovaMed, Inc.	Illinois	$214,000,000	1.38	5.10	$155,000,000	$42,000,000	27.1%
04/07/11	National Surgical Care	Texas	$173,500,000	1.39	8.07	$124,500,000	$21,500,000	17.3%
11/01/11	Kentucky Lake Surgery Center, LLC	Tennessee	$7,000,000		14.00		$500,000	
			Low	1.38	5.10	$12,000,000	$500,000	17.3%
			High	1.93	14.00	$155,000,000	$42,000,000	41.7%
			Mean	1.57	8.08	$76,433,000	$14,864,400	30.9%
			Median	1.39	6.62	$69,366,000	$5,322,000	32.2%

Attachment Response 10

Transactions	Revenue Multiple	EBITDA Multiple	EBITDA Margin	Revenue
Low	1.38	5.10	17.3%	$12,000,000
High	1.93	14.00	41.7%	$155,000,000
Mean	1.57	8.08	30.9%	$76,433,000
Median	1.39	6.62	32.2%	$69,366,000

Tri-Cities Surgery Center, LLC

	Revenue	EBITDA	EBITDA Margin
FY 2014	$ 7,788,278	$ 2,619,730	33.6%
Selected Multiple	1.40	6.0	
Indications	$ 10,903,589	$ 15,718,380	
Weights	50.0%	50.0%	
Weighted Conclusion	**$ 13,310,985**		
Indicated Value			**$ 13,310,985**
Debt-free Net Working Capital			$ 1,372,224
Overall Value (Rounded)			**$ 14,680,000**

We found five transactions that involved sales of surgery centers that could establish some reasonable valuation benchmarks for the Subject. These sales indicated an overall revenue multiple range from 1.38 to 1.93 with the mean of 1.57 and a median of 1.39. These sales indicated an overall EBITDA multiple range from 5.10 to 14.00 with a mean of 8.08 and a median of 6.62.

The Subject had an EBITDA margin of 33.6% for the fiscal year 2014, which is slightly above the EBITDA margin of the transacted companies with an average of 30.9% and a median of 32.2%. The Subject's EBITDA margin is expected to decline to 23.0% in Year 1 of the projection which is less than the median and average of the transactions, but the EBITDA margin is expected to recover and stabilize at 30.9%, which is similar to the transactions.

Multiples similar to the medians were utilized in applying the approach to the fiscal 2014 data.

Weighting the EBITDA multiple at 50% and the revenue multiple at 50%, results in an indicated value of $13,310,985. Working capital is generally not included in the comparable data, as a result it is added to the conclusion. After adjusting for working capital transferred, the business enterprise value of the Subject was indicated at $14,680,000.

Market Approach Conclusion

Giving consideration to both the Guideline Company and Guideline Transaction approach yields a value range from $14,680,000 to $16,860,000. Since limited information is provided about the overall assets transferred in the Guideline Transaction approach, in particular working capital assets, we tend to place primary reliance upon the Guideline Company Approach (weighted 75%) and accordingly have estimated the operating value of the enterprise under the market approach at $16,315,000.

SECTION 6. VALUE CONCLUSION

RECONCILIATION OF VALUE

Each valuation approach was reviewed to: (a) to ascertain the reliability of the data; (b) to ascertain which approach best represents the value of the target entity; and (c) to determine which approach best represents the actions of typical investors in the marketplace.

The Income Approach is generally given the greatest weight in Fair Market Valuations as it incorporates the excess earnings of the business. The Income Approach is valuable as it is tailored to reflect the specific operations of the subject company. If significant weight is given to the Income Approach, the Market Approach is used to confirm the valuation range.

The Market Approach is a useful indication of value; however it reflects an estimate of value based upon the valuations of other comparable companies. Therefore, it does not reflect the projected excess earnings capabilities and operating characteristics of the subject company. Therefore, if adequate data is available, the Income Approach is typically given deference over the Market Approach.

The concluded enterprise value is in a range determined by the Income & Market Approaches to value.

The overall conclusion for the Subject's business enterprise value is reasonably represented in the rounded amount of:

$15,320,000 to $16,315,000

Discounted Cash Flow Approach		$15,320,000
Market Based Approaches		$16,315,000
Public Company Approach	$16,860,000	
Transaction Approach	$14,680,000	
Total Business Enterprise Value (Rounded)	**$15,320,000 to**	**$16,315,000**

ADJUSTMENTS TO BUSINESS ENTERPRISE VALUE DERIVED

In order to establish the equity value of the Center, adjustments for the long term debt of the subject and any excess assets have to be made to the overall business value derived.

The long-term debt of the Subject property was equal to $41,515 as of September 30, 2015.

We also gave consideration for any excess assets. Based on our conversations with management we have determined that no excess assets exist, above those included in working capital.

The total equity value on a marketable control basis is reasonably represented in the rounded amount of $15,280,000 to $16,270,000 as shown in the table below:

Tri-Cities Surgery Center, LLC Summary and Conclusion			
Total Business Enterprise Value (Rounded)	**$15,320,000**	**to**	**$16,315,000**
Less: Debt/Other Liabilities	**$41,515**		**$41,515**
Majority Stockholders' Equity Value (100%)	**$15,280,000**	**to**	**$16,270,000**
50% Interest (based off of the majority value)	**$7,640,000**	**to**	**$8,135,000**

Based upon the results of our analysis, the fair market value of 100% of the stockholders' equity of Tri-Cities Surgery Center, LLC, on a majority interest basis, as of December 1, 2015, is reasonably represented in the range of:

FIFTEEN MILLION TWO HUNDRED EIGHTY THOUSAND DOLLARS
TO
SIXTEEN MILLION TWO HUNDRED SEVENTY THOUSAND DOLLARS

$15,280,000 to $16,270,000

Based upon the results of our analysis, the fair market value of a 50% interest in the stockholders' equity of Tri-Cities Surgery Center, LLC, on a majority interest basis, as of December 1, 2015, is reasonably represented in the range of:

SEVEN MILLION SIX HUNDRED FORTY THOUSAND DOLLARS
TO
EIGHT MILLION ONE HUNDRED THIRTY-FIVE THOUSAND DOLLARS

$7,640,000 to $8,135,000

The valuation assumes that a working capital balance of $1,372,224 is present and available. Should this balance significantly fall or increase an overall adjustment to our estimates may be warranted.

APPENDICES

ASSUMPTIONS AND LIMITING CONDITIONS

We strive to clearly and accurately disclose the assumptions, and limiting conditions that directly affect a valuation analysis, opinion, or conclusion. The appraisal report will be made with the following general assumptions and limiting conditions:

No opinion is expressed for matters that require legal expertise, specialized investigation or knowledge beyond that customarily employed by valuation industry standard. No investigation has been made of, and no responsibility is assumed for, the legal description or legal matters related to the asset(s) being valued, including title or encumbrances. Title to the asset(s) is assumed to be good and marketable unless otherwise stated. The asset(s) is (are) assumed to be free and clear of any liens, easements or encumbrances unless otherwise stated.

Information furnished by others, upon which all or portions of this appraisal are based, is believed to be reliable, but has not been verified in all cases. No warranty is given as to the accuracy of such information.

Use of the valuation report for another purpose other than that which has been defined in the report could result in inaccurate or inappropriate conclusions.

Neither this report nor any portions thereof including, without limitations, any conclusions as to value, the identity of Principle Valuation or any individuals signing or associated with this report, or the professional associations or organizations with which they are affiliated shall be disseminated to third parties by any means or included or referred to in any Securities and Exchange Commission filing or other public document without the prior written consent and approval of Principle Valuation.

Any forecasts of income and expenses are not predictions of the future. Rather, they are our best estimates of current market and management thinking on future income and expenses. We make no warranty or representation that these forecasts will materialize. In addition, it is understood that through this valuation, you accept and take responsibility for any such projections as being realistic and reflective of market conditions as of the valuation date. Additionally, it is understood that such projections represent your realistic projections. The real estate and healthcare markets are constantly fluctuating and changing. It is not our task to predict or in any way warrant the conditions of a future market; we can only reflect what the investment community, as of the date of the engagement, envisions for the future in terms of rates, expenses, and supply and demand.

The valuation estimates are based on the status of the local business economy and the purchasing power of the dollar as of the date of the valuation report, unless otherwise stated in the report.

Valuation assignments are accepted with the understanding that there is no obligation to furnish services after completion of the original assignment. If the need for subsequent services related to a valuation assignment is contemplated, special arrangements acceptable to Principle Valuation can be made under separate agreement.

We are not required to give testimony in court with reference to the valuation or the report, unless otherwise previously arranged. If required to give such testimony or produce documents for the court on matters related to this engagement, you agree to reasonably compensate us for such services. These services and other additional services provided beyond the scope of the engagement letter will be billed separately.

We reserve the right to make adjustments to the analyses, opinions and conclusions set forth in this report as it may deem necessary by consideration of additional or more reliable data that may become available.

However, we have no responsibility to update the report for events and circumstances occurring after the report date.

It is assumed that all required licenses, certificates of occupancy, consents, or other legislative or administrative authority from any local, state, or national, government or private entity or organization have been, or can readily be, obtained or renewed for any use on which the value estimate contained in this report is based.

Full compliance with all applicable federal, state and local zoning, use, environmental and similar laws and regulations is assumed, unless otherwise stated.

Responsible ownership and competent property management are assumed.

Unless otherwise stated in the report, we have no knowledge of the existence of hazardous material on, or in, the property; however, we are not qualified to detect such substances. The presence of potentially hazardous substances such as asbestos, urea-formaldehyde foam insulation, or industrial wastes may affect the value of the property. The value estimate herein is predicated on the assumption that there is no such material on, in, or near the property that would cause a loss in value. No responsibility is assumed for any such conditions or for any expertise or engineering knowledge required to discover them. The client should retain an expert in this field if further information is desired.

Unless otherwise stated in the report, compliance with the requirements of the Americans with Disabilities Act of 1990 (ADA) has not been considered in arriving at the opinion of value. Failure to comply with the requirements of the ADA may adversely affect the valuation. You may wish to obtain an expert in this field.

Our description and valuation of the improvements, including, but not limited to the heating, plumbing, and electrical systems is based on the assumption that they will be in normal working condition; no liability is assumed for the soundness of any structural member.

This is an Appraisal Report. All supporting documentation concerning the data, reasoning, and analyses is retained in the appraiser's file. The information contained in this report is specific to the needs of the client and for the intended use stated in this report.

Certification

We certify to the best of our knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, unbiased professional analyses, opinions, and conclusions.
- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest with respect to the parties involved.
- I have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.
- My engagement in this assignment was not contingent upon development or reporting predetermined results.
- My compensation for completing this assignment is not contingent upon the development or reporting of a predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal.
- My analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the *Uniform Standards of Professional Appraisal Practice*.
- I have not made a personal inspection of the property that is the subject of this report.
- I have appraised the property as of March 31, 2013 for internal planning and the potential sale of a 50% interest. This is the only appraisal prepared by Principle Valuation of the property in the past three years.

Patrick J. Simers
Executive Vice President
Florida Certified General Real Estate Appraiser License #RZ3581

Sally Domijan

PATRICK J. SIMERS
EXECUTIVE VICE PRESIDENT

EXPERIENCE

Mr. Simers has extensive experience in serving the valuation needs of the health-care industry. He has valued all tangible and intangible assets associated with health-care enterprises, including the capital stock of majority and minority share holdings; medical specialty and physician joint ventures; fee simple, leased fee, and leasehold interests in real estate for hospital systems, stand-alone hospital campuses, and medical office buildings; major and minor movable equipment; certificates of need; contractual agreements; and preferred provider arrangements.

Specific healthcare enterprises appraised include acute care hospital facilities, LTACH hospitals, psychiatric hospitals, rehab hospital facilities, single physician practices, multi-specialty practices, cath labs, diagnostic centers, cardiac care practices, home health agencies, nursing homes, assisted living facilities, and medical office buildings.

Mr. Simers has performed fair market value studies for purchase, sale, or financing; merger and acquisition consulting; negotiation of purchase price; fairness opinions; purchase price allocations; financial reporting; SEC reporting; Medicare regulatory requirements; Safe Harbor requirements; and 501(c)(3) private placement offerings.

PROFESSIONAL HISTORY

Mr. Simers began his appraisal career with Valuation Counselors in 1982 and held various consulting, business development, and management roles, including four years as president of Valuation Counselors, leading up to its merger with CBIZ Inc. Most recently, Mr. Simers has served as the National Director for Healthcare services for American Appraisal Associates where he spear-headed the development of healthcare services for this international appraisal firm.

Patrick J. Simers is Executive Vice President for Principle Valuation. He is responsible for the development and overall business plan for Principle's consulting and appraisal services to for-profit, nonprofit, and public health-care providers. Mr. Simers is located in Principle Valuation's Atlanta office.

PROFESSIONAL AFFILIATIONS

- American Health Lawyers Association
- Healthcare Financial Management Association

EDUCATION LICENSES, AND DESIGNATIONS

- Graduate of Northern Illinois University with a Bachelor of Science in Finance and Economics
- Graduate of Moraine Valley College with an Associate in Arts in Business Administration
- Certified General Real Estate Appraiser in Georgia
- Certified General Real Estate Appraiser in Florida (#RZ3581)

SALLY M. DOMIJAN

EXPERIENCE

Ms. Domijan has experience in the valuation of business enterprises, majority and minority capital stock interests in privately held companies, intangible assets, preferred stock, restricted stock, and options. In addition she has completed valuations for acquisitions, corporate planning, financial accounting, employee stock ownership plans, fairness opinions, divorce litigation, possible sale, and estate planning purposes.

She has experience valuing a variety of business assets including: trade names, assembled workforce, computer software, medical records, Certificates of Need, noncompete agreements, and specific technologies. She has specialized experience in performing healthcare valuations, including those for hospital systems, ambulatory surgical centers, diagnostic imaging centers, physician practices, clinical labs, healthcare information systems, inpatient and outpatient rehabilitation centers, dialysis centers, home health agencies, medical device companies, HMOs/PPOs, and medical supply companies.

PROFESSIONAL HISTORY

Ms. Domijan is in the Financial Valuation department for Principle Valuation. She has over 20 years in the valuation industry, formerly as a Director of Financial Valuations with American Appraisal, as Director of Financial Valuations with L.T. Annum Appraisal Services, Inc., and a Manager at CBIZ Valuation Group (formerly Valuation Counselors). Prior to that she was a financial analyst in the savings and loan industry.

PROFESSIONAL AFFILIATIONS

- CFA Institute
- CFA Society, Chicago

EDUCATION LICENSES, AND DESIGNATIONS

- University of Illinois at Chicago, Master of Business Administration with a specialization in finance and economics
- Miami University, Oxford, Ohio, Bachelor of Science with a concentration in accounting and finance
- Chartered Financial Analyst

TESTIMONY

- Ms. Domijan has presented testimony as an expert witness in Divorce Court in Cook County. Ms. Domijan has been deposed on valuation matters.

11. DATE OF PROPOSED TRANSACTION.

The proposed agreement finalization with Tri-Cities Physician Group, LLC will occur on or before June 1, 2016. Delnor Community Hospital will immediately assume 100% ownership and full operating responsibilities at that time. Subsequent to the approval of the Change of Ownership Exemption application, Delnor Community Hospital intends to seek approval of the discontinuation of the Ambulatory Surgical Treatment Center license held by Tri-Cities Surgery Center, LLC, so as to operate the facility as an extension of the Hospital's surgical services department. In the interim, Tri-Cities Surgery Center, LLC, under Hospital ownership, will continue to be operated as a licensed ASTC.

12. NARRATIVE DESCRIPTION. Provide a narrative description explaining the transaction.

On June 15, 2004, the HFSRB approved Project #04-055 for the establishment of Tri-Cities Surgery Center, LLC, a multi-specialty ASTC in Geneva, immediately adjacent to Delnor Community Hospital (Delnor). The ASTC is a joint venture between Delnor and participating physicians. Currently, 50% of the membership interest in Tri-Cities Surgery Center, LLC is owned by DelCom Corporation, a wholly-owned subsidiary of CDH-Delnor Health System and 50% is owned by Tri-Cities Physician Group, LLC which is comprised of 29 physician shareholders.

Northwestern Memorial HealthCare seeks approval of this Certificate of Exemption (COE) to allow Delnor Community Hospital to acquire 100% of the ASTC. If approved, Delnor will purchase 50% of the membership interest from Tri-Cities Physician Group, LLC and 50% of the membership interest from DelCom Corporation. At the end of the transaction, Tri-Cities Surgery Center will be a wholly owned corporation of Delnor. Subsequent to this transaction, Delnor intends to seek approval of the discontinuation of the Ambulatory Surgical Treatment Center license held by Tri-Cities Surgery Center, LLC, so as to operate the facility as an extension of the Hospital's surgical services department. In the interim, Tri-Cities Surgery Center, LLC, under Hospital ownership, will continue to be operated as a licensed ASTC.

By becoming the sole owner of Tri-Cities Surgery Center, Delnor's charity care policy and non-profit mission would be in place for Tri-Cities Surgery Center patients. Patients who meet Delnor's charity care guidelines will be provided care regardless of their ability to pay. In addition, Tri-Cities Surgery Center would be in compliance with all regulatory and JCAHO standards that are required.

Background

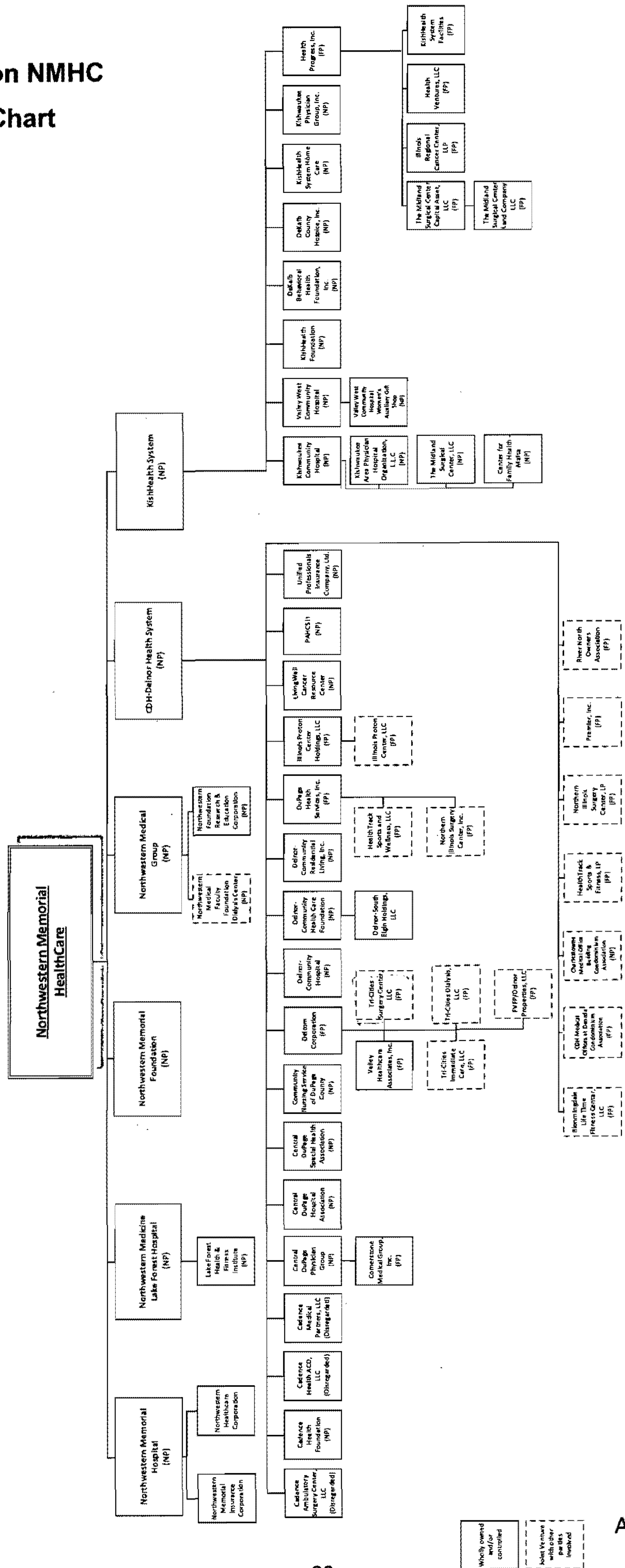
Northwestern Medicine is the collaboration between Northwestern Memorial HealthCare and Northwestern University Feinberg School of Medicine around a strategic vision to transform the future of healthcare. It encompasses the research, teaching, and patient care activities of the academic medical center.

Northwestern Memorial HealthCare

Northwestern Memorial HealthCare is the parent company of a premier not-for-profit health system primarily serving Cook, Lake, DuPage, Kane, DeKalb, Kendall, and LaSalle Counties, Illinois and surrounding areas, which includes Northwestern Memorial Hospital, Lake Forest Hospital, CDH-Delnor Health System (Central DuPage Hospital and Delnor Community Hospital), KishHealth System (Kishwaukee Community Hospital and Valley West Community Hospital), Northwestern Medical Group, and Northwestern Memorial Foundation.

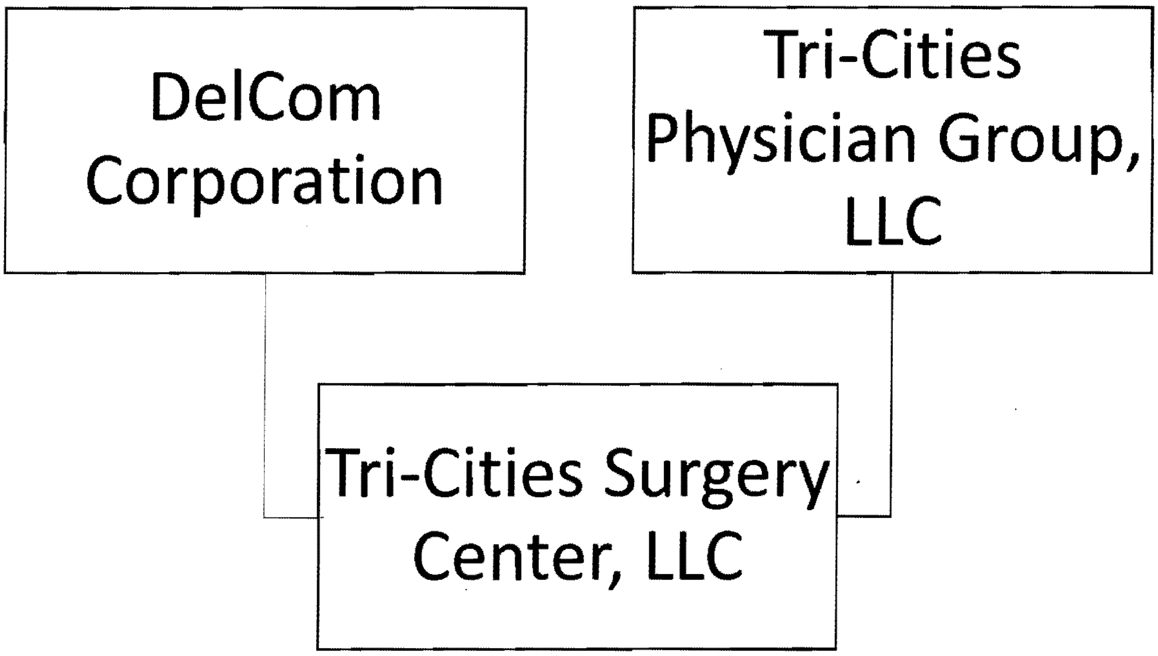
Delnor Community Hospital, located in Geneva, IL, is a 159-bed acute care facility with a medical staff of over 500 physicians in 80 specialties providing comprehensive medical care.

Pre-Transaction NMHC
Organization Chart

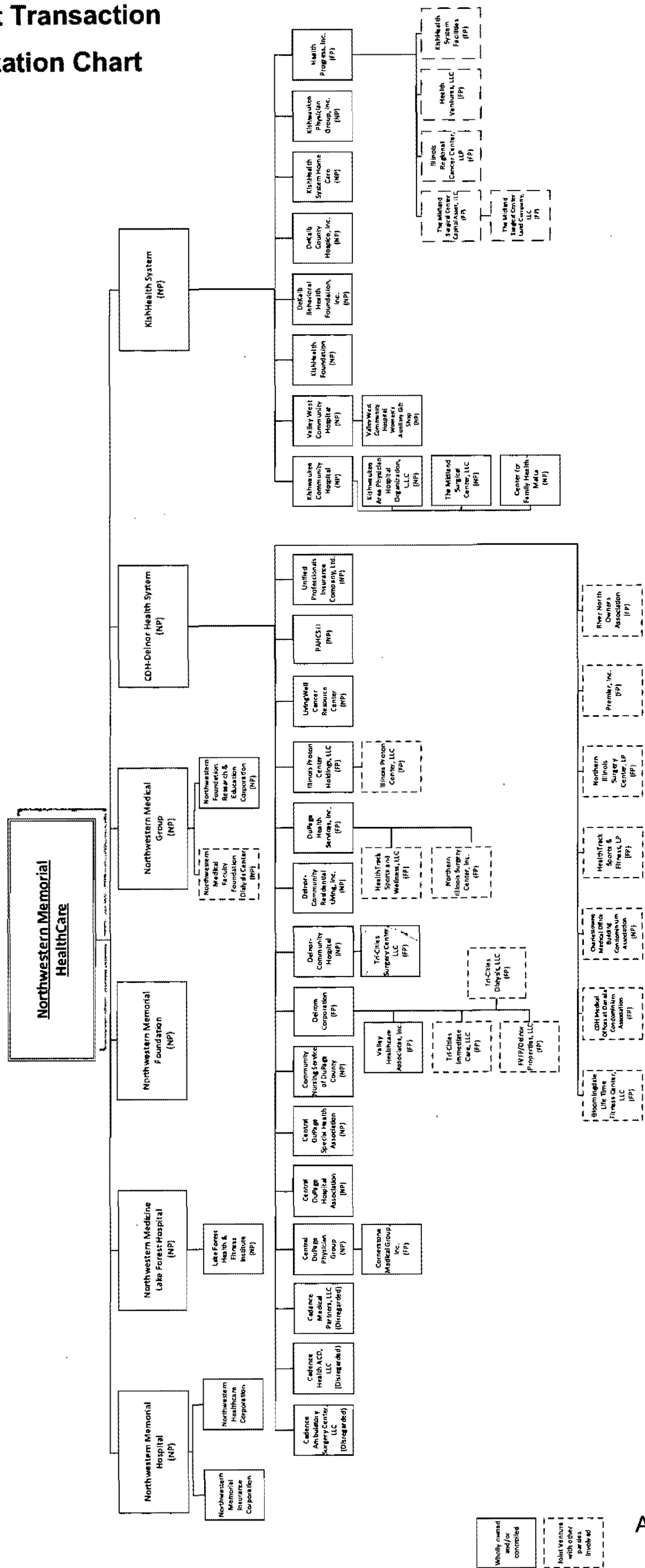


ATTACHMENT #3
Attachment Response 12

Tri-Cities Surgery Center Pre-Transaction Organization Chart



Proposed Post Transaction
NMHC Organization Chart



ATTACHMENT #3
Attachment Response 12

File Number 5257-740-3

STATE OF ILLINOIS

OFFICE OF THE SECRETARY OF STATE

To all to whom these Presents Shall Come, Greeting:

I, Jesse White, Secretary of State of the State of Illinois, do hereby certify that I am the keeper of the records of the Department of Business Services. I certify that

NORTHWESTERN MEMORIAL HEALTHCARE, A DOMESTIC CORPORATION, INCORPORATED UNDER THE LAWS OF THIS STATE ON NOVEMBER 30, 1981, APPEARS TO HAVE COMPLIED WITH ALL THE PROVISIONS OF THE GENERAL NOT FOR PROFIT CORPORATION ACT OF THIS STATE, AND AS OF THIS DATE, IS IN GOOD STANDING AS A DOMESTIC CORPORATION IN THE STATE OF ILLINOIS.

In Testimony Whereof, *I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois, this* 21ST *day of* JULY *A.D.* 2015 .

Authentication #: 1520201406 verifiable until 07/21/2016

Authenticate at: http://www.cyberdriveillinois.com

Jesse White

SECRETARY OF STATE

ATTACHMENT #4

Attachment Response 13

File Number 5217-963-7

STATE OF ILLINOIS

OFFICE OF THE SECRETARY OF STATE

To all to whom these Presents Shall Come, Greeting:

I, Jesse White, Secretary of State of the State of Illinois, do hereby certify that I am the keeper of the records of the Department of Business Services. I certify that

CDH-DELNOR HEALTH SYSTEM, A DOMESTIC CORPORATION, INCORPORATED UNDER THE LAWS OF THIS STATE ON OCTOBER 03, 1980, APPEARS TO HAVE COMPLIED WITH ALL THE PROVISIONS OF THE GENERAL NOT FOR PROFIT CORPORATION ACT OF THIS STATE, AND AS OF THIS DATE, IS IN GOOD STANDING AS A DOMESTIC CORPORATION IN THE STATE OF ILLINOIS.

In Testimony Whereof, *I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois, this* 26TH *day of* JANUARY *A.D.* 2016 .

Jesse White

SECRETARY OF STATE

Authentication #: 1602602462 verifiable until 01/26/2017

Authenticate at: http://www.cyberdriveillinois.com

ATTACHMENT #4
Attachment Response 13

File Number 5432-979-2

STATE OF ILLINOIS

OFFICE OF THE SECRETARY OF STATE

To all to whom these Presents Shall Come, Greeting:

I, Jesse White, Secretary of State of the State of Illinois, do hereby certify that I am the keeper of the records of the Department of Business Services. I certify that

DELNOR-COMMUNITY HOSPITAL, A DOMESTIC CORPORATION, INCORPORATED UNDER THE LAWS OF THIS STATE ON JULY 29, 1986, APPEARS TO HAVE COMPLIED WITH ALL THE PROVISIONS OF THE GENERAL NOT FOR PROFIT CORPORATION ACT OF THIS STATE, AND AS OF THIS DATE, IS IN GOOD STANDING AS A DOMESTIC CORPORATION IN THE STATE OF ILLINOIS.

In Testimony Whereof, *I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois, this* 26TH *day of* JANUARY ***A.D.*** 2016 .

SEAL OF THE STATE OF ILLINOIS AUG. 26TH 1818

Authentication #: 1602602480 verifiable until 01/26/2017
Authenticate at: http://www.cyberdriveillinois.com

Jesse White

SECRETARY OF STATE

ATTACHMENT #4
Attachment Response 13

File Number 5358-434-9

STATE OF ILLINOIS
OFFICE OF THE SECRETARY OF STATE

To all to whom these Presents Shall Come, Greeting:

I, Jesse White, Secretary of State of the State of Illinois, do hereby certify that I am the keeper of the records of the Department of Business Services. I certify that

DELCOM CORPORATION, A DOMESTIC CORPORATION, INCORPORATED UNDER THE LAWS OF THIS STATE ON SEPTEMBER 13, 1984, APPEARS TO HAVE COMPLIED WITH ALL THE PROVISIONS OF THE BUSINESS CORPORATION ACT OF THIS STATE RELATING TO THE PAYMENT OF FRANCHISE TAXES, AND AS OF THIS DATE, IS IN GOOD STANDING AS A DOMESTIC CORPORATION IN THE STATE OF ILLINOIS.

In Testimony Whereof, *I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois, this* 26TH *day of* JANUARY ***A.D.*** 2016 .

SEAL OF THE STATE OF ILLINOIS AUG. 26TH 1818

Authentication #: 1602602498 verifiable until 01/26/2017
Authenticate at: http://www.cyberdriveillinois.com

Jesse White
SECRETARY OF STATE

ATTACHMENT #4
Attachment Response 13

File Number 0109577-3

STATE OF ILLINOIS
OFFICE OF THE SECRETARY OF STATE

To all to whom these Presents Shall Come, Greeting:

I, Jesse White, Secretary of State of the State of Illinois, do hereby certify that I am the keeper of the records of the Department of Business Services. I certify that

TRI-CITIES SURGERY CENTER, LLC, HAVING ORGANIZED IN THE STATE OF ILLINOIS ON JANUARY 21, 2004, APPEARS TO HAVE COMPLIED WITH ALL PROVISIONS OF THE LIMITED LIABILITY COMPANY ACT OF THIS STATE, AND AS OF THIS DATE IS IN GOOD STANDING AS A DOMESTIC LIMITED LIABILITY COMPANY IN THE STATE OF ILLINOIS.

SEAL OF THE STATE OF ILLINOIS AUG. 26TH 1818

In Testimony Whereof, *I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois, this* 26TH *day of* JANUARY *A.D.* 2016 .

Authentication #: 1602602510 verifiable until 01/26/2017
Authenticate at: http://www.cyberdriveillinois.com

Jesse White

SECRETARY OF STATE

ATTACHMENT #4
Attachment Response 13

File Number 0109026-7

STATE OF ILLINOIS

OFFICE OF THE SECRETARY OF STATE

To all to whom these Presents Shall Come, Greeting:

I, Jesse White, Secretary of State of the State of Illinois, do hereby certify that I am the keeper of the records of the Department of Business Services. I certify that

TRI-CITIES PHYSICIAN GROUP, LLC, HAVING ORGANIZED IN THE STATE OF ILLINOIS ON JANUARY 12, 2004, APPEARS TO HAVE COMPLIED WITH ALL PROVISIONS OF THE LIMITED LIABILITY COMPANY ACT OF THIS STATE, AND AS OF THIS DATE IS IN GOOD STANDING AS A DOMESTIC LIMITED LIABILITY COMPANY IN THE STATE OF ILLINOIS.

In Testimony Whereof, *I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois, this* 26TH *day of* JANUARY *A.D.* 2016 .

SEAL OF THE STATE OF ILLINOIS AUG. 26TH 1818

Authentication #: 1602602558 verifiable until 01/26/2017
Authenticate at: http://www.cyberdriveillinois.com

Jesse White

SECRETARY OF STATE

ATTACHMENT #4
Attachment Response 13

15. FINANCIAL STATEMENTS. (Co-applicants must also provide this information). Provide a copy of the applicants latest audited financial statements, and append it to this application.

NMHC has an Aa2 bond rating from Moody's Investors Service and an AA+ from Standard & Poor's Ratings Services. Attached are copies of NMHC's applicable bond ratings and most recent audited financial statements.

18a. CERTIFICATION

I certify that the above information and all attached information are true and correct to the best of my knowledge and belief. I certify that the number of beds within the facility will not change as part of this transaction. I certify that no adverse action has been taken against the applicant(s) by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois. I certify that I am fully aware that a change in ownership will void any permits for projects that have not been completed unless such projects will be completed or altered pursuant to the requirements in 77 IAC 1130.520(f) prior to the effective date of the proposed ownership change. I also certify that the applicant has not already acquired the facility named in this application or entered into an agreement to acquire the facility named in the application unless the contract contains a clause that the transaction is contingent upon approval by the State Board.

Northwestern Memorial HealthCare (NMHC)

Signature of Authorized Officer Dean M. Harrison

Typed or Printed Name of Authorized Officer Dean M. Harrison

Title of Authorized Officer: President and Chief Executive Officer, Northwestern Memorial HealthCare

Address: 251 East Huron Street

City, State & Zip Code: Chicago, IL 60611

Telephone (312) 926-3007 Date:

Attachment Response 18

18b. CERTIFICATION

I certify that the above information and all attached information are true and correct to the best of my knowledge and belief. I certify that the number of beds within the facility will not change as part of this transaction. I certify that no adverse action has been taken against the applicant(s) by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois. I certify that I am fully aware that a change in ownership will void any permits for projects that have not been completed unless such projects will be completed or altered pursuant to the requirements in 77 IAC 1130.520(f) prior to the effective date of the proposed ownership change. I also certify that the applicant has not already acquired the facility named in this application or entered into an agreement to acquire the facility named in the application unless the contract contains a clause that the transaction is contingent upon approval by the State Board.

CDH-Delnor Health System

Signature of Authorized Officer Michael V. Vivoda

Typed or Printed Name of Authorized Officer Michael V. Vivoda

Title of Authorized Officer: Senior Vice President, NMHC and President, West Region

Address: 25 North Winfield Road

City, State & Zip Code: Winfield, IL 60190

Telephone (630) 933-5066 Date: Feb 4, 2016

18c. CERTIFICATION

I certify that the above information and all attached information are true and correct to the best of my knowledge and belief. I certify that the number of beds within the facility will not change as part of this transaction. I certify that no adverse action has been taken against the applicant(s) by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois. I certify that I am fully aware that a change in ownership will void any permits for projects that have not been completed unless such projects will be completed or altered pursuant to the requirements in 77 IAC 1130.520(f) prior to the effective date of the proposed ownership change. I also certify that the applicant has not already acquired the facility named in this application or entered into an agreement to acquire the facility named in the application unless the contract contains a clause that the transaction is contingent upon approval by the State Board.

Delnor-Community Hospital

Signature of Authorized Officer Maureen Bryant

Typed or Printed Name of Authorized Officer Maureen Bryant

Title of Authorized Officer: President, Delnor-Community Hospital

Address: 300 Randall Road

City, State & Zip Code: Geneva, IL 60134

Telephone (630) 208-3073 Date: 2/4/16

18d. CERTIFICATION

I certify that the above information and all attached information are true and correct to the best of my knowledge and belief. I certify that the number of beds within the facility will not change as part of this transaction. I certify that no adverse action has been taken against the applicant(s) by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois. I certify that I am fully aware that a change in ownership will void any permits for projects that have not been completed unless such projects will be completed or altered pursuant to the requirements in 77 IAC 1130.520(f) prior to the effective date of the proposed ownership change. I also certify that the applicant has not already acquired the facility named in this application or entered into an agreement to acquire the facility named in the application unless the contract contains a clause that the transaction is contingent upon approval by the State Board.

DelCom Corporation

Signature of Authorized Officer Michael V. V[illegible]

Typed or Printed Name of Authorized Officer Michael V. Vivoda

Title of Authorized Officer: Senior Vice President, NMHC and President, West Region

Address: 3755 East Main Street #120

City, State & Zip Code: St. Charles, IL 60174

Telephone (630) 933-5066 Date: Feb 4, 2016

18e. CERTIFICATION

I certify that the above information and all attached information are true and correct to the best of my knowledge and belief. I certify that the number of beds within the facility will not change as part of this transaction. I certify that no adverse action has been taken against the applicant(s) by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois. I certify that I am fully aware that a change in ownership will void any permits for projects that have not been completed unless such projects will be completed or altered pursuant to the requirements in 77 IAC 1130.520(f) prior to the effective date of the proposed ownership change. I also certify that the applicant has not already acquired the facility named in this application or entered into an agreement to acquire the facility named in the application unless the contract contains a clause that the transaction is contingent upon approval by the State Board.

Tri-Cities Surgery Center, LLC

Signature of Authorized Officer Kevin M King MD

Typed or Printed Name of Authorized Officer Dr. Kevin King

Title of Authorized Officer: Board Chairman, Tri-Cities Surgery Center, LLC

Address: 345 Delnor Drive

City, State & Zip Code: Geneva, IL 60134

Telephone (630) 232-1282 Date: 2-8-10

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18f. CERTIFICATION

I certify that the above information and all attached information are true and correct to the best of my knowledge and belief. I certify that the number of beds within the facility will not change as part of this transaction. I certify that no adverse action has been taken against the applicant(s) by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois. I certify that I am fully aware that a change in ownership will void any permits for projects that have not been completed unless such projects will be completed or altered pursuant to the requirements in 77 IAC 1130.520(f) prior to the effective date of the proposed ownership change. I also certify that the applicant has not already acquired the facility named in this application or entered into an agreement to acquire the facility named in the application unless the contract contains a clause that the transaction is contingent upon approval by the State Board.

Tri-Cities Physician Group, LLC

Signature of Authorized Officer ____________________

Typed or Printed Name of Authorized Officer Dr. John Plante

Title of Authorized Officer: Board Chairman, Tri-Cities Physician Group, LLC

Address: 345 Delnor Drive

City, State & Zip Code: Geneva, IL 60134

Telephone (630) 232-7300 Date: 2/8/16

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plan. NMHC's quality plan is designed to align leadership, staff, and resources to accomplish defined quality improvement goals. The goals consider key components of the national quality agendas, value, and input from stakeholders both internal and external to the system including patients and their family members. NMHC follows a DMAIC-based approach to process improvement. DMAIC (Define, Measure, Analyze, Improve, and Control), the process improvement methodology from Six Sigma, is the "roadmap" that is followed on every improvement project. Change Management is also a core element of the approach.

11. The organization chart for NM System is included in ATTACHMENT #3.

12. As of December 1, 2015, the Boards of Directors of CDH-Delnor Health System, KishHealth System, Central DuPage Hospital, Delnor Community Hospital, Kishwaukee Community Hospital, and Valley West Hospital are identical, comprised of fifteen individuals, and collectively known as the Northwestern Medicine West Region Board of Directors. The Nominating and Corporate Governance Committee of the NMHC Board review proposed candidates to fill vacancies and make recommendations to the Executive Committee of the NMHC Board. The NMHC Board will review the candidates recommended by the Executive Committee and elect directors to the Northwestern Medicine West Region Board.

13. A written response addressing the review criteria contained in 77 Ill. Adm. Code 1110.240 is available for public review on the premises of the health care facility.

14. NMHC does not anticipate any reductions to the scope of services or levels of care currently provided at Tri-Cities Surgery Center. On the contrary, the proposed acquisition will potentially increase capability in General, Urological, and Gynecological surgeries. It will also create capacity in the hospital's operating rooms to provide higher acuity services.

Signature of Authorized Officer:	Dean M Harrison
Typed Name of Authorized Officer:	Dean M. Harrison
Title of Authorized Officer:	President and Chief Executive Officer Northwestern Memorial HealthCare

MOODY'S
INVESTORS SERVICE

Rating Update: Moody's affirms Northwestern Memorial HealthCare, IL's Aa2 and Aa2/VMIG 1; stable outlook

Global Credit Research - 11 Feb 2015

Aa2 assigned to $378M of Cadence Health's debt, now secured by NMHC

ILLINOIS FINANCE AUTHORITY
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NEW YORK, February 11, 2015 --Moody's Investors Service affirmed the Aa2 and Aa2/VMIG 1 ratings on Northwestern Memorial HealthCare's outstanding bonds. The rating outlook is stable. Cadence Health recently joined NMHC's obligated group; as a result, Cadence's debt is now secured by the NMHC obligated group. At this time, we are assigning ratings to the following Cadence Health outstanding fixed rate bonds: (1) Aa2 rating to the Series 2009 and Series 2009B bonds, originally issued under the name Central DuPage Health, and (2) Aa2 underlying rating (bonds are insured by Assured Guaranty) to the Series 2002A, Series 2002B, Series 2002C, Series 2002D, Series 2003A, Series 2003B, and Series 2003C bonds, originally issued under the name Delnor-Community Hospital.

SUMMARY RATING RATIONALE

The Aa2 long-term rating is based on NMHC's prominent market position in the greater Chicagoland area, excellent investment position providing good coverage of debt, solid operating margins, and improved debt measures. The Aa2 rating also incorporates challenges related to increasing competition in a consolidating market, comparatively moderate liquidity with a relatively high allocation to alternative investments, and several years of low revenue growth. NMHC's recent merger with Cadence will bring integration challenges given the scope of operations and intended consolidation. However, we expect NMHC's measured approach of executing strategies will minimize risks, including coordinating activities among academic and community physicians. Additionally, the combined organization's financial strength affords the system time to implement strategies and realize benefits.

The short-term VMIG 1 ratings are based on support from bank standby bond purchase agreements.

OUTLOOK

The stable rating outlook is based on our expectation that NMHC will maintain strong operating cash flow margins as suggested by proforma numbers and the first quarter including Cadence, integration risks will be manageable with little disruption to operations, and the relative investment position will be maintained given capital spending can be funded with cashflow.

WHAT COULD MAKE THE RATING GO UP

-Diversification of cashflow geographically

-Significant increase in market share

-Material and sustained improvement in operating margins, along with reduction in debt

-Stronger wealth position with greater liquidity

WHAT COULD MAKE THE RATING GO DOWN

-Large increase in debt with weakening of debt metrics

-Multi-year decline in margins or investment position

-Greater than expected integration challenges, resulting in lower margins

-Materially dilutive acquisition or merger

ATTACHMENT #6
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STRENGTHS

-NMHC maintains a prominent market position with attractive facilities (average age of plant is very low at 8.9 years) in favorable locations in the greater Chicago area.

-The merger with Cadence Health expands NMHC's geographic coverage and market share in the western suburbs of Chicago. Cadence Health's exceptional margins and balance sheet result in an accretive impact to most measures.

-Strong growth in investments resulted in over $2.6 billion of unrestricted cash and investments at fiscal yearend 2014, equating to a very strong 446 days of cash on hand and 335% cash-to-debt.

-The system achieved a solid 12% operating cashflow margin in FY 2014, including transfers for academic support, driven by cost reductions that compensated for low revenue growth.

-The Clinical Affiliation Agreement between NMHC and Northwestern Medical Faculty Foundation (d/b/a Northwestern Medical Group (NMG)) and NMHC's relationship with Northwestern University's Feinberg School of Medicine support a strong brand identity.

-Following operating improvement and investment growth, debt metrics improved to be consistent with the rating category with favorably low 1.7 times debt-to-cashflow and 9.7 times peak debt service coverage.

-Medicare and Medicaid dependency is below average, limiting exposure to funding delays and cuts, especially in Medicaid.

-The pension plan is fully funded and the system has modest operating lease obligations.

-The management team has shown a disciplined and detailed approach to evaluating strategic alternatives and capital commitments and ability to adapt to slower revenue growth with effective expense management strategies.

CHALLENGES

-Same-facility revenue growth has been low at 0-2% annually since 2011, in part reflecting declines in area use rates.

-The greater Chicago market is an increasingly competitive market with rapid consolidation, several large academic medical centers in the market, and competitors expanding facilities.

-Integrating the legacy Cadence Health and NMHC organizations poses execution risks given the scope of operations and difference in academic and non-academic cultures.

-NMHC has a high asset allocation to alternative investments, resulting in a low 46% of unrestricted investments that can be liquidated monthly, indicating comparatively less liquidity than other health systems in the Aa rating category. Mitigating factors to this risk are the system's large investment portfolio, manageable liquidity needs related to pension and swap collateral and availability of $130 million in operating lines.

RECENT DEVELOPMENTS

On September 1, 2014, CDH-Delnor Health System d/b/a Cadence Health (Cadence) became a wholly owned subsidiary of NMHC pursuant to a Clinical Affiliation Agreement between NMHC and Cadence. The affiliation was effected through a membership substitution with no consideration paid.

DETAILED RATING RATIONALE

MARKET POSITION: GOOD MARKET POSITION IN COMPETITIVE MARKET

The affiliation with Cadence expands and enhances NMHC's locations in attractive and growing markets in the region, which is especially important in a market that is quickly consolidating. With $3.7 billion in revenue, the combined organization is one of the largest in the region and state. Both legacy organizations have large employed physician groups, including the Northwestern Medical Group and the Cadence Physician Group. While the system may consider adding hospitals, there will be a strong focus on building ambulatory capabilities.

Typical of mergers of this scope, there are integration risks but we expect NMHC to manage these risks to minimize disruption. Primary risks include integrating hospitals and physician organizations with academic and non-academic cultures as well as eventually combining information systems. The organization will move to centralize corporate services and organize management around regions, which will reduce costs and increase strategic coordination. NMHC has a history of executing strategies with a measured and deliberate approach and the financial strength of both legacy organizations afford NMHC time to achieve benefits while minimizing risk.

NMHC continues to further integrate and coordinate strategies with Northwestern University's Feinberg School of Medicine (NU) through a joint planning process and governance oversight structure that coordinates activities for the school, the faculty practice plan and hospitals. Strategically, we believe closer integration is positive in advancing the strong brand of Northwestern and building on clinical capabilities.

The Chicago market is increasingly competitive with an increase in the pace of consolidation among hospitals. Of note is the intended merger between Advocate Health Network and NorthShore University HealthSystem, which would become the largest healthcare system in the state if completed.

OPERATING PERFORMANCE, BALANCE SHEET AND CAPITAL PLANS: SOLID MARGINS AND REDUCED LEVERAGE

Despite flat same-store revenue for several years, NMHC's operating margins remain solid. Absolute operating cashflow in fiscal year 2014 was relatively stable to fiscal year 2013; the margin declined reflecting the addition of NMG, although the operating cashflow margins remained solid at 12%. Proforma operating cashflow margin approaches 15% with Cadence Health and is very strong at 16% in the first quarter of fiscal year 2015. The system benefitted from extensive cost reductions and increased net payments under the state's Hospital Assessment Program. Margins include transfers to the school of medicine as an operating expense, as noted below. The transfers are formulaic and tied to net patient revenue and operating cashflow of NMHC.

NMHC's primary operating challenge is several years of relatively flat revenue. Same-facility revenue (excluding NMG) grew 2% in fiscal year 2014. Revenue is challenged by declining use rates in the region. NMHC's admissions declined 2.6% in 2014.

Liquidity

NMHC has a strong investment position, but liquidity is less than peers due to the asset allocation. Days cash on hand grew to 446 days at fiscal yearend 2014 and is slightly stronger at approximately 460 days on a proforma basis with Cadence. Proforma cash-to-debt is lower, but still strong, at under 300%. Based on fiscal yearend data, monthly liquidity is low at 46%, reflecting a heavy allocation to alternative investments. NMHC has minimal swap collateral posted and no expected pension payments, which limits liquidity needs.

Capital spending is expected to be manageable and under operating cashflow levels. The largest project is a replacement hospital for Northwestern Lake Forest Hospital, estimated to cost $400 million. While there are no definitive new debt plans, the system is completing a new strategic plan.

DEBT AND OTHER LIABILITIES

With growth in operating cashflow and investments, NMHC has deleveraged and debt measures are more consistent with the peers in the rating category.

Debt Structure

NMHC had 40% variable rate debt at fiscal yearend 2014, including bonds supported by bank standby bond purchase agreements. The bank counterparties are diversified with three banks and expiration dates are staggered. Monthly liquidity-to-demand debt was good at 390%. Cadence adds several series of privately placed bank debt.

Debt-Related Derivatives

As of February 2015, NMHC (including legacy Cadence Health) has interest rate swaps with three counterparties with a total notional amount of $396 million. All of the swaps convert variable rate bonds to synthetic fixed rate bonds. Two of the swaps have $35 million thresholds at Aa2, two have no collateral requirements and two have no collateral requirements unless the rating falls below A3. NMHC has posted limited collateral over time; at FYE 2014 no collateral was posted.

Pensions and OPEB

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NMHC's pension plan is fully funded.

MANAGEMENT AND GOVERNANCE

The management team has shown a disciplined and detailed approach to evaluating strategic alternatives and capital commitments and ability to adapt to slower revenue growth with effective expense management strategies. This measured approach will be important as the system integrates the historically academic culture of legacy NMHC and non-academic culture of legacy Cadence.

Debt structure risks have been well managed with diversified counterparties and staggered commitment periods. Importantly, with the merger NMHC amended all bank agreements to make covenants and reporting requirements consistent across agreements.

KEY STATISTICS

Assumptions & Adjustments:

-Based on financial statements for Northwestern Memorial HealthCare & Subsidiaries

-First number reflects audit year ended August 31, 2013

-Second number reflects audit year ended August 31, 2014

-Investment returns normalized at 6% unless otherwise noted

-Comprehensive debt includes direct debt, operating leases, and pension obligation, if applicable

-Monthly liquidity to demand debt ratio is not included if demand debt is de minimis

-Adjustments: $18 million and $41 million of Grants and academic support (representing transfers to the school of medicine and faculty) reallocated to total expenses from nonoperating gains/(losses) in FY 2013 and FY 2014, respectively

-Inpatient admissions: 53,986; 52,607

-Observation stays: 17,864; 17,873

-Medicare % of gross revenues: 33%; 33%

-Medicaid % of gross revenues: 10%; 9%

-Total operating revenues ($): $1.7 billion; $2.4 billion

-Revenue growth rate (%) (3 yr CAGR): 3%; 13%

-Operating margin (%): 6.6%; 4.2%

-Operating cash flow margin (%): 17.2%; 11.8%

-Debt to cash flow (x): 1.7 times; 1.7 times

-Days cash on hand: 601 days; 446 days

-Maximum annual debt service (MADS): $52 million; $52 million

-Moody's-adjusted MADS Coverage with normalized investment income (x): 9.6 times; 9.7 times

-Direct debt ($): $805 million; $791 million

-Cash to direct debt (%): 297%; 335%

-Comprehensive debt: $868 million; $865 million

-Cash to comprehensive debt (%): 275%; 306%

-Monthly liquidity to demand debt (%): 526%; 390%

OBLIGOR PROFILE

NMHC's largest subsidiaries are noted in the Legal Security section. Northwestern Memorial Hospital is a major academic medical center located in the Streeterville neighborhood of Chicago, providing a complete range of adult inpatient and outpatient services, primarily to residents of Chicago and surrounding areas, in an educational and research environment. It is licensed for 894 beds. NMH is the primary teaching hospital for Northwestern University's Feinberg School of Medicine (FSM).

LEGAL SECURITY

The bonds are an unsecured general obligation of the Obligated Group, including Northwestern Memorial HealthCare (parent), Northwestern Memorial Hospital, Northwestern Lake Forest Hospital, Northwestern Memorial Foundation, and Northwestern Memorial Faculty Foundation (dba Northwestern Medical Group). The indentures do not provide limitations on additional indebtedness. On November 25, 2014, Cadence, and three of its subsidiaries, Central DuPage Physician Group (doing business as Cadence Physician Group), Central DuPage Hospital Association and Delnor-Community Hospital became members of the obligated group created under the NMHC Master Indenture. All debt of NMHC and its subsidiaries (other than certain capital leases and letters of credit) is secured by, or guaranteed by, the NMHC obligated group.

USE OF PROCEEDS

Not applicable

RATING METHODOLOGIES

The principal methodology used in this rating was Not-for-Profit Healthcare Rating Methodology published in March 2012. An additional methodology used for the short-term enhanced rating was Variable Rate Instruments Supported by Conditional Liquidity Facilities published in May 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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Northwestern Memorial HealthCare, Illinois; Hospital

Credit Profile		
Illinois Fin Auth, Illinois		
CDH/Delnor Hlth Sys d/b/a Cadence Hlth & Affiliates, Illinois		
Series 2009		
Long Term Rating	AA+/Stable	Upgraded
Illinois Fin Auth, Illinois		
Northwestern Mem HlthCare, Illinois		
Series 2009 A&B. 2013		
Long Term Rating	AA+/Stable	Affirmed
Illinois Hlth Fac Auth, Illinois		
Delnor Comnty Hosp, Illinois		
Illinois Hlth Fac Auth (Delnor Community Hospital)		
Unenhanced Rating	AA+(SPUR)/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services affirmed its 'AA+' long-term rating on the Illinois Finance Authority's series 2013, 2009A, and 2009B bonds, and its 'AA+/A-1+' dual rating on the authority's series 2002C, 2007A-2, 2007A-4, 2008A-1, 2008A-2, 2007A-1, and 2007A-3 bonds. All bonds were issued on behalf of Northwestern Memorial HealthCare (NMHC). The outlook is stable.

At the same time, Standard & Poor's raised to 'AA+' from 'AA' its long-term rating on the authority's series 2009 and 2009B fixed-rate revenue bonds issued for Central DuPage Hospital Assn. (CDH) and its underlying rating (SPUR) on the authority's series 2002 and 2003 hospital fixed-rate revenue bonds issued for Delnor Community Hospital (Delnor). CDH and Delnor together previously operated as CDH-Delnor Health System, doing business as Cadence Health. The ratings were raised because Cadence became a part of the obligated group NMHC, the parent of Northwestern Memorial Hospital. The outlook is stable.

The ratings reflect our view of NMHC's strong operations for the first nine months of fiscal 2015. As a system, NMHC has smoothly transitioned Cadence Health into the operations and is outperforming its budget for fiscal 2015. NMHC reports that the system has moved into the mode of activating the system from the integration phase. Although more actions must be completed over the near term, NMHC is poised to continue to perform at a high level into the near future. With the smooth integration of Cadence, management has maintained financial flexibility so that NMHC is able to assess the future acquisition of other organizations in the greater Chicagoland area. With this in mind, NMHC recently signed a definitive agreement with KishHealth System, located in DeKalb, Ill. The affiliation, if finalized, will bring NMHC to a total of six hospitals and more than 90 locations covering eight counties. Finally, NMHC's management team maintained its solid balance sheet even amid continued investments in capital, and this helps NMHC remain a relevant provider in the very competitive Chicagoland market.

The 'AA+' rating further reflect our view of NMHC's:

- Strong liquidity, with approximately 470 days' cash on hand as of May 31, 2015;
- Good maximum annual debt service (MADS) coverage of 8.8x as a result of the solid operations noted above and solid investment income for the first nine months of fiscal 2015;
- Outstanding governance and management, including the numerous benefits realized through affiliations with all Northwestern University-related entities, including the Feinberg School of Medicine; and
- Growing business position through its acquisition strategy.

Partly offsetting the above strengths, in our view, are NMHC's:

- Capital plans that include a replacement of the NLFH campus; and
- Increasingly competitive service area, with provider consolidation continuing in the greater Chicago market.

The 'AA+' rating is based on our view of NMHC's group credit profile and the credit group's "core" status. Accordingly, we rate the bonds at the same level as the group credit profile. The analysis and financial figures in this report pertain to the activities of NMHC, the sole corporate member of Northwestern Memorial Hospital (NMH), Northwestern Lake Forest Hospital (NLFH), Northwestern Medical Faculty Foundation (NMFF, doing business as Northwestern Medical Group, or NMG), Northwestern Memorial Foundation (NMF) and Cadence Health. The revenue bonds are an unsecured general obligation (GO) of the NMHC obligated group, which consists of NMHC, NMH, NLFH, NLHF's not-for-profit subsidiary, NMF, NMG, and NMG's not-for-profit subsidiary. As of Nov. 25, 2014, Cadence Health, CDH, Delnor and Cadence Physician Group became members of NMHC's obligated group and NMHC provided guarantees of the obligations of the Cadence Health obligated group for full and timely payment of the debt of the aforementioned entities.

Outlook

The stable outlook reflects our opinion that the system will continue to post strong operations as NMHC's leadership implements its strategies to maintain the expense base, update its electronic medical record, and expand the system through affiliations. Also, as NMHC spends capital to help sustain the system, we anticipate that the balance sheet will not suffer.

Downside scenario

NMHC has defined a level of operations that it will need to achieve to meet its future needs. However, if operations begin to trend negative for a sustained period and capital spending begins to negatively affect the balance sheet, we could lower the rating or revise the outlook to negative. Finally, because of market consolidation, a dilutive acquisition or loss of leading market position by NMHC could also affect the rating.

Upside scenario

We do not anticipate raising the rating in the outlook period.

Enterprise Profile

NMHC is the corporate parent of NMH, NLFH, NMG, NMF, and Cadence Health. NMH has a total of 894 licensed beds (823 staffed) in the Feinberg/Galter Pavilion and Prentice Women's Hospital. It is the primary teaching hospital for Northwestern University's Feinberg School of Medicine. NLFH is a 201-bed community hospital with more than 700 physicians who are board certified in 68 medical specialties and who are located in offices throughout Lake County. NMG has approximately 1,100 employed physicians, including 145 physicians from Northwestern Memorial Physicians Group, a primary care medical group practice that merged with NMG on May 1, 2014. NMHC also includes Northwestern Memorial Insurance Co.

Northwestern University (AAA) is a separate corporation and is not obligated to repay debt service associated with the bonds. However, in our opinion, the university's Feinberg School of Medicine is integrally linked with NMHC through a shared strategic plan.

Cadence Health formally came together in April 2011. CDH is a 347-licensed-bed hospital and Delnor is a 159-licensed-bed hospital. CDH and its affiliates are located in Winfield, a western suburb of Chicago, and Delnor is located approximately 11 miles west of CDH. Other entities that are part of Cadence Health but are not part of the Cadence Health obligated group are Community Nursing Service of DuPage County Inc. (providing home health care and hospice), Cadence Physician Group (which employs more than 230 physicians, including the 23-member orthopedic group acquired in early fiscal 2013), an orthopedic ambulatory surgery center, a foundation for both Delnor and CDH, a residential living facility, a captive for managing self-insurance, and a few smaller entities with more limited operations.

Utilization

Anecdotally, NMHC's inpatient volume has continued to decline, but that is a challenge that has been witnessed across the industry. Management remains keenly aware of the decline and continues to look at numerous strategies to help maintain or improve admissions and other utilization statistics. Management attributes the decline mostly to the continued shift to outpatient services. However, management does note that it is seeing inpatient volume growth at both Delnor and NLFH. The growth at NLFH results mainly from NMG's physicians' sending more patients to the facility.

As with many others in the industry, NMHC notes that if it can keep the NMHC-aligned physicians' patients within the system and if it can continue to take advantage of the favorable geographic relationship of the hospitals and health care sites, NMHC should be able to maintain if not improve its business position.

NMHC's primary service area market share (a seven-county area) equates to an 8.8% market share. NMHC's market share may seem modest, but admissions and related market share among other hospitals in the service area are stagnant when excluding consolidation. This, coupled with the expectation of further health care reform, continues to lead to more consolidations, with health systems and hospitals aligning to strengthen their competitive position.

Management

NMHC continues to have a strong leadership team. The team has continued to produce strong operations and balance sheet measures while investing in its facilities. NMHC has had no major missteps in aligning with Cadence. With this alignment, Cadence was able to bring three of its executive leaders to the NMHC, which was a big factor in the smooth transition. Coupled with the integration of the three executives, NMHC put in place a strong integration team that incorporated members from both NMHC and Cadence. As the integration proceeded, 12 members of the Cadence board became members of the NMHC board. The Cadence and Delnor boards came together and function as new Northwestern Medicine West Regional board of directors. Now NMHC operates in three regions: Central region for NMH and facilities in downtown Chicago, North region for the areas surrounding NLFH, and West region for the areas surrounding Cadence. The management team continues to seek affiliation partners in the greater Chicago area and is reviewing an affiliation with KishHealth. Finally, since the affiliation with Cadence, NMHC has been updating its current long-range plan.

Table 1

Northwestern Memorial HealthCare and Subsidiaries Utilization			
	--Nine-month interim ended May 31--	**--Fiscal year ended Aug. 31--**	
	2015*	**2014**	**2013**
PSA population	9,670,195	8,515,733	8,509,702
PSA market share %	8.8	5.8	5.7
Inpatient admissions§	59,407	51,592	52,949
Equivalent inpatient admissions	133,505	106,505	107,299
Emergency visits	185,198	129,070	133,492
Inpatient surgeries	16,760	14,435	13,920
Outpatient surgeries	31,948	27,349	27,482
Medicare case mix index	1.817	1.895	1.78
FTE employees	16,930	10,362	7,575
Active physicians	3,806	2,508	2,506
Top 10 physician admissions (%)			
Medicare %†	18.3	21.8	23.5
Medicaid %†	8.3	5.0	6.4
Commercial / Blues %†	68.0	67.0	67.2

*Interim period is not comparable to full year as NMHC added Cadence Health to the organization. §Excludes newborns, psychiatric, and rehabilitation admissions. †Based on net revenue. FTE--Full-time equivalent. PSA--Primary service area.

Financial Profile

Operations

NMHC's financial performance remained strong in the first nine months of fiscal 2015 ended May 31. NMHC generated an operating margin of 7.7% for the period compared with a budgeted 5.0%. Because this is the first year of the combined entities, we are not comparing it to earlier periods. The continued success of the operations can still be attributed to the attention that management has placed on watching the expense base as NMHC faces the declining utilization and operates on a much larger scale. With that in mind, management did note an increase medical supply cost because of a rise in drug prices. To help offset this rise in the expense base, NMHC saw its top line outperform the budget. For the nine-month period, NHMC's net patient revenue was 1.2% ahead of budget. Also, NMHC and other hospitals in the state continued to benefit from the Hospital Assessment Program.

Management reports that NMHC will continue to address strategies to help offset the challenge of inpatient volumes coupled with health care reform. With this in mind, management maintains that its long-term goal is to break even on Medicare patients while continuing to produce operating margins of at least 4.5% to 5.0% to meet NMHC's future needs, which include capital expenditures and the tightening of the relationship with the university and others.

With the strong operations and investment income, NMHC continues to post solid MADS coverage. For the first nine months of fiscal 2015, NMHC posted MADS coverage of 8.8x (6.9x when including operating leases).

Balance sheet

As of May 31, 2015, NMHC's leverage remained in line with that of other 'AA+' rated facilities at 20.9%. For the same date, unrestricted reserves to long-term debt was adequate at 296%, while unrestricted reserves to contingent liabilities was greater than 800%. Unrestricted reserves remain solid at 471 days.

When NMHC acquired NLFH, it agreed to refurbish the existing facility or build a replacement hospital. NMHC has received regulatory approval to build a replacement hospital and construction has begun. In addition, NMHC has committed to spend capital in excess of $1 billion on projects that will be completed over the next three years. To date, NMHC has spent more than $700 million on the projects. NMHC is keenly aware of and plans to maintain its balance sheet strength, adjusting its capital schedule toward that end.

Short-term bank-supported ratings

The 'A-1+' short-term component of the rating on the series 2002C, 2008A1, and 2008A2 bonds reflects the likelihood of payment of tenders as well as a liquidity facility: a standby bond purchase agreement (SBPA) provided by Northern Trust Co. (AA-/A-1+). The SBPA provides for a maximum of 35 days' interest at the 12% maximum rate. We will withdraw our short-term rating on the expiration date unless the SBPA is extended pursuant to its terms or an alternative SBPA is delivered.

The 'A-1' short-term component of the rating on the authority's variable-rate demand revenue bonds (VRDBs) subseries 2007A-2 and 2007A-4, issued for NMH, is based on liquidity facilities provided by Wells Fargo Bank N.A. (AA-/A-1+).

The 'A-1' short-term component of the rating on the authority's VRDBs subseries 2007A-1 and 2007A-3, issued for NMH, is based on liquidity facilities provided by JPMorgan Chase Bank N.A.(A+/A-1).

Bondholders may tender their bonds during the daily and weekly modes upon delivering appropriate notice. The bonds are further subject to mandatory tender upon conversion to another interest rate mode and one business day before expiration, substitution, or termination. The bonds may be called because of optional redemptions and are subject to mandatory sinking fund payments.

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Contingent liabilities: swaps, direct purchase debt, and other contingent liabilities

NMHC is a party to two floating- to fixed-rate swaps with a notional amount of $208.4 million as of May 31, 2015: one with a notional amount of $104.2 million with UBS AG (A+/A-1/Negative) as the counterparty, and one with a notional amount of $104.2 million with JPMorgan Chase Bank as the counterparty.

Cadence is party to four variable- to fixed-rate swaps. Two swaps are with CDH, with Morgan Stanley Capital Services Inc. (guaranteed by 'A' rated Morgan Stanley) as the counterparty, for a current notional amount of $125.426 million. The other two variable- to fixed-rate swaps are with Delnor, with UBS AG as the counterparty, for a current notional amount of $59.675 million.

Cadence Health has additional contingent liability risk related to $177.1 million of direct purchase debt (series 2011A, B, and C).

Table 2

Northwestern Memorial HealthCare and Subsidiaries				
	--Nine-month interim ended May 31--	--Fiscal year ended Aug. 31--		'AA+' rated health care system medians
	2015*	2014	2013	2014
Financial performance				
Net patient revenue ($000s)	2,753,005	2,296,846	1,592,321	2,678,034
Total operating revenue ($000s)	2,892,965	2,426,460	1,709,666	MNR
Total operating expenses ($000s)	2,670,563	2,284,349	1,578,319	MNR
Operating income ($000s)	222,402	142,111	131,347	MNR
Operating margin (%)	7.69	5.86	7.68	6.50
Net non-operating income ($000s)	150,187	261,462	188,900	MNR
Excess income ($000s)	372,589	403,573	320,247	MNR
Excess margin (%)	12.24	15.01	16.87	9.90
Operating EBIDA margin (%)	16.63	13.45	18.27	12.10
EBIDA margin (%)	20.74	21.87	26.40	15.20
Net available for debt service ($000s)	631,210	587,746	501,277	538,975
Maximum annual debt service (MADS; $000s)	95,490	55,765	52,031	MNR
MADS coverage (x)	8.81	10.54	9.63	7.90
Operating-lease-adjusted coverage (x)	6.93	9.22	7.99	4.50
Liquidity and financial flexibility				
Unrestricted reserves ($000s)	4,230,179	2,648,946	2,388,407	4,024,012
Unrestricted days' cash on hand	471.3	454.1	608.5	440.5
Unrestricted reserves/long-term debt (%)	295.8	339.9	300.9	295.7
Unrestricted reserves/contingent liabilities (%)	860.2	841.9	756.5	MNR
Average age of plant (years)	5.4	8.9	8.5	8.9
Capital expenditures/depreciation and amortization (%)	116.4	135.9	120.4	186.9
Debt and liabilities				
Long-term debt ($000s)	1,429,950	779,337	793,819	MNR
Long-term debt/capitalization (%)	20.9	19.3	22.7	24.1

Table 2

Northwestern Memorial HealthCare and Subsidiaries (cont.)				
Contingent liabilities ($000s)	491,765	314,625	315,725	MNR
Contingent liabilities/long-term debt (%)	34.4	40.4	39.8	MNR
Debt burden (%)	2.35	2.07	2.74	1.70
Defined benefit plan funded status (%)	N.A.	115.06	120.11	94.60

*Interim period is not comparable to full year, as NMHC added Cadence Health to the organization. MNR--median not reported. N.A.--not available.

Related Criteria And Research

Related Criteria

- USPF Criteria: Not-For-Profit Health Care, June 14, 2007
- General Criteria: The Interaction Of Bond Insurance And Credit Ratings, Aug. 24, 2009
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012
- USPF Criteria: Bank Liquidity Facilities, June 22, 2007
- USPF Criteria: Standby Bond Purchase Agreement Automatic Termination Events, April 11, 2008
- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- General Criteria: Methodology: Industry Risk, Nov. 20, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Glossary: Not-For-Profit Health Care Ratios, Oct. 26, 2011
- U.S. Not-For-Profit Health Care Outlook Remains Negative Despite A Glimmer Of Relief , Dec. 17, 2014
- U.S. Not-For-Profit Health Care System Ratios: Operating Performance Weakened In 2013, Aug. 13, 2014
- Health Care Providers And Insurers Pursue Value Initiatives Despite Reform Uncertainties, May 9, 2013
- Standard & Poor's Assigns Industry Risk Assessments To 38 Nonfinancial Corporate Industries, Nov. 20, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014
- Health Care Organizations See Integration And Greater Transparency As Prescriptions For Success, May 19, 2014
- The Growing And Evolving Role Of Provider-Sponsored Health Plans In U.S. Health Care, June 8, 2015

Ratings Detail (As Of September 8, 2015)		
Illinois Fin Auth, Illinois		
Northwestern Mem HlthCare, Illinois		
Illinois Finance Authority (Northwestern Memorial Hospital) hosp VRDO ser 2007A-1		
Long Term Rating	AA+/A-1/Stable	Affirmed
Illinois Finance Authority (Northwestern Memorial Hospital) hosp VRDO ser 2007A-2		
Long Term Rating	AA+/A-1+/Stable	Affirmed
Illinois Finance Authority (Northwestern Memorial Hospital) hosp VRDO ser 2007A-3		
Long Term Rating	AA+/A-1/Stable	Affirmed
Illinois Finance Authority (Northwestern Memorial Hospital) hosp VRDO ser 2007A-4		
Long Term Rating	AA+/A-1+/Stable	Affirmed
Illinois Fin Auth (Northwestern Mem HlthCare) rev bnds ser 2013 dtd 02/27/2013 due 08/15/2033 2037 2042 2043		
Long Term Rating	AA+/Stable	Affirmed
Series 2002C		

Ratings Detail (As Of September 8, 2015) (cont.)		
Long Term Rating	AA+/A-1+/Stable	Affirmed
Series 2008A-1 & A-2		
Long Term Rating	AA+/A-1+/Stable	Affirmed

Many issues are enhanced by bond insurance.

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CONSOLIDATED FINANCIAL STATEMENTS

Northwestern Memorial HealthCare and Subsidiaries
Years Ended August 31, 2015 and 2014
With Report of Independent Auditors

Ernst & Young LLP

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Northwestern Memorial HealthCare and Subsidiaries

Consolidated Financial Statements

Years Ended August 31, 2015 and 2014

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Report of Independent Auditors

The Board of Directors
Northwestern Memorial HealthCare

We have audited the accompanying consolidated financial statements of Northwestern Memorial HealthCare (an Illinois not-for-profit corporation) and Subsidiaries (Northwestern Memorial), which comprise the consolidated balance sheets as of August 31, 2015 and 2014, and the related consolidated statements of operations and 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 Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Northwestern Memorial HealthCare and subsidiaries at August 31, 2015 and 2014, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

November 30, 2015

1507-1590856

Northwestern Memorial HealthCare and Subsidiaries

Consolidated Balance Sheets
(In Thousands)

	August 31 2015	August 31 2014
Assets		
Current assets:		
Cash and cash equivalents	**$ 258,313**	$ 108,490
Short-term investments	**41,516**	59,280
Current portion of investments, including assets limited as to use	**117,970**	99,518
Patient accounts receivable, net of estimated uncollectible accounts of $142,385 and $70,977 in 2015 and 2014, respectively	**485,548**	344,850
Current portion of pledges and grants receivable, net	**18,043**	41,299
Current portion of insurance recoverable	**9,533**	7,624
Inventories	**48,217**	36,075
Other current assets	**129,352**	36,026
Total current assets	**1,108,492**	733,162
Investments, including assets limited as to use, less current portion	**4,605,578**	3,148,448
Property and equipment, at cost:		
Land	**325,369**	264,324
Buildings	**2,986,891**	1,884,384
Equipment and furniture	**930,058**	558,349
Construction in progress	**165,403**	295,612
	4,407,721	3,002,669
Less accumulated depreciation	**1,611,748**	1,378,205
	2,795,973	1,624,464
Prepaid pension cost	**94,392**	93,063
Insurance recoverable, less current portion	**64,986**	58,927
Other assets, net	**165,341**	123,438
Total assets	**$ 8,834,762**	$ 5,781,502

	August 31	
	2015	**2014**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 211,457**	$ 135,434
Accrued salaries and benefits	**261,769**	145,281
Grants and academic support payable, current portion	**68,868**	126,213
Accrued expenses and other current liabilities	**112,462**	50,546
Due to third-party payors	**362,556**	230,996
Current accrued liabilities under self-insurance programs	**77,371**	59,437
Current maturities of long-term debt	**27,336**	14,095
Long-term debt subject to short term remarketing agreements	**116,045**	–
Total current liabilities	**1,237,864**	762,002
Long-term debt, net, less current maturities	**1,298,164**	772,867
Accrued liabilities under self-insurance programs, less current portion	**454,399**	409,247
Grants and academic support payable, less current portion	**131,575**	106,333
Interest rate swaps	**113,317**	52,872
Other liabilities	**114,393**	94,061
Total liabilities	**3,349,712**	2,197,382
Net assets:		
Unrestricted:		
Undesignated	**4,918,920**	3,055,576
Board-designated	**205,497**	198,506
Noncontrolling interest in consolidated venture	**(1,571)**	–
Total unrestricted	**5,122,846**	3,254,082
Temporarily restricted	**201,429**	175,990
Permanently restricted	**160,775**	154,048
Total net assets	**5,485,050**	3,584,120
Total liabilities and net assets	**$ 8,834,762**	$ 5,781,502

See accompanying notes to consolidated financial statements.

Northwestern Memorial HealthCare and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

(In Thousands)

	Year Ended August 31 2015	2014
Revenue		
Net patient service revenue	$ **3,867,302**	$ 2,379,932
Provision for uncollectible accounts	**164,316**	83,086
Net patient service revenue after provision for uncollectible accounts	**3,702,986**	2,296,846
Rental and other revenue	**148,352**	98,614
Net assets released from donor restrictions and federal and state grants	**34,292**	31,000
Total revenue	**3,885,630**	2,426,460
Expenses		
Salaries and professional fees	**1,506,588**	938,973
Employee benefits	**394,304**	245,654
Supplies	**630,487**	387,976
Purchased services	**343,329**	214,963
Depreciation and amortization	**291,198**	155,058
Insurance	**82,731**	47,484
Rent and utilities	**74,661**	48,525
Repairs and maintenance	**80,911**	71,145
Interest	**59,016**	29,115
Illinois Hospital Assessment	**81,489**	74,044
Other	**127,052**	71,412
Total expenses	**3,671,766**	2,284,349
Operating income	**213,864**	142,111
Nonoperating gains (losses)		
Investment return	**(53,758)**	444,959
Change in fair value of interest rate swaps	**(20,414)**	(8,956)
Contribution of Cadence Health unrestricted net assets	**1,781,068**	–
Contribution of Northwestern Medical Faculty Foundation unrestricted net assets in excess of consideration	**–**	28,730
Loss on extinguishment of long-term debt	**–**	(2,867)
Grants and academic support provided	**(51,072)**	(41,111)
Other	**9,806**	23,378
Total nonoperating gains, net	**1,665,630**	444,133
Excess of revenue over expenses	**1,879,494**	586,244
Gain attributable to noncontrolling interest in subsidiary	**366**	–
Excess of revenue over expenses attributable to NMHC and Subsidiaries	**1,879,128**	586,244

Northwestern Memorial HealthCare and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (continued)

(In Thousands)

	Year Ended August 31					
	2015			2014		
	Total	Controlling	Non-controlling	Total	Controlling	Non-controlling
Unrestricted net assets						
Excess of revenue over expenses	$ 1,879,494	$ 1,879,128	$ 366	$ 586,244	$ 586,244	$ –
Net assets released from restrictions used for property and equipment additions	8,193	8,193	–	1,348	1,348	–
Postretirement benefit-related changes other than net periodic pension cost	(16,884)	(16,884)	–	(32,621)	(32,621)	–
Initial value of noncontrolling interests in acquired companies	(2,185)	–	(2,185)	–	–	–
Other	146	(102)	248	42	42	–
Increase (decrease) in unrestricted net assets	1,868,764	1,870,335	(1,571)	555,013	555,013	–
Temporarily restricted net assets						
Contributions	46,893	46,893	–	29,900	29,900	–
Investment return	10,213	10,213	–	8,625	8,625	–
Net assets released from restrictions used for:						
Operating expenses, charity care, and research and education	(39,825)	(39,825)	–	(29,946)	(29,946)	–
Property and equipment additions	(8,193)	(8,193)	–	(1,348)	(1,348)	–
Change in fair value of split-interest agreements	(590)	(590)	–	645	645	–
Contribution of Northwestern Medical Faculty Foundation restricted net assets	–	–	–	10,374	10,374	–
Contribution of Cadence Health restricted net assets	17,835	17,835	–	–	–	–
Other	(894)	(894)	–	58	58	–
Increase in temporarily restricted net assets	25,439	25,439	–	18,308	18,308	–
Permanently restricted net assets						
Contributions	2,459	2,459	–	2,420	2,420	–
Change in fair value of split-interest agreements	(286)	(286)	–	986	986	–
Contribution of Cadence Health restricted net assets	5,655	5,655	–	–	–	–
Other	(1,101)	(1,101)	–	(100)	(100)	–
Increase in permanently restricted net assets	6,727	6,727	–	3,306	3,306	–
Change in total net assets	1,900,930	1,902,501	(1,571)	576,627	576,627	–
Net assets, beginning of year	3,584,120	3,584,120	–	3,007,493	3,007,493	–
Net assets, end of year	$ 5,485,050	$ 5,486,621	$ (1,571)	$ 3,584,120	$ 3,584,120	$ –

See accompanying notes to consolidated financial statements.

Northwestern Memorial HealthCare and Subsidiaries

Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended August 31	
	2015	**2014**
Operating activities		
Change in total net assets	$ **1,900,930**	$ 576,627
Adjustments to reconcile change in total net assets to net cash provided by operating activities:		
Postretirement benefit-related changes other than net periodic pension cost	**16,884**	32,621
Change in fair value of interest rate swaps	**20,414**	8,956
Loss on extinguishment of long-term debt	**–**	2,867
Net investment return and net change in unrealized investment gains	**52,429**	(445,852)
Restricted contributions, change in fair value of split interest agreements, and realized investment return	**(57,360)**	(41,683)
Contribution of Cadence Health net assets less noncontrolling interest	**(1,802,373)**	–
Contribution of Northwestern Medical Faculty Foundation net assets	**–**	(39,104)
Depreciation and amortization	**291,198**	155,058
Provision for uncollectible accounts	**165,176**	83,140
Change in operating assets and liabilities:		
Patient accounts receivable	**(174,687)**	(108,588)
Due to third-party payors	**(20,697)**	2,363
Grants and academic support payable	**(32,103)**	(65,922)
Other operating assets and liabilities	**58,680**	(131,978)
Net cash provided by operating activities	**418,491**	28,505
Investing activities		
Purchases of trading securities	**(1,829,297)**	(837,572)
Sales of trading securities	**1,609,160**	933,472
Cash received from contribution of Cadence Health System	**123,001**	–
Acquisition of Northwestern Medical Faculty Foundation, net of cash acquired	**–**	(123,557)
Building acquisition, net of cash acquired	**–**	(79,673)
Net unrestricted realized investment return	**159,332**	201,622
Capital expenditures, net	**(365,606)**	(210,786)
Net cash used in investing activities	**(303,410)**	(116,494)
Financing activities		
Payments of long-term debt	**(127,618)**	(75,530)
Proceeds from issuance of long-term debt	**105,000**	–
Restricted contributions and realized investment return	**57,360**	41,683
Net cash provided by (used in) financing activities	**34,742**	(33,847)
Net increase (decrease) in cash and cash equivalents	**149,823**	(121,836)
Cash and cash equivalents, beginning of year	**108,490**	230,326
Cash and cash equivalents, end of year	$ **258,313**	$ 108,490

See accompanying notes to consolidated financial statements.

1. Organization and Summary of Significant Accounting Policies

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

Basis of Presentation

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

Charity Care and Community Benefit

Northwestern Memorial provides care to patients regardless of their ability to pay. Northwestern Memorial developed a Free and Discounted Care Policy (the Policy) for both the uninsured and the underinsured. Under the Policy, patients are offered discounts of up to 100% of charges on a sliding scale, which is based on income as a percentage of the Federal Poverty Level guidelines (up to 600%). The Policy also contains provisions that are responsive to those patients subject to catastrophic health care expenses and uninsured patients not covered by the provisions above. Since Northwestern Memorial does not pursue collection of these amounts, they are not reported as net patient service revenue, and the cost of providing such care is recognized within operating expenses.

Northwestern Memorial estimates the direct and indirect costs of providing charity care by applying a cost to gross charges ratio to the gross uncompensated charges associated with providing charity care to patients. The cost of providing charity care was $61,221 and $57,498 for the years ended August 31, 2015 and 2014, respectively. Northwestern Memorial also received certain funds of $520 and $513 for the years ended August 31, 2015 and 2014, respectively, to offset or subsidize charity care services provided. These funds are primarily received from investment return on free care endowment funds. In the Annual Non Profit Hospital Community Benefits Plan Report filed with the Illinois Attorney General for the year ended August 31, 2014, Northwestern Memorial reported total community benefit of $427,939 (unaudited), including unreimbursed cost of charity care of $66,747 (unaudited), which is calculated using a different methodology than that used for the consolidated financial statements. Management is currently collecting the information needed to file the 2015 report.

1. Organization and Summary of Significant Accounting Policies (continued)

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid short-term investments with maturities of 90 days or less from the date of purchase.

Patient Accounts Receivable

Patient accounts receivable are stated at net realizable value. Northwestern Memorial maintains allowances for uncollectible accounts and for estimated losses resulting from a payor's inability to make payments on accounts. Northwestern Memorial estimates the allowance for uncollectible accounts based on management's assessment of historical and expected net collections, considering historical and current business and economic conditions, trends in health care coverage, and other collection indicators. Patient accounts receivable are charged to the provision for uncollectible accounts when they are deemed uncollectible.

Assets Limited as to Use

Assets limited as to use consist primarily of investments designated by the appropriate board of directors (the Board) for certain medical education and health care programs. The appropriate Board retains control of these investments and may, at its discretion, subsequently use them for other purposes. In addition, assets limited as to use include investments held by trustees under debt agreements and for self-insurance and collateral related to interest rate swaps.

1. Organization and Summary of Significant Accounting Policies (continued)

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value based on quoted market prices. Unless in pension plan assets, alternative investments are reported using the equity method. Alternative investments include common collective trusts, commingled funds, 103-12 entities, and other limited partnership interests in hedge funds, private equity, venture capital, and real estate funds. Alternative investments in the pension plan are reported at fair value based on net asset value (NAV) per share or equivalent.

Derivative Instruments

Derivative instruments, specifically interest rate swaps, are recorded in the accompanying consolidated balance sheets at fair value. The change in the fair value of derivative instruments is recorded in nonoperating gains (losses).

Inventories

Inventories, consisting primarily of pharmaceuticals and other medical supplies, are stated at the lower of cost on the first-in, first-out method or fair value.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Typical useful lives are 5 to 40 years for buildings and building service equipment and 3 to 20 years for equipment and furniture. Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Other Intangible Assets

Intangible assets are stated at fair value at time of purchase and are amortized using the straight-line method over the estimated life based on terms of the underlying agreement giving rise to the intangible.

1. Organization and Summary of Significant Accounting Policies (continued)

Asset Impairment

Northwestern Memorial considers whether indicators of impairment are present and performs the necessary tests to determine if the carrying value of an asset is appropriate. Impairment write-downs are recognized in operating income at the time the impairment is identified. There were no impairments of long-lived assets in 2015 or 2014.

Deferred Charges

Deferred finance charges and bond discounts or premium are amortized or accreted using the effective interest method or the bonds outstanding method, which approximates the effective interest method, over the life of the related debt.

Net Assets

Resources are classified for reporting purposes into four net asset categories as general unrestricted, board-designated unrestricted, temporarily restricted, and permanently restricted, according to the absence or existence of board designations or donor-imposed restrictions. Board-designated net assets are unrestricted net assets that have been set aside by the Board for specific purposes. Temporarily restricted net assets are those assets, including contributions and accumulated investment returns, whose use has been limited by donors for a specific purpose or time period. Permanently restricted net assets are those for which donors require the principal of the gifts to be maintained in perpetuity to provide a permanent source of income.

Any changes in donor restrictions that change the net asset category of previously recorded contributions are recorded as other in the accompanying consolidated statements of operations and changes in net assets in the period communicated by the donor.

Net Patient Service Revenue

Northwestern Memorial has agreements with third-party payors that provide for payments to Northwestern Memorial at amounts different from its established rates. Payment arrangements include prospectively determined rates per admission or visit, reimbursed costs, discounted

1. Organization and Summary of Significant Accounting Policies (continued)

charges, and per diem rates. Net patient service revenue is reported at the estimated net amount due from patients and third-party payors for services rendered, including estimated adjustments under reimbursement agreements with third-party payors, certain of which are subject to audit by administering agencies. These adjustments are accrued on an estimated basis and are adjusted, as needed, in future periods.

EHR Incentive Payments

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health records (EHR) technology and establish the requirements for a Medicare and Medicaid incentive payment program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid payments are available to providers that adopt, implement, or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments.

Northwestern Memorial recognizes HITECH incentive payments as revenue under the grant accounting model when it is reasonably assured that the meaningful use objectives have been achieved. Northwestern Memorial recognized incentive payments totaling $9,055 and $8,485 for the years ended August 31, 2015 and 2014, respectively, as Net assets released from donor restrictions and federal and state grants in the accompanying consolidated statements of operations and changes in net assets. Northwestern Memorial's compliance with the meaningful use criteria is subject to audit by the federal government.

Contributions

Unrestricted gifts, other than long-lived assets, are recorded as a component of Other nonoperating gains in the accompanying consolidated statements of operations and changes in net assets. Unrestricted gifts of long-lived assets, such as land, buildings, or equipment, are recorded at fair value as an increase in unrestricted net assets. Contributions are reported as

1. Organization and Summary of Significant Accounting Policies (continued)

either temporarily or permanently restricted net assets if they are received with donor restrictions. 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 in the accompanying consolidated statements of operations and changes in net assets as net assets released from restrictions.

Unconditional promises to give cash or other assets are reported as pledges receivable and contributions within the appropriate net asset category. An allowance for uncollectible pledges receivable is estimated based on historical experience and other collection indicators. Pledges receivable with payment terms extending beyond one year are discounted using market rates of return reflecting the terms and credit of the pledges at the time a pledge is made.

Northwestern Memorial is a beneficiary of several split-interest agreements, primarily perpetual trusts held by others and recognizes its interest in these perpetual trusts as temporarily or permanently restricted net assets based on its percentage of the fair value of the trusts' assets.

Nonoperating Gains (Losses)

Nonoperating gains (losses) consist primarily of investment returns (including realized gains and losses; net change in unrealized investment gains and losses; changes in Northwestern Memorial's proportionate share of its equity interest in alternative investments, interest, and dividends); contributions of unrestricted net assets in excess of consideration paid (where applicable); unrestricted contributions received; grants and academic support provided to external organizations; net assets released from restrictions and used for grants and academic support; changes in fair value of interest rate swaps and loss on extinguishment of debt.

Excess of Revenue Over Expenses

The accompanying consolidated statements of operations and changes in net assets include the Excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from the Excess of revenue over expenses, consist primarily of contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, are to be used for the

1. Organization and Summary of Significant Accounting Policies (continued)

purposes of acquiring such assets), transfers between net asset categories based on changes in donor restrictions, and postretirement benefit-related changes other than net periodic pension cost.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 requires an entity to recognize 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. An entity should disclose sufficient information to enable the financial statement users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued ASU 2015-14 which defers the effective date to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Northwestern Memorial is evaluating the effect this guidance will have on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. ASU 2015-03 requires that all costs incurred to issue debt be presented as a direct deduction from the carrying value of debt. Previous standards required these costs to be shown as a deferred charge (i.e., an asset). There is no change as to the presentation or method of amortizing these costs to the consolidated statements of operations and changes in net assets. The adoption of ASU 2015-03 resulted in a decrease in both Other assets, net and Long-term debt, net, less current maturities of $6,072 and $6,470 as of August 31, 2015 and 2014, respectively. See Note 8.

In April 2015, the FASB issued ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. ASU 2015-05 provides explicit guidance on how to account for fees paid in cloud computing arrangements to remove the diversity in practice for accounting for these arrangements. Cloud computing arrangements include software as a service, platform as a service, infrastructure as a service, and other similar hosting arrangements. This ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license,

1. Organization and Summary of Significant Accounting Policies (continued)

the customer should account for the arrangement as a service contract. This new guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2015, with early adoption permitted. Northwestern Memorial is evaluating the effect this guidance will have on its consolidated financial statements.

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent),* which requires that investments for which fair value is measured at net asset value per share (or its equivalent) using the practical expedient no longer be included in the fair value hierarchy. Investments that calculate net asset value per share (or its equivalent) but for which the practical expedient is not applied will continue to be included in the fair value hierarchy. With the adoption of ASU 2015-07, these investments are not included in the fair value hierarchy disclosures, but instead disclosed as a reconciling item between fair value investments and total investments in the consolidated balance sheets. ASU 2015-07 amendments are effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted. Management has elected to adopt ASU 2015-07 early for Northwestern Memorial's investments disclosure, as well as for the investments of the Pension Plan. The adoption had no impact on the consolidated balance sheets or consolidated statements of operations and changes in net assets or on the net assets available for the benefits of the Pension Plan.

2. Acquisitions

Affiliation Agreement with Cadence

On September 1, 2014, CDH-Delnor Health System (Cadence) became a wholly owned subsidiary of NMHC, pursuant to an affiliation agreement between NMHC and Cadence. This affiliation positions Northwestern Memorial, under the Northwestern Medicine brand, to create an integrated academic health delivery system that serves a broad community, offering patients access to leading-edge care closer to where they live and work.

The affiliation was effected through a membership substitution with no consideration paid. For accounting purposes, this transaction is considered an acquisition under Accounting Standards Codification (ASC) 958-805, *Not-for-Profit Mergers and Acquisitions*, and a contribution was recorded for the fair value of assets, net of liabilities of Cadence. No goodwill was recorded as a result of this transaction.

(In Thousands)

2. Acquisitions (continued)

The preliminary acquisition-date fair value of identifiable assets and liabilities of Cadence at September 1, 2014 consisted of the following:

Fair value of identifiable net assets:	
Cash and cash equivalents	$ 123,001
Other current assets	228,351
Property and equipment	1,091,947
Other long-term assets	1,496,861
Current liabilities	(426,129)
Long-term debt	(606,304)
Other long-term liabilities	(105,354)
Noncontrolling interest in unrestricted net assets	2,185
Temporarily restricted net assets	(17,835)
Permanently restricted net assets	(5,655)
Contribution of unrestricted net assets	$ 1,781,068

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

Operating expenses for the year ended August 31, 2015 include costs related to the integration of Cadence into Northwestern Memorial, including transition costs of benefit plans, incentive plans and operating programs with other health practitioners, as well as costs of valuation and integration consulting.

(In Thousands)

2. Acquisitions (continued)

541 N. Fairbanks Acquisition

On March 31, 2014, NMH acquired the office building, in-place leases and certain equipment located at 541 North Fairbanks Court in Chicago, IL (541 N. Fairbanks). NMH leased approximately 40% of this building prior to the acquisition. The acquisition allows for continued growth of NMHC by providing space for the support staff of NMHC at a lower cost than continued leasing in the neighborhood around NMHC's corporate offices

Consideration of $71,019 consisted of a cash payment of $79,902 less the impact of the elimination of preexisting payables and receivables between the parties of $8,883. For accounting purposes, this transaction is considered an acquisition under ASC 958-805.

The fair value of identifiable assets and liabilities of 541 N. Fairbanks at the March 31, 2014 acquisition date, and consideration therefor, consist of the following:

Fair value of identifiable net assets:		
Cash	$	229
Current assets		64
Property and equipment		60,739
Other long-term assets		457
Intangible assets		17,723
Current liabilities		(3,357)
Other long-term liabilities		(4,836)
		71,019
Consideration		71,019
	$	–

The valuation of property and equipment, other current and long-term assets, identifiable intangible assets, and current liabilities have been completed. In valuing these assets and liabilities, fair values were based on, but not limited to, independent appraisals, discounted cash flows and replacement costs.

(In Thousands)

2. Acquisitions (continued)

Following are the combined results for the entities acquired in the Cadence affiliation and the 541 N. Fairbanks acquisition for the years ended August 31, 2015 and 2014 included in the accompanying consolidated statements of operations and changes in net assets:

	2015	2014
Total operating revenue	**$ 1,379,708**	$ 3,000
Excess of expenses over revenue	**100,854**	3,046
Change in unrestricted net assets	**100,712**	(3,046)
Change in temporarily restricted net assets	**(6,107)**	–

Following are the unaudited pro forma results as if the Cadence affiliation and the 541 N. Fairbanks acquisition had occurred on September 1, 2013:

	Year Ended August 31, 2014
Total operating revenue	$ 3,730,879
Operating income	262,292
Excess of revenue over expenses	789,481

The pro forma information provided should not be construed to be indicative of Northwestern Memorial's consolidated results of operations had the acquisitions been consummated on September 1, 2013, and is not intended to project Northwestern Memorial's consolidated results of operations for any future period.

(In Thousands)

3. Investments and Other Financial Instruments

The composition of investments, including assets limited as to use, and cash and cash equivalents and short-term investments, at August 31 is as follows:

	2015	2014
Measured at fair value:		
Cash and short-term investments	$ 367,774	$ 210,732
Mutual funds	902,419	676,869
Other fixed income	812	–
Corporate bonds	119,241	60,784
U.S. government and agency issues	79,600	38,528
Equity securities	117,514	104,766
	1,587,360	1,091,679
Investments using net asset value as practical expedient:		
Common collective trusts and commingled funds	552,979	200,444
Interest in 103-12 investment entities	191,617	201,969
	744,596	402,413
Accounted for under the equity method:		
Alternative investments	2,691,421	1,921,644
	$ 5,023,377	$ 3,415,736

(In Thousands)

3. Investments and Other Financial Instruments (continued)

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

	2015	2014
Assets limited as to use:		
Trustee-held funds	**$ 63,914**	$ 3
Self-insurance programs	**573,804**	498,939
Board-designated funds	**160,015**	153,024
Total assets limited as to use	**797,733**	651,966
Donor-restricted funds	**300,555**	267,848
Unrestricted, undesignated funds	**3,625,260**	2,328,152
Total investments, excluding short-term investments	**4,723,548**	3,247,966
Other financial instruments:		
Cash and cash equivalents and short-term investments	**299,829**	167,770
	$ 5,023,377	$ 3,415,736

The composition and presentation of investment returns are as follows for the years ended August 31:

	2015	2014
Interest and dividend income	**$ 43,375**	$ 26,435
Investment expenses	**(3,752)**	(3,760)
Realized gains on alternative investments, net	**92,446**	69,191
Realized gains on other investments, net	**33,386**	117,488
Net change in unrealized gains/losses on alternative investments	**(50,661)**	200,958
Net increase in unrealized gains/losses on other investments	**(160,546)**	43,272
Change in value of joint ventures	**2,760**	–
	$ (42,992)	$ 453,584
Reported as:		
Rental and other revenue	**$ 553**	$ –
Nonoperating investment return	**(53,758)**	444,959
Temporarily restricted – investment return	**10,213**	8,625
	$ (42,992)	$ 453,584

3. Investments and Other Financial Instruments (continued)

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

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

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

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

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

3. Investments and Other Financial Instruments (continued)

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

As of August 31, 2015, $1,855,163 of alternative investments are subject to various redemption limits and lockup provisions, of which $1,283,869 expires within one year and $571,294 expires after one year from the balance sheet date.

At August 31, 2015, Northwestern Memorial had commitments to fund an additional $677,843 to alternative investment entities, which is expected to occur over the next 12 years.

4. Fair Value Measurements

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

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

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

Fair Values

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

(In Thousands)

4. Fair Value Measurements (continued)

The following table presents the financial instruments measured at fair value on a recurring basis as of August 31, 2015:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 258,313	$ –	$ –	$ 258,313
Investments:				
Short-term investments:				
Currency	27	–	–	27
Fixed income	41,489	–	–	41,489
Total short-term investments	41,516	–	–	41,516
Mutual funds:				
Fixed income	451,648	–	–	451,648
International equities	73,367	–	–	73,367
U.S. equities	219,404	–	–	219,404
Blended equities	158,000	–	–	158,000
Total mutual funds	902,419	–	–	902,419
Other fixed income	–	812		812
Bonds:				
Corporate bonds	–	119,241	–	119,241
U.S. government and agencies' issues	–	79,600	–	79,600
Total bonds	–	198,841	–	198,841
Equity securities	117,168	346	–	117,514
Cash equivalents in investment accounts	67,945	–	–	67,945
Total investments	1,129,048	199,999	–	1,329,047
Beneficial interests in trusts	–	14,073	–	14,073
Total assets measured on a recurring basis at fair value	$ 1,387,361	$ 214,072	$ –	1,601,433
Investments recorded at fair value based on NAV				744,596
Total assets measured at fair value				$ 2,346,029
Liabilities				
Interest rate swaps	$ –	$ 113,317	$ –	$ 113,317

(In Thousands)

4. Fair Value Measurements (continued)

The following table presents the financial instruments measured at fair value on a recurring basis as of August 31, 2014:

	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents	$ 108,490	$ –	$ –	$ 108,490
Investments:				
Short-term investments:				
Currency	27	–	–	27
Total short-term investments	27	–	–	27
Mutual funds:				
Fixed income	240,790	–	–	240,790
International equities	72,646	–	–	72,646
U.S. equities	363,433	–	–	363,433
Total mutual funds	676,869	–	–	676,869
Bonds:				
Corporate bonds	–	60,784	–	60,784
U.S. government and agencies' issues	–	38,528	–	38,528
Total bonds	–	99,312	–	99,312
Equity securities	104,437	329	–	104,766
Cash equivalents in investment accounts	42,962	–	–	42,962
Total investments	824,295	99,641	–	923,936
Beneficial interests in trusts	–	14,924	–	14,924
Total assets measured on a recurring basis at fair value	$ 932,785	$ 114,565	$ –	1,047,350
Investments recorded at fair value based on NAV				461,666
Total assets measured at fair value				$ 1,509,016
Liabilities				
Interest rate swaps	$ –	$ 52,872	$ –	$ 52,872

There were no transfers into or out of Level 2 or Level 1 during the years ended August 31, 2015 and 2014.

(In Thousands)

4. Fair Value Measurements (continued)

Reconciliation to the Consolidated Balance Sheets

A reconciliation of the fair value of the assets to the consolidated balance sheets at August 31, 2015 and 2014 is as follows:

	2015	2014
Short-term investments measured at fair value	**$ 41,516**	$ 59,280
Investments, including assets limited as to use measured at fair value	**2,032,127**	1,326,322
Total investments at fair value	**2,073,643**	1,385,602
Alternative investments accounted for under equity method included in investments, including assets limited as to use	**2,691,421**	1,921,644
Total investments	**$ 4,765,064**	$ 3,307,246
Other long-term assets:		
Beneficial interests in trusts at fair value	**$ 14,073**	$ 14,924
Other long-term assets, net	**151,268**	108,514
Total other long-term assets	**$ 165,341**	$ 123,438

Valuation Techniques and Inputs

Beneficial Interests in Trusts

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

Interest Rate Swaps

The fair value of interest rate swaps is based on generally accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative and quoted prices from dealer counterparties and other independent market sources. The valuation incorporates observable interest rates and yield curves for the full term of the swaps. The valuation is also adjusted to incorporate non-performance risk for NMHC or the respective

4. Fair Value Measurements (continued)

counterparty. The adjustment is based on the credit spread for entities with similar credit characteristics as NMHC or market-related data for the respective counterparty. Northwestern Memorial pays various fixed rates and receives cash flows based on rates equal to a percentage of the London Interbank Offered Rate (LIBOR) plus a spread for certain interest rate swaps.

Investments

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

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

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

(In Thousands)

4. Fair Value Measurements (continued)

The fair value of the long-term debt portfolio, including the current portion, was $1,516,883 and $807,131 at August 31, 2015 and 2014, respectively. The fair value of this Level 2 liability is based on quoted market prices for the same or similar issues and the relationship of those bond yields with various market indices. The market data used to determine yield and calculate fair value represents Aa/AA-rated tax-exempt municipal health care bonds. The effect of third-party credit valuation adjustments, if any, is immaterial.

The fair value of pledges receivable, a Level 2 asset, is based on discounted cash flow analysis and approximates the carrying value at August 31, 2015 and 2014.

5. Investment in Joint Ventures

Northwestern Memorial has joint venture and operating partnership investment interests, ranging from 33.3% to 50.0% in health-related businesses as well as a 33.3% restricted interest in two non-health-related businesses that were donated to Northwestern Memorial. These investment interests are accounted for under the equity method of accounting, as Northwestern Memorial holds a 20% or more voting interest. The following is a summary of financial information as of and for the years ended August 31, 2015 and 2014 relating to these investments:

	2015	**2014**
Current assets	**$ 96,827**	$ 70,387
Current liabilities	**36,131**	3,422
Net working capital	**60,696**	66,965
Property, plant and equipment	**38,399**	1,135
Other long-term assets	**20,517**	8,470
Long-term liabilities	**41,458**	37,800
Net assets	**$ 78,154**	$ 38,770
Revenue	**$ 72,810**	$ 23,233
Expenses	**57,794**	17,368
Excess of revenue over expenses	**$ 15,016**	$ 5,865

5. Investment in Joint Ventures (continued)

The carrying value of the health-related investments of $30,044 and $0 at August 31, 2015 and 2014, respectively, is included in Other assets, net in the accompanying consolidated balance sheets. The carrying value of the non-health-related investments of $9,129 and $8,810 at August 31, 2015 and 2014, respectively, is included in Investments, including assets limited to use, less current portion in the accompanying consolidated balance sheets. Net equity earnings from the health-related investments totaled $2,760 and $0 for the years ended August 31, 2015 and 2014, respectively, and is included in Investment return in the accompanying consolidated statements of operations and changes in net assets. The carrying value of these investments exceeds the underlying equity in net assets by $10,407, reflecting the fair value change recorded at the time of acquisition of Cadence.

Net equity earnings from the non-health-related investments totaled $1,719 and $893 for the years ended August 31, 2015 and 2014, respectively, and is included in Temporarily restricted investment return in the accompanying consolidated statements of operations and changes in net assets. Northwestern Memorial made no capital contributions to such joint ventures for the years ended August 31, 2015 and 2014. Northwestern Memorial received cash distributions from such joint ventures of $4,476 and $3,600 for the years ended August 31, 2015 and 2014, respectively.

6. Self-Insurance Liabilities and Related Insurance Recoverables

Northwestern Memorial retains certain levels of professional and general liability risks. Northwestern Memorial also retain certain levels of workers' compensation risks through State of Illinois sanctioned self-insurance arrangements and through commercial insurance programs subject to large deductibles. For those self-insured risks, Northwestern Memorial has established revocable trust funds and two captive insurance companies to pay claims and related costs. In addition, various insurance policies have been purchased to provide coverage in excess of self-insured limits.

Northwestern Memorial's self-insurance liability and related amounts recoverable from reinsurers are reported in the accompanying consolidated balance sheets at present value based on an annual discount rate of 1.5% as of August 31, 2015 and 2014. This discount rate is based on several factors, including rolling averages of risk-free rates based on estimated payment patterns of the underlying liability. The undiscounted gross liabilities for the self-insured programs were $564,258 and $497,933 at August 31, 2015 and 2014, respectively. The undiscounted amounts recoverable from reinsurers were $79,016 and $70,135 at August 31, 2015 and 2014, respectively. Provisions for the professional and general liability risks are based

(In Thousands)

6. Self-Insurance Liabilities and Related Insurance Recoverables (continued)

on an actuarial estimate of losses using actual loss data adjusted for industry trends and current conditions and on an evaluation of claims by Northwestern Memorial's legal counsel. The provision for estimated self-insured claims includes estimates of ultimate costs for both reported claims and claims incurred but not reported.

In the opinion of management, based in part on the advice of outside actuaries, adequate provision has been made at August 31, 2015, for all claims incurred to date. Although there is considerable variability inherent in such estimates, management further believes that the ultimate disposition of these claims will not have a material adverse effect on the consolidated financial position of Northwestern Memorial.

7. Employee Benefits Obligations

There are two non-contributory defined benefit pension plans (the Plans) maintained within Northwestern Memorial that cover specified employee groups. The sponsors for the Plans approved resolutions to amend the Plans effective at the end of the day on December 31, 2012. The amendments implement a hard freeze, such that no participant will earn any additional or new benefits under the Plans on and after January 1, 2013, and no compensation earned or service performed by any Plan participant on and after January 1, 2013, will count for any purpose other than continued vesting under the Plans in benefits earned prior to 2013.

The following table summarizes the change in the projected benefit obligation for the years ended August 31:

	2015	**2014**
Projected benefit obligation, beginning of year	**$ 617,933**	$ 526,878
Interest cost	**26,043**	26,564
Net actuarial (gain) loss	**(32,029)**	86,186
Benefits paid	**(26,578)**	(21,695)
Projected benefit obligation, end of year	**$ 585,369**	$ 617,933

(In Thousands)

7. Employee Benefits Obligations (continued)

The following table summarizes the changes in the Plans' assets for the years ended August 31:

	2015	2014
Plan assets at fair value, beginning of year	**$ 710,996**	$ 632,840
Actual return on the Plans' assets, net of expenses	**(4,657)**	99,851
Benefits paid	**(26,578)**	(21,695)
Plan assets at fair value, end of year	**$ 679,761**	$ 710,996

The following table sets forth the Plans' funded status, as well as recognized amounts in the accompanying consolidated balance sheets as of August 31:

	2015	2014
Plan assets at fair value	**$ 679,761**	$ 710,996
Projected benefit obligation	**585,369**	617,933
Funded status recognized as prepaid pension cost	**$ 94,392**	$ 93,063

The accumulated benefit obligations of the Plans are $585,369 and $617,933 as of August 31, 2015 and 2014, respectively.

Included in unrestricted net assets are the Plans' amounts that have not yet been recognized in net periodic pension cost at August 31 as follows:

	2015	2014
Unrecognized actuarial loss	**$ 117,429**	$ 98,226

(In Thousands)

7. Employee Benefits Obligations (continued)

Changes in the Plans' assets and benefit obligations recognized in unrestricted net assets for the years ended August 31 include the following:

	2015	2014
Current year actuarial loss	**$ (19,940)**	$ (31,627)
Recognized actuarial loss	**737**	461
	$ (19,203)	$ (31,166)

The Plans' prior service cost and net actuarial gain included in unrestricted net assets expected to be recognized in net periodic pension cost during 2016 are $0 and $1,381, respectively.

Net periodic pension benefit included in operating results for the years ended August 31 consists of the following:

	2015	2014
Plan expenses	**$ 1,499**	$ 1,251
Interest cost of projected benefit obligation	**26,043**	26,564
Expected return on the Plans' assets	**(48,810)**	(46,545)
Recognized actuarial loss	**737**	461
Net periodic pension benefit	**$ (20,531)**	$ (18,269)

(In Thousands)

7. Employee Benefits Obligations (continued)

The following table sets forth the weighted-average assumptions used to determine the projected benefit obligation and benefit cost as of August 31:

	2015	2014
Used to determine projected benefit obligation		
Discount rate	**4.55%**	4.30%
Used to determine benefit cost		
Discount rate	**4.30%**	5.15%
Expected long-term rate of return on the Plans' assets	**7.00%**	7.50%

The expected long-term rate of return on assets is determined based on a capital market asset model, which assumes that future returns are based on long-term, historical performance as adjusted for contemporary dividend yields. The adjusted historical returns were weighted by the current long-term asset allocation targets and reduced by 100 basis points to produce a more normal risk premium. Northwestern Memorial's investment advisor assisted with the analysis.

The Plans' asset allocation and investment strategies are designed to earn returns on plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, sectors, and manager style to minimize the risk of loss. Northwestern Memorial uses professional investment managers specializing in each asset category and, where appropriate, provides the investment managers with specific guidelines that include allowable and/or prohibited investment types. Northwestern Memorial regularly monitors manager performance and compliance with investment guidelines.

The target allocation of the Plans' assets as of August 31 is as follows:

	2015	2014
Cash and cash equivalents	**–%**	–%
Equity securities	**49**	47
Alternative investments	**41**	43
Fixed income	**10**	10
	100%	100%

(In Thousands)

7. Employee Benefits Obligations (continued)

The following table presents the Plans' financial instruments as of August 31, 2015, measured at fair value on a recurring basis by the valuation hierarchy described in Note 4:

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 36	$ –	$ –	$ 36
U.S. government securities	–	7,968	–	7,968
Corporate debt:				
Preferred	–	1,694	–	1,694
Other	–	14,318	–	14,318
Total corporate debt	–	16,012	–	16,012
Equity securities:				
U.S. equities	25,565	140	–	25,705
International equities	41	–	–	41
Total Equity securities	25,606	140	–	25,746
Mutual funds:				
Fixed income	45,377	–	–	45,377
International equities	9,071	–	–	9,071
U.S. equities	42,968	–	–	42,968
Total mutual funds	97,416	–	–	97,416
Total assets measured on recurring basis at fair value	$ 123,058	$ 24,120	$ –	147,178
Investments recorded at fair value based on NAV				532,583
Total assets measured at fair value				$ 679,761

(In Thousands)

7. Employee Benefits Obligations (continued)

The following table presents the Plans' financial instruments as of August 31, 2014, measured at fair value on a recurring basis by the valuation hierarchy described in Note 4:

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 252	$ –	$ –	$ 252
U.S. government securities	–	9,797	–	9,797
Corporate debt:				
Preferred	–	1,649	–	1,649
Other	–	12,373	–	12,373
Total corporate debt	–	14,022	–	14,022
Equity securities:				
U.S. equities	23,947	128	–	24,075
Mutual funds:				
Fixed income	42,145	–	–	42,145
International equities	17,949	–	–	17,949
U.S. equities	87,833	–	–	87,833
Total mutual funds	147,927	–	–	147,927
Total assets measured on recurring basis at fair value	$ 172,126	$ 23,947	$ –	196,073
Investments recorded at fair value based on NAV				514,923
Total assets measured at fair value				$ 710,996

7. Employee Benefits Obligations (continued)

The fair value of Level 1 investments, which consist of equity securities and certain mutual funds, is based on quoted market prices that are valued on a daily basis. Level 2 investments consist of U.S. government securities, corporate bonds, and U.S. equities. The fair value of the U.S. government securities and corporate bonds is established based on values obtained from nationally recognized pricing services that value the investments based on similar securities and matrix pricing of similar quality and maturity securities.

Included in the other pension investments are commingled funds, common collective trusts, 103-12 entities, and alternative investments (principally limited partnership interests in hedge, private equity, real estate, and natural resources funds) for which the fair values are based on NAV. The fair values of the commingled funds, common collective trusts, and 103-12 entities are based on the Master Trust's ownership interest in the NAV per share of its equivalent of the respective fund.

The fair values of the securities held by limited partnerships that do not have readily determinable fair values are determined by the general partner taking into consideration, among other things, the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information. In addition, actual market exchanges at period-end provide additional observable market inputs of the exit price. NAV is calculated by the investment's management monthly for all of the Master Trust's alternative investments other than limited partnerships, whose NAV is calculated on a quarterly basis. 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 Plans' 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.

(In Thousands)

7. Employee Benefits Obligations (continued)

Investments in LPs, which cannot be redeemed on request, totaled $97,881 as of August 31, 2015. Certain marketable alternative investments are subject to various redemption restrictions. As of August 31, 2015, $308,424 of alternative investments are subject to various redemption limits and lockup provisions, of which $216,196 expires within one year and $92,228 expires after one year from the balance sheet date.

The Plans' assets are managed solely in the interest of the Plans' participants and their beneficiaries. The assets are invested with the investment objective of funding the accumulated and projected retirement benefit obligations of the Plans consistent with the Plans' long-term rate-of-return assumption. A time horizon of greater than five years is assumed and, therefore, interim volatility in returns is regarded with appropriate perspective.

Northwestern Memorial has no current plans to contribute to the Plans during the year ending August 31, 2016.

Benefit payments, which reflect future service, as appropriate, are expected to be paid as follows:

Year ending August 31:	
2016	$ 27,558
2017	26,827
2018	27,628
2019	29,397
2020	31,350
2021–2025	171,295

Northwestern Memorial also maintains defined contribution plans covering substantially all of its full-time and part-time employees. Participants can make voluntary tax-deferred contributions to the plans, subject to certain IRS limitations. Northwestern Memorial contributes a specified percentage of eligible compensation to the plans on behalf of each participant. Participants are always fully vested in their own tax-deferred contributions and related earnings and become fully vested in Northwestern Memorial contributions and related earnings upon completion of vesting service. Employer contributions related to these defined contribution plans, included in Employee benefits expense in the accompanying consolidated statements of operations and changes in net assets totaled $63,817 and $54,603 in 2015 and 2014, respectively.

(In Thousands)

7. Employee Benefits Obligations (continued)

NMHC also maintains other noncontributory postretirement benefit plans (the Noncontributory Plans) for certain executive employees.

Included in unrestricted net assets are an unrecognized actuarial (gain) loss of $(1,036) and $1,282 at August 31, 2015 and 2014, respectively, for the Noncontributory Plans that have not yet been recognized in net periodic pension cost.

Changes in the Noncontributory Plans' assets and benefit obligations recognized in unrestricted net assets during 2015 and 2014, include the following:

	2015	**2014**
Current year actuarial gain (loss)	**$ 1,427**	$ (1,021)
Recognized actuarial net gain (loss)	**892**	(434)
	$ 2,319	$ (1,455)

As of August 31, 2015 and 2014, the Noncontributory Plans' unfunded projected benefit obligation amounted to $1,129 and $1,609, respectively, and is included in Other long-term liabilities in the accompanying consolidated balance sheets. The weighted-average discount rate utilized in determining the actuarial present value was 4.55% and 4.30% in 2015 and 2014, respectively. The Noncontributory Plans' actuarial (gain) included in unrestricted net assets expected to be recognized in net periodic pension cost during 2016 is ($919).

(In Thousands)

8. Long-Term Debt

Long-term debt consists of the following at August 31:

	2015	2014
Revenue Bonds, Series 2013 (NMHC), payable in annual installments beginning August 15, 2031 through August 15, 2043 (fixed coupon rates from 4.00% to 5.00%)	**$ 111,235**	$ 111,235
Revenue Bonds, Series 2011A and 2011B (CDH), with interest at a variable rate payable in annual installments through November 1, 2038 (weighted-average interest rate of 0.53% for the twelve months ended August 31, 2015)	**119,650**	–
Revenue Bonds, Series 2011C (Delnor), with interest at a variable rate payable in annual installments through November 1, 2038 (weighted-average interest rate of 0.64% for the twelve months ended August 31, 2015)	**57,490**	–
Revenue Bonds, Series 2009A (NMH), payable in annual installments through August 15, 2039 (fixed coupon rates range from 5.00% to 6.00%)	**309,680**	319,610
Revenue Bonds, Series 2009B (NMH), payable in annual installments through August 15, 2030 (fixed coupon rates range from 5.00% to 5.75%)	**43,055**	46,020
Revenue Bonds, Series 2009 (CDH) payable in annual installments through November 1, 2039 (fixed coupon rates range from 5.00% to 5.25%)	**88,170**	–
Revenue Bonds, Series 2009B (CDH) payable in annual installments through November 1, 2039 (fixed coupon rates range from 3.30% to 5.75%)	**227,505**	–
Variable Rate Demand Revenue Bonds, Series 2008A (NMH), payable in annual installments through August 15, 2038 (weighted-average interest rate was 0.03% and 0.05% for the twelve months ended August 31, 2015 and 2014, respectively)	**78,775**	78,775
Variable Rate Demand Revenue Bonds, Series 2007A (NMH), payable in annual installments through August 15, 2042 (weighted-average interest rate was 0.04% and 0.06% for the twelve months ended August 31, 2015 and 2014, respectively)	**207,200**	208,400
Revenue Bonds, Series 2003A – Series 2003C (Delnor) payable in annual installments through November 1, 2033 (fixed coupon rates range from 5.00% – 5.25%)	**24,675**	–

(In Thousands)

8. Long-Term Debt (continued)

Long-term debt consists of the following at August 31:

	2015	2014
Variable Rate Demand Revenue Bonds, Series 2002C (NMH), payable in annual installments beginning August 15, 2026 through August 15, 2031 (weighted-average interest rate was 0.03% and 0.05% for the twelve months ended August 31, 2015 and 2014, respectively)	**$ 27,450**	$ 27,450
Revenue Bonds, Series 2002B – Series 2002D (Delnor) payable in annual installments beginning May 1 2022 through May 1, 2032 (fixed coupon rate of 5.25%)	**35,000**	–
Delnor medical office building loan, interest fixed at 6.34%, matures September 1, 2017	**13,799**	–
CDH-Delnor Health System variable rate note dated November 25, 2014 to a bank, matures November 25, 2017 (weighted-average interest rate of 0.76% for the twelve months ended August 31, 2015)	**105,000**	–
	1,448,684	791,490
Less:		
Unamortized discount, net and debt issuance costs	**7,139**	4,528
Current maturities	**27,336**	14,095
Long-term debt subject to short-term remarketing agreements	**116,045**	–
	$ 1,298,164	$ 772,867

Effective November 25, 2014, Cadence, Central DuPage Hospital (CDH), Delnor-Community Hospital (Delnor) and Cadence Physician Group (CPG) became members of the obligated group created under the Amended and Restated Master Trust Indenture dated as of May 1, 2004, as supplemented and amended (the NMHC Master Indenture), among NMHC, NMH, Northwestern Lake Forest Hospital (NLFH), Northwestern Memorial Foundation (the Foundation), NMG, Northwestern Foundation for Research and Education d/b/a Northwestern Medical Group Management Services (NMGMS), Lake Forest Health and Fitness Institute (HFI), and Wells Fargo Bank, N.A., as master trustee. Supplemental Master Trust Indentures were issued so that all the debt as of November 30, 2014 is either secured, or guaranteed by, the NMHC obligated group.

8. Long-Term Debt (continued)

Effective September 13, 2013, NMG and NMGMS became members of the obligated group created under the NMHC Master Indenture, among NMHC, NMH, NLFH, the Foundation, HFI, and Wells Fargo Bank, N.A., as master trustee. The bond trustee for the $62,095 in aggregate principal amount of tax-exempt bonds issued for the benefit of NMG (the NMG Bonds) accepted a promissory note issued by NMHC under the NMHC Master Indenture as security for the NMG Bonds in substitution for the note previously securing the NMG Bonds. The bondholder accepted a promissory note issued by NMHC under the NMHC Master Indenture related to the purchase by the bondholder of the NMG Bonds in substitution for the note previously issued under the NMG Master Indenture. The bondholder and other lenders also accepted promissory notes issued by NMHC under the NMHC Master Indenture related to an $80,000 undrawn revolving line of credit available to NMHC in substitution for the notes previously securing the line of credit. As a result of these transactions, NMG and NMGMS are both members of the obligated group created under the NMHC Master Indenture and have joint and several liability for all of the outstanding debt secured thereunder. The NMG master trust indenture and the master notes issued thereunder have been terminated. In January 2014, NMG redeemed all the outstanding Series 2012 Bonds ($58,775). A $2,867 loss on extinguishment of long-term debt as a result of the above-mentioned transaction for the year ended August 31, 2014 is included in the consolidated statements of operations and changes in net assets.

Northwestern Memorial has lines of credit of $50,000 and $80,000 (mentioned above), which expire in May 2016 and September 2018, respectively. These lines of credit are available for operations, except for $467 of the $50,000 line which is restricted to secure a letter of credit. Northwestern Memorial has the option to borrow at various rates expressed as an adjustment to LIBOR, Prime Rate or other bank-offered rates. At August 31, 2015 and 2014, no amounts were borrowed under the lines of credit.

(In Thousands)

8. Long-Term Debt (continued)

Northwestern Memorial has standby bond purchase agreements (SBPAs) with multiple banks that cover all of its variable rate demand revenue bonds (VRDBs). The short-term credit rating for each series of VRDBs is based on the respective bank's short-term credit rating. The long-term credit rating for each series of VRDBs is based on Northwestern Memorial's long-term credit rating. Changes in credit ratings may impact the interest paid on or remarketing of the VRDBs. The banks provide liquidity support in the event of a failed remarketing as follows:

	Par Value	Expiration Date
Series 2007A-1, 2007A-3	$ 103,600	December 2016
Series 2008A	78,775	July 2017
Series 2002C	27,450	July 2017
Series 2007A-2, 2007A-4	103,600	December 2018

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

CDH and Delnor Series 2011A, 2011B and 2011C Revenue Bonds, which are classified as long-term due to their long-term amortization periods, have one-year remarketing periods that occur at staggered dates throughout the year. The bondholders are required to hold the bonds for additional one year periods, unless notice of their intent to put the bonds to the NMHC obligated group is given not less than 150 days prior to the end of the remarketing date. To the extent that bondholders may, under the terms of the debt, put their bonds within a maximum of 12 months after August 31, 2015, the principal amount of such bonds has been classified as a current obligation in the accompanying consolidated balance sheets. Management believes the likelihood of a material amount of bonds being put to the NMHC obligated group is remote.

(In Thousands)

8. Long-Term Debt (continued)

Scheduled principal repayments for the next five years, assuming remarketing of variable rate debt, on long-term debt are as follows:

Year ending August 31:	
2016	$ 27,336
2017	41,913
2018	29,715
2019	31,050
2020	32,600

The provisions under the respective debt agreements require the obligated group to maintain reporting, financial, and other covenants. At August 31, 2015, the obligated group was in compliance with these provisions.

Northwestern Memorial paid interest of $55,580 and $34,733 in 2015 and 2014, respectively, (which includes $7,067 and $7,589, respectively, for net swap payments included in Interest expense in the accompanying consolidated statements of operations and changes in net assets). Northwestern Memorial capitalized interest of $5,685 and $8,683 in 2015 and 2014, respectively.

9. Derivatives

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

(In Thousands)

9. Derivatives (continued)

credit risk for Northwestern Memorial. When the fair value of a swap is zero or negative, the counterparty does not owe Northwestern Memorial. Northwestern Memorial minimizes the credit risk in its swap contracts by entering into transactions that require the counterparty to post collateral for the benefit of Northwestern Memorial based on the credit rating of the counterparty and the fair value of the swap contract or whose cash flows are insured by a third party. The aggregate fair value liability of the swaps in the accompanying consolidated balance sheets as of August 31, 2015 and 2014 reflects a reduction of $1,602 and $7,442, respectively, for nonperformance risk. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Management also mitigates risk through periodic reviews of its swap positions in the context of their total blended cost of capital.

The following is a summary of the outstanding positions under existing interest rate swap agreements at August 31:

2015	2014	Maturity	Rate Paid	Rate Received
$ 103,600	$ 104,200	Aug-42	3.89%	63% of 1-Month LIBOR + 28 bps
103,600	104,200	Aug-42	3.89	63% of 1-Month LIBOR + 28 bps
62,713	–	Nov-38	3.82	67% of 3-Month LIBOR
62,713	–	Nov-38	3.52	67% of 3-Month LIBOR
35,000	–	May-32	4.18	67% of 1-Month LIBOR
24,675	–	May-33	2.89	67% of 1-Month LIBOR
$ 392,301	$ 208,400			

The fair value of derivative instruments at August 31 is as follows:

	Balance Sheet Location	Liabilities 2015	Liabilities 2014
Derivatives not designated as hedging instruments:			
Interest rate contracts	Interest rate swaps	**$ 113,317**	$ 52,872

(In Thousands)

9. Derivatives (continued)

The effects of derivative instruments on the accompanying consolidated statements of operations and changes in net assets for August 31, are as follows:

Interest Rate Contracts	Amount of Loss Recognized in Excess of Revenue Over Expenses on Derivatives 2015	2014
Derivatives not designated as hedging instruments:		
Operating expense – interest	$ **(7,067)**	$ (7,589)
Nonoperating – change in fair value of interest rate swaps	**(20,414)**	(8,956)

Northwestern Memorial's derivative instruments contain provisions that require Northwestern Memorial's debt to maintain an A- or better credit rating from Standard & Poor's and an A3 or better rating from Moody's. If Northwestern Memorial's debt were to fall below those levels, it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing collateralization on derivative instruments in net liability positions. Northwestern Memorial has posted collateral of $0 as of August 31, 2015 and 2014. If the credit risk-related contingent features underlying these agreements were triggered to the fullest extent on August 31, 2015, Northwestern Memorial would be required to post $114,918 of collateral to its counterparties. Additionally, one of the November 2038 maturity swaps gives the swap counterparty a one-time option to cancel the swap at par value on November 1, 2017, after which, if unexercised, the swap will remain outstanding through its stated expiration.

10. Goodwill and Other Intangible Assets

Goodwill has been recorded at the excess of purchase price over fair value of assets purchased in business acquisitions of several medical practices. Northwestern Memorial has goodwill of $16,244 and $14,546 included in Other assets, net, at August 31, 2015 and 2014, respectively. There were no impairments of goodwill in the years ended August 31, 2015 and 2014.

(In Thousands)

10. Goodwill and Other Intangible Assets (continued)

The fair value of in-place leases is the present value associated with re-leasing the in-place lease as if the property was vacant. The value of at market in-place leases is amortized as amortization expense over the expected life of the lease. Above-market and below-market lease values for acquired properties are recorded based upon the present value of the difference between the contractual amounts to be paid pursuant to the in-place leases and management's estimates of the fair market lease rates for comparable leases. The value of above- and below-market leases are recorded as an adjustment to rental revenue over the remaining terms of the leases.

The following table summarizes NMHC's identifiable intangible asset balances as of August 31, 2015 and 2014 which are included in Other assets, net on the accompanying consolidated balance sheets:

	2015		
	Gross Carrying Value	**Accumulated Amortization**	**Net Carrying Amount**
Amortized intangible assets:			
In-place leases	**$ 17,922**	**$ (7,655)**	**$ 10,267**
Above-market leases	**1,141**	**(916)**	**225**
Other	**862**	**(862)**	**–**
Total intangible assets	**$ 19,925**	**$ (9,433)**	**$ 10,492**
Below-market lease intangibles	**$ (6,186)**	**$ 1,890**	**$ (4,296)**

	2014		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets:			
In-place leases	$ 16,832	$ (3,024)	$ 13,808
Above-market leases	891	(267)	624
Other	350	(221)	129
Total intangible assets	$ 18,073	$ (3,512)	$ 14,561
Below-market lease intangibles	$ (4,836)	$ 589	$ (4,247)

10. Goodwill and Other Intangible Assets (continued)

Amortization expense, which is included in Depreciation and amortization, was $4,631 and $3,245 for the years ended August 31, 2015 and 2014, respectively. The estimated amortization expense for intangible assets subject to amortization for each of the years ending August 31, 2016 through August 31, 2020 is as follows: $3,515, $2,795; $2,360; $1,880; and $518.

11. Income Tax Status

Each of the NMHC not-for-profit entities are qualified under the Internal Revenue Code (the Code) as tax-exempt organizations and are exempt from tax on income related to their tax-exempt purposes under Section 501(a) of the Code. Accordingly, no income taxes are provided for the majority of the income in the accompanying consolidated financial statements for these corporations. Certain corporations had unrelated business income (UBI) generated primarily from the sale of certain services that are not directly related to patient care and through limited partnerships within the investment portfolio. Certain corporations have unused net operating loss carryforwards available to offset the UBI tax. The net operating loss carryforwards expire through 2035. The deferred tax assets associated with these net operating loss carryforwards of $3,622 and $3,315 at August 31, 2015 and 2014, respectively, are offset by valuation allowances on the accompanying consolidated balance sheets of $3,622 and $3,315, respectively. The total net operating loss carryforwards at August 31, 2015 and 2014 were $9,239 and $8,500, respectively.

NMHC calculates income taxes for its taxable subsidiaries. Taxable income differs from pretax book income principally due to certain income and deductions for tax purposes being recorded in the consolidated financial statements in different periods. Deferred income tax assets and liabilities are recorded for the tax effect of these differences using enacted tax rates for the years in which the differences are expected to reverse.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent on the generation of future taxable income during the periods in which those temporary differences become deductible.

(In Thousands)

11. Income Tax Status (continued)

NMHC has two subsidiaries incorporated under the laws of the Cayman Islands. The Cayman Islands government imposes no tax on income or capital gains. However, these corporations are subject to U.S. federal corporate taxation to the extent that it generates net income that is effectively connected with a U.S. trade or business. These corporations are not engaged in any such trade or business in the U.S. Therefore, no income tax provision has been recorded related to these corporations and their operations.

Provisions for federal and state income taxes of $9,651 and $433 for the years ended August 31, 2015 and 2014, respectively, are included within Other non-operating gains and losses in the accompanying consolidated statements of operations and changes in net assets.

12. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at August 31:

	2015	2014
Health care services:		
Purchase of property and equipment	**$ 38,001**	$ 27,095
Operating expenses and charity care	**71,074**	54,090
Research, education, and other	**92,354**	94,805
	$ 201,429	$ 175,990

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

	2015	2014
Health care services:		
Purchase of property and equipment	**$ 8,193**	$ 1,348
Clinical expenses and charity care	**19,590**	12,519
Research, education, and other	**20,235**	17,427
	$ 48,018	$ 31,294

(In Thousands)

12. Temporarily and Permanently Restricted Net Assets (continued)

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

	2015	2014
Net assets released from donor restrictions and federal and state grants	**$ 21,608**	$ 13,995
Nonoperating other	**18,217**	15,951
	$ 39,825	$ 29,946

Permanently restricted net assets at August 31 are summarized below, the income from which is expendable to support:

	2015	2014
Health care services:		
Purchase of property and equipment	**$ 14,304**	$ 14,304
Operating expenses and charity care	**76,208**	69,696
Research, education, and other	**70,263**	70,048
	$ 160,775	$ 154,048

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

Northwestern Memorial has interpreted the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), as adopted by the state of Illinois, as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Northwestern Memorial classifies as permanently restricted net assets the original value of gifts donated to the permanent endowment, the original value of subsequent gifts to the permanent endowment, and accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure, consistent with the donor intent or, where silent, standard of prudence prescribed by UPMIFA.

12. Temporarily and Permanently Restricted Net Assets (continued)

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

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

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

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

(In Thousands)

12. Temporarily and Permanently Restricted Net Assets (continued)

The changes in endowment net assets for the years ended August 31, 2015 and 2014 are summarized below:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets,			
September 1, 2013	$ 48,928	$ 150,742	$ 199,670
Contributions	163	2,420	2,583
Change in value of trusts	114	986	1,100
Investment return	6,350	–	6,350
Appropriation for expenditure	(5,354)	–	(5,354)
Other	(1,617)	(100)	(1,717)
Endowment net assets,			
August 31, 2014	48,584	154,048	202,632
Contributions	**352**	**2,459**	**2,811**
Contribution – Cadence net assets	–	**5,655**	**5,655**
Change in value of trusts	**(26)**	**(286)**	**(312)**
Investment return	**7,003**	–	**7,003**
Appropriation for expenditure	**(7,474)**	–	**(7,474)**
Other	**6,992**	**(1,101)**	**5,891**
Endowment net assets,			
August 31, 2015	**$ 55,431**	**$ 160,775**	**$ 216,206**

(In Thousands)

13. Pledges Receivable

As of August 31, 2015, donor-restricted pledges, which are included in Current portion of pledges and grants receivable and other assets, are expected to be realized as follows:

Less than one year	$	17,304
One to five years		31,045
Thereafter		1,407
Total pledges receivable		49,756
Less discount and allowance		(1,823)
Less present value discount		(4,362)
Net pledges receivable	$	43,571

14. Net Patient Service Revenue

Northwestern Memorial recognizes net patient service revenue associated with services provided to patients who have third-party payment coverage with Medicare, Medicaid, Blue Cross, other managed care programs, and other third-party payors on the basis of the contractual rates for the services rendered at the time services are provided. Payment arrangements with those payors include prospectively determined rates per admission or visit, reimbursed costs, discounted charges, and per diem rates. Reported costs and/or services provided under certain of the arrangements are subject to retroactive audit and adjustment. Net patient revenue increased by $21,158 and $13,191 in 2015 and 2014, respectively, as a result of changes in estimates due to prior fiscal year's cost report settlements and the disposition of other payor audits and settlements. Changes in Medicare and Medicaid programs and reduction in funding levels could have an adverse effect on Northwestern Memorial.

Northwestern Memorial also provides care to self-pay patients. Under its Free and Discounted Care Policy (the Policy), Northwestern Memorial provides medically necessary care to patients in its community with inadequate financial resources at discounts of up to 100% of charges using a sliding scale that is based on patient household income as a percentage (up to 600%) of the Federal Poverty Level Guidelines. The Policy also contains a catastrophic financial assistance provision that limits a patient's total financial responsibility to Northwestern Memorial. Since Northwestern Memorial does not pursue collection of these amounts, they are not reported as net patient service revenue. The Policy has not changed in fiscal year 2015 or 2014. Northwestern Memorial implemented presumptive eligibility screening procedures for free care in fiscal year 2014. Northwestern Memorial recognizes net patient service revenue on services provided to these patients at the discounted rate at the time services are rendered.

(In Thousands)

14. Net Patient Service Revenue (continued)

Net patient service revenue, net of contractual allowances and discounts, is reduced by the provision for uncollectible accounts, and net patient accounts receivable are reduced by an allowance for uncollectible accounts. These amounts are based primarily on management's assessment of historical and expected write-offs and net collections, along with the aging status for each major payor source. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. Based on historical experience, a portion of Northwestern Memorial's self-pay patients who do not qualify for charity care will be unable or unwilling to pay for the services provided. Thus, a provision is recorded for uncollectible accounts in the period services are provided related to these patients. After all reasonable collection efforts have been exhausted in accordance with Northwestern Memorial's policies, accounts receivable are written off and charged against the allowance for uncollectible accounts.

Northwestern Memorial has determined, based on an assessment at the reporting-entity level, that net patient service revenue is primarily recorded prior to assessing the patient's ability to pay and, as such, the entire provision for uncollectible accounts related to net patient service revenue is recorded as a deduction from net patient service revenue in the accompanying consolidated statements of operations and changes in net assets.

Net patient service revenue (including patient co-pays and deductibles), net of contractual allowances and discounts (but before the provision for uncollectible accounts) by primary payor source was as follows for the years ended August 31:

	2015	2014
Third-party payors	**$ 3,778,008**	$ 2,317,450
Patients	**89,294**	62,482
	$ 3,867,302	$ 2,379,932

Third-party payors include Medicaid net patient service revenue received through the Illinois Hospital Assessment Program (see Note 15). In June 2014, this program was extended to June 30, 2018 as part of the Omnibus Medicaid Bill Senate Bill 741. Additionally, this bill authorizes a new supplemental program to cover new Medicaid beneficiaries under the Affordable Care Act. This new program was approved by the Centers for Medicare and Medicaid Services (CMS) in January 2015. This new supplemental program provided an additional $28,856 included in Net patient service revenue for the year ended August 31, 2015.

(In Thousands)

14. Net Patient Revenue (continued)

Northwestern Memorial grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Patient accounts receivable, by major primary payor source including related patient co-pays and deductibles, before deducting estimated uncollectibles, was as follows at August 31:

	2015	2014
Medicare	**17%**	15%
Medicaid	**9**	7
Blue Cross	**15**	23
Other managed care	**28**	30
Other third-party payors	**13**	14
Patients	**18**	11
	100%	100%

The Provision for uncollectible accounts was $142,385 and $70,977, or 22.7% and 17.1%, of the related patient accounts receivable, net of contractual adjustments as of August 31, 2015 and 2014, respectively. The Provision for uncollectible accounts as a percent of patient accounts receivable, net of contractual allowances, has increased mainly due to the affiliation with Cadence (see Note 2) and its differing mix of payors and aging in its accounts receivable at August 31, 2015, compared to August 31, 2014.

15. Illinois Hospital Assessment Program

In December 2008, the Illinois Hospital Assessment Program was approved by the Federal Centers for Medicare and Medicaid Services (CMS) for the period from July 1, 2008 through June 30, 2013. In July 2012, this program was extended to December 31, 2014, as part of the Save Medicaid Access and Resources Together (SMART) Act. In June 2014, this program was extended to June 30, 2018 as part of the Omnibus Medicaid Bill Senate Bill 741.

In October 2013, the Enhanced Illinois Hospital Assessment Program as authorized under Illinois Public Act 97-688 was approved by CMS retroactive to June 10, 2012. As such, 26 months and 21 days of program revenue and expenses are included in operating results for the year ended August 31, 2014 and 12 months are included in the year ended August 31, 2015. Together, these two programs are referred to herein as HAP.

(In Thousands)

15. Illinois Hospital Assessment Program (continued)

Under HAP, the state receives additional federal Medicaid funds for the State's healthcare system, administered by the Illinois Department of Healthcare and Family Services. HAP includes both payments to NMH, CDH, Delnor and NLFH from the state and assessments against NMH, CDH, Delnor and NLFH, which are paid to the state in the same year. Included in the accompanying consolidated statements of operations and changes in net assets for the years ended August 31, 2015 and 2014, respectively, are $101,801 and $103,410 of Net patient service revenue and $81,489 and $74,044 of assessment.

16. Functional Expenses

Northwestern Memorial provides general health care services primarily to residents within its geographic location and supports research and education programs. Expenses related to providing these services were as follows for the years ended August 31:

	2015	2014
Health care services	**$ 2,694,860**	$ 1,748,490
Research and education	**129,421**	119,747
Fundraising	**11,377**	5,891
General, administrative, and other	**836,108**	410,221
	$ 3,671,766	$ 2,284,349

The research and education costs include $2,421 and $2,819 of expenses supported by federal, state, and corporate grants and $17,678 and $14,608 of expenses supported by other donor-restricted funds in 2015 and 2014, respectively.

17. Commitments and Contingencies

Academic, Program, and Other Support

Consistent with its mission, Northwestern Memorial provides academic, program, and other support to other not-for-profit entities. The present value of the total remaining commitments related to this support is $200,443 and $232,546 at August 31, 2015 and 2014, respectively, which is reported as Grants and academic support payable, less current maturities in the accompanying consolidated balance sheets.

17. Commitments and Contingencies (continued)

Northwestern Memorial will provide continuing funding to Northwestern University in support of the research and education mission of the Feinberg School of Medicine. The continuing funding is based on the average net patient service revenue and operating results of Northwestern Memorial, with the minimum annual amount of such funding being $39,500, plus inflation based on the Consumer Price Index, for fiscal years 2014 through 2016 and no minimum thereafter. The expense incurred of $54,322 and $40,924 for the years ended August 31, 2015 and 2014, respectively, is recorded in Other expense in the accompanying consolidated statements of operations and changes in net assets, and a related liability of $1,270 and $713 is reported in Accrued expenses and other current liabilities in the accompanying consolidated balance sheets as of August 31, 2015 and 2014, respectively.

Other

As of August 31, 2015, approximately 6% of Northwestern Memorial employees were represented by a collective bargaining agreement. This collective bargaining agreement does not expire within one year.

Capital and Leases

Various capital projects are currently being constructed that are expected to be placed in service over the next three years. The total estimated cost of these projects is $1,779,760 (unaudited). As of August 31, 2015, project commitments totaled $1,108,343, of which $782,902 has been incurred. These projected and related commitments include those agreed to by Northwestern Memorial as part of the affiliation agreement with Lake Forest Hospital to refurbish or replace existing inpatient and outpatient facilities on the Lake Forest Campus within ten years of the February 1, 2010 affiliation date (Replacement Project). On June 3, 2014, the Replacement Project received regulatory approval from the Illinois Health Facilities and Services Review Board. All governmental reviews, approvals and building permits have been received. Construction began in February 2015, and will continue into the summer of 2017. Building occupancy and hospital opening are planned for the fall of 2017.

(In Thousands)

17. Commitments and Contingencies (continued)

Certain Northwestern Memorial buildings are located on land leased from Northwestern University under various lease agreements. The principal lease requires annual payments of $314 through 2075. At August 31, 2015, minimum future rental payments under other noncancelable operating leases, which consist primarily of leases for office space and equipment, some of which include renewal options, are as follows:

Year ending August 31:	
2016	$ 22,178
2017	18,690
2018	16,828
2019	14,944
2020	12,380
Thereafter	67,208

Regulatory

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

In addition, an increasing number of the operations or practices of not-for-profit health care providers has been challenged or questioned to determine if they are consistent with the regulatory requirements for nonprofit, tax-exempt organizations. These challenges are broader than concerns about compliance with federal and state statutes and regulations of core business practices of the health care organizations. The laws and regulations regarding these practices are also subject to interpretation and challenge. Areas that have come under examination have included pricing practices, billing and collection practices, charity care, community benefit, executive compensation, exemption of property from real property taxation, and others. Northwestern Memorial expects that the level of review and audit to which it and other health

17. Commitments and Contingencies (continued)

care providers are subject will increase. There can be no assurance that regulatory authorities will not challenge Northwestern Memorial's compliance with these laws and regulations or that the laws and regulations themselves will not be subject to challenge, and it is not possible to determine the effect, if any, such claims or penalties would have on Northwestern Memorial.

Northwestern Memorial is aware of, has investigated and made disclosure to the United States Department of Health and Human Services Office for Civil Rights ("OCR") of two material privacy breaches. OCR has completed its investigation of one of the two privacy breaches and has issued a letter to NMHC closing the investigation with no subsequent required action or penalty. With respect to the second breach, management is unable to determine what, if any, fines may be imposed by OCR or other actions that might be taken as a result of this privacy breach.

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

18. Affiliation Agreement with KishHealth

On August 5, 2015, NMHC and KishHealth System (KishHealth) in DeKalb, Illinois, the corporate parent of Kishwaukee Hospital and Valley West Hospital, executed an Affiliation Agreement. The parties have completed their due diligence. The parties have obtained a Change of Ownership Exemption from the Illinois Health Facilities and Services Planning Board. The Federal Trade Commission did not take any action to seek more information during the Hart-Scott-Rodino notice period. Accordingly, the parties expect to close the transaction in December 2015.

19. Non-binding Letter of Intent With Marianjoy

In October 2015, NMHC and Wheaton Franciscan Healthcare, the corporate parent of Marianjoy Rehabilitation Hospital (Marianjoy) in Wheaton, Illinois, executed a non-binding letter of intent that provides for a period of exclusive discussions regarding a potential affiliation between NMHC and Marianjoy. Northwestern Memorial cannot predict whether these discussions will result in an agreement between the two organizations. Any definitive agreement would be subject to both parties' governing bodies and applicable regulatory approvals.

20. Subsequent Events

Northwestern Memorial evaluated events and transactions occurring subsequent to August 31, 2015 through November 30, 2015, the date of issuance of the accompanying consolidated financial statements. There were no recognized subsequent events and no unrecognized subsequent events requiring disclosure, except as noted in Notes 18 and 19.

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ATTACHMENT #6
Attachment Response 15