



The University of Chicago

2017–2018

*Financial Statements and Supplemental
University Information*

THE UNIVERSITY OF CHICAGO
Years ended June 30, 2018 and 2017

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THE UNIVERSITY OF CHICAGO

Management's Responsibility for Consolidated Financial Statements

June 30, 2018 and 2017

The management of The University of Chicago (University) is responsible for the preparation and fair presentation of the consolidated financial statements. The consolidated financial statements, presented on pages 4 to 48, have been prepared in conformity with U.S. generally accepted accounting principles and, as such, include amounts and disclosures based on judgments and estimates by management.

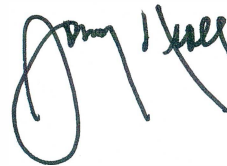
The consolidated financial statements have been audited by the independent accounting firm KPMG LLP (KPMG), which was given unrestricted access to all financial records and related data, including minutes of all meetings of Trustees. The University believes that all management representations made to KPMG during its audit were valid, complete, and appropriate. KPMG's audit opinion is presented on pages 2 and 3.

The University maintains a system of internal control over financial reporting, which is designed to provide reasonable assurance that the consolidated financial statements are free from material misstatement, whether due to fraud or error. Such controls are maintained through the establishment and communication of accounting and financial policies and procedures, selection and training of qualified personnel, and an internal audit program designed to identify internal control weaknesses in order to permit management to take appropriate corrective action on a timely basis. There are, however, inherent limitations in the effectiveness of any system of internal control, including the possibility of human or system error and the intentional circumvention of controls. Accordingly, even an effective internal control system can provide only reasonable assurance.

The Trustees of the University, through its Audit Committee comprised of Trustees not employed by the University, are responsible for engaging the independent accountants and meeting with management, internal auditors, and the independent accountants to ensure that each is carrying out their responsibilities. Both internal auditors and the independent accountants have full and free access to the Audit Committee.



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Vice President and Chief Financial Officer



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Independent Auditors' Report

The Board of Trustees
The University of Chicago:

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of The University of Chicago (the University), which comprise the consolidated balance sheets as of June 30, 2018 and 2017, the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The University of Chicago as of June 30, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Other Matter

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

KPMG LLP

Chicago, Illinois
November 7, 2018

THE UNIVERSITY OF CHICAGO

Consolidated Balance Sheets

June 30, 2018 and 2017

(In thousands of dollars)

| Assets | 2018 | 2017 |
|--|---------------|-------------|
| Cash and cash equivalents | \$ 280,197 | 50,384 |
| Notes and accounts receivable, net | 568,434 | 659,593 |
| Prepaid expenses and other assets | 273,108 | 254,309 |
| Pledges receivable, net | 600,566 | 655,584 |
| Investments | 9,046,311 | 8,704,732 |
| Land, buildings, equipment, and books, net | 4,919,243 | 4,912,286 |
| Total assets | \$ 15,687,859 | 15,236,888 |
| Liabilities and Net Assets | | |
| Liabilities: | | |
| Accounts payable and accrued liabilities | \$ 1,060,214 | 1,005,745 |
| Deferred revenue | 129,150 | 115,633 |
| Assets held in custody for others | 150,183 | 129,832 |
| Self-insurance liability | 260,998 | 287,581 |
| Pension and other postretirement benefit obligations | 434,400 | 491,828 |
| Asset retirement obligation | 54,457 | 55,827 |
| Notes and bonds payable | 4,820,232 | 4,691,832 |
| Refundable U.S. government student loan funds | 30,470 | 39,375 |
| Total liabilities | 6,940,104 | 6,817,653 |
| Net assets: | | |
| Without donor restrictions | 2,892,694 | 2,815,466 |
| With donor restrictions | 5,855,061 | 5,603,769 |
| Total net assets | 8,747,755 | 8,419,235 |
| Total liabilities and net assets | \$ 15,687,859 | 15,236,888 |

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO
Consolidated Statements of Activities
Years ended June 30, 2018 and 2017
(In thousands of dollars)

| | <u>2018</u> | <u>2017</u> |
|---|------------------|------------------|
| Changes in net assets without donor restrictions: | | |
| Operating: | | |
| Revenue: | | |
| Tuition and fees – gross | \$ 904,033 | 830,550 |
| Less student aid | (436,235) | (405,833) |
| Tuition and fees – net | 467,798 | 424,717 |
| Government grants and contracts | 348,489 | 367,577 |
| Private gifts, grants, and contracts | 287,859 | 229,526 |
| Endowment payout | 505,143 | 454,220 |
| Patient service | 2,286,885 | 2,128,591 |
| Auxiliaries | 226,131 | 216,622 |
| Other income | 417,255 | 393,729 |
| Net assets released from restrictions | 136,532 | 140,293 |
| Total operating revenue | <u>4,676,092</u> | <u>4,355,275</u> |
| Expenses: | | |
| Compensation: | | |
| Academic salaries | 619,857 | 590,246 |
| Staff salaries | 1,396,727 | 1,279,412 |
| Benefits | 488,951 | 475,024 |
| Total compensation | <u>2,505,535</u> | <u>2,344,682</u> |
| Other operating expenses: | | |
| Utilities, alterations, and repairs | 94,985 | 85,109 |
| Depreciation | 331,855 | 321,327 |
| Interest | 177,276 | 166,571 |
| Supplies, services, and other | 1,562,607 | 1,409,963 |
| Total other operating expenses | <u>2,166,723</u> | <u>1,982,970</u> |
| Total operating expenses | <u>4,672,258</u> | <u>4,327,652</u> |
| Excess of operating revenue over expenses | <u>\$ 3,834</u> | <u>27,623</u> |

THE UNIVERSITY OF CHICAGO
Consolidated Statements of Activities
Years ended June 30, 2018 and 2017
(In thousands of dollars)

| | <u>2018</u> | <u>2017</u> |
|--|---------------------|------------------|
| Changes in net assets without donor restrictions : | | |
| Nonoperating: | | |
| Investment gains (losses) | \$ (11,173) | 105,275 |
| Net periodic benefit cost other than service cost | (30,606) | (16,485) |
| Defined benefit pension plan curtailment - partial | — | 64,241 |
| Other postretirement benefit changes | 83,321 | 34,669 |
| Changes in fair value of derivative instruments | 37,207 | 67,401 |
| Loss on debt refinancing | — | (27,028) |
| Contribution of Ingalls Health System net assets | — | 309,740 |
| Other, net | (7,528) | (32,175) |
| Net assets released from restrictions | <u>2,173</u> | <u>—</u> |
| Nonoperating changes in net assets without donor restrictions | <u>73,394</u> | <u>505,638</u> |
| Increase in net assets without donor restrictions | <u>77,228</u> | <u>533,261</u> |
| Changes in net assets with donor restrictions: | | |
| Private gifts | 246,390 | 334,589 |
| Endowment payout | 948 | 923 |
| Investment gains | 104,688 | 212,306 |
| Contribution of Ingalls Health System net assets | — | 13,122 |
| Other, net | 37,970 | 26,544 |
| Net assets released from restrictions | <u>(138,704)</u> | <u>(140,293)</u> |
| Increase in net assets with donor restrictions | <u>251,292</u> | <u>447,191</u> |
| Increase in net assets | 328,520 | 980,452 |
| Net assets at beginning of year | <u>8,419,235</u> | <u>7,438,783</u> |
| Net assets at end of year | <u>\$ 8,747,755</u> | <u>8,419,235</u> |

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO
Consolidated Statements of Cash Flows
Years ended June 30, 2018 and 2017
(In thousands of dollars)

| | 2018 | 2017 |
|---|-------------|-------------|
| Cash flows from operating activities: | | |
| Increase in net assets | \$ 328,520 | 980,452 |
| Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities: | | |
| Contribution of Ingalls Health System net assets | — | (322,862) |
| Depreciation | 331,855 | 321,327 |
| Change in value of derivative instruments | (37,610) | (71,358) |
| Loss on debt refinancing | — | 27,028 |
| Loss on disposal of land, buildings, equipment, and books | 4,047 | 10,537 |
| Gain on sale of property | — | (44,687) |
| Net gain on investments | (520,068) | (676,860) |
| Private gifts and grants restricted for long-term investment | (249,846) | (338,944) |
| Other nonoperating changes | 115,535 | 207,400 |
| Postretirement benefit changes | (52,700) | (84,375) |
| Changes in operating assets and liabilities: | | |
| Notes and accounts receivable | 85,804 | (113,809) |
| Prepaid expenses and other assets | (52,324) | (106,206) |
| Accounts payable and other liabilities | 111,390 | 140,725 |
| Self-insurance liability | (26,583) | (2,510) |
| Total adjustments | (290,500) | (1,054,594) |
| Net cash provided by (used in) operating activities | 38,020 | (74,142) |
| Cash flows from investing activities: | | |
| Purchase of investments | (2,626,860) | (2,216,663) |
| Proceeds from sale of investments | 2,805,349 | 2,491,198 |
| Contribution of Ingalls Health System | — | 28,003 |
| Acquisition of land, buildings, equipment, and books | (341,208) | (444,570) |
| Proceeds from sale of property | — | 64,716 |
| Loans disbursed | — | (2,976) |
| Principal collected on loans | 6,497 | 7,914 |
| Net cash used in investing activities | (156,222) | (72,378) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of debt instruments | 1,931,799 | 1,787,661 |
| Principal payments on debt instruments | (1,805,652) | (1,749,925) |
| Proceeds from private gifts and grants restricted for long-term investment | 238,254 | 158,706 |
| Other nonoperating changes | (16,386) | (71,657) |
| Net cash provided by financing activities | 348,015 | 124,785 |
| Increase (decrease) in cash and cash equivalents | 229,813 | (21,735) |
| Cash and cash equivalents at: | | |
| Beginning of year | 50,384 | 72,119 |
| End of year | \$ 280,197 | 50,384 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 175,028 | 178,968 |
| Change in construction payable | (146) | (46,800) |

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

(1) Summary of Significant Accounting Policies

(a) Description of Business

The University of Chicago (the University) is a private, nondenominational, coeducational institution of higher learning and research. The University provides education and training services, primarily for students enrolled in undergraduate, graduate, and professional degree programs, and performs research, training, and other services under grants, contracts, and other agreements with sponsoring organizations, including both government agencies and private enterprises. Certain members of the University's faculty also provide professional medical services to patients at The University of Chicago Medical Center (the Medical Center) and other healthcare facilities located in the area.

Significant accounting policies followed by the University, the Medical Center, and the Marine Biological Laboratory (MBL) are set forth as follows. Accounting policies specific to the Medical Center and MBL are discussed in notes 2 and 3, respectively.

(b) Basis of Presentation

The consolidated financial statements of the University have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and include the accounts of the University, the Medical Center, and MBL. The organization of the Medical Center and MBL and associated agreements with the University are discussed in notes 2 and 3, respectively.

The University maintains its accounts in accordance with the principles of fund accounting. Under this method of accounting, resources for various purposes are classified into funds that are in accordance with activities or objectives specified by donors. Separate accounts are maintained for each fund.

For financial reporting purposes, however, the University follows the reporting requirements of GAAP, which requires that resources be classified for reporting purposes based on the existence or absence of donor-imposed restrictions. This is accomplished by classification of fund balances into two classes of net assets: without donor restrictions and with donor restrictions. Descriptions of the two net asset categories and the types of transactions affecting each category follow:

- Without Donor Restrictions – Net assets that are not subject to donor-imposed restrictions. Items that affect this net asset category principally consist of fees for service and related expenses associated with the core activities of the University: instruction, conduct of sponsored research, and provision of healthcare services. In addition to these exchange transactions, changes in this category of net assets include investment returns on “funds functioning as endowment” funds, actuarial adjustments to self-insurance liabilities, changes in postretirement benefit obligations, and certain types of philanthropic support.

Such philanthropic support includes gifts without restrictions, including those designated by the Board of Trustees (the Board) to function as endowment and restricted gifts whose donor-imposed restrictions were met during the fiscal year, as well as previously restricted gifts and grants for buildings and equipment that have been placed in service.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

- With Donor Restrictions – Net assets subject to donor-imposed restrictions that will be met either by actions of the University or the passage of time. Items that affect this net asset category are gifts for which donor-imposed restrictions have not been met in the year of receipt, including gifts and grants for buildings and equipment not yet placed in service; endowment, annuity, and life income gifts; pledges; and investment returns on “true” endowment funds, and endowments where the principal may be expended upon the passage of a stated period of time (term endowments). Expirations of restrictions on net assets with donor restrictions, including reclassification of restricted gifts and grants for buildings and equipment when the associated long-lived asset is placed in service, are reported as net assets released from restrictions.

Also included in this category are net assets subject to donor-imposed restrictions to be maintained permanently by the University, including gifts and pledges wherein donors stipulate that the corpus of the gift be held in perpetuity (primarily gifts for endowment and providing loans to students) and that only the income be made available for program operations. Other permanently restricted items in this net asset category include annuity and life income gifts for which the ultimate purpose of the proceeds is permanently restricted.

Net assets consisted of the following at June 30:

| Detail of net assets | 2018 | | | 2017 | | |
|--------------------------------|----------------------------|-------------------------|-------------|----------------------------|-------------------------|-----------|
| | Without donor restrictions | With donor restrictions | Total | Without donor restrictions | With donor restrictions | Total |
| University: | | | | | | |
| Operating | \$ (1,095,499) | 68,738 | (1,026,761) | (987,160) | 25,256 | (961,904) |
| Unamortized capital | | | | | | |
| gifts for construction | 132,901 | 31,490 | 164,391 | 140,991 | 21,897 | 162,888 |
| Pledges receivable | — | 595,274 | 595,274 | — | 648,341 | 648,341 |
| Student loan funds | — | 26,528 | 26,528 | — | 24,552 | 24,552 |
| Endowment funds | 2,056,342 | 4,869,300 | 6,925,642 | 1,909,298 | 4,627,648 | 6,536,946 |
| Annuity and life income funds | — | 69,929 | 69,929 | — | 67,298 | 67,298 |
| Subtotal | 1,093,744 | 5,661,259 | 6,755,003 | 1,063,129 | 5,414,992 | 6,478,121 |
| Medical Center: | | | | | | |
| Operating | 884,192 | 14,114 | 898,306 | 849,046 | 11,635 | 860,681 |
| Pledges receivable | — | 2,487 | 2,487 | — | 3,619 | 3,619 |
| Endowment funds | 824,607 | 94,867 | 919,474 | 813,993 | 92,652 | 906,645 |
| Subtotal | 1,708,799 | 111,468 | 1,820,267 | 1,663,039 | 107,906 | 1,770,945 |
| Marine Biological Laboratories | | | | | | |
| Operating | 80,263 | 4,938 | 85,201 | 79,704 | 5,486 | 85,190 |
| Pledges receivable | — | 2,805 | 2,805 | — | 3,624 | 3,624 |
| Annuity and life income funds | — | 1,109 | 1,109 | — | 1,225 | 1,225 |
| Endowment funds | 9,888 | 73,482 | 83,370 | 9,594 | 70,536 | 80,130 |
| Subtotal | 90,151 | 82,334 | 172,485 | 89,298 | 80,871 | 170,169 |
| Total | \$ 2,892,694 | 5,855,061 | 8,747,755 | 2,815,466 | 5,603,769 | 8,419,235 |

The endowment component of net assets without donor restrictions is comprised of amounts designated by the Board to function as endowment which amounted to \$2,890,837 and \$2,732,885 as of June 30, 2018 and 2017, respectively. Included in the University’s endowment without donor restrictions is a fund designated by the Board to be used to support the University’s strategic initiatives which amounted to \$230,811 and \$288,123 as of June 30, 2018 and 2017, respectively.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

(c) Operations

Operating results in the consolidated statements of activities reflect all transactions increasing or decreasing net assets without donor restrictions except those items associated with long-term investment, actuarial adjustments to self-insurance liabilities, changes in postretirement benefit obligations other than service cost, changes in the fair value of derivative instruments, unamortized capital gifts associated with the acquisition or construction of long-lived assets placed in service, and other infrequent transactions. Operating results also include a reclassification associated with amortization of capital gifts placed in service, as described below.

(d) Capital Gifts to Acquire or Construct Long-Lived Assets

Capital gifts to acquire or construct a long-lived asset are recorded as a donor restricted gift until the related asset is placed in service, at which time the capital gift is released from net assets with donor restrictions to net assets without donor restrictions and subsequently amortized into operations over the estimated useful life of the acquired or constructed asset. This amortization, which amounted to \$10,278 in fiscal year 2018 and \$10,302 in fiscal year 2017, is recorded as a reclassification between the non-operating and operating sections of the change in net assets without donor restrictions in the consolidated statements of activities.

(e) Tuition and Fees

Student tuition and fees are recorded as revenue during the year in which the related academic services are rendered. Student tuition and fees received in advance of services to be rendered are recorded as deferred revenue.

(f) Gifts, Grants, and Contracts

Gifts, including unconditional pledges, are recognized in the appropriate category of net assets in the period received. Contributions of assets other than cash are recorded at their estimated fair value at the date of gift. Pledges receivable are stated at the estimated net present value, net of an allowance for uncollectible amounts. Conditional promises to give are not recognized until the conditions on which they depend are substantially met.

Revenue from government and private grant and contract agreements is recognized as it is earned through expenditure in accordance with the agreements. Any funding received in advance of expenditure is recorded as deferred revenue on the consolidated balance sheets. Included in deferred revenue at June 30, 2018 and 2017 are \$62,635 and \$50,693, respectively, of private grant and contract receipts, that have not been expended.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

Private gifts, grants, and contracts operating revenue for fiscal years 2018 and 2017 consist of the following:

| | 2018 | | | 2017 | |
|---|-------------------|-----------------------|--------------|---------------------|---------------------|
| | <u>University</u> | <u>Medical Center</u> | <u>MBL</u> | <u>Consolidated</u> | <u>Consolidated</u> |
| Private gifts: | | | | | |
| Unrestricted as to use | \$ 18,493 | 206 | 1,108 | 19,807 | 20,644 |
| Restricted gifts whose restrictions were met during the fiscal year and reported as operating revenue | 145,699 | — | — | 145,699 | 108,057 |
| Private grants and contracts | <u>117,715</u> | <u>—</u> | <u>4,638</u> | <u>122,353</u> | <u>100,825</u> |
| Total | <u>\$ 281,907</u> | <u>206</u> | <u>5,746</u> | <u>287,859</u> | <u>229,526</u> |

(g) Patient Service

Patient service revenue is reported net of a provision for doubtful accounts of \$8,272 and \$7,302 for the University and \$182,894 and \$152,888 for the Medical Center for the years ended June 30, 2018 and 2017, respectively. This provision reflects the estimated net realizable amounts due from third-party payors for services rendered. The Medical Center analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for uncollectible accounts receivable. A majority of patient service revenue is derived from contractual agreements with Medicare, Medicaid, Blue Cross/Blue Shield, managed care, and certain other programs. Payments under these agreements and programs are based on specific amounts per case or contracted prices. Certain revenue received from third-party payors is subject to audit and retroactive adjustment. Any changes in estimates under these contracts are recorded in operations currently. The Medical Center's gross write-offs increased from approximately \$210,841 in fiscal year 2017 to \$249,734 in fiscal year 2018. The Medical Center did not have significant write-offs from third-party payors.

(h) Capitalized Interest

The University capitalizes interest costs incurred on debt during the construction of major projects exceeding one year. During fiscal years 2018 and 2017, the amount of interest capitalized amounted to \$2,444 and \$3,141 for the University and \$1,075 and \$2,766 for the Medical Center, respectively.

(i) Fair Value

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

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

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

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

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

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

(i) *Cash Equivalents*

Cash equivalents include U.S. Treasury notes, commercial paper, and corporate notes with original maturities of three months or less, except that such instruments purchased with endowment assets or funds on deposit with bond trustees are classified as investments. Cash equivalents are classified in Level 1 of the fair value hierarchy.

(ii) *Investments*

Investments are recorded in the consolidated financial statements at estimated fair value. If an investment is held directly by the University and an active market with quoted prices exists, the market price of an identical security is used as reported fair value. Reported fair values for shares in mutual funds are based on share prices reported by the funds as of the last business day of the fiscal year and are classified in Level 1. The University's interests in alternative investment funds such as private debt, global public equity, private equity, real estate, natural resources, and absolute return are generally reported at the net asset value (NAV) reported by the fund managers, which is used as a practical expedient to estimate the fair value, unless it is probable that all or a portion of the investment will be sold for an amount different from NAV. As of June 30, 2018 and 2017, the University had no plans to sell investments at amounts different from NAV. Funds measured at NAV as a practical expedient to estimate fair value are not classified in the fair value hierarchy.

The University does not engage directly in unhedged speculative investments; however, the Board has authorized the use of derivative investments to adjust market exposure within asset class ranges.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

A summary of the inputs used in valuing the University's investments as of June 30, 2018 and 2017 is included in note 5.

(iii) *Pledges Receivable*

Unconditional promises to give are recognized initially at fair value as private gift revenue in the period the promise is made by a donor. The fair value of the pledge is estimated based on anticipated future cash receipts (net of an allowance for uncollectible amounts), discounted using a risk-adjusted rate commensurate with the duration of the payment plan. These inputs to the fair value estimate are classified in Level 3 of the fair value hierarchy. In subsequent periods, the discount rate is unchanged and the allowance for uncollectible amounts is reassessed and adjusted if necessary.

(iv) *Land, Buildings, Equipment, and Books*

Land, buildings, equipment, and books are generally stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, ranging from 20 to 45 years for buildings and building improvements, 3 to 10 years for equipment, and 10 years for library books.

(v) *Split-Interest Agreements*

Split-interest agreements with donors consist primarily of charitable remainder trusts for which the University serves as trustee, gift annuity contracts, and pooled life income agreements. Assets associated with split-interest agreements are included in investments. A liability for split-interest obligations is recorded when the agreement is established at the estimated net present value of future cash flows using a risk-adjusted discount rate commensurate with the duration of the estimated payments. These inputs to the fair value estimate are classified in Level 3 of the fair value hierarchy. At June 30, 2018 and 2017, the University had liabilities of \$56,432 and \$55,439 associated with its charitable remainder trust and gift annuity contracts and deferred revenue of \$5,368 and \$5,369 associated with its pooled income agreements, respectively. In subsequent periods, the discount rate is unchanged.

(vi) *Interest Rate Swap Agreements*

In order to reduce exposure to adjustable interest rates on variable rate debt, the University has entered into debt-related interest rate swap agreements. These agreements have the effect of fixing the rate of interest for the variable rate debt. The fair value of these swap agreements is the estimated amount that the University would have to pay or receive to terminate the agreements as of the consolidated balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparty. These inputs to the fair value estimate are classified in Level 2 of the fair value hierarchy.

(vii) *Assets Held in Custody For Others*

Assets held in custody for others consist of resources, primarily investments, held by the University as a custodian for affiliated organizations. Investments held for others are included in the University's investment portfolio. The leveling of these investments is presented in note 5.

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(viii) Self-insurance Liability

The self-insurance liability is the estimated present value of self-insured claims that will be settled in the future and considers anticipated payout patterns as well as investment returns on available assets prior to payment. The discount rate used to value the self-insurance liability is a risk-adjusted rate commensurate with the duration of anticipated payments. These inputs to the fair value estimate of the liability are considered Level 2 in the fair value hierarchy.

(ix) Pension and Other Postretirement Benefit Obligations

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

(x) Asset Retirement Obligation

Asset retirement obligations arise primarily from regulations that specify how to dispose of asbestos if facilities are demolished or undergo major renovations or repairs. The obligation to remove asbestos is estimated using site-specific surveys where available and a per square foot estimate where surveys were unavailable.

(xi) Notes and Bonds Payable

The carrying value of long-term debt does not differ materially from its estimated fair value based on quoted market prices for the same or similar issues.

(xii) All Other Assets and Liabilities

The carrying value of all other assets and liabilities do not differ materially from their estimated fair value.

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(j) Internally Managed Investment Derivatives

The following tables set forth the gross and net notional values and the University's gain related to internally managed investment derivative activities as of June 30, 2018 and 2017 and for the fiscal years then ended:

| | 2018 | | |
|--------------------|---------------------------|---------------------|-------------|
| | Gross notional | Net notional | Gain |
| Equity derivatives | \$ 19,385 | 19,385 | 11,510 |
| | 2017 | | |
| | Gross notional | Net notional | Gain |
| Equity derivatives | \$ 159,191 | 159,191 | 7,191 |

To minimize the risk of loss, externally managed absolute return investments are diversified by strategy, external manager, and number of positions. In addition, the activities of external hedge fund managers are externally audited and reviewed by the University Investment Office. The risk of any derivative exposure associated with an externally managed hedge fund is limited to the amount invested with each manager. Investment managers report derivative investments at fair value and valuation gains and losses are included in investment gains (losses) in the consolidated statements of activities.

(k) Income Taxes

The University, Medical Center, and MBL are tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code and, except for unrelated business income, are exempt from federal income taxes. There was no provision for income taxes due on unrelated business income in fiscal years 2018 and 2017, and there are no uncertain tax positions considered to be material.

(l) Use of Estimates

The preparation of the consolidated financial statements in accordance with GAAP requires that management make a number of estimates and assumptions related to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the consolidated balance sheet dates, and the reporting of revenue, expenses, gains, and losses during the reporting periods. Actual results may differ from those estimates.

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(m) Subsequent Events

In July 2018, the University entered into a 65 year ground lease agreement with a developer to construct a 1,300 bed residential housing and dining facility on University land. The \$158,000 facility will be financed by the developer.

In September 2018, the University issued \$400,000 in taxable fixed rate bonds. Proceeds were used to refinance existing commercial paper and lines of credit debt outstanding.

In September 2018, the Medical Center reduced its bank line of credit from \$100,000 to \$50,000.

In October 2018, the University reduced its bank lines of credit from \$500,000 to \$400,000.

(2) The University of Chicago Medical Center

(a) Organization

The Medical Center, an Illinois not-for-profit corporation, operates the Center for Care and Discovery, the Bernard Mitchell Hospital, the University of Chicago Comer Children's Hospital, the Duchossois Center for Advanced Medicine, the University of Chicago Medicine Care Network, various other outpatient clinics and treatment areas, and as of October 1, 2016, Ingalls Health System. The University, as the sole corporate member of the Medical Center, elects the Medical Center's Board of Trustees and approves its bylaws.

(b) Acquisition of Ingalls Health System

On October 1, 2016 the Medical Center acquired Ingalls Health System through an affiliation and member substitution agreement. As a result of this transaction, Ingalls Health System became a wholly owned subsidiary of the Medical Center through a newly created Community Health and Hospital Division of the Medical Center. Amounts included in the accompanying notes and consolidated financial statements and supplemental schedules reflect Ingalls activity beginning on October 1, 2016. Ingalls net assets of \$322,862 at October 1, 2016 have been recognized as a contribution in the consolidated statements of activities in fiscal 2018.

The following table sets forth the fair value of Ingalls assets and liabilities at October 1, 2016 which have been recognized in the consolidated financial statements.

| | | |
|-----------------------------------|----|-----------------|
| Cash | \$ | 28,003 |
| Investments | | 298,975 |
| Land, buildings, and equipment | | 187,641 |
| Notes and bonds payable | | (111,990) |
| Other assets and liabilities, net | | <u>(79,767)</u> |
| Net assets | \$ | <u>322,862</u> |

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(c) Agreements with the University

The relationship between the University and the Medical Center is defined in an Affiliation Agreement and an Operating Agreement along with an associated Lease Agreement. The Affiliation Agreement specifies University and Medical Center responsibilities for the provision of patient care, teaching, and research at the hospitals and clinics. The Operating Agreement provides for the management and operation by the Medical Center of the University's hospital and clinic facilities. The Lease Agreement provides the Medical Center a leasehold interest in certain University facilities and land.

(d) Community Benefits

The Medical Center's policy is to treat patients in immediate need of medical services without regard to their ability to pay for such services, including patients transferred from other hospitals and patients accepted through the Perinatal and Pediatrics Trauma Networks. Patients are offered discounts of up to 100% of charges on a sliding scale based both on income as a percentage of the Federal Poverty Level guidelines and the charges for services rendered. The Medical Center policy also contains provisions that are responsive to those patients subject to catastrophic healthcare expenses. Since the Medical Center does not pursue collection of these amounts, they are not reported as net patient care revenue. The unreimbursed cost of providing such care, along with the unreimbursed cost of government sponsored indigent healthcare programs, unreimbursed cost to support education, clinical research, and other community programs, amounted to \$399,888 and \$374,957 for the years ended June 30, 2018 and 2017, respectively.

(e) Basis of Presentation

The Medical Center maintains its accounts and prepares stand-alone financial statements in conformity with GAAP applicable to not-for-profit health care entities. For purposes of presentation of the Medical Center financial position and changes in net assets in the accompanying consolidated financial statements, several reclassifications have been made as follows: (1) investment gains used for operations of \$50,713 in fiscal year 2018 and \$41,389 in 2017 have been recorded as operating revenue and (2) transfers to the University of \$43,235 in fiscal year 2018 and \$61,002 in fiscal year 2017 have been recorded as a reduction of other income.

(3) Marine Biological Laboratory (MBL)

(a) Organization

MBL is a private, independent not-for-profit research and educational institution dedicated to establishing and maintaining a laboratory and station for scientific study and investigations, and a school for instruction in biology and natural history. MBL is located in Woods Hole, Massachusetts. The University is the sole corporate member of MBL, elects MBL's Board of Trustees, and approves its bylaws.

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(b) Agreement with the University

The relationship between the University and MBL is defined in an Affiliation Agreement which specifies the University and MBL responsibilities for the provision of research and education in biology, biomedicine, ecology, and related fields.

(4) Financial Assets and Liquidity Resources

As of June 30, 2018 and 2017, financial assets and liquidity resources available within one year for general expenditure, such as operating expenses, scheduled principal payments on debt, and capital construction costs not financed with debt, were as follows:

| | 2018 | | | | 2017 Consolidated |
|---|--------------|-------------------|--------|--------------|----------------------|
| | University | Medical Center | MBL | Consolidated | |
| Financial assets: | | | | | |
| Cash and cash equivalents | \$ 66,770 | 211,751 | 1,676 | 280,197 | 50,384 |
| Notes and accounts receivable, net | 134,850 | 347,870 | 3,529 | 486,249 | 569,978 |
| Pledge payments available for operations | 68,856 | 1,052 | 594 | 70,502 | 117,853 |
| Short-term investments | 125,798 | — | 9,911 | 135,709 | 202,408 |
| Board designations: | | | | | |
| Funds functioning as endowment available for operations | 230,811 | — | — | 230,811 | 288,123 |
| Subsequent year's endowment payout | 379,691 | 55,423 | 4,443 | 439,557 | 438,188 |
| Total financial assets available within one year | 1,006,776 | 616,096 | 20,153 | 1,643,025 | 1,666,934 |
| Liquidity resources: | | | | | |
| Taxable commercial paper | 200,000 | — | — | 200,000 | 200,000 |
| Bank lines of credit | 400,000 | 60,000 | 3,000 | 463,000 | 553,000 |
| Total financial assets and liquidity resources available within one year | \$ 1,606,776 | 676,096 | 23,153 | 2,306,025 | 2,419,934 |

The University's cash flows have seasonal variations during the year attributable to tuition billing, patient service reimbursement from the State of Illinois, and a concentration of contributions received at calendar and fiscal year-end. To manage liquidity, the University maintains lines of credit with several banks and a taxable commercial paper program that are drawn upon as needed during the year to manage cash flows. As of June 30, 2018, amounts outstanding under these lines of credit facilities amounted to \$493,500, \$400,000 of which was refinanced in September 2018 through the issuance of taxable fixed rate bonds.

In addition, as of June 30, 2018 the University, Medical Center, and MBL had an additional \$1,825,531, \$824,607, and \$9,888 in funds functioning as endowment, respectively, which is available for general expenditure with Board approval.

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(5) Investments

Investments at June 30, 2018 and 2017 are comprised of the following:

| | 2018 | 2017 |
|---|----------------------------|----------------------------|
| | <u>Consolidated</u> | <u>Consolidated</u> |
| Cash equivalents | \$ 130,578 | 538,277 |
| Global public equities (primarily international) | 2,521,312 | 2,085,220 |
| Private debt | 382,659 | 380,089 |
| Private equity: | | |
| U.S. venture capital | 454,075 | 482,875 |
| U.S. corporate finance | 291,800 | 306,809 |
| International | 505,231 | 449,109 |
| Real estate | 538,662 | 497,359 |
| Natural resources | 627,543 | 582,574 |
| Absolute return: | | |
| Equity-oriented | 842,923 | 769,693 |
| Global macro/relative value | 493,087 | 515,996 |
| Multistrategy | 625,374 | 605,844 |
| Credit-oriented | 468,179 | 436,552 |
| Protection-oriented | 156,665 | 141,202 |
| Fixed income: | | |
| U.S. treasuries | 521,149 | 481,345 |
| Other fixed income | 357,849 | 318,756 |
| Funds in trust | 129,225 | 113,032 |
| Total | \$ 9,046,311 | 8,704,732 |

(a) Overall Investment Objective

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

(b) Investment Strategies

Cash equivalent investments include cash equivalents and fixed-income investments with maturities of less than one year, which are valued based on quoted market prices in active markets. The majority of these investments are held in U.S. money market accounts. Global public equity investments consist of

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separate accounts, exchange traded funds (ETFs), commingled funds with liquidity ranging from daily to annually, hedge funds investing primarily in long only public equities, and limited partnerships. ETFs and securities held in separate accounts and daily traded commingled funds are generally valued based on quoted market prices in active markets. Commingled funds with monthly liquidity are valued based on independently determined NAV. Limited partnership interests in equity-oriented funds are valued based upon NAV provided by external fund managers.

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

Funds in trust investments consist primarily of project construction funds and externally managed endowments.

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

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

The University believes that the reported amount of its investments is a reasonable estimate of fair value as of June 30, 2018 and 2017. Because of the inherent uncertainties of valuation, these estimated fair values may differ significantly from values that would have been used had a ready market existed.

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(c) Fair Value Hierarchy of Investments

Following is the fair value hierarchy of investments as of June 30, 2018:

| | <u>Level 1</u> | <u>Level 2</u> | <u>2018 Consolidated total</u> |
|---|---------------------|----------------|--|
| Cash equivalents | \$ 130,578 | — | 130,578 |
| Global public equities (primarily international) | 882,835 | 126,228 | 1,009,063 |
| Private equity - U.S. venture capital | 5,613 | — | 5,613 |
| Real estate | 154,652 | — | 154,652 |
| Natural resources | 86,888 | — | 86,888 |
| Absolute return - Global macro/relative value | 86,073 | 27,922 | 113,995 |
| Fixed income: | | | |
| U.S. treasuries | 521,149 | — | 521,149 |
| Other fixed income (primarily credit funds) | 357,774 | 75 | 357,849 |
| Funds in trust | 86,337 | 30,599 | 116,936 |
| | <u>\$ 2,311,899</u> | <u>184,824</u> | <u>2,496,723</u> |
| Investments measured at net asset value | | | <u>6,549,588</u> |
| Total investments at fair value as of June 30, 2018 | | | <u>\$ 9,046,311</u> |

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Following is the fair value hierarchy of investments as of June 30, 2017:

| | <u>Level 1</u> | <u>Level 2</u> | <u>2017 Consolidated total</u> |
|---|---------------------|----------------|--|
| Cash equivalents | \$ 538,278 | — | 538,278 |
| Global public equities (primarily international) | 608,390 | 44,956 | 653,346 |
| Real estate | 102,113 | — | 102,113 |
| Natural resources | 48,884 | — | 48,884 |
| Absolute return: | | | |
| Global macro/relative value | 83,583 | 27,754 | 111,337 |
| Fixed income: | | | |
| U.S. treasuries | 481,345 | — | 481,345 |
| Other fixed income (primarily credit funds) | 282,558 | 50 | 282,608 |
| Funds in trust | 74,928 | 20,370 | 95,298 |
| | <u>\$ 2,220,079</u> | <u>93,130</u> | 2,313,209 |
| Investments measured at net asset value | | | <u>6,391,523</u> |
| Total investments at fair value as of June 30, 2017 | | | <u>\$ 8,704,732</u> |

During fiscal years 2018 and 2017, there were no transfers between investment Levels 1 and 2.

A summary of investment return by entity, net of expenses, is presented below for the years ended June 30, 2018 and 2017:

| | <u>2018</u> | | | | <u>2017</u> |
|-----------------------------------|-------------------|-----------------------|--------------|---------------------|---------------------|
| | <u>University</u> | <u>Medical Center</u> | <u>MBL</u> | <u>Consolidated</u> | <u>Consolidated</u> |
| Investment return: | | | | | |
| Interest and dividends | \$ 64,428 | 13,890 | 730 | 79,048 | 85,127 |
| Net realized and unrealized gains | 462,083 | 61,307 | 5,558 | 528,948 | 687,597 |
| Investment return | <u>\$ 526,511</u> | <u>75,197</u> | <u>6,288</u> | <u>607,996</u> | <u>772,724</u> |

Investment return is reported in the accompanying consolidated statements of activities as endowment payout and investment gains.

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The University is obligated under certain limited partnership investment fund agreements to advance additional funding periodically up to specified levels. At June 30, 2018, the University had unfunded commitments of \$1,259,961, which are likely to be called through 2026. Details of these commitments are as follows:

| | |
|-------------------|---------------------------------|
| | Unfunded commitments |
| Private equity | \$ 513,915 |
| Real estate | 310,296 |
| Natural resources | 163,711 |
| Absolute return | 4,084 |
| Private debt | <u>267,955</u> |
| Total | \$ <u>1,259,961</u> |

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

| | Remaining life | Redemption terms | Redemption restrictions and terms | Redemption restrictions or side pockets at June 30, 2018 |
|--------------------------------|----------------|---|---|--|
| Cash | N/A | Daily | None | None |
| Global public equities: | | | | |
| Commingled funds | N/A | Daily to annual with notice periods of 2 to 180 days | Lock-up provisions for up to 2 years, some investments have a portion of capital held in side pockets with no redemptions permitted | \$31.3 million |
| Partnerships | N/A | Monthly to biennial with notice periods of 7 to 90 days | Lock-up provisions for up to 4 years, some investments have a portion of capital held in side pockets with no redemptions permitted | \$29.1 million |

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| | Remaining life | Redemption terms | Redemption restrictions and terms | Redemption restrictions or side pockets at June 30, 2018 |
|--|----------------|---|---|--|
| Exchange traded funds | N/A | Daily | None | None |
| Separate accounts | N/A | Daily with notice periods of 1 to 7 days | Lock-up provisions ranging for up to 1 year | None |
| Private debt: | | | | |
| Drawdown partnerships | 1 to 11 years | Redemptions not permitted | N/A | N/A |
| Partnerships | N/A | Redemptions not permitted | Capital held in side pockets with no redemptions permitted | \$0.3 million |
| Private equity: | | | | |
| Drawdown partnerships | 1 to 19 years | Redemptions not permitted | N/A | N/A |
| Separate account | N/A | Daily with notice period of 1 day | None | None |
| Partnerships | N/A | Semi-annual with notice period of 90 days | A portion of capital is held in side pockets with no redemption permitted | \$11.6 million |
| Direct investments in a Series A Preferred | 1 to 19 years | Redemptions permitted | N/A | \$2.4 million |

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| | | | | |
|---------------------------|---------------|---|---|-----------------|
| Real estate: | | | | |
| Drawdown partnerships | 1 to 19 years | Redemptions not permitted | N/A | N/A |
| Separate account | N/A | Daily with notice period of 5 days | None | None |
| Natural resources: | | | | |
| Drawdown partnerships | 1 to 17 years | Redemptions not permitted | N/A | N/A |
| Separate account | N/A | Daily with notice period of 30 days | None | None |
| Absolute return: | | | | |
| Commingled funds | N/A | Daily to triennial with notice periods of 1 to 122 days | Lock-up provisions for up to 3 years, some investments have a portion of capital held in side pockets with no redemptions permitted | \$106.3 million |
| Drawdown partnerships | 1 to 2 years | Redemptions not permitted | N/A | N/A |
| Partnerships | N/A | Quarterly to triennial with notice periods of 45 to 90 days | Lock-up provisions for up to 5 years, some investments have a portion of capital held in side pockets with no redemptions permitted | \$254.1 million |
| Fixed Income | N/A | Daily | None | None |
| Funds in Trust | N/A | Daily | None | None |

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(6) Endowments

The University's endowment consists of approximately 4,000 individual funds established for a variety of purposes. The endowment includes both donor-restricted "true" endowment funds and funds designated by the Board to function as endowments commonly referred to as "funds functioning as endowment" (FFE). Net assets associated with endowment funds, including funds functioning as endowment, are classified and reported based on the existence or absence of donor-imposed restrictions.

The University, Medical Center, and MBL endowment each invest in an investment pool referred to as the Total Return Investment Pool (TRIP). As of June 30, 2018, 99%, 96%, and 100% of the University, Medical Center, and MBL endowments respectively, are invested in TRIP.

(a) University Endowment

Changes in the fair value of the University endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2018:

| | 2018 | | |
|---|-------------------------------|----------------------------|-----------|
| | Without Donor Restrictions | With Donor Restrictions | Total |
| Changes in the fair value of endowment investments: | | | |
| Investment return: | | | |
| Endowment yield (interest and dividends) | \$ 18,415 | 45,989 | 64,404 |
| Net appreciation (realized and unrealized) on investments | 151,508 | 310,598 | 462,106 |
| Total investment return | 169,923 | 356,587 | 526,510 |
| Endowment payout | (196,096) | (259,314) | (455,410) |
| Investment return, net of payout | (26,173) | 97,273 | 71,100 |
| Other changes in endowment investments: | | | |
| Gifts and pledge payments received in cash | — | 124,679 | 124,679 |
| Transfers to create funds functioning as endowment | 174,962 | — | 174,962 |
| Other changes | (1,745) | 19,700 | 17,955 |
| Total other changes in endowment investments | 173,217 | 144,379 | 317,596 |
| Net change in endowment investments | 147,044 | 241,652 | 388,696 |
| Endowment investments at: | | | |
| Beginning of year | 1,909,298 | 4,627,648 | 6,536,946 |
| End of year | \$ 2,056,342 | 4,869,300 | 6,925,642 |
| Investments by type of fund: | | | |
| Donor-restricted "true" endowment: | | | |
| Historical gift value | \$ — | 2,027,530 | 2,027,530 |
| Appreciation | — | 2,841,770 | 2,841,770 |
| Board-designated "funds functioning as endowment" | 2,056,342 | — | 2,056,342 |
| Total – as above | \$ 2,056,342 | 4,869,300 | 6,925,642 |

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Changes in the fair value of the University endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2017:

| | 2017 | | Total |
|---|-------------------------------|----------------------------|-----------|
| | Without Donor Restrictions | With Donor Restrictions | |
| Changes in the fair value of endowment investments: | | | |
| Investment return: | | | |
| Endowment yield (interest and dividends) | \$ 19,813 | 49,523 | 69,336 |
| Net appreciation (realized and unrealized) on investments | 190,812 | 403,210 | 594,022 |
| Total investment return | 210,625 | 452,733 | 663,358 |
| Endowment payout | (153,444) | (251,346) | (404,790) |
| Investment return, net of payout | 57,181 | 201,387 | 258,568 |
| Other changes in endowment investments: | | | |
| Gifts and pledge payments received in cash | — | 140,920 | 140,920 |
| Transfers to create funds functioning as endowment | 56,409 | — | 56,409 |
| Other changes | 551 | 35,495 | 36,046 |
| Total other changes in endowment investments | 56,960 | 176,415 | 233,375 |
| Net change in endowment investments | 114,141 | 377,802 | 491,943 |
| Endowment investments at: | | | |
| Beginning of year | 1,795,157 | 4,249,846 | 6,045,003 |
| End of year | \$ 1,909,298 | 4,627,648 | 6,536,946 |
| Investments by type of fund: | | | |
| Donor-restricted "true" endowment: | | | |
| Historical gift value | \$ — | 1,900,208 | 1,900,208 |
| Appreciation | — | 2,727,440 | 2,727,440 |
| Board-designated "funds functioning as endowment" | 1,909,298 | — | 1,909,298 |
| Total – as above | \$ 1,909,298 | 4,627,648 | 6,536,946 |

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(b) Medical Center Endowment

Changes in the fair value of the Medical Center endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2018:

| | 2018 | | |
|--|-------------------------------|----------------------------|----------|
| | Without donor restrictions | With donor restrictions | Total |
| Changes in the fair value of endowment investments: | | | |
| Investment return: | | | |
| Endowment yield (interest and dividends) | \$ 10,748 | 719 | 11,467 |
| Net appreciation (realized and unrealized) on investments | 37,964 | 5,081 | 43,045 |
| Total investment return | 48,712 | 5,800 | 54,512 |
| Endowment payout | (41,431) | (4,819) | (46,250) |
| Investment return, net of payout | 7,281 | 981 | 8,262 |
| Other changes in endowment investments: | | | |
| Gifts and pledge payments received in cash | — | 1,234 | 1,234 |
| Other changes | 3,333 | — | 3,333 |
| Total other changes in endowment investments | 3,333 | 1,234 | 4,567 |
| Net change in endowment investments | 10,614 | 2,215 | 12,829 |
| Endowment investments at: | | | |
| Beginning of year | 813,993 | 92,652 | 906,645 |
| End of year | \$ 824,607 | 94,867 | 919,474 |
| Investments by type of fund: | | | |
| Donor-restricted "true" endowment: | | | |
| Historical gift value | \$ — | 17,487 | 17,487 |
| Appreciation | — | 77,380 | 77,380 |
| Board-designated "funds functioning as endowment" | 824,607 | — | 824,607 |
| Total – as above | \$ 824,607 | 94,867 | 919,474 |

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Changes in the fair value of the Medical Center endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2017:

| | 2017 | | |
|--|-------------------------------|----------------------------|----------|
| | Without donor restrictions | With donor restrictions | Total |
| Changes in the fair value of endowment investments: | | | |
| Investment return: | | | |
| Endowment yield (interest and dividends) | \$ 29,989 | 1,001 | 30,990 |
| Net appreciation (realized and unrealized) on investments | 42,567 | 6,843 | 49,410 |
| Total investment return | 72,556 | 7,844 | 80,400 |
| Endowment payout | (40,953) | (4,997) | (45,950) |
| Investment return, net of payout | 31,603 | 2,847 | 34,450 |
| Other changes in endowment investments: | | | |
| Gifts and pledge payments received in cash | — | 799 | 799 |
| Contribution - Ingalls Health System | — | 13,122 | 13,122 |
| Withdrawal to finance capital expenditures | (25,000) | — | (25,000) |
| Other changes | 2,953 | 371 | 3,324 |
| Total other changes in endowment investments | (22,047) | 14,292 | (7,755) |
| Net change in endowment investments | 9,556 | 17,139 | 26,695 |
| Endowment investments at: | | | |
| Beginning of year | 804,437 | 75,513 | 879,950 |
| End of year | \$ 813,993 | 92,652 | 906,645 |
| Investments by type of fund: | | | |
| Donor-restricted "true" endowment: | | | |
| Historical gift value | \$ — | 17,445 | 17,445 |
| Appreciation | — | 75,207 | 75,207 |
| Board-designated "funds functioning as endowment" | 813,993 | — | 813,993 |
| Total – as above | \$ 813,993 | 92,652 | 906,645 |

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(c) MBL

Changes in the fair value of the MBL endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2018:

| | 2018 | | |
|--|-------------------------------|----------------------------|----------------|
| | Without donor restrictions | With donor restrictions | Total |
| Changes in the fair value of endowment investments: | | | |
| Investment return: | | | |
| Endowment yield (interest and dividends) | \$ 88 | 642 | 730 |
| Net appreciation (realized and unrealized) on investments | <u>668</u> | <u>4,889</u> | <u>5,557</u> |
| Total investment return | 756 | 5,531 | 6,287 |
| Endowment payout | <u>(547)</u> | <u>(3,884)</u> | <u>(4,431)</u> |
| Investment return, net of payout | <u>209</u> | <u>1,647</u> | <u>1,856</u> |
| Other changes in endowment investments: | | | |
| Gifts and pledge payments received in cash | — | 1,377 | 1,377 |
| Other changes | <u>85</u> | <u>(78)</u> | <u>7</u> |
| Total other changes in endowment investments | <u>85</u> | <u>1,299</u> | <u>1,384</u> |
| Net change in endowment investments | 294 | 2,946 | 3,240 |
| Endowment investments at: | | | |
| Beginning of year | <u>9,594</u> | <u>70,536</u> | <u>80,130</u> |
| End of year | <u>\$ 9,888</u> | <u>73,482</u> | <u>83,370</u> |
| Investments by type of fund: | | | |
| Donor-restricted "true" endowment: | | | |
| Historical gift value | \$ — | 53,890 | 53,890 |
| Appreciation | — | 19,592 | 19,592 |
| Board-designated "funds functioning as endowment" | <u>9,888</u> | <u>—</u> | <u>9,888</u> |
| Total – as above | <u>\$ 9,888</u> | <u>73,482</u> | <u>83,370</u> |

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Changes in the fair value of the MBL endowment investments and net assets by type of fund were as follows for the fiscal year ended June 30, 2017:

| | 2017 | | |
|--|-------------------------------|----------------------------|---------|
| | Without donor restrictions | With donor restrictions | Total |
| Changes in the fair value of endowment investments: | | | |
| Investment return: | | | |
| Endowment yield (interest and dividends) | \$ 99 | 714 | 813 |
| Net appreciation (realized and unrealized) on investments | 794 | 6,455 | 7,249 |
| Total investment return | 893 | 7,169 | 8,062 |
| Endowment payout | (564) | (3,839) | (4,403) |
| Investment return, net of payout | 329 | 3,330 | 3,659 |
| Other changes in endowment investments: | | | |
| Gifts and pledge payments received in cash | — | 205 | 205 |
| Other changes | 80 | (77) | 3 |
| Total other changes in endowment investments | 80 | 128 | 208 |
| Net change in endowment investments | 409 | 3,458 | 3,867 |
| Endowment investments at: | | | |
| Beginning of year | 9,185 | 67,078 | 76,263 |
| End of year | \$ 9,594 | 70,536 | 80,130 |
| Investments by type of fund: | | | |
| Donor-restricted "true" endowment: | | | |
| Historical gift value | \$ — | 52,513 | 52,513 |
| Appreciation | — | 18,023 | 18,023 |
| Board-designated "funds functioning as endowment" | 9,594 | — | 9,594 |
| Total – as above | \$ 9,594 | 70,536 | 80,130 |

(d) Interpretation of Relevant Law

The "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), which was enacted in the state of Illinois in 2009, does not preclude the University from spending below the original gift value of donor-restricted "true" endowment funds.

For accounting and reporting purposes, the University, Medical Center, and MBL classify as net assets with donor restrictions the historical value of donor-restricted "true" endowment funds, which includes (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) changes to the permanent endowment made in accordance with the direction of the applicable donor gift instrument. Also included in net assets with donor restrictions is accumulated appreciation on donor restricted "true" endowment funds which are available for expenditure in a manner consistent with the standard of prudence prescribed by UPMIFA, and deficiencies associated with funds where the value of the fund has fallen below the original value of the gift.

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(e) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor restricted “true” endowment funds may fall below the level that the donor or UPMIFA requires to be retained as a fund of perpetual duration. Deficiencies of this nature are reported in net assets with donor restrictions. As of June 30, 2018 and 2017, funds with an original gift value of \$150,718 and \$216,528 were “underwater” by \$3,493 and \$5,905, respectively.

(f) Endowment Payout

Approximately 98% of the University, Medical Center, and MBL endowment is merged into one investment pool referred to as the Total Return Investment Pool (TRIP). The University utilizes the total return concept in allocating endowment income from TRIP. In accordance with the University’s return objective, between 4.5% and 5.5% of a 12 quarter moving average of the fair value of endowment investments lagged by one year, is available each year for expenditure in the form of endowment payout. The payout percentage, which is set each year by the Board with the objective of a 5.0% average payout over time, was 5.5% for the fiscal years ended June 30, 2018 and 2017. Periodically, the University’s Board will adjust the endowment payout to fund specifically approved strategic initiatives.

If endowment income received is not sufficient to support the total return objective, the balance is provided from capital gains. If income received is in excess of the objective, the balance is reinvested in the endowment.

The endowment payout is comprised of the TRIP formula payout, payout from separately held investments, as well as special payouts for the funding of Alumni Relations and Development and University wide strategic initiatives as follows:

| | 2018 | | | | 2017 |
|---|-------------------|-----------------------|--------------|---------------------|---------------------|
| | University | Medical Center | MBL | Consolidated | Consolidated |
| TRIP formula payout | \$ 364,254 | 37,039 | 4,431 | 405,724 | 395,670 |
| Payout from separately invested endowment | 4,409 | 9,211 | — | 13,620 | 11,976 |
| Special payouts: | | | | | |
| Alumni Relations and Development | 22,773 | — | — | 22,773 | 21,897 |
| Strategic initiatives | 13,974 | — | — | 13,974 | 16,600 |
| Operational support | 50,000 | — | — | 50,000 | 9,000 |
| Total | <u>\$ 455,410</u> | <u>46,250</u> | <u>4,431</u> | <u>506,091</u> | <u>455,143</u> |

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(7) Notes and Accounts Receivable

Components of notes and accounts receivable at June 30, 2018 and 2017 are shown as follows:

| | 2018 | | | 2017 Net receivable |
|---------------------------|------------|---------------------------------------|-------------------|---------------------------|
| | Receivable | Allowance for doubtful accounts | Net receivable | |
| University: | | | | |
| Patients | \$ 27,520 | (1,492) | 26,028 | 30,723 |
| Students: | | | | |
| Loans | 36,368 | (2,500) | 33,868 | 39,272 |
| Tuition and fees | 3,630 | (1,550) | 2,080 | 1,441 |
| U.S. government | 56,249 | — | 56,249 | 50,301 |
| All other | 103,670 | (5,960) | 97,710 | 100,415 |
| Total University | 227,437 | (11,502) | 215,935 | 222,152 |
| Medical Center - patients | 508,177 | (160,307) | 347,870 | 432,100 |
| MBL | 4,664 | (35) | 4,629 | 5,341 |
| Total | \$ 740,278 | (171,844) | 568,434 | 659,593 |

Accounts receivable are carried at estimated net realizable value. Management regularly assesses the adequacy of the allowance for doubtful accounts, and balances are written off when deemed uncollectible.

(8) Land, Buildings, Equipment, and Books

Components of land, buildings, equipment, and books at June 30, 2018 and 2017 are shown as follows:

| | 2018 | | | | 2017 Consolidated |
|--------------------------------------|--------------|-------------------|----------|--------------|----------------------|
| | University | Medical Center | MBL | Consolidated | |
| Land | \$ 119,271 | 55,587 | 52,931 | 227,789 | 226,707 |
| Buildings | 4,184,571 | 1,824,214 | 105,153 | 6,113,938 | 5,933,411 |
| Equipment | 549,883 | 686,998 | 28,463 | 1,265,344 | 1,237,348 |
| Books | 393,075 | — | — | 393,075 | 377,434 |
| Construction in progress | 200,011 | 33,295 | 540 | 233,846 | 180,453 |
| Subtotal | 5,446,811 | 2,600,094 | 187,087 | 8,233,992 | 7,955,353 |
| Less accumulated depreciation | (2,240,616) | (997,343) | (81,520) | (3,319,479) | (3,043,152) |
| Subtotal | 3,206,195 | 1,602,751 | 105,567 | 4,914,513 | 4,912,201 |
| Residential properties held for sale | 4,730 | — | — | 4,730 | 85 |
| Total | \$ 3,210,925 | 1,602,751 | 105,567 | 4,919,243 | 4,912,286 |

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(9) Notes and Bonds Payable

Notes and bonds payable at June 30, 2018 and 2017 are shown as follows:

| | <u>Fiscal year maturity</u> | <u>Interest rate</u> | <u>2018</u> | <u>2017</u> |
|--|---------------------------------|----------------------|---------------------|------------------|
| University: | | | | |
| Fixed rate: | | | | |
| Illinois Finance Authority (IFA) | 2039–2053 | 3.2%–5.0% | \$ 1,774,343 | 1,704,856 |
| Taxable bonds | 2031–2046 | 3.4–5.2 | 1,043,315 | 1,002,885 |
| Unamortized premium net of issuance costs | | | 156,427 | 146,621 |
| Total fixed rate | | | <u>2,974,085</u> | <u>2,854,362</u> |
| Variable rate: | | | | |
| Illinois Educational Facilities Authority (IEFA) | 2026–2037 | 0.5–1.8 | 224,638 | 226,142 |
| IFA | 2035 | 0.7 | 73,148 | 76,107 |
| Taxable commercial paper (\$200,000 available) | 2018 | 2.2 | 100,000 | 172,265 |
| Bank lines of credit (\$500,000 available) | 2018 | 2.1–2.5 | 393,500 | 301,500 |
| Total variable rate | | | <u>791,286</u> | <u>776,014</u> |
| Total University | | | <u>3,765,371</u> | <u>3,630,376</u> |
| Medical Center: | | | | |
| Fixed rate: | | | | |
| IFA | 2027–2045 | 3.5–5.0 | 752,355 | 765,555 |
| Taxable bonds | 2047 | 4.4 | 30,000 | 30,000 |
| New market tax credit bonds (NMTC) | 2024–2047 | 1.0–1.8 | 42,176 | 21,296 |
| Unamortized premium and issuance costs | | | 23,069 | 25,425 |
| Total fixed rate | | | <u>847,600</u> | <u>842,276</u> |
| Variable rate: | | | | |
| IFA | 2020 | 2.2 | 111,499 | 116,402 |
| IEFA | 2038 | 1.2 | 69,353 | 72,567 |
| Bank lines of credit (\$110,000 available) | 2018 | 2.3 | — | 3,000 |
| Total variable rate | | | <u>180,852</u> | <u>191,969</u> |
| Total Medical Center | | | <u>1,028,452</u> | <u>1,034,245</u> |
| MBL: | | | | |
| Fixed rate: | | | | |
| Massachusetts Development Finance Authority | 2018–2038 | 3.4 | 26,555 | 27,365 |
| Unamortized issuance cost | | | (146) | (154) |
| Variable rate: | | | | |
| Bank line of credit (\$3,000 available) | 2018 | — | — | — |
| Total MBL | | | <u>26,409</u> | <u>27,211</u> |
| Total notes and bonds payable | | | <u>\$ 4,820,232</u> | <u>4,691,832</u> |

As of June 30, 2018, the University, Medical Center, and MBL fixed rate notes and bonds payable include variable rate debt with interest rates that have been fixed through interest rate swap agreements which amounted to \$174,483, \$325,000, and \$26,555, respectively. As of June 30, 2017, the University, Medical Center, and MBL fixed rate notes and bonds payable include variable rate debt with interest rates that have been fixed through interest rate swap agreements which amounted to \$177,751, \$325,000, and \$27,365, respectively.

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(a) Fiscal 2018 Transactions

During fiscal year 2018, the University issued \$164,705 of fixed rate bonds through the IFA. Proceeds were used to 1) refinance \$72,265 of taxable commercial paper which was used by the University in fiscal year 2017 to redeem \$72,265 of the IFA variable rate bonds and 2) finance the construction and renovation of certain educational and research facilities.

During fiscal year 2018, the Medical Center issued \$40,340 in variable rate bonds through the IFA. Proceeds were used to advance refund \$43,974 of the Series 2004 bonds. During fiscal year 2018, the Medical Center also entered into NMTC financing agreements amounting to \$20,880 for the purpose of financing a variety of projects that benefit the surrounding community.

(b) Interest Rate Swaps

At June 30, 2018 and 2017, the fair value of the interest rate swap agreements was an accrued liability of \$142,747 and \$179,954, respectively as follows:

| | 2018 | 2017 |
|----------------|-------------|-------------|
| University | \$ 34,955 | 46,236 |
| Medical center | 104,815 | 129,450 |
| MBL | 2,977 | 4,268 |
| Total | \$ 142,747 | 179,954 |

Changes in the fair value of the interest rate swap agreements are included as a nonoperating change in the without donor restrictions section of accompanying consolidated statements of activities.

These financial instruments involve counterparty credit exposure. The counterparties for these swap transactions are major financial institutions that meet the University's criteria for financial stability and creditworthiness.

The Medical Center maintains two cash flow hedges against interest on variable rate debt which were entered into in August 2011 and have a combined notional amount of \$325,000. The interest rate swaps terminate on February 1, 2044.

The Medical Center is required to provide collateral on one of the interest rate swap agreements when the liability of that swap exceeds \$50,000. If the Medical Center's credit rating were to be downgraded one level, collateral would need to be provided under the swap with JP Morgan when the liability of that swap exceeds \$60,000 and under the Wells Fargo swap when the liability of that swap exceeds \$40,000. Upon further downgrade, the collateral requirements increase. No collateral was held at June 30, 2018 and \$14,200 was held as collateral as of June 30, 2017.

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(c) Debt Payments

Principal payments required in each of the five years ending June 30, 2019 through 2023 for the University notes and bonds are \$27,629, \$43,225, \$89,698, \$46,729, and \$71,810, respectively.

Principal payments required in each of the five years ending June 30, 2019 through 2023 for the Medical Center notes and bonds are \$17,323, \$18,098, \$19,230, \$21,510, and \$8,628 respectively.

Principal payments required in each of the five years ending June 30, 2019 through 2023 for MBL's notes and bonds are \$840, \$875, \$910, \$945, and, \$980, respectively.

(d) Collateral

Each of the Medical Center bond series is collateralized by accounts receivable and subject to certain contractual restrictions. In addition, the Medical Center variable rate bonds are guaranteed by bank letters of credit.

(e) Remarketing

Included in the University, Medical Center, and MBL's notes and bonds payable are \$965,769, \$505,852, and \$26,555, respectively, of variable rate notes and bonds maturing through fiscal year 2045. In the event the University, Medical Center, or MBL's remarketing agents are unable to remarket the notes and bonds, they become demand obligations and require immediate payment. To supplement internal liquidity, the University, Medical Center, and MBL have credit facility agreements totaling \$400,000, \$394,353 and \$26,802, respectively, which support variable rate debt in the event of a failed remarketing.

(10) Pledges

Pledges receivable at June 30, 2018 and 2017 are shown as follows:

| | 2018 | | | | 2017 |
|---|------------|----------------|-------|--------------|----------|
| | University | Medical Center | MBL | Consolidated | |
| Unconditional promises expected to be collected in: | | | | | |
| Less than one year | \$ 189,009 | 1,052 | 954 | 191,015 | 164,068 |
| One year to five years | 286,638 | 1,570 | 2,384 | 290,592 | 391,868 |
| More than five years | 231,282 | — | — | 231,282 | 232,009 |
| | 706,929 | 2,622 | 3,338 | 712,889 | 787,945 |
| Less: | | | | | |
| Unamortized discount | (64,958) | (135) | (383) | (65,476) | (79,114) |
| Allowance for uncollectible pledges | (46,697) | — | (150) | (46,847) | (53,247) |
| Total | \$ 595,274 | 2,487 | 2,805 | 600,566 | 655,584 |

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The University's five largest pledges comprise 85% of pledges expected to be collected in more than five years. Included in this amount is the estimated fair value of a nonmarketable equity investment (based on discounted cash flow and market multiples) specifically aligned with a promise to give, the proceeds of which, when sold, will be used to satisfy the pledge.

In addition, at June 30, 2018, the University has received \$374,014 of promises to give, that are conditional upon the raising of matching gifts from other sources, implementation of new academic programs, or future income from pledged investments. These amounts will be recognized as revenue in the periods in which the conditions are fulfilled.

(11) Self-Insurance Liability

The University maintains a self-insurance program for medical malpractice liability. This program is supplemented with commercial excess insurance above the University's self-insurance retention, which, for the years ended June 30, 2018 and 2017, was \$5,000 per claim and unlimited in the aggregate. Claims in excess of \$5,000 are subject to an additional self-insurance retention limited to \$12,500 per claim and \$22,500 in annual aggregate. The Medical Center is included under this insurance program and is charged for its portion of self-insurance costs. The University and Medical Center also maintain a self-insurance program for workers' compensation and certain other liability claims.

Under the medical malpractice self-insurance program, the University and Medical Center make annual contributions to a related trust fund at an actuarially determined rate that is intended to provide adequate funding of the self-insurance liability over a period of years. Actual settlements of medical malpractice claims may be more or less than the liability estimated by the University.

The medical malpractice self-insurance liability is the estimated present value of self-insured claims that will be settled in the future, and considers anticipated payout patterns as well as interest to be earned on available assets prior to payment. If the present value method was not used, the liability for medical malpractice self-insurance claims would be approximately \$32,000 higher than the amount recorded in the consolidated financial statements at June 30, 2018. The interest rate assumed in determining the present value was 4.0%. The University recorded nonoperating actuarial adjustments of \$11,178 and (\$2,195) during the years ended June 30, 2018 and 2017, respectively, which are included in the without donor restrictions section of the accompanying consolidated statements of activities.

In addition, the Medical Center's Community Health and Hospital Division maintains a separate self-insurance program for medical malpractice and workers' compensation. Coverage from commercial insurance carriers is maintained for claims in excess of self-insured retentions at various levels by policy year. Under this program, annual contributions are made to a related trust at an actuarially determined rate.

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The estimated liability for incurred malpractice, workers' compensation, and other claims (filed and unfiled) as of June 30, 2018 and 2017 is presented as follows:

| | 2018 | | | 2017 Consolidated |
|-----------------------|------------|-------------------|--------------|----------------------|
| | University | Medical Center | Consolidated | |
| Medical malpractice | \$ 201,440 | 40,835 | 242,275 | 266,279 |
| Workers' compensation | 7,176 | 5,782 | 12,958 | 16,176 |
| Others | 5,765 | — | 5,765 | 5,126 |
| Total | \$ 214,381 | 46,617 | 260,998 | 287,581 |

(12) Pension Plans and Other Postretirement Benefits

(a) Pension Plans

Substantially all personnel of the University participate in either the defined contribution pension plan for academic staff or the defined benefit and contribution pension plans for nonacademic personnel. The majority of Medical Center employees participate in the University's pension plans for nonacademic employees. The University and Medical Center make annual contributions to the defined benefit pension plans at a rate necessary to maintain plan funding on an actuarially recommended basis. The University and Medical Center share contributions to the defined benefit pension plans based primarily on participation.

Effective January 1, 2017, the 401(a) plan was frozen for all Medical Center employees participating in the plan and replaced with an enhanced defined contribution plan. This curtailment, along with a further reduction of University employees participating in the 401(a) plan, resulted in a fiscal year 2017 reduction in the defined benefit obligation of \$64,241 and a curtailment credit of \$5,002 in pension cost.

(b) Postretirement Benefits

In addition to providing pension benefits, the University and MBL provide certain healthcare benefits for retired employees and a retirement incentive bonus for eligible faculty electing to participate in a retirement incentive program. In addition to a retirement bonus, all Medicare eligible-tenured faculty who elect to participate in the retirement incentive program receive supplemental health insurance at no cost for themselves and their spouses. All other academic and nonacademic employees are entitled to supplemental health insurance coverage subject to deductibles, copayment provisions, and other limitations.

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(c) Funded Status

The funded status and amounts recognized in the consolidated financial statements for the defined benefit pension plans and other postretirement benefit plans are shown as follows:

| | Defined benefit pension plans | | Other postretirement benefit plans | |
|--|-------------------------------|-----------|------------------------------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Change in benefit obligation: | | | | |
| Benefit obligation at beginning of year | \$ 967,817 | 1,017,137 | 342,038 | 318,714 |
| Service cost | 1,473 | 14,061 | 13,997 | 12,496 |
| Interest cost | 34,323 | 34,597 | 12,929 | 11,568 |
| Benefits paid | (60,064) | (46,835) | (7,934) | (7,822) |
| Plan amendment | — | — | — | (26,503) |
| Curtailment (effect of partial plan freeze) | — | (64,241) | — | — |
| Actuarial (gain) loss, net | (21,755) | 13,098 | (40,520) | 33,585 |
| Benefit obligation at end of year | 921,794 | 967,817 | 320,510 | 342,038 |
| Change in fair value of plan assets: | | | | |
| Fair value of plan assets at beginning of year | 772,032 | 741,696 | 45,995 | 37,019 |
| Actual return on plan assets | 31,304 | 77,171 | 3,478 | 3,470 |
| Employer contributions | 2,496 | — | 20,597 | 13,328 |
| Benefits paid | (60,064) | (46,835) | (7,934) | (7,822) |
| Fair value of plan assets at end of year | 745,768 | 772,032 | 62,136 | 45,995 |
| Funded status – liability | \$ 176,026 | 195,785 | 258,374 | 296,043 |

The accumulated benefit obligation for the defined benefit pension plans was \$918,305 and \$963,930 at June 30, 2018 and 2017, respectively.

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(d) Components of Net Periodic Benefit Cost

| | Defined benefit pension plans | | Other postretirement benefit plans | |
|--|--------------------------------------|---------------|---|---------------|
| | 2018 | 2017 | 2018 | 2017 |
| Operating - Service cost | \$ 1,473 | 14,061 | 14,011 | 12,496 |
| Nonoperating: | | | | |
| Interest cost | 34,323 | 34,597 | 12,994 | 11,568 |
| Expected return on plan assets | (46,392) | (47,094) | (4,048) | (2,744) |
| Amortization of prior service benefit | (258) | (986) | (10,207) | (8,828) |
| Amortization of actuarial loss | 20,773 | 24,715 | 11,617 | 10,259 |
| Settlements | 11,804 | — | — | — |
| Partial curtailment | — | (5,002) | — | — |
| Total nonoperating | <u>20,250</u> | <u>6,230</u> | <u>10,356</u> | <u>10,255</u> |
| Net periodic benefit cost | <u>\$ 21,723</u> | <u>20,291</u> | <u>24,367</u> | <u>22,751</u> |
| Amounts included in the consolidated statements of activities: | | | | |
| University | \$ 11,209 | 7,640 | 24,700 | 22,751 |
| Medical Center | 10,514 | 12,651 | — | — |
| MBL | — | — | (333) | — |
| Total | <u>\$ 21,723</u> | <u>20,291</u> | <u>24,367</u> | <u>22,751</u> |

(e) Actuarial Assumptions

The weighted average assumptions used in the accounting for the pension and other postretirement benefit plans are shown as follows:

| | Defined benefit pension plans | | Other postretirement benefit plans | |
|--------------------------------|--------------------------------------|-------------|---|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| Discount rate | 4.2 % | 3.7 % | 4.3 % | 4.0 % |
| Expected return on plan assets | 6.5 | 6.5 | 6.5 | 6.5 |
| Rate of compensation increase | 3.5 | 3.5 | 4.3 | 4.3 |
| Healthcare cost trend rates: | | | | |
| Next two fiscal years | | | 7.2%–7.5% | 7.5%–7.8% |
| Next seven fiscal years | | | 5.0%–6.9% | 5.3%–7.2% |
| Thereafter | | | 4.5%–4.7% | 4.5%–5.0% |

The expected return on plan assets assumptions for both the defined benefit pension plan and the other postretirement benefit plans is determined based on models that incorporate a number of different methodologies, including historical returns and capital market forecasts.

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Notes to Consolidated Financial Statements
June 30, 2018 and 2017
(In thousands of dollars)

Assumed healthcare cost trend rates have a significant effect on the amounts reported for healthcare plans. A one-percentage-point change in assumed healthcare cost trend rates would have the following effects for the fiscal years ended June 30:

| | <u>2018</u> | <u>2017</u> |
|---|-------------|-------------|
| Effect on total service cost and interest cost: | | |
| One-percentage-point increase | \$ 5,450 | 5,091 |
| One-percentage-point decrease | (4,149) | (3,764) |
| Effect on year-end postretirement benefit obligation: | | |
| One-percentage-point increase | \$ 52,635 | 59,667 |
| One-percentage-point decrease | (41,586) | (46,855) |

(f) Plan Assets

Weighted average asset allocations as of fiscal year end by asset category are as follows:

| | <u>Defined benefit pension plans</u> | | <u>Other postretirement benefit plans</u> | |
|-------------------------------|--|--------------|---|--------------|
| | <u>2018</u> | <u>2017</u> | <u>2018</u> | <u>2017</u> |
| Domestic public equities | 24 % | 26 % | 51 % | 50 % |
| International public equities | 26 | 21 | — | — |
| Fixed income | 50 | 53 | 49 | 50 |
| | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> |

As of June 30, 2018, 73% of plan assets for the defined benefit pension plans are invested in cash, mutual funds, exchange traded funds, or separately managed accounts comprised of individual securities and are valued based on quoted market prices in active markets for identical investments (Level 1). The remaining 27% of plan assets are primarily invested in commingled funds and limited partnerships generally reported at NAV by external fund managers.

The defined benefit plans combined target asset allocation of 49% public equities and 51% fixed income securities is meant to result in a favorable long-term rate of return from a diversified portfolio of equity and fixed income investments. Plan assets for the other postretirement benefit plans are managed by the University and were held in mutual funds (Level 1) at June 30, 2018.

(g) Contributions

The University expects to make a \$13,900 contribution to its postretirement healthcare plan and, combined with the Medial Center, expects to make a \$13,300 contribution to the defined benefit pension plans in fiscal year 2019.

THE UNIVERSITY OF CHICAGO
Notes to Consolidated Financial Statements
June 30, 2018 and 2017
(In thousands of dollars)

(h) Estimated Future Benefits Payments

The following benefit payments, which reflect expected future service, are expected to be paid for each of the fiscal years ending June 30:

| Fiscal year | Defined benefit pension plans | Other postretirement benefit plans |
|-------------|-------------------------------|------------------------------------|
| 2019 | \$ 103,523 | 10,317 |
| 2020 | 59,953 | 10,366 |
| 2021 | 60,651 | 12,202 |
| 2022 | 59,989 | 12,762 |
| 2023 | 57,812 | 13,687 |
| 2024–2028 | 272,824 | 88,325 |

(i) Prescription Drug Act

The Medicare Prescription Drug, Improvement, and Modernization Act provides for special tax-free subsidies to employers that offer retiree medical benefit plans with qualifying drug coverage. Effective January 1, 2014, the University ceased its participation in the Part D Retiree Drug Subsidy (RDS) program and began providing prescription drug benefits to Medicare eligible retirees through an Employer Group Waiver Plan (EGWP) design. As a result, the University is eligible for reimbursement from the federal government prescription drug program and, in addition, is eligible for government mandated rebates from pharmaceutical companies that participate in the Medicare Part D program. The University has recognized the effect of these subsidies in the calculation of its postretirement benefit obligation, the impact of which was to reduce the benefit obligation by \$25,406 at June 30, 2018.

(j) Curtailed Pension Plan

The Medical Center maintains a separate noncontributory defined benefit pension plan on behalf of a former affiliated organization. Prior to assumption, the benefit plan was curtailed by freezing participation and benefit accruals. At June 30, 2018 and 2017, the benefit obligation for the plan exceeded the plan's assets thus creating an unfunded liability of \$1,938 and \$10,583 at June 30, 2018 and 2017, respectively.

(k) Defined Contribution Pension Plan

Defined contribution pension plan expenses included in the consolidated statements of activities amounted to \$66,720 in fiscal year 2018 and \$71,986 in fiscal year 2017 for the University and \$32,400 in fiscal year 2018 and \$24,600 in fiscal year 2017 for the Medical Center.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(In thousands of dollars)

(14) Affiliated Organizations

The University has an ongoing relationship with the National Opinion Research Center (NORC), a not-for-profit organization that conducts research in the public interest primarily for various federal agencies. The majority of NORC's Board of Trustees are faculty members or officers of the University. Program-related revenue for the years ended December 31, 2017 and 2016 was \$186,800 and \$188,131, respectively. Net assets at December 31, 2017 and 2016 were \$45,341 and \$38,340, respectively. Consolidation of this not-for-profit organization is not required because the University does not have both control and an economic interest.

The University, through its affiliate UChicago Argonne, LLC, operates Argonne National Laboratory (ANL) under a contract with the U.S. Department of Energy (DOE). This contract provides for the payment of a fixed management allowance and an additional fee based on performance judged against established measures. The University is the sole member of UChicago Argonne, LLC; however, the performance fee is shared with a subcontractor that assists UChicago Argonne, LLC with the management and operation of ANL.

The University, as a member of Fermi Research Alliance, LLC (FRA), also operates Fermi National Accelerator Laboratory (Fermilab) on behalf of DOE. The Fermilab contract between DOE and FRA provides for the payment of a fixed management allowance and an additional performance fee. The University shares the performance fee with Universities Research Association, the other member of FRA, and with a subcontractor that assists FRA with the management and operation of Fermilab.

The expenditures under the respective contracts and the related reimbursements of \$401,192 for ANL and \$771,182 for Fermilab in fiscal year 2018, and \$794,889 for ANL and \$402,169 for Fermilab in fiscal year 2017 are not included in the consolidated statements of activities. Net assets relating to ANL and to Fermilab are owned by the U.S. government and, therefore, are not included in the consolidated balance sheets.

(15) Contingencies

Various lawsuits, claims, and other contingent liabilities arise in the ordinary course of the University's education, research, and healthcare activities. In the opinion of management, all such matters have been adequately provided for, are without merit, or are of such kind that if disposed of unfavorably, would not have a material adverse effect on the consolidated financial position of the University.

THE UNIVERSITY OF CHICAGO

Consolidating Balance Sheet

June 30, 2018

(In thousands of dollars)

| Assets | University | Medical Center | MBL | 2018 Consolidated |
|--|----------------------|---------------------------|----------------|------------------------------|
| Cash and cash equivalents | \$ 66,770 | 211,751 | 1,676 | 280,197 |
| Notes and accounts receivable, net | 215,935 | 347,870 | 4,629 | 568,434 |
| Prepaid expenses and other assets | 128,004 | 141,939 | 3,165 | 273,108 |
| Pledges receivable, net | 595,274 | 2,487 | 2,805 | 600,566 |
| Investments | 7,743,778 | 1,209,285 | 93,248 | 9,046,311 |
| Land, buildings, equipment, and books, net | 3,210,925 | 1,602,751 | 105,567 | 4,919,243 |
| Total assets | <u>\$ 11,960,686</u> | <u>3,516,083</u> | <u>211,090</u> | <u>15,687,859</u> |
| Liabilities and Net Assets | | | | |
| Liabilities: | | | | |
| Accounts payable and accrued liabilities | \$ 444,310 | 608,257 | 7,647 | 1,060,214 |
| Deferred revenue | 125,705 | — | 3,445 | 129,150 |
| Assets held in custody for others | 149,079 | — | 1,104 | 150,183 |
| Self-insurance liability | 214,381 | 46,617 | — | 260,998 |
| Pension and other postretirement benefit obligations | 434,400 | — | — | 434,400 |
| Asset retirement obligation | 41,967 | 12,490 | — | 54,457 |
| Notes and bonds payable | 3,765,371 | 1,028,452 | 26,409 | 4,820,232 |
| Refundable U.S. government student loan funds | 30,470 | — | — | 30,470 |
| Total liabilities | <u>5,205,683</u> | <u>1,695,816</u> | <u>38,605</u> | <u>6,940,104</u> |
| Net assets: | | | | |
| Without donor restrictions | 1,093,744 | 1,708,799 | 90,151 | 2,892,694 |
| With donor restrictions | 5,661,259 | 111,468 | 82,334 | 5,855,061 |
| Total net assets | <u>6,755,003</u> | <u>1,820,267</u> | <u>172,485</u> | <u>8,747,755</u> |
| Total liabilities and net assets | <u>\$ 11,960,686</u> | <u>3,516,083</u> | <u>211,090</u> | <u>15,687,859</u> |

See accompanying independent auditors' report.

THE UNIVERSITY OF CHICAGO

Consolidating Statement of Activities

Year ended June 30, 2018

(In thousands of dollars)

| | <u>University</u> | <u>Medical Center</u> | <u>MBL</u> | <u>2018 Consolidated</u> |
|--|--------------------|---------------------------|-----------------|------------------------------|
| Changes in net assets without donor restrictions: | | | | |
| Operating: | | | | |
| Revenue: | | | | |
| Tuition and fees – gross | \$ 901,909 | — | 2,124 | 904,033 |
| Less student aid | <u>(434,612)</u> | <u>—</u> | <u>(1,623)</u> | <u>(436,235)</u> |
| Tuition and fees – net | 467,297 | — | 501 | 467,798 |
| Government grants and contracts | 335,779 | — | 12,710 | 348,489 |
| Private gifts, grants, and contracts | 281,907 | 206 | 5,746 | 287,859 |
| Endowment payout | 454,462 | 46,250 | 4,431 | 505,143 |
| Patient service | 286,768 | 2,000,117 | — | 2,286,885 |
| Auxiliaries | 222,146 | — | 3,985 | 226,131 |
| Other income | 250,518 | 165,625 | 1,112 | 417,255 |
| Net assets released from restrictions | <u>126,365</u> | <u>7,295</u> | <u>2,872</u> | <u>136,532</u> |
| Total operating revenue | <u>2,425,242</u> | <u>2,219,493</u> | <u>31,357</u> | <u>4,676,092</u> |
| Expenses: | | | | |
| Compensation: | | | | |
| Academic salaries | 612,173 | — | 7,684 | 619,857 |
| Staff salaries | 623,758 | 764,306 | 8,663 | 1,396,727 |
| Benefits | <u>303,853</u> | <u>179,244</u> | <u>5,854</u> | <u>488,951</u> |
| Total compensation | <u>1,539,784</u> | <u>943,550</u> | <u>22,201</u> | <u>2,505,535</u> |
| Other operating expenses: | | | | |
| Utilities, alterations, and repairs | 48,101 | 44,364 | 2,520 | 94,985 |
| Depreciation | 202,406 | 125,032 | 4,417 | 331,855 |
| Interest | 132,333 | 43,924 | 1,019 | 177,276 |
| Supplies, services, and other | <u>527,196</u> | <u>1,022,369</u> | <u>13,042</u> | <u>1,562,607</u> |
| Total other operating expenses | <u>910,036</u> | <u>1,235,689</u> | <u>20,998</u> | <u>2,166,723</u> |
| Total operating expenses | <u>2,449,820</u> | <u>2,179,239</u> | <u>43,199</u> | <u>4,672,258</u> |
| Excess (deficiency) of operating revenue over expenses | <u>\$ (24,578)</u> | <u>40,254</u> | <u>(11,842)</u> | <u>3,834</u> |

THE UNIVERSITY OF CHICAGO

Consolidating Statement of Activities

Year ended June 30, 2018

(In thousands of dollars)

| | <u>University</u> | <u>Medical Center</u> | <u>MBL</u> | <u>2018 Consolidated</u> |
|--|---------------------|---------------------------|----------------|------------------------------|
| Changes in net assets without donor restrictions: | | | | |
| Nonoperating: | | | | |
| Investment gains (losses) | \$ (26,173) | 14,790 | 210 | (11,173) |
| Net periodic benefit cost other than service cost | (20,440) | (10,514) | 348 | (30,606) |
| Other postretirement benefit changes | 80,758 | 2,661 | (98) | 83,321 |
| Change in value of derivative instruments | 11,281 | 24,635 | 1,291 | 37,207 |
| Other, net | 7,594 | (26,066) | 10,944 | (7,528) |
| Net assets released from restrictions | 2,173 | — | — | 2,173 |
| Nonoperating changes in net assets without donor restrictions | <u>55,193</u> | <u>5,506</u> | <u>12,695</u> | <u>73,394</u> |
| Increase in net assets without donor restrictions | <u>30,615</u> | <u>45,760</u> | <u>853</u> | <u>77,228</u> |
| Changes in net assets with donor restrictions: | | | | |
| Private gifts | 238,578 | 5,048 | 2,764 | 246,390 |
| Endowment payout | 948 | — | — | 948 |
| Investment gains | 97,274 | 5,767 | 1,647 | 104,688 |
| Other, net | 38,004 | 42 | (76) | 37,970 |
| Net assets released from restrictions | (128,537) | (7,295) | (2,872) | (138,704) |
| Increase in net assets with donor restrictions | <u>246,267</u> | <u>3,562</u> | <u>1,463</u> | <u>251,292</u> |
| Increase in net assets | 276,882 | 49,322 | 2,316 | 328,520 |
| Net assets at beginning of year | <u>6,478,121</u> | <u>1,770,945</u> | <u>170,169</u> | <u>8,419,235</u> |
| Net assets at end of year | <u>\$ 6,755,003</u> | <u>1,820,267</u> | <u>172,485</u> | <u>8,747,755</u> |

See accompanying independent auditors' report.

THE UNIVERSITY OF CHICAGO

Consolidating Statement of Cash Flows

Year ended June 30, 2018

(In thousands of dollars)

| | University | Medical Center | MBL | 2018 Consolidated |
|---|-------------|-------------------|----------|----------------------|
| Cash flows from operating activities: | | | | |
| Increase in net assets | \$ 276,882 | 49,322 | 2,316 | 328,520 |
| Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities: | | | | |
| Depreciation | 202,406 | 125,032 | 4,417 | 331,855 |
| Change in value of derivative instruments | (11,281) | (25,038) | (1,291) | (37,610) |
| Loss on disposal of land, buildings, equipment, and books | 4,128 | (122) | 41 | 4,047 |
| Net gain on investments | (462,107) | (51,613) | (6,348) | (520,068) |
| Private gifts and grants restricted for long-term investment | (238,578) | (10,857) | (411) | (249,846) |
| Other nonoperating changes | 90,996 | 35,810 | (11,271) | 115,535 |
| Postretirement benefit changes | (60,318) | 7,853 | (235) | (52,700) |
| Changes in operating assets and liabilities: | | | | |
| Notes and accounts receivable | (279) | 84,230 | 1,853 | 85,804 |
| Prepaid expenses and other assets | (23,777) | (28,883) | 336 | (52,324) |
| Accounts payable and other liabilities | 59,608 | 52,108 | (326) | 111,390 |
| Self-insurance liability | (35,483) | 8,900 | — | (26,583) |
| Total adjustments | (474,685) | 197,420 | (13,235) | (290,500) |
| Net cash provided by (used in) operating activities | (197,803) | 246,742 | (10,919) | 38,020 |
| Cash flows from investing activities: | | | | |
| Purchase of investments | (2,171,772) | (451,471) | (3,617) | (2,626,860) |
| Proceeds from sale of investments | 2,280,897 | 517,379 | 7,073 | 2,805,349 |
| Acquisition of land, buildings, equipment, and books | (232,645) | (105,346) | (3,217) | (341,208) |
| Principal collected on loans | 6,497 | — | — | 6,497 |
| Net cash provided by (used in) investing activities | (117,023) | (39,438) | 239 | (156,222) |
| Cash flows from financing activities: | | | | |
| Proceeds from issuance of debt instruments | 1,870,579 | 61,220 | — | 1,931,799 |
| Principal payments on debt instruments | (1,735,584) | (69,266) | (802) | (1,805,652) |
| Proceeds from private gifts and grants restricted for long-term investment | 234,184 | 3,562 | 508 | 238,254 |
| Other nonoperating changes | 1,357 | (28,515) | 10,772 | (16,386) |
| Net cash provided by (used in) financing activities | 370,536 | (32,999) | 10,478 | 348,015 |
| Increase (decrease) in cash and cash equivalents | 55,710 | 174,305 | (202) | 229,813 |
| Cash and cash equivalents at: | | | | |
| Beginning of year | 11,060 | 37,446 | 1,878 | 50,384 |
| End of year | \$ 66,770 | 211,751 | 1,676 | 280,197 |
| Supplemental disclosure of cash flow information: | | | | |
| Cash paid for interest | \$ 135,951 | 38,050 | 1,027 | 175,028 |
| Change in construction payable | 4,516 | (5,143) | 481 | (146) |

See accompanying independent auditors' report.