

National Jewish Health and Subsidiary

Consolidated Financial Statements
(With Independent Auditor's Report Thereon)

June 30, 2018 and 2017

National Jewish Health and Subsidiary
June 30, 2018 and 2017

Contents

Independent Auditor's Report..... 1

Consolidated Financial Statements

Statements of Financial Position 3
Statements of Activities..... 5
Statements of Cash Flows 7
Notes to Financial Statements 8

Independent Auditor's Report

Board of Directors
National Jewish Health
Denver, Colorado

We have audited the accompanying consolidated financial statements of National Jewish Health and Subsidiary (National Jewish), which comprise the consolidated statements of financial position as of June 30, 2018 and 2017, and 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 Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; 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.

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

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

Board of Directors
National Jewish Health

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of National Jewish 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 accounting principles generally accepted in the United States of America.

BKD, LLP

Denver, Colorado
October 15, 2018

National Jewish Health and Subsidiary
Consolidated Statements of Financial Position
June 30, 2018 and 2017
(In thousands)

	2018	2017
Current assets:		
Cash and cash equivalents	\$ 2,577	\$ 3,496
Accounts receivable:		
Patient care, net of estimated uncollectibles of \$24,062 and \$28,355, respectively	28,026	29,053
Grant revenue receivable	3,373	3,022
Bequests, net of allowance for uncollectibles of \$160 and \$25, respectively	2,266	527
Pledges receivable, current portion, net of allowance for uncollectibles of \$3,367 and \$347, respectively	20,332	6,002
Receivable from joint ventures	9,315	5,121
Other	4,704	8,081
Total receivables	68,016	51,806
Assets held by trustees – current portion	2,653	2,616
Prepaid expenses	2,203	1,160
Drugs and supplies	2,299	1,926
Total current assets	77,748	61,004
Assets whose use is limited:		
Internally-designated assets	46,732	44,797
Assets held by trustee, net of current portion	1,276	1,416
Assets reserved for gift annuities	8,021	8,866
Other	128	135
Total assets whose use is limited	56,157	55,214
Other assets:		
Long-term investments	63,918	62,116
Contributions receivable under unitrust agreements	2,001	2,539
Pledges receivable, net of current portion and allowance for uncollectibles of \$3,659 and \$4,046, respectively	13,394	18,934
Beneficial interest under perpetual and other trust agreements	12,963	12,676
Goodwill	900	900
Other	1,411	1,859
Total other assets	94,587	99,024
Property and equipment, at cost:		
Land	13,053	13,053
Buildings	99,976	98,227
Equipment and software	81,941	78,115
Construction-in-progress	-	2,395
	194,970	191,790
Less accumulated depreciation	(121,590)	(115,075)
Property and equipment, net	73,380	76,715
Total assets	\$ 301,872	\$ 291,957

National Jewish Health and Subsidiary
Consolidated Statements of Financial Position (continued)
June 30, 2018 and 2017
(In thousands)

	<u>2018</u>	<u>2017</u>
Current liabilities:		
Accounts payable and accrued expenses	\$ 9,226	\$ 11,912
Line of credit	13,581	9,572
Current portion of workers' compensation	144	196
Accrued salaries, wages, and employee benefits	7,695	7,656
Unearned grant revenue	3,413	4,759
Estimated settlements with third-party payors	1,798	1,774
Current portion of accrued vacation	3,335	3,305
Current portion of long-term debt, including capital lease	4,040	4,012
Current liability under annuity contracts	1,401	1,509
Current liability under unitrust agreements	155	164
Total current liabilities	<u>44,788</u>	<u>44,859</u>
Accrued vacation	1,092	1,059
Other	1,409	3,747
Liability under annuity contracts	8,453	9,324
Liability under unitrust agreements	2,234	2,820
Long-term debt, net of current portion	30,103	33,298
Total liabilities	<u>88,079</u>	<u>95,107</u>
Net assets:		
Unrestricted	71,082	72,431
Temporarily restricted	90,519	77,363
Permanently restricted	52,192	47,056
Total net assets	<u>213,793</u>	<u>196,850</u>
Total liabilities and net assets	<u>\$ 301,872</u>	<u>\$ 291,957</u>

National Jewish Health and Subsidiary
Consolidated Statements of Activities
Years Ended June 30, 2018 and 2017
(In thousands)

	2018	2017
Changes in unrestricted net assets:		
Unrestricted revenue, gains, and other support:		
Net patient service revenue	\$ 140,965	\$ 143,764
Health initiatives revenue	9,711	10,345
Revenue from affiliates	17,186	7,417
Professional education revenue	3,001	2,185
Federal grant revenue	40,670	39,487
Other operating revenue	14,077	13,175
Major gifts	1,789	1,840
Direct mail	2,258	2,336
Special events, net of direct donor benefits of \$3,211 and \$3,022, respectively	2,684	2,154
Bequests	2,464	2,518
Gift annuity contributions	346	545
Investment income, net	3,208	5,744
Total unrestricted revenue, gains, and other support	238,359	231,510
Net assets released from restriction:		
Net assets released from restriction – grants	10,351	10,237
Net assets released from restriction – public support	11,006	10,733
Total net assets released from restriction	21,357	20,970
Expenses:		
Academic services	98,794	95,919
Clinical services	92,900	86,370
Administration and fiscal support	31,937	30,198
Support services	12,133	11,915
Marketing and health initiatives	13,053	14,704
Professional education	2,232	1,532
Fund development	8,137	8,307
Bad debt expense	1,843	1,952
Total expenses	261,029	250,897
Decrease in value of split-interest agreements	16	1,198
Loss on disposal of property and equipment	20	321
Total expenses and losses	261,065	252,416
Increase (decrease) in unrestricted net assets	(1,349)	64

National Jewish Health and Subsidiary
Consolidated Statements of Activities (continued)
Years Ended June 30, 2018 and 2017
(In thousands)

	2018	2017
Changes in temporarily restricted net assets:		
Restricted grant support	10,850	10,402
Major gifts	15,396	8,327
Direct mail	191	163
Special events	1,161	1,114
Bequests	2,417	333
Change in value of split-interest agreements	2,757	5,424
Investment gain, net	1,741	1,173
Total temporarily restricted revenue	34,513	26,936
Net assets released from restriction – grants	(10,351)	(10,237)
Net assets released from restriction – public support	(11,006)	(10,733)
Total net assets released from restriction	(21,357)	(20,970)
Increase in temporarily restricted net assets	13,156	5,966
Changes in permanently restricted net assets:		
Contributions	4,832	413
Change in beneficial interest in perpetual trusts	304	781
Increase in permanently restricted net assets	5,136	1,194
Increase in net assets	16,943	7,224
Net assets, beginning of year	196,850	189,626
Net assets, end of year	\$ 213,793	\$ 196,850

National Jewish Health and Subsidiary
Consolidated Statements of Cash Flows
Years Ended June 30, 2018 and 2017
(In thousands)

	2018	2017
Cash flows from operating activities:		
Increase in net assets	\$ 16,943	\$ 7,224
Items not requiring cash		
Depreciation	7,987	8,398
Bad debt expense	1,843	1,952
Unrealized gains	(120)	(7,575)
Permanently restricted revenue, net	(5,136)	(1,194)
Loss on disposal of property and equipment	20	321
Bond premium, discount, and issuance cost amortization	(54)	(53)
Changes in		
Patient care accounts receivable	(814)	(5,858)
Grant receivables	(351)	275
Bequests receivable	(1,739)	300
Other current assets	(2,235)	(7,160)
Contribution receivable	538	95
Pledges receivable	(8,790)	6,005
Beneficial interest under perpetual trust	(287)	(764)
Other assets	448	(111)
Estimated third-party payor settlements	24	1,055
Accounts payable, accrued expenses, and unearned revenue	(6,383)	2,245
Accrued vacation	63	199
Net cash provided by operating activities	1,957	5,354
Cash flows from investing activities:		
Purchases of property and equipment	(3,660)	(3,833)
Proceeds from sales of internally designated assets	10,495	2,415
Purchases of internally designated assets	(12,430)	(5,832)
Proceeds from sale of assets held by trustee	103	56
Purchases of investments and assets reserved for gift annuities	(23,209)	(14,476)
Proceeds from sale of investments and assets reserved for gift annuities	22,379	14,677
Net cash used in investing activities	(6,322)	(6,993)
Cash flows from financing activities:		
Line of credit, net change	4,009	4,562
Repayment of long-term debt	(4,125)	(3,829)
Increase (decrease) in liability under gift annuity agreements	(979)	390
Increase (decrease) in liability under unitrust agreements	(595)	659
Increase in permanently restricted net assets	5,136	1,194
Net cash provided by financing activities	3,446	2,976
Net increase (decrease) in cash and cash equivalents	(919)	1,337
Cash and cash equivalents, beginning of year	3,496	2,159
Cash and cash equivalents, end of year	\$ 2,577	\$ 3,496
Supplemental schedule of noncash activities:		
Capital lease obligation incurred for property and equipment	\$ 1,012	\$ 758
Cash paid for interest	\$ 1,782	\$ 1,715

National Jewish Health and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

(1) Corporate Organization

(a) Organization

National Jewish Health and Subsidiary (National Jewish), a Colorado nonprofit corporation, is a national referral medical institute engaged in patient care, medical research, and teaching, primarily in areas of respiratory, allergic, and immunologic medicine. National Jewish is the product of a consolidation in 1978 between National Jewish Hospital and Research Center, founded in 1899, and National Asthma Center, founded in 1907.

National Jewish is a nonprofit corporation as described in Section 501(c)(3) of the Internal Revenue Code (IRC) and is exempt from federal income taxes on related income pursuant to Section 501(a) of the IRC and a similar provision of state law.

In 2002, the National Jewish Illiquid Assets Holding Company, LLC, a wholly owned subsidiary of National Jewish, was incorporated. The purpose of this subsidiary is to hold donated property until sold. All related intercompany transactions and balances have been eliminated in consolidation.

Joint Ventures

Effective December 2013, National Jewish formed a limited liability corporation in a joint venture with the Icahn School of Medicine doing business as the Mount Sinai – National Jewish Respiratory Institute to oversee the creation and operations of a joint respiratory institute at various sites in the Mount Sinai integrated health care system in New York City, New York.

Effective August 2014, National Jewish entered into a joint operating agreement with Sisters of Charity of Leavenworth (SCL) Health/St. Joseph Hospital for the joint management and operation of National Jewish's in-state patient care and St. Joseph Hospital. The new entity is overseen by a Board of Directors with representation from both entities.

Effective April 2017, National Jewish formed a limited liability corporation in a joint venture with Thomas Jefferson University doing business as the Jane and Leonard Korman Jefferson Health | National Jewish Health Respiratory Institute to oversee the development and operations of a joint respiratory institute at various sites in the Jefferson Health System in Philadelphia, Pennsylvania.

Total revenue from the joint agreements as of June 30, 2018 and 2017 was approximately \$17,186,000 and \$7,417,000, respectively, which is included in the revenue from affiliates line on the consolidated statements of activities.

(b) Compliance with Health Care Industry Laws and Regulations

All hospitals and other providers of healthcare are subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse.

Recently, government activity has increased with respect to investigations and allegations involving several healthcare providers throughout the country concerning possible violations of fraud and abuse statutes and regulations by these healthcare providers. Violations of these laws and regulations can result in expulsion from government healthcare programs together with imposition of significant fines and penalties, as well as significant repayments for patient services

National Jewish Health and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

previously billed. Management believes that National Jewish is in substantial compliance with applicable government laws and regulations.

(2) Summary of Significant Accounting Policies

(a) Use of Estimates

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

(b) Contributions, Promises to Give and Bequests

National Jewish receives funding from a number of sources. Contributions received from donors are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those respective net asset classes. Gifts and investment income that are originally restricted by the donor and for which the restriction is met in the same time period are recorded as temporarily restricted and then released from restriction. When the donor restriction expires, the contribution is reclassified to unrestricted net assets and reported in the consolidated statements of activities as “net assets released from restriction – public support.” All expenses directly related to donor restrictions are included in the appropriate expense category as a reduction in unrestricted net assets on the accompanying consolidated statements of activities.

Unconditional promises to give that are expected to be collected within one year are recorded at fair value. Unconditional promises to give that are expected to be collected in future years are also recorded at their estimated fair value, which represents the present value of their estimated future cash flows. Amortization of the related present value discounts is included in contribution revenue. Conditional promises to give are not included as support until the conditions placed on the gift by the donor are substantially met. At June 30, 2018 and 2017, approximately 54% and 44% of promises to give were from two donors, respectively.

Bequest income is recognized when all of the following criteria are met: (1) National Jewish has received notification of the donor’s death; (2) National Jewish has a copy of the valid will or trust document evidencing the bequest; and (3) the value of the gift can be reasonably estimated. Accrued bequest income is shown as temporarily restricted until received.

(c) Pooled Income Gifts

National Jewish also receives pooled income gifts. Under the terms of these contributions, the gifts of various donors are pooled and invested as a group. Each donor is allocated a percentage of the assets, referred to as units. The donor is paid the income, as defined under the arrangement, earned on the donor’s assigned units. Upon the donor’s death, the value of these assigned units reverts to National Jewish. The remainder interest in the assets received is recognized as temporarily restricted contributions revenue in the period in which the assets are received from the donor. The

National Jewish Health and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

contribution is measured at the fair value of the assets to be received, discounted for the estimated time period until the donor's death. The contributed assets are recognized at fair value when received. The difference between the fair value of the assets received and the revenue recognized is recorded as deferred revenue and reported in the liability under annuity contracts in the consolidated statements of financial position. This represents the amount of discount for future interest.

(d) Beneficial Interest in Perpetual Trusts

National Jewish receives perpetual trusts in which it has the irrevocable right to receive the income earned on the trust assets in perpetuity, but never receives the corpus. These trusts are administered by third parties and are recognized as contribution revenue and as an asset upon notification of the trust's existence. The contribution is measured at the fair value of the trust's assets, which approximates the present value of the estimated future cash receipts from the trust's assets. The revenue is classified as permanently restricted support. Annual distributions from the trusts are reported as unrestricted investment income unless restricted by the donor.

(e) Charitable Remainder Trusts

National Jewish is the beneficiary in various charitable remainder trusts in which a donor establishes and funds a trust with specified distributions to be made to a designated beneficiary or beneficiaries over the trust's term. Under the terms of the trust, National Jewish receives the assets remaining upon termination of the trust. The distributions to the beneficiaries may be for a specified dollar amount, an arrangement called a charitable remainder annuity trust (CRAT), or for a specified percentage of the trust's fair value determined annually, an arrangement called a charitable remainder unitrust (CRUT). Some CRUTs limit the annual payout to the lesser of the stated percentage or the actual income earned. Obligations to the beneficiaries are limited to the trust's assets. Contributions are recognized in the period in which the trust is established. For those trusts in which National Jewish is the trustee, the assets are recorded at fair value when received, and the liability to the donor's beneficiary is recorded as the present value of the estimated future payments to be distributed over the beneficiary's expected life. The amount of the contribution is the difference between these amounts and is classified as temporarily restricted support. Changes in actuarial assumptions are recognized in the consolidated statements of activities as changes in value of split-interest agreements in the temporarily restricted net asset class. Income earned on trust assets, gains, and losses is reflected in the consolidated statements of activities. Adjustments to the liability to reflect amortization of the discount or revaluation of the present value of the estimated future payments to the beneficiary are reflected in the consolidated statements of activities. Upon the death of the beneficiary, the liability is closed, and any balance is recognized as a change in the value of split-interest agreements and is reclassified to either temporarily restricted or unrestricted net assets as appropriate.

For those trusts of which National Jewish is not the trustee, the agreement is recognized as an unconditional promise to give. National Jewish recognizes, as temporarily restricted contributions revenue and as a receivable, the estimated fair value of the contribution which represents the present value of the estimated future benefits to be received when the trust assets are distributed upon termination of the trust. Adjustments to the receivable to reflect amortization of the discount or revaluation of the present value of the estimated future benefits are recognized as changes in the value of split-interest agreements. Upon the death of the beneficiary, the receivable is closed, the assets received from the trust are recognized at fair value, and any difference is reported as a

National Jewish Health and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2018 and 2017

change in the value of split-interest agreements and is reclassified to either temporarily restricted or unrestricted net assets as appropriate.

(f) Charitable Lead Trusts

National Jewish is the beneficiary in a charitable lead annuity trust (CLAT) in which a donor establishes and funds a trust with specific distributions to be made to National Jewish over a specified period. The contribution is recognized in the period in which the trust is established. For the trust of which National Jewish is not the trustee, the agreement is recognized as an unconditional promise to give. National Jewish recognizes its beneficial interest in the assets as temporarily restricted contributions revenue and as a receivable, the estimated fair value of the contribution which represents the present value of the estimated future cash flows. Distributions from the trust are reflected as a reduction in the receivable and as reclassifications from temporarily restricted net assets to unrestricted net assets.

(g) Gift Annuities

National Jewish receives charitable gift annuities under terms of which the donor contributes assets to National Jewish in exchange for a promise to pay a fixed amount for a specified period of time to the donor or to individuals or organizations designated by the donor. Assets received under gift annuity agreements are recognized at fair value when received. A corresponding annuity liability is recognized as the present value of future cash flows expected to be paid to the assigned beneficiary. Unrestricted contribution revenue is recognized as the difference between these two amounts. Adjustments to the annuity liability to reflect amortization of the discount and changes in the life expectancy of the beneficiary are recognized in the consolidated statements of activities as changes in the value of split-interest agreements in unrestricted net assets. Upon the death of the beneficiary, the annuity liability is closed, and a change in the value of the split-interest agreements is recognized.

(h) Grant Revenue

Research grant awards are accounted for as either contributions or exchange transactions based on the provisions of the award document. To the extent that grants are contributions, they are recognized as temporarily restricted support until conditions placed on the award by the granting agency have been satisfied. The related revenue is reclassified to unrestricted net assets as the required restrictions are satisfied and is reported in the consolidated statements of activities as “net assets released from restriction – grants.” All expenses directly related to grant agreements are included in the academic services expense category as a reduction in unrestricted net assets on the accompanying consolidated statements of activities.

(i) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with original maturities of three months or less, excluding amounts whose use is limited by internal designation or other arrangements.

(j) Debt Issuance Costs

Bond issuance costs and bond discounts related to the issuance of bonds are deferred and amortized over the life of the respective bond issue using the straight-line method. Additionally, capital lease

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

issuance costs related to the issuance of capital leases are deferred and amortized over the life of the capital lease using the straight-line method.

(k) Goodwill

Goodwill, which represents the excess of the purchase price over the fair value of the net assets of the Colorado operations of Sleep Health Centers, a department of National Jewish, is evaluated annually for impairment.

(l) Property and Equipment

Property and equipment that is purchased is stated at cost. Contributed property and equipment is recorded at fair value at the date of donation. If donors stipulate how long the assets must be used, the contributions are recorded as restricted support. In the absence of such stipulations, contributions of property and equipment are recorded as unrestricted support. Depreciation of buildings and equipment, including amortization of assets under capital leases, is calculated using the straight-line method over the estimated useful lives of the assets in accordance with American Hospital Association guidelines.

The estimated useful lives for each major depreciable classification of property and equipment are as follows:

Buildings	20 - 40 years
Equipment and software	3 - 15 years

(m) Long-lived Asset Impairment

National Jewish evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimate of future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended June 30, 2018 and 2017.

(n) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by National Jewish has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by National Jewish in perpetuity.

(o) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts receivable from patients, third-party payors, and others for services rendered.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

Amounts reimbursed for services rendered to patients recovered under various insurance programs are generally less than the established billing rates. The estimated difference is recorded as a reduction to net patient service revenue in the period the services are rendered.

Estimated amounts receivable or payable under reimbursement agreements with the Medicare and Medicaid programs are subject to examination and retroactive adjustment. Provisions for estimated retroactive adjustments under such programs are provided in the period the related services are rendered and adjusted in future periods as final settlements are determined.

(p) Subsequent Events

Subsequent events have been evaluated through October 15, 2018, which is the date the financial statements were available to be issued.

(q) Presentation of Financial Statements

Management has elected to present the financial statements under the not-for-profit model rather than that of a healthcare entity as National Jewish has historically had non-patient revenues, gains and other support in excess of patient revenue. The difference in presentation would have no effect on the change in net assets.

(r) Revisions

A revision has been made to the 2017 financial statements for the fair value hierarchy disclosure. This revision did not have a significant impact on the financial statement disclosures.

(3) Charity Care

National Jewish treats all patients who can benefit from National Jewish's care. Financial assistance is made available to patients based upon their ability to pay, and determinations in individual cases are made during National Jewish's preadmission process. Because National Jewish does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Expansion of eligibility coverage under Medicaid by the Affordable Care Act has decreased Charity Care substantially, with National Jewish's direct and indirect costs for services furnished under its charity care policy aggregated approximately \$463,000 and \$588,000 in 2018 and 2017, respectively.

National Jewish also participates in the Medicare and Medicaid programs. Under these programs, National Jewish provides care to patients at payment rates determined by governmental agencies, regardless of actual cost. Governmental rates are frequently below cost.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(4) Net Patient Service Revenue

National Jewish has agreements with third-party payors that provide for reimbursement to National Jewish at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between National Jewish's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with major third-party payors follows:

Medicare – Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain inpatient non-acute services and defined medical education costs are paid based on a cost reimbursement methodology. National Jewish is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by National Jewish and audits thereof by the Medicare fiscal intermediary.

Medicaid – Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology for certain services and at prospectively determined rates for all other services. Effective October 31, 2016, outpatient hospital services are paid at prospectively determined rates using the Enhanced Ambulatory Patient Grouping (EAPG) methodology. The original implementation was postponed until March 1, 2017 and was retroactively implemented to November 1, 2016 in the spring of 2018.

Managed Care – National Jewish has entered into agreements with numerous managed care organizations. The basis for payment to National Jewish under these agreements is primarily discounts from established charges and negotiated fee schedules.

National Jewish provides services in Colorado to patients from throughout the United States and internationally. As of June 30, 2018 and 2017, National Jewish's net patient receivable for services rendered was approximately \$28,026,000 and \$29,053,000, respectively. Possible credit losses are provided for in National Jewish's allowance for uncollectible accounts and contractual adjustments.

The mix of gross patient charges from third-party payors is as follows:

	Revenue	
	2018	2017
Medicare	43%	41%
Medicaid	15%	16%
Blue Cross	11%	13%
Managed care	21%	20%
Other third-party payors	10%	10%
	<u>100%</u>	<u>100%</u>

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(5) Grant Revenue

Total grant revenue consists of grants from the federal government as well as grants from charitable foundations and private corporations. The composition of total grant revenue included in unrestricted and temporarily restricted revenue for the years ended June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Federal grants	\$ 40,670,000	\$ 39,597,000
Charitable foundation and private corporation grants	<u>10,850,000</u>	<u>10,292,000</u>
	<u>\$ 51,520,000</u>	<u>\$ 49,889,000</u>

(6) Promises to Give

Included as receivables are the following unconditional promises to give as of June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Pledges	\$ 42,478,000	\$ 31,429,000
Bequests	<u>2,426,000</u>	<u>552,000</u>
Unconditional promises to give before unamortized discount and allowance for uncollectibles	44,904,000	31,981,000
Less unamortized discount – pledges	<u>(1,726,000)</u>	<u>(2,100,000)</u>
	43,178,000	29,881,000
Less:		
Allowance for uncollectibles – pledges	(7,026,000)	(4,393,000)
Allowance for uncollectibles – bequests	<u>(160,000)</u>	<u>(25,000)</u>
Net unconditional promises to give	<u>\$ 35,992,000</u>	<u>\$ 25,463,000</u>
Amounts due in:		
Less than one year	\$ 26,569,000	\$ 7,343,000
One to five years	13,531,000	19,117,000
More than five years	<u>4,804,000</u>	<u>5,521,000</u>
Total	<u>\$ 44,904,000</u>	<u>\$ 31,981,000</u>

Discount rates are established when the promise to give is made. Discount rates ranged from 0.48% to 3.42% and 0.48% to 5.01% for June 30, 2018 and 2017, respectively.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(7) Internally-designated Assets

The governing body has designated certain assets for strategic and other future purposes. The composition of internally-designated assets stated at fair value, as determined by the most recent market quotations or an estimate based on significant other observable inputs, at June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 8,381,000	\$ 6,722,000
Common stocks and equity funds	9,131,000	10,286,000
International securities and equities	10,130,000	11,974,000
Fixed income securities	15,225,000	11,732,000
U.S. government and agency obligations	584,000	549,000
Alternative investments	<u>3,281,000</u>	<u>3,534,000</u>
	<u>\$ 46,732,000</u>	<u>\$ 44,797,000</u>

(8) Long-term Investments

The composition of long-term investments, stated at fair value, as determined by the most recent market quotations or an estimate based on significant other observable inputs at June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 307,000	\$ 1,997,000
Convertible securities and equities	28,174,000	21,056,000
International securities and equities	9,838,000	15,992,000
Fixed income securities	14,105,000	10,186,000
U.S. government and agency obligations	285,000	637,000
Alternative investments	<u>11,209,000</u>	<u>12,248,000</u>
	<u>\$ 63,918,000</u>	<u>\$ 62,116,000</u>

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(9) Composition of Investment Returns

The following summarizes investment returns and classification in the statements of activities:

	2018		
	Unrestricted	Temporarily Restricted *	Permanently Restricted **
Interest income	\$ 1,328,000	\$ 2,420,000	\$ -
Gains:			
Realized gains	1,801,000	1,741,000	304,000
Unrealized gains	<u>79,000</u>	<u>41,000</u>	<u>-</u>
Total gains	<u>1,880,000</u>	<u>1,782,000</u>	<u>304,000</u>
Total return on investments in stock and bond portfolios	<u>\$ 3,208,000</u>	<u>\$ 4,202,000</u>	<u>\$ 304,000</u>
	2017		
	Unrestricted	Temporarily Restricted *	Permanently Restricted **
Interest income	\$ 1,268,000	\$ 2,004,000	\$ -
Gains:			
Realized gains	776,000	1,173,000	781,000
Unrealized gains	<u>3,700,000</u>	<u>3,875,000</u>	<u>-</u>
Total gains	<u>4,476,000</u>	<u>5,048,000</u>	<u>781,000</u>
Total return on investments in stock and bond portfolios	<u>\$ 5,744,000</u>	<u>\$ 7,052,000</u>	<u>\$ 781,000</u>

* Some amounts are included in change in value of split-interest agreements on the statements of activities.

** Amount represents change in beneficial interest in perpetual trusts. National Jewish is not the trustee of these investments.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(10) Split-interest Agreements

National Jewish has the following split-interest agreements:

	2018		
	Assets	Liabilities	Net
Gift annuities	\$ 39,314,000	\$ 9,378,000	\$ 29,936,000
Unitrust agreements:			
National Jewish trusteeships	2,713,000	2,389,000	324,000
Third-party trusteeship, net	2,360,000	-	2,360,000
Term endowments	2,422,000	-	2,422,000
Pooled income agreements	520,000	432,000	88,000
Total	\$ 47,329,000	\$ 12,199,000	\$ 35,130,000

	2017		
	Assets	Liabilities	Net
Gift annuities	\$ 39,345,000	\$ 10,388,000	\$ 28,957,000
Unitrust agreements:			
National Jewish trusteeships	2,934,000	2,984,000	(50,000)
Third-party trusteeship, net	2,915,000	-	2,915,000
Term endowments	2,387,000	-	2,387,000
Pooled income agreements	586,000	433,000	153,000
Total	\$ 48,167,000	\$ 13,805,000	\$ 34,362,000

For the above split-interest agreements, a risk-free rate, obtained using U.S. Treasury bonds at the date of the gift, was used in conjunction with actuarially determined life expectancies to calculate present values. The interest rates ranged from 0.48% to 10.00% for 2018 and 2017.

Though the assets received under gift annuity agreements are generally available for unrestricted use and the liability is a general obligation of National Jewish, National Jewish is required by several states to set assets aside to pay the regulatory minimum annuity obligation. These funds are classified as assets reserved for gift annuities on the consolidated statements of financial position. These assets are invested in equities and bonds, which are stated at fair value, as determined by the most recent market quotations or an estimate based on significant other observable inputs, and totaled \$8,021,000 and \$8,866,000 at June 30, 2018 and 2017, respectively.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(11) Construction in Progress

At June 30, 2017, National Jewish had four projects in-progress for which \$2,395,000 had been expended. These projects were completed by June 30, 2018, leaving a construction in progress balance of \$0 on June 30, 2018. Completed projects include implementing a Laboratory Information Management System (LIMS) in the Advanced Diagnostics Laboratories, moving the Library to the old gift shop location, converting the library space to clinic space, and replacing the elevator in the Neustadt building.

(12) Long-term Debt

Long-term debt at June 30, 2018 and 2017 is summarized as follows:

	2018	2017
	<u> </u>	<u> </u>
Revenue Bonds, Series 2012 (a)	\$ 17,705,000	\$ 19,435,000
Revenue Bonds, Series 2005 (b)	9,500,000	9,900,000
Gove School Property (c)	4,250,000	5,250,000
Unamortized Bond Premium		
Revenue Bonds, Series 2012	799,000	891,000
Capital Lease/Financing Arrangement (d)	<u>2,291,000</u>	<u>2,274,000</u>
	34,545,000	37,750,000
Less: unamortized debt issuance costs	(402,000)	(440,000)
Less: current portion	<u>(4,040,000)</u>	<u>(4,012,000)</u>
	<u>\$ 30,103,000</u>	<u>\$ 33,298,000</u>

(a) Series 2012 Revenue Bonds

The Colorado Health Facilities Authority issued \$26,790,000 aggregate principal amount of its Refunding Revenue Bonds Series 2012 (the 2012 Bonds) dated March 1, 2012. The proceeds were used to refund the Series 1998 and Series 1998B Bonds. National Jewish recorded a loss on the early extinguishment of debt relative to the Series 1998 and Series 1998B Bonds of approximately \$1,175,000. The 2012 Bonds are subject to a mandatory sinking fund redemption beginning January 1, 2026. Final principal payments on the bonds are due in January 2027. Redemption amounts are as follows at June 30, 2018:

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

2019	\$ 1,810,000
2020	1,910,000
2021	2,000,000
2022	2,105,000
2023	2,205,000
Thereafter	<u>7,675,000</u>
	<u><u>\$ 17,705,000</u></u>

The 2012 Bonds bear interest at fixed rates varying from 3.00% to 5.00% and are secured by the rights to all future revenue derived from National Jewish's property, excluding revenue derived from donor-restricted property if such revenue is unavailable for debt service. The 2012 Bonds are subject to covenants that impose certain operating and financial restrictions on National Jewish. Management believes National Jewish is in compliance with all covenants for the years ended June 30, 2018 and 2017. Unamortized debt issuance costs for the 2012 Bonds were \$255,000 and \$285,000 at June 30, 2018 and 2017, respectively.

(b) Series 2005 Revenue Bonds

In January 2005, the Colorado Health Facilities Authority issued \$13,500,000 aggregate principal amount of its Series 2005 Revenue Bonds (the 2005 Bonds) dated January 20, 2005. Proceeds from the 2005 Bonds were used to finance the construction of a clinical and research building, as well as several renovation projects and equipment. Unamortized debt issuance costs for the 2005 Bonds were \$147,000 and \$155,000 at June 30, 2018 and 2017, respectively.

The 2005 Bonds require annual payments of varying amounts. These payments began on January 1, 2007. Final principal payments on the bonds are due in January 2035. Redemption amounts are as follows at June 30, 2018:

2019	\$ 400,000
2020	400,000
2021	400,000
2022	400,000
2023	500,000
Thereafter	<u>7,400,000</u>
	<u><u>\$ 9,500,000</u></u>

The 2005 Bonds bear a variable rate of interest based on the rate at which the bonds could be remarketed at their face value and are secured by the rights to all future revenue derived from National Jewish's property, excluding revenue derived from donor restricted property if such revenue is unavailable for debt service. The interest rate at June 30, 2018 was 1.6%. The 2005 Bonds are backed by an irrevocable transferable letter of credit, which is automatically extended without amendment for an additional period of 12 months beginning on March 1, 2016. The letter of credit expires April 1, 2019, and is automatically extended by one year, each year, beginning April 1, unless otherwise terminated before the updated expiration date. Unless certain events occur, such as the expiration date of the letter of credit, advances made on the letter of credit are not due for 366 days from the date of the advance. At June 30, 2018 and 2017, no borrowings were

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

outstanding. The 2005 Bonds are subject to covenants, which impose certain operating and financial restrictions on National Jewish. Management believes National Jewish is in compliance with all covenants for the years ended June 30, 2018 and 2017.

(c) Gove Middle School Property Promissory Note

In February 2011, National Jewish entered into a contract with School District No. 1, in the City and County of Denver and State of Colorado (DPS) to purchase the closed Gove Middle School property for \$9,000,000. The property is located adjacent to National Jewish's main campus, and will be used for furthering National Jewish's clinical, research and educational missions. Principal payments as of June 30, 2018, are as follows:

2019	\$ 1,250,000
2020	<u>3,000,000</u>
	<u>\$ 4,250,000</u>

DPS issued a non-recourse promissory note in the amount of \$8,750,000 which bears interest at a fixed rate of 4%. A final balloon payment of the remaining principal outstanding is due May 23, 2020. The note is collateralized by the land.

(d) Capital Lease

In August 2012, National Jewish entered into multiple five year capital leases with U.S. Bank for the purchase of a new Enterprise Resource Planning (ERP) system and clinical equipment totaling \$4,636,000. The interest rates were approximately 2% and principal and interest paid in quarterly installments of approximately \$246,000. The leases are collateralized by property and equipment. As of June 15, 2018, all capital leases with U.S. Bank were paid in full.

In December 2015, National Jewish entered into a five year capital lease with Commerce Bank for the purchase of a new Laboratory Information Management System (LIMS). The total approved under the lease agreement is \$3,000,000, and draws are made on the financing as vendor invoices are submitted. As of June 30, 2018, \$2,828,000 has been drawn. Two repayment schedules were finalized on March 1, 2017 and December 27, 2017 both ending March 1, 2022 for \$1,816,000 and \$1,012,000 with interest rates of 3.58% and 4.08%, respectively.

The following leased equipment and software is included in the accompanying consolidated financial statements at June 30, 2018 and 2017 as follows:

	<u>2018</u>	<u>2017</u>
Classes of assets:		
Equipment and software - U.S. Bank lease	\$ -	\$ 4,636,000
Construction in Progress - Commerce Lease	-	1,816,000
Equipment and software - Commerce Lease	2,712,000	-
Less accumulated depreciation	<u>(350,000)</u>	<u>(2,002,000)</u>
	<u>\$ 2,362,000</u>	<u>\$ 4,450,000</u>

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

Future minimum lease payments under capital leases, together with the present value of the net minimum lease payments as of June 30, 2018, are as follows:

2019	\$ 656,000
2020	656,000
2021	656,000
2022	492,000
Less amount representing interest	<u>(169,000)</u>
Present value of current lease payments	<u>\$ 2,291,000</u>

(e) Held by Trustee

Assets held by trustees represent funds designated by the bond indenture to pay principal and interest on the 2012 and 2005 Bonds. The composition of these funds stated at contractual value, which approximates fair value, at June 30, 2018 and 2017, is as follows:

	<u>2018</u>	<u>2017</u>
	<u>Cash and Cash Equivalents</u>	<u>Cash and Cash Equivalents</u>
2012 Bonds		
Bond Reserve Fund	\$ 2,698,000	\$ 2,730,000
Bond Interest/Principal Fund	<u>443,000</u>	<u>518,000</u>
	<u>\$ 3,141,000</u>	<u>\$ 3,248,000</u>
2005 Bonds		
Bond Reserve Fund	\$ 783,000	\$ 783,000
Bond Interest/Principal Fund	<u>5,000</u>	<u>1,000</u>
	<u>\$ 788,000</u>	<u>\$ 784,000</u>

(13) Line of Credit

National Jewish has a \$15,000,000 unsecured revolving bank line of credit expiring on March 1, 2020. At June 30, 2018 and 2017, there was \$13,581,000 and \$9,572,000, respectively, borrowed against this line, including accrued interest. Interest accrues at the greater of the prime rate less 1%; 30, 60, or 90 day LIBOR rate plus 175 basis points; or 2.75%. National Jewish's borrowing interest rate was 4.00% and 3.25% on June 30, 2018 and 2017, respectively.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(14) Commitments and Contingencies

(a) Operating Leases

National Jewish leases certain facilities and equipment under operating leases. The leases expire in various years through 2027. These leases generally require National Jewish to pay all executory costs (property taxes, maintenance, and insurance). Future minimum rental payments as of June 30, 2018, that have initial or remaining non-cancelable lease terms equal to or greater than one year are as follows:

2019	\$ 2,266,000
2020	2,227,000
2021	1,983,000
2022	1,734,000
2023	1,358,000
Thereafter	<u>1,819,000</u>
Total future minimum payments	<u>\$ 11,387,000</u>

Rental expense for operating leases was approximately \$2,735,000 and \$2,659,000 for the years ended June 30, 2018 and 2017, respectively.

(b) Professional Liability

Reserves for professional liability claims were \$815,000 and \$3,148,000 at June 30, 2018 and 2017, respectively. For claims covered by insurance, National Jewish recorded an additional \$492,000 and \$2,858,000 of professional liability reserves and an equal amount of insurance coverage receivables.

The current portion of the above reserves, \$65,000 and \$2,110,000 at June 30, 2018 and 2017, respectively, is included in other accrued expenses in the accompanying consolidated statements of financial position. The provision for losses related to professional liability risks is presented net of expected insurance recoveries in the consolidated statements of operations and was (\$33,000) and \$168,000 for 2018 and 2017, respectively.

Professional liability reserve estimates represent the estimated ultimate cost of all reported and unreported losses incurred through the respective consolidated statements of financial position. The reserves for unpaid losses and loss expenses are estimated using individual case-basis valuations and actuarial analyses. Those estimates are subject to the effects of trends in loss severity and frequency. The estimates are continually reviewed and adjustments are recorded as experience develops or new information becomes known. The time period required to resolve these claims can vary depending upon whether the claim is settled or litigated. The estimation of the timing of payments beyond a year can vary significantly. Although considerable variability is inherent in professional liability reserve estimates, we believe the reserves for losses and loss expenses are adequate based on information currently known. It is reasonably possible that this estimate could change materially in the near term.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(c) Other

National Jewish has certain pending litigation and claims incurred in the ordinary course of business; however, management believes, based on the advice of legal counsel, that the probable resolution of such contingencies will not materially affect the financial position or operations of National Jewish.

National Jewish maintains professional and general liability coverage through a claims-made policy with COPIC Insurance. The policy's liability is \$1,000,000 per medical incident and \$3,000,000 in the aggregate, with deductibles of \$100,000 per medical incident/occurrence and \$300,000 in the aggregate. In addition, umbrella coverage is provided to National Jewish through a claims-made policy with COPIC Insurance. The liability limit under the umbrella policy is \$20,000,000 combined medical incident and in aggregate.

(d) Risks and Uncertainties

National Jewish invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and those changes could materially affect the investment amounts reported in the statements of financial position.

(15) Temporarily Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

	2018	2017
Net assets reserved for future unrestricted uses	\$ 2,268,000	\$ 530,000
Restricted for research, education, patient care, and capital construction	64,917,000	55,160,000
Endowed assets not yet appropriated for expenditure	18,142,000	16,632,000
Unitrust agreements and pooled income agreements	5,192,000	5,041,000
	<u>\$ 90,519,000</u>	<u>\$ 77,363,000</u>

Net assets reserved for future unrestricted uses represent contributions not yet received by National Jewish. Endowed assets not yet appropriated for expenditure represent earnings on permanently endowed funds that have not been appropriated for expenditure by National Jewish in a manner consistent with the standard of prudence prescribed by State of Colorado Prudent Management of Institutional Funds Act (SPMIFA). See Note 17 for further discussion.

During 2018 and 2017, net assets were released from donor restrictions by incurring expenses to satisfy the restricted purpose for research, education, patient care, and other purposes in the amounts of approximately \$21,357,000 and \$20,970,000, respectively.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(16) Permanently Restricted Net Assets

Permanently restricted net assets consist of the following:

	2018	2017
Beneficial interest in perpetual trust agreement	\$ 12,604,000	\$ 12,300,000
Permanent endowments	39,588,000	34,756,000
Total	\$ 52,192,000	\$ 47,056,000

National Jewish is an income beneficiary of several perpetual trusts controlled by unrelated third-party trustees. The trust document or the trustees' policies govern the investment and distribution of trust assets. Trust income distributed to National Jewish for the years ended June 30, 2018 and 2017 was \$482,000 and \$574,000, respectively.

(17) Endowment

National Jewish's endowment consists of approximately 78 individual, donor-restricted funds established as endowments and intended for a variety of purposes. The Board of Directors has interpreted the SPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, National Jewish classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by National Jewish in a manner consistent with the standard of prudence prescribed by SPMIFA. National Jewish considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- 1) The duration and preservation of the fund
- 2) The purpose of National Jewish and the donor-restricted endowment fund
- 3) General economic conditions
- 4) The possible effect of inflation and deflation
- 5) The expected total return from income and appreciation of investments
- 6) The resources of National Jewish
- 7) The investment policies of National Jewish

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(a) Investment Policy

National Jewish has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by the endowment while balancing fund growth. Under this policy, approved by the Board of Directors, the assets are invested in a manner that is intended to produce results that exceed Consumer Price Index plus 5% per year as measured over a rolling 36-month period. To satisfy this long-term rate of return objective, National Jewish relies on a total return strategy in which investment returns are achieved through both capital appreciation and current yield. National Jewish targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives with prudent risk constraints.

(b) Spending Policy

National Jewish's spending policy varies by the purpose of the endowment and was established by the Board of Directors after considering all seven factors outlined by SPMIFA above. Funds with donor specific purposes have a spending policy of between 3% and 4% of the market value of the fund averaged over the past 12 fiscal quarters preceding the fiscal year in which the distribution is made.

(c) Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or SPMIFA requires National Jewish to retain as an endowment. There were no such deficiencies as of June 30, 2018.

The composition of net assets by type of endowment fund at June 30, 2018:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 20,450,000	\$ 39,588,000	\$ 60,038,000
Board-designated endowment funds	11,762,000	-	-	11,762,000
Total funds	<u>\$ 11,762,000</u>	<u>\$ 20,450,000</u>	<u>\$ 39,588,000</u>	<u>\$ 71,800,000</u>

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

Changes in endowment net assets for fiscal year ended June 30, 2018:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 11,538,000	\$ 18,904,000	\$ 34,756,000	\$ 65,198,000
Contributions	-	-	4,832,000	4,832,000
Endowment transfer	(500,000)	(2,057,000)	-	(2,557,000)
Investment income	410,000	2,186,000	-	2,596,000
Net assets released from restriction	-	(141,000)	-	(141,000)
Gain on sale of investments	150,000	1,546,000	-	1,696,000
Unrealized gain on investments	164,000	12,000	-	176,000
Endowment net assets, end of year	<u>\$ 11,762,000</u>	<u>\$ 20,450,000</u>	<u>\$ 39,588,000</u>	<u>\$ 71,800,000</u>

The composition of net assets by type of endowment fund at June 30, 2017:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ -	\$ 18,904,000	\$ 34,756,000	\$ 53,660,000
Board-designated endowment funds	<u>11,538,000</u>	<u>-</u>	<u>-</u>	<u>11,538,000</u>
Total funds	<u>\$ 11,538,000</u>	<u>\$ 18,904,000</u>	<u>\$ 34,756,000</u>	<u>\$ 65,198,000</u>

Changes in endowment net assets for fiscal year ended June 30, 2017:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 10,200,000	\$ 14,588,000	\$ 34,343,000	\$ 59,131,000
Contributions	-	-	413,000	413,000
Endowment transfer	-	(2,048,000)	-	(2,048,000)
Investment income	374,000	1,709,000	-	2,083,000
Net assets released from restriction	-	(56,000)	-	(56,000)
Gain on sale of investments	(25,000)	1,049,000	-	1,024,000
Unrealized gain on investments	989,000	3,662,000	-	4,651,000
Endowment net assets, end of year	<u>\$ 11,538,000</u>	<u>\$ 18,904,000</u>	<u>\$ 34,756,000</u>	<u>\$ 65,198,000</u>

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(18) Fair Value Disclosure

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets for identical assets or liabilities

Level 2: Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active, other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(a) Recurring Measurements

The following tables represent the fair value measurement of assets recognized in the accompanying consolidated statements of financial position measured at fair value on a recurring basis and the level within the ASC 820 fair value hierarchy in which the fair value measurements fall at June 30, 2018 and 2017:

	June 30, 2018	Fair Value	Fair Value Measurements at Reporting Date Using					
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)			
Internally-designated assets								
Common stocks and equity funds	\$	9,131,000	\$	9,131,000	\$	-	\$	-
International securities and equities		10,130,000		10,130,000		-		-
Fixed income securities		15,224,000		15,224,000		-		-
U.S. government and agency securities		584,000		584,000		-		-
Alternative investments (A)		3,281,000		-		-		-
Total internally-designated assets		38,350,000		35,069,000		-		-
Assets reserved for gift annuities								
Convertible securities and equities		2,063,000		2,063,000		-		-
International securities and equities		2,143,000		2,143,000		-		-
Fixed income securities		3,815,000		3,815,000		-		-
U.S. government and agency securities		1,401,000		1,401,000		-		-
Total assets reserved for gift annuities		9,422,000		9,422,000		-		-
Long-term investments								
Convertible securities and equities		28,174,000		28,174,000		-		-
International securities and equities		9,838,000		9,838,000		-		-
Fixed income securities		14,105,000		14,105,000		-		-
U.S. government and agency securities		285,000		285,000		-		-
Alternative investments (A)		11,208,000		-		-		-
Total long-term investments		63,610,000		52,402,000		-		-
Other								
Bonds and notes		134,500		132,000		2,500		-
Beneficial interest in perpetual trust		12,604,000		-		-		12,604,000
Total other		12,738,500		132,000		2,500		12,604,000
Total assets above		124,120,500	\$	97,025,000	\$	2,500	\$	12,604,000
Cash and cash equivalents not included above								
		8,838,000						
Total		\$ 132,958,500						

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(A) Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts included above are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated statements of financial position.

	June 30, 2017	Fair Value	Fair Value Measurements at Reporting Date Using			
			Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Internally-designated assets						
Common stocks and equity funds	\$	10,286,000	\$	10,286,000	\$	-
International securities and equities		11,974,000		11,974,000		-
Fixed income securities		11,732,000		11,732,000		-
U.S. government and agency securities		549,000		549,000		-
Alternative investments (A)		3,534,000		-		-
Total internally-designated assets		38,075,000		34,541,000		-
Assets reserved for gift annuities						
Convertible securities and equities		684,000		684,000		-
International securities and equities		3,748,000		3,748,000		-
Fixed income securities		3,480,000		3,480,000		-
U.S. government and agency securities		954,000		954,000		-
Total assets reserved for gift annuities		8,866,000		8,866,000		-
Long-term investments						
Convertible securities and equities		21,056,000		21,056,000		-
International securities and equities		15,992,000		15,992,000		-
Fixed income securities		10,186,000		10,186,000		-
U.S. government and agency securities		637,000		637,000		-
Alternative investments (A)		12,248,000		-		-
Total long-term investments		60,119,000		47,871,000		-
Other						
Bonds and notes		150,000		15,000		135,000
Beneficial interest in perpetual trust		12,300,000		-		12,300,000
Total other		12,450,000		15,000		135,000
Total assets above		119,510,000	\$	91,293,000	\$	135,000
Cash and cash equivalents not included above		10,385,000				
Total		\$ 129,895,000				

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

- (A) Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts included above are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated statements of financial position.

Following is a description of the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying consolidated statements of financial position, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended June 30, 2018. For assets classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

(b) Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

(c) Beneficial Interest in Perpetual Trusts

Fair value is estimated at the fair value of the trust assets using quoted market prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters. Due to the trusts being held to perpetuity, National Jewish will not have the ability to redeem the corpus, and therefore is classified within Level 3 of the hierarchy.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(d) Alternative Investments

Except as described below, the fair value of alternative investments has been estimated using the net asset value per share of the investments. Alternative investments held at June 30 consist of the following:

June 30, 2018				
	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Fund to Fund	\$ 14,489,000	\$ 4,404,000	Quarterly or Fund Termination	60 Days or Fund Termination
June 30, 2017				
	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Fund to Fund	\$ 15,782,000	\$ 2,432,000	Quarterly or Fund Termination	60 Days or Fund Termination

This category includes investments in fund of funds that pursue multiple strategies to diversify risks and reduce volatility. The funds' composite portfolio includes investments in U.S. common stocks, global real estate projects, private equity, pooled income vehicles and arbitrage investments. However, as of June 30, 2017, it is probable that all investments in this category will be sold at an amount different from the net asset value of National Jewish's ownership interest in partners' capital. Therefore, the fair values of the investments in this category have been estimated using recent observable transaction information for similar investments. Investments with quarterly redemptions require lock-up periods of one year which has expired on the funds currently held. Of the remaining funds, they cannot be liquidated prior to the termination of the fund without the approval of the General Manager of the fund. Investment in the funds is intended to be long-term.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(e) Level 3 Reconciliation

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying consolidated statements of financial position using significant unobservable (Level 3) inputs:

	Beneficial Interest in Perpetual Trust
Balance, July 1, 2016	\$ 11,519,000
Unrealized appreciation on investments included in change in net assets	<u>781,000</u>
Balance, June 30, 2017	12,300,000
Unrealized appreciation on investments included in change in net assets	<u>304,000</u>
Balance, June 30, 2018	<u><u>\$ 12,604,000</u></u>

Unobservable (Level 3) Inputs

The following table present quantitative information about unobservable inputs used in recurring Level 3 fair value measurements.

	Fair Value June 30, 2018	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Beneficial Interest in Perpetual Trusts	\$ 12,604,000	Fair value of trust assets	Lack of redeemability	Not applicable

	Fair Value June 30, 2017	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Beneficial Interest in Perpetual Trusts	\$ 12,300,000	Fair value of trust assets	Lack of redeemability	Not applicable

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(f) Nonrecurring Measurements

The following tables present the fair value measurement of assets and liabilities measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2018 and 2017:

Description	June 30, 2018	Fair Value Measurements during Reporting Year		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Receivables related to:				
Charitable Remainder Unitrust	\$ 67,000	\$ -	\$ 67,000	\$ -
Gift Annuities	<u>346,000</u>	<u>-</u>	<u>346,000</u>	<u>-</u>
Total	<u>\$ 413,000</u>	<u>\$ -</u>	<u>\$ 413,000</u>	<u>\$ -</u>

Description	June 30, 2017	Fair Value Measurements during Reporting Year		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Receivables related to:				
Charitable Remainder Unitrust	\$ 62,000	\$ -	\$ 62,000	\$ -
Gift Annuities	<u>545,000</u>	<u>-</u>	<u>545,000</u>	<u>-</u>
Total	<u>\$ 607,000</u>	<u>\$ -</u>	<u>\$ 607,000</u>	<u>\$ -</u>

(19) Employee Benefit Plans

National Jewish maintains a defined contribution plan (the Plan) covering substantially all benefit eligible employees. Under the terms of the Plan, National Jewish contributes between 5% and 6% of an employee's covered wages up to the Social Security wage base and between 10% and 11% of covered wages in excess of the Social Security wage base. The Plan contains no provisions requiring National Jewish to match a portion of employee contributions. Expenses under the Plan for 2018 and 2017 approximated \$5,900,000 and \$5,500,000, respectively.

National Jewish Health and Subsidiary
Notes to Consolidated Financial Statements
June 30, 2018 and 2017

(20) Related-party Transactions

National Jewish from time-to-time in the normal course of business and within the guidelines of its conflict of interest policy, has entered into transactions with companies for which certain members of the companies' management also serve on the Board of National Jewish. Management believes that prices paid by National Jewish have been equal to or less than the prices that would have been paid in transactions with parties not related to National Jewish.