

AUDITED FINANCIAL STATEMENTS 2017-2018



CONSOLIDATED FINANCIAL STATEMENTS

July 31, 2018 and 2017

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Report of Independent Auditors

To the Board of Regents of Pepperdine University

We have audited the accompanying consolidated financial statements of Pepperdine University (the "University"), which comprise the consolidated statements of financial position as of July 31, 2018 and July 31, 2017, and the related consolidated statements of activities and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the 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.

Auditors' Responsibility

Our responsibility is to express an opinion on the 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 our 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, we consider internal control relevant to the University'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 University'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 Pepperdine University as of July 31, 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.

Pricenaterhouse Cooper IIP November 28, 2018

Consolidated Statements of Financial Position At July 31, 2018 and 2017 (In thousands)

	2018	2017
ASSETS		
Cash and cash equivalents	\$ 148,113	\$ 144,456
doubtful accounts of \$1,587 and \$1,460, respectively	2,562	1,587
Other accounts receivable	6,547	5,953
Prepaid expenses, inventories, and other assets Student loans, less allowance for	4,862	4,126
loan losses of \$1,578 and \$1,466, respectively	19,516	20,621
Beneficial interests and contributions receivable, net	38,122	31,909
Investments	1,147,769	1,034,457
Assets held as trustee or agent	118,853	113,273
Property, facilities, and equipment, net	444,814	389,976
Total assets	\$1,931,158	\$1,746,358
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued liabilities	\$ 32,490	\$ 28,856
Accrued salaries and wages	4,052	4,093
Student deposits, advance payments, and		
deferred revenue	10,099	13,925
Asset retirement obligations	6,757	6,506
U.S. government-funded student loans	13,188	15,495
Trust and agency obligations	67,500	71,086
Other long-term obligations	3,233	3,233
Long-term bonds payable, net	425,989	305,939
Total liabilities	563,308	449,133
Net assets:		
Unrestricted	828,530	798,831
Temporarily restricted	129,423	115,569
Permanently restricted	409,897	382,825
Total net assets	1,367,850	1,297,225
Total liabilities and net assets	\$1,931,158	\$1,746,358

See accompanying notes to consolidated financial statements.

Consolidated Statement of Activities For the year ended July 31, 2018 (In thousands)

	Un	restricted		mporarily estricted		nanently estricted		Total
REVENUES AND OTHER SUPPORT								
Student tuition and fees.	\$	362,808	\$	-	\$	_	\$	362,808
Less student aid	•	(113,321)	,	_	•	_	•	(113,321)
Net student tuition and fees		249,487	-	_		_		249,487
Room and board		20 500						20 500
		38,580		-		62		38,580 40,585
Endowment support.		40,523		5,662		~-		-
Private gifts and grants.		10,471		3,002		19,017		35,150
Government grants		3,397		14		-		3,411
Other revenue		7,065		50		92		7,065
Net assets released from restriction		9,188 4,914				83		9,321
Total revenues and other support			-	(4,914) 812		19,162		383,599
Total revenues and other support		363,625		812		19,102		383,399
EXPENSES								
Instruction and research		98,107		-		-		98,107
Academic support		68,625		-		-		68,625
Student services.		62,211		-		-		62,211
Management and plant operations		64,314		-		-		64,314
Auxiliary enterprises		30,236		-		-		30,236
Public service.		17,754		-		-		17,754
Fundraising.		6,991		-		-		6,991
Alumni relations and development		3,690		-		-		3,690
Total expenses		351,928		-		_		351,928
Change in net assets before non-operating								
revenues and expenses		11,697		812		19,162		31,671
NON-OPERATING REVENUES AND EXPENSES								
Actuarial adjustment of trust and agency obligations		-		2,439		4,776		7,215
Investment income:								
Dividends		7,534		2,946		2		10,482
Interest		6,128		941		24		7,093
Other		11,579		-		-		11,579
Investment expenses		(4,284)		(2,156)				(6,440)
Net realized and unrealized investment gains		6,362		5,748		6,681		18,791
Foreign currency translation		(66)		-		-		(66)
Other		(9,251)		3,124		(3,573)		(9,700)
Total non-operating revenues and expenses		18,002		13,042		7,910		38,954
Change in net assets		29,699		13,854		27,072		70,625
Net assets at beginning of year		798,831		115,569		382,825		1,297,225
Net assets at end of year	\$	828,530	\$	129,423	\$	409,897	\$	1,367,850

See accompanying notes to consolidated financial statements.

Consolidated Statement of Activities For the year ended July 31, 2017 (In thousands)

	Uni	restricted		mporarily estricted		rmanently estricted		Total
REVENUES AND OTHER SUPPORT								
Student tuition and fees	\$	350,208	\$	_	\$	_	\$	350,208
Less student aid		(109,017)	•	_	4	_	•	(109,017)
Net student tuition and fees		241,191		-				241,191
Room and board		36,592		-		-		36,592
Endowment support		39,914		_		76		39,990
Private gifts and grants		10,516		9,712		5,590		25,818
Government grants		3,736		-		-		3,736
Sales and services		6,451		-		-		6,451
Other revenue		6,436		_		1,069		7,505
Net assets released from restriction		17,469		(17,397)		(72)		-
Total revenues and other support		362,305		(7,685)		6,663		361,283
EXPENSES								
Instruction and research		95,764		-		-		95,764
Academic support		58,838		-		-		58,838
Student services		56,288		-		-		56,288
Management and plant operations		56,803		-		-		56,803
Auxiliary enterprises		28,496		-		-		28,496
Public service		16,066		-		-		16,066
Fundraising		7,002		-		-		7,002
Alumni relations and development		2,898		-		-		2,898
Total expenses.		322,155		-		-		322,155
Change in net assets before non-operating								
revenues and expenses		40,150		(7,685)		6,663		39,128
NON-OPERATING REVENUES AND EXPENSES								
Actuarial adjustment of trust and agency obligations		-		(2,962)		(1,140)		(4,102)
Investment income:		5.040		0.074		2		0.225
Dividends		5,848		2,374		3		8,225
Interest.		1,467		529		42		2,038
Other		12,544		- (2.20.4)		-		12,544
Investment expenses.		(4,540)		(2,204)		- 0.015		(6,744)
Net realized and unrealized investment gains		47,832		14,646		8,817		71,295
Foreign currency translation		216		(0.554)		-		216
Other		(10,884)		(8,554)		2,479		(16,959)
Total non-operating revenues and expenses		52,483		3,829		10,201		66,513
Change in net assets.		92,633		(3,856)		16,864		105,641
Net assets at beginning of year		706,198		119,425		365,961		1,191,584
Net assets at end of year	\$	798,831	\$	115,569	\$	382,825	\$	1,297,225

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows For the Years Ended July 31, 2018 and 2017 (In thousands)

CASH FLOWS FROM OPERATING ACTIVITIES	2018	2017
Change in net assets.	\$ 70,625	\$ 105,641
Adjustments to reconcile change in net assets to net		
cash and cash equivalents provided by operating activities:		
Depreciation and amortization	20,806	20,803
Provision for doubtful accounts	200	-
Loss on early extinguishment of debt	15	-
Non-cash gifts	(11,896)	(10,051)
Actuarial adjustment of trust and agency obligations	(7,215)	4,102
Contributions restricted for long-term investment.	(8,440)	(3,389)
Income restricted for long-term investment	(63)	(76)
Premium received on issuance of long-term obligations	2,847	-
Loss on disposal of property, facilities and equipment	70	224
Net realized and unrealized (gains) losses on investments	(54,150)	(105,751)
Change in assets and liabilities:		
Student receivables	(1,175)	974
Other accounts receivable	(594)	(2,803)
Beneficial interests and contributions receivable.	734	10,298
Prepaid expenses, inventories and other assets	(736)	(360)
Accounts payable and accrued liabilities	1,233	(2,444)
Accrued salaries and wages	(41)	400
Student deposits, advance payments and deferred revenue	(3,607)	2,956
Net cash and cash equivalents provided by operating activities	8,613	20,524
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of investments	206,922	278,451
Purchases of investments	(257,940)	(242,475)
Purchases of property, facilities and equipment	(77,133)	(46,535)
Student loans repaid	3,716	3,818
Student loans issued.	(2,611)	(3,508)
Net cash and cash equivalents used in investing activities	 (127,046)	(10,249)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from contributions restricted for		
long-term investment	10,442	3,899
Income restricted for long-term investment	63	76
Principal received on issuance of long-term obligations	145,870	-
Principal payments on long-term obligations	(24,745)	(3,135)
Net change in bond issue costs.	(84)	-
Increase (decrease) in U.S. government-funded student loans	(2,307)	290
Investment activity on annuities	(2,149)	(1,599)
Payment of trust and agency obligations	(5,000)	(5,245)
Net cash and cash equivalents provided by (used in) financing activities	122,090	(5,714)
Net change in cash and cash equivalents	3,657	4,561
Cash and cash equivalents at beginning of year	 144,456	 139,895
Cash and cash equivalents at end of year	\$ 148,113	\$ 144,456

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1. Nature of Operations

Pepperdine University (the "University") is an independent private Christian university committed to the highest standards of academic excellence and Christian values, where students are strengthened for lives of purpose, service, and leadership. The University enrolls approximately 7,600 students in its five colleges and schools. Seaver College, the University's undergraduate liberal arts college, the School of Law, and the School of Public Policy are headquartered on 830 acres in the Santa Monica Mountains overlooking the Pacific Ocean in Malibu, California. The Graduate School of Education and Psychology and the Pepperdine Graziadio Business School are headquartered at the University's West Los Angeles, California graduate campus.

Mr. George Pepperdine, the founder of Western Auto Supply Company, established George Pepperdine College in 1937. He envisioned a college with the highest academic standards guided by the spiritual and ethical ideals of Christian faith. University status was achieved in 1970 with the addition of the graduate and professional schools. Through the generosity of Mrs. Frank Roger Seaver, the University's Malibu campus of Seaver College opened in 1972. Since then, the Malibu campus expanded to include the School of Law in 1978, and the Drescher Graduate Campus in 2003.

The University operates several consolidated affiliated companies. All material transactions and balances between the University and its affiliates have been eliminated in consolidation.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Consolidated Financial Statements of the University are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP") applicable to not-for-profit organizations. In preparing the Consolidated Financial Statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities and revenues and expenses for the periods presented. Significant items which could be materially affected by such estimates include: the allowance for doubtful accounts, the allowance for loan losses, beneficial interests and contributions receivable, investments, assets held as trustee or agent, accounts payable and accrued liabilities and trust and agency obligations. The University's actual results could differ significantly from management's estimates. Management also utilizes certain estimates based on square footage to allocate depreciation, interest expense, and central plant operations expense to the functional expense categories included on the Consolidated Statements of Activities.

New Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. This standard outlines a single comprehensive standard for revenue recognition across all industries and supersedes most existing revenue recognition guidance. In addition, ASU 2014-09 will require new and enhanced disclosures. ASU 2014-09, as amended, will become effective for annual reporting periods beginning after December 15, 2017. Management believes adoption will have a material impact on the financial statements.

In February 2016 the FASB issued ASU 2016-02, *Leases*. This guidance requires the recognition of rights and obligations arising from lease contracts, including existing and new arrangements, as assets and liabilities on the balance sheet. The guidance is effective for annual reporting periods beginning after

Notes to Consolidated Financial Statements

December 15, 2018. Management believes adoption will have a material impact on the financial statements.

In August 2016 the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit-Entities*. This guidance revises the not-for-profit reporting model. The guidance streamlines and clarifies net asset reporting, provides flexibility regarding the definition of reported operating subtotals, and imposes new reporting requirements related to liquidity and expenses. The guidance is effective for fiscal years beginning after December 15, 2017. Management believes adoption will have a material impact on the financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. The standard addresses the classification of certain transactions within the statement of cash flows, including cash payments for debt repayment or debt extinguishment costs, contingent considerations payments made after a business combination, and distribution received from equity method investments. The guidance is effective for fiscal years beginning after December 15, 2018. The University is evaluating the impact this will have on its financial statements.

In June 2018, the FASB issued ASU 2018-08, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made. The FASB is issuing this Update to clarify and improve the scope and the accounting guidance for contributions received and contributions made. The amendments in this Update should assist entities in (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) within the scope of Topic 958, Not-for-Profit Entities, or as exchange (reciprocal) transactions subject to other guidance and (2) determining whether a contribution is conditional. The guidance is effective for fiscal years beginning after December 15, 2018. Management believes adoption will not have a material impact on the financial statements.

Income Taxes

As a not-for-profit educational institution, the University is exempt from Federal and California income taxes under Section 501(c)(3) of the Internal Revenue Code, and Section 23701(d) of the California Revenue and Taxation Code (except for taxes on unrelated business income). Since the University's unrelated business income for the years ended July 31, 2018 and 2017 was immaterial, no provision for income taxes has been made in the accompanying Consolidated Financial Statements.

Public Law 115-97, known as the Tax Cuts and Jobs Act ("TCJA") was signed into law on December 22, 2017. The TCJA included several provisions that effected Internal Revenue Code Section 501(c)(3) tax-exempt organizations, such as Pepperdine University. Management has reviewed the provisions effecting tax-exempt organizations and has determined that the income tax impact is immaterial for the fiscal year ended July 31, 2018.

Net Assets

The University is required to classify its net assets into the following three categories according to donor-imposed restrictions or provisions of law:

Unrestricted net assets represent resources that are not restricted, either temporarily or permanently, by donor-imposed stipulations. They are available for support of all organizational operations and services.

Notes to Consolidated Financial Statements

Temporarily restricted net assets represent contributions and other assets whose use is limited by donor-imposed stipulations. These restrictions are temporary in that they either expire by the passage of time or by the fulfillment of certain obligations of the University pursuant to those stipulations.

Permanently restricted net assets represent contributions and other assets whose use by the University is restricted by donor-imposed stipulations. These restrictions are permanent in that they neither expire by passage of time nor can they be otherwise removed by the University. Income from these assets can be unrestricted or restricted based on donor stipulations.

Revenue Recognition

Student tuition and fees and room and board are recorded as revenues in the period the services are rendered. Private gifts, including unconditional promises to give, are recognized as revenue in the period received and are reported as increases in the appropriate category of net assets. Conditional or contingent grant awards are not recorded as revenue until the conditions on which they depend have been substantially met. Grants received from departments or agencies of the government considered to be exchange transactions are not recorded as revenue until related costs are incurred. These revenues are subject to audit by government authorities. A receivable is recorded equal to the amount of expenditures incurred prior to the fiscal year end for which cash reimbursement has not been received. Endowment support, limited to the payout calculated under the Total Rate of Return methodology, is comprised of ordinary income and accumulated gains on endowment and quasi-endowment assets.

Concentrations of Financial Aid

A significant number of students attending the University receive financial assistance from U.S. government student financial aid programs. These programs require the University to comply with record keeping, eligibility, and other requirements. Failure to comply with such U.S. government requirements could result in the loss of U.S. government financial assistance to the University's students and adversely impact the operations of the University.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, cash in checking and savings accounts, money-market funds, cash held by external trustees, and short-term investments with an original maturity of three months or less. Other short-term resources held by external investment managers are classified as investments.

Student Receivables

Student receivables are carried at cost, less an allowance for doubtful accounts.

Management uses available information to recognize losses on student receivables. Future additions to the allowance may be necessary based on changes in economic conditions and other factors.

Student Loans

Student loans are recorded at the contractual amounts owed by students adjusted for unamortized discounts, premiums, unearned income, undisbursed funds, deferred loan fees and the allowance for loan losses. Interest income is recorded on the accrual basis of accounting in accordance with the terms of the receivables, except interest accruals are discontinued when the payment of principal or interest is 90 or

Notes to Consolidated Financial Statements

more days past due, or when repayment of principal and interest in full is doubtful. Payments received on delinquent loans are applied to the principal outstanding until the loan is restored to current status.

A student loan is impaired when it is probable that the University will be unable to collect all amounts due according to the contractual terms of the loan agreement. The measurement of impairment may be based on (i) the present value of the expected future cash flows of the impaired loan discounted at the loan's original effective interest rate or (ii) the observable market price of the impaired loan. If the recorded investment of the loan exceeds the measure of impairment, an allowance is recorded in the amount of the excess. The University measures impairment by utilizing a discounted cash flow analysis. The University's income recognition policies for impaired loans are consistent with those for delinquent loans. All loans designated as impaired are either placed on delinquent status or are designated as restructured. Payments received on impaired loans are applied to the principal outstanding until the loan is returned to current status.

On an ongoing basis, management monitors the student loan portfolio and evaluates the adequacy of the allowance for loan losses. In determining the adequacy of the allowance for loan losses, management considers such factors as historical loss experience, known problem loans, assessment of economic conditions, and other appropriate data to identify the risks in the student loan portfolio. The amount of the allowance for loan losses is based on estimates and the University's actual losses may vary from management's estimates. Loans deemed by management to be uncollectible are charged to the allowance for loan losses. Recoveries on loans previously charged off are credited to the allowance for loan losses. Provisions for loan losses are charged to expense and credited to the allowance for loan losses in amounts that are deemed appropriate by management based upon its evaluation of the known and inherent risks in the student loan portfolio. Future additions to the allowance may be necessary based on changes in economic conditions and other factors.

Beneficial Interests and Contributions Receivable

Beneficial interests and contributions receivable, including unconditional promises to give, are recognized as revenue in the period received and are reported as increases in the appropriate category of net assets based on donor-imposed restrictions. Beneficial interests and contributions receivable where donor restrictions are met in the same fiscal year as the beneficial interest and contribution receivable is made are reported as unrestricted support. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Beneficial interests and contributions receivable are recorded at their estimated fair value. Amounts to be received in future periods are discounted at a credit-adjusted interest rate.

Investments

Investments are stated at fair value and all related transactions are recorded on the trade date. The fair value of investments is based on quoted market prices from national security exchanges, except for alternative investments for which quoted market prices are not available. The fair value of certain alternative investments, which include limited partnerships in venture capital, real estate and other private debt and equity funds, is typically Net Asset Value ("NAV") provided by the external investment managers or general partners, adjusted for receipts and disbursements of cash and distributions of securities if the date of valuation is prior to the University's fiscal year end. Such valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments, and other pertinent information. The University believes the carrying amount of these financial instruments is a reasonable estimate of fair value. For those investments that

Notes to Consolidated Financial Statements

are not traded on a ready market, the estimates of their fair value may differ from the value that would have been used had a ready market for those investments existed.

Investment income, as well as realized and unrealized gains and losses, are accounted for within unrestricted net assets, or as changes in temporarily or permanently restricted net assets if so stipulated by the donor of such assets.

Investment return up to the institutions approved spending rate is presented as endowment support within operating revenue and other support. Endowment support is calculated based upon the Total Rate of Return methodology noted below in Pooled Assets. The difference between that amount and the actual total return (which may be positive or negative) is presented in non-operating revenues and expenses.

Pooled Assets

The University manages two separate investment pools designated as Pool A and Pool D. Pooled investments and allocation of pooled investment income are accounted for using the unit market value method.

The Total Rate of Return methodology is utilized for Pool A which consists primarily of quasi and true endowment funds. The annual total payout is calculated based on an approved spending rate that is applied to a five-year monthly average market value of Pool A funds. For fiscal years 2018 and 2017, the approved spending rate was 5.0%.

Pool D is the charitable gift annuity reserve pool and is invested in accordance with California State Insurance Commission requirements.

Endowment

The University's endowment consists of 497 individual donor-restricted endowment funds and 74 University-designated quasi-endowment funds for a variety of purposes. The net assets associated with endowment funds, including funds designated by the University to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The University has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as allowing the University to appropriate for expenditure or accumulate so much of an endowment fund as the University determines is prudent for the uses, benefits, purposes, and duration for which the endowment funding is established, subject to the intent of the donor as expressed in the gift instrument. As a result of this interpretation, the University 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. The remaining portion of donor-restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate endowment funds:

- 1) The duration and preservation of the fund
- 2) The purposes of the University and the donor-restricted endowment fund
- 3) General economic conditions
- 4) The possible effect of inflation and deflation

Notes to Consolidated Financial Statements

- 5) The expected total return from income and the appreciation of investments
- 6) Other resources of the University
- 7) The investment policies of the University

Derivatives

From time to time, the University enters into derivative transactions either as part of its overall investment asset allocation or as a specific hedge or risk management tool. Derivatives used as part of the asset allocation strategy are recorded at fair value with realized and unrealized gains and losses reflected in the Consolidated Statements of Activities. These derivatives are included in the investment portfolio categorized as "Other."

Derivatives used to economically hedge specific operations, such as foreign currency contracts, are discussed under the heading, "Foreign Currency Management."

Assets Held As Trustee or Agent and Trust and Agent Obligations

The University uses the actuarial method of recording charitable gift annuities and charitable remainder trusts. When a gift is received, the fair value of the gift received is recorded as an asset and the present value of the related amounts due is recorded as a liability based on the Individual Annuity Reserve 2012 tables and the remainder is recorded as private gift and grant revenue in the appropriate net asset category on the Consolidated Statements of Activities. Investment income is credited, and annuity payments, direct costs of funds management, and investment losses are charged to the related liability. In situations where trust assets are not readily convertible to cash, annuitant payments have been made by the University. For life contingent gifts, the liability is adjusted annually based on the changes in the expected life, and is reflected as an adjustment of the actuarial liability on the Consolidated Statements of Activities. At July 31, 2018 and 2017, the discount rate used to calculate future payments to be made by the University ranged from 1.8% per annum to 10.6% per annum.

Remainder interests in real estate are recorded at their estimated fair value at the date of gift. Investment income and gains are credited, and direct costs of asset management and investment losses are charged to the related net asset category.

The University and its consolidated subsidiaries have legal title, either in their name or as trustee, to the charitable gift annuities, charitable remainder trusts, and life estates subject to life interests of the beneficiaries. No significant financial benefit can be realized until the contractual obligations are released.

Deferred Compensation Plans

Contributions to the University's deferred compensation plan under Section 457(b) and 457(f) of the United States Internal Revenue Code are carried at fair value as a component of assets held as trustee or agent, with an equal and offsetting obligation to pay the employees as a component of trust and agency obligations on the Consolidated Statements of Financial Position.

Property, Facilities and Equipment

Property, facilities and equipment are stated at cost or, if received by gift, at fair value at the date of the gift. Depreciation on buildings, improvements, furniture, fixtures, and equipment is provided on a straight-line basis over the estimated useful lives as described in the table below:

Notes to Consolidated Financial Statements

Asset Class	<u>Useful Life</u>
Furniture and Other Equipment	10-15 years
Computer Hardware and Software	2-10 years
Motor Vehicles	5 years
Buildings	20-70 years
Land Improvements	20 years

Amounts spent for repairs and maintenance are charged to expense as incurred. When assets are sold or retired, the associated cost and accumulated depreciation are removed. Any gain or loss from such disposition is recorded as a component of revenues and other support and expenses on the Consolidated Statements of Activities.

Debt Issuance Costs

Capitalized debt issue costs included in long-term obligations are amortized over the life of the related debt using the effective interest method.

U.S. Government-Funded Student Loans

Funds provided by the United States government under the Federal Perkins Loan Program are loaned to qualified students and may be loaned again after their collection. These funds are ultimately refundable to the U.S. government and as such are included as liabilities in the Consolidated Statements of Financial Position.

Foreign Currency Management

The University uses derivative financial instruments to reduce its net exposure to currency fluctuations. As such, the University enters into forward contracts and purchases currency futures (principally the Euro, the British pound, and Swiss francs) to economically hedge forecasted cash flows denominated in foreign currencies. The purpose of the University's foreign currency hedging activities is to reduce the risk of eventual United States dollar net cash outflows resulting from costs outside the U.S. that will be adversely affected by changes in exchange rates.

Asset Retirement Obligations

The University recognizes liabilities for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation is conditional on a future event. The fair value of a liability for a conditional asset retirement obligation is recognized in the period in which it occurs if a reasonable estimate of fair value can be made

Reclassifications and Revisions

Certain amounts were reclassified at, or for the year ended July 31, 2017, to conform with the current year's presentation.

In 2018, there were certain errors identified in the previously issued 2017 Consolidated Financial Statements, specifically related to the misclassification of net realized and unrealized (gains) on investments in the Statement of Cash Flows and certain other misclassifications in the Statement of Cash Flows and Statement of Activities. In evaluating whether its previously issued Consolidated Financial Statements were materially misstated, the University considered the guidance in Accounting Standards

Notes to Consolidated Financial Statements

Codification ("ASC") Topic 250, Accounting Changes and Error Corrections, ASC Topic 250-10-S99-1, Assessing Materiality, and ASC Topic 250-10-S99-2, Considering the Effects of Prior Year Misstatements when Quantifying Misstatement in Current Year Financial Statements. In addition, there were certain disclosure errors identified. The University has concluded that these classification and disclosure errors were not material to the 2017 Consolidated Financial Statements however has revised the 2017 Consolidated Financial Statements to reflect the correction of these errors, the effects of which are detailed below.

Adjustments to reflect corrections of errors to the Non-operating Revenues and Expenses section of the Consolidated Statement of Activities for the year ended July 31, 2017 are shown below:

	(In thousands)											
	As Issued		As Issued Adjustments to		Revised		Temporarily		Permanently		As revised	
	Unre	estricted	Unr	estricted	Un	restricted	Re	estricted	Re	stricted		Total
NON-OPERATING REVENUES AND EXPENSES												
Actuarial adjustment of trust and agency obligations	\$	-	\$	-	\$	-	\$	(2,962)	\$	(1,140)	\$	(4,102)
Investment income:												
Dividends		5,848		-		5,848		2,374		3		8,225
Interest		1,467		-		1,467		529		42		2,038
Other		4,724		7,820		12,544		-		-		12,544
Investment expenses		(4,540)		-		(4,540)		(2,204)		-		(6,744)
Net realized and unrealized investment gains		47,832		-		47,832		14,646		8,817		71,295
Foreign currency translation		216		-		216		-		-		216
Other		(3,064)		(7,820)		(10,884)		(8,554)		2,479		(16,959)
Total non-operating revenues and expenses	\$	52,483	\$		\$	52,483	\$	3,829	\$	10,201	\$	66,513

Notes to Consolidated Financial Statements

Adjustments to reflect corrections of errors to the Consolidated Statement of Cash Flows for the year ended July 31, 2017 are shown below:

chaca sary 51, 2017 are shown below:		(To the conference)	
	As issued	Adiustments	As revised
CASH FLOWS FROM OPERATING ACTIVITIES	2017	C .	2017
Change in net assets	\$ 105,641		\$ 105,641
Adjustments to reconcile change in net assets to net			
Depreciation and amortization.	20.803	1	20.803
Provision for doubtful accounts	1	1	1
Loss on early extinguishment of debt.	1	1	1
Non-cash gifts	(10,051)	•	(10,051)
Actuarial adjustment of trust and agency obligations	4,102	•	4,102
Contributions restricted for long-term investment	(3,389)	•	(3,389)
Income restricted for long-term investment	(9 <i>L</i>)	ı	(9 <i>L</i>)
Premium received on issuance of long-term obligations	ı	1	I
Loss on disposal of property, facilities and equipment	224	ı	224
Net realized and unrealized (gains) losses on investments	(71,295)	(34,456)	(105,751)
Change in assets and liabilities:			1
Student receivables	974	•	974
Other accounts receivable	(2,803)	•	(2,803)
Beneficial interests and contributions receivable	10,298	1	10,298
Prepaid expenses, inventories and other assets	(360)	1	(360)
Accounts payable and accrued liabilities	(2,444)	1	(2,444)
Accrued salaries and wages	400	ı	400
Student deposits, advance payments and deferred revenue	2,956	1	2,956
Net cash and cash equivalents provided by operating activities	54,980	(34,456)	20,524
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sales of investments	108,356	170,095	278,451
Purchases of investments	(114,970)	(127,505)	(242,475)
Purchases of property, facilities and equipment	(46,535)	ı	(46,535)
Student loans repaid	3,818	ı	3,818
Student loans issued	(3,508)	1	(3,508)
Net cash and cash equivalents used in investing activities	(52,839)	42,590	(10,249)
CASH FLOWS FROM FINANCING ACTIVITIES Proceeds from contributions restricted for hone-term investment	3 899	,	3 800
Income restricted for long-term investment	76		76
Principal received on issuance of long-term obligations	1	ı	ı
Principal payments on long-term obligations	(3,135)	•	(3,135)
Net change in bond issue costs	- 060	1	- 000
Investment activity on annuities	6535	(8.134)	(1 599)
Payment of trust and agency obligations.	(5.245)	-	(5,245)
Net cash and cash equivalents provided by financing activities	2,420	(8,134)	(5,714)
Net change in cash and cash equivalents	4,561	1	4,561
Cash and cash equivalents at beginning of year	139,895	1	139,895
Cash and cash equivalents at end of year	\$ 144,456	S	\$ 144,456

Notes to Consolidated Financial Statements

Details on investment return were omitted from the investment footnote (Note 6) for 2017. The details on investment return for the year ended July 31, 2017 are shown below:

	<u> 2017</u>
	(In thousands)
Investment income	\$ 22,807
Realized gains	62,372
Unrealized gains	43,378
	\$ <u>128,557</u>

Adjustments to reflect corrections of errors to the changes in endowment net assets (Note 7) for the year ended July 31, 2017 are shown below:

	(In thousands)													
					P	Adjustments								
			Α	s Issued		to]	Revised						
	Ur	restricted	Temporarily		Temporarily 7		Temporarily		Temporarily		Pe	ermanently	A	s revised
	P	Principal	R	Restricted		Resticted		Resticted		Restricted		Total		
Endowment net assets, beginning of year	\$	398,863	\$	53,099	\$	S -	\$	53,099	\$	329,379	\$	781,341		
Investment income		5,166		2,902		-		2,902		3		8,071		
Net realized and unrealized												-		
appreciation		39,351		53,118		(7,820)		45,298		8,893		93,542		
Private gifts and grants		15		56		-		56		4,448		4,519		
Maturation of Assets Held as Trustee												-		
or Agent		-		-		-		-		2,162		2,162		
Endowment support		(1,394)		(38,520)		7,820		(30,700)		(76)		(32,170)		
Reinvestments and transfers		5,370		(4)		-		(4)		3,615		8,981		
Expenditures		(3,909)		(2,204)		-		(2,204)		_		(6,113)		
Total endowment net assets, end of year	\$	443,462	\$	68,447	\$	-	\$	68,447	\$	348,424	\$	860,333		

Notes to Consolidated Financial Statements

3. Student Receivables

Student receivables consist of the following at July 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
	(In thou	sands)
Graziadio School of Business and Management	\$1,475	\$1,641
Seaver College	1,561	981
Graduate School of Education and Psychology	584	312
Other	<u>529</u>	113
Gross student receivables	4,149	3,047
Allowance for doubtful accounts	(1,587)	(<u>1,460</u>)
	\$ <u>2,562</u>	\$ <u>1,587</u>

Activity in the allowance for doubtful accounts was as follows:

	For the year en	ded July 31,
	<u>2018</u>	<u>2017</u>
	(In thou	sands)
Beginning balance	\$1,460	\$1,506
Provision for doubtful accounts	200	-
Accounts charged off	(217)	(263)
Recoveries of previously charged off accounts	<u>144</u>	217
Net recoveries/(charge-offs)	(73)	<u>(46</u>)
Ending balance	\$ <u>1,587</u>	\$ <u>1,460</u>

4. Student Loans

Student loans consist of the following at July 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
	(In thous	ands)
Perkins.	\$13,300	\$14,381
Weingart	6,789	6,782
Other	1,005	924
Gross student loans	21,094	22,087
Allowance for loan losses	<u>(1,578</u>)	(1,466)
	\$19,516	\$20,621

Notes to Consolidated Financial Statements

Activity in the allowance for loan losses was as follows:

	For the year ended July 31,		
	<u>2018</u>	<u>2017</u>	
	(In thousa	inds)	
Beginning balance	\$1,466	\$1,537	
Provision for doubtful accounts	-	-	
Loans charged off	(68)	(177)	
Recoveries of previously charged off loans	<u> 180</u>	<u> 106</u>	
Net charge-offs	<u>112</u>	<u>(71</u>)	
Ending balance	\$ <u>1,578</u>	\$ <u>1,466</u>	

5. Beneficial Interests and Contributions Receivable

Unconditional promises to give with payments due in future periods are reported as temporarily or permanently restricted beneficial interests and contributions receivable. Unconditional promises to give are recorded at their discounted present value based on a credit-adjusted interest rate. At July 31, 2018, the discount rate applied to beneficial interests and contributions receivable ranged from 1.51% per annum to 3.15% per annum and at July 31, 2017, ranged from 1.22% per annum to 3.29% per annum.

The following table provides a summary of beneficial interests and contributions receivable by expected collection date at July 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
	(In thousands)	
In one year or less.	\$ 74	\$ 63
Between one and five years.	13,446	11,088
More than five years.	<u>25,668</u>	<u>21,548</u>
	39,188	32,699
Less discount.	(1,066)	<u>(790</u>)
	\$ <u>38,122</u>	\$ <u>31,909</u>

During the years ended July 31, 2018 and 2017, the University received payments on prior year promises to give of \$3.2 million, and \$1.2 million, respectively.

Beneficial interests and contributions receivable include assets held by external trustees totaling \$25.0 million at July 31, 2018, and \$20.8 million at July 31, 2017.

In the event beneficial interests and contributions receivable are deemed uncollectable, they are charged to expense as a component of "other non-operating revenues and expenses." Beneficial interests and contributions receivable written off during the years ended July 31, 2018 and 2017 amounted to \$3.0 million and \$362,000, respectively.

During the years ended July 31, 2018 and 2017, promises to give in the net amount of \$5.6 million and \$6.0 million were received but not recognized, respectively. Promises to give may not be recognized because a donor has not provided sufficient documentation, the promise is conditional, or the promise is revocable.

Notes to Consolidated Financial Statements

6. Investments

The University's investments consist of the following at July 31, 2018 and 2017:

	<u>2018</u>	<u> 2017</u>	
	(In thousands)		
Cash and cash equivalents	\$ 144,749	\$ 155,028	
Absolute return	174,149	166,439	
Assets held by trustee	165,822	159,157	
Mutual funds	50,993	50,020	
Fixed income	167,300	75,730	
Real estate	118,469	109,931	
Private equity	124,180	118,009	
Natural resources	108,572	93,855	
Public equity	76,923	87,667	
Opportunistic distressed	13,928	16,661	
Other	2,684	1,960	
	\$ <u>1,147,769</u>	\$ <u>1,034,457</u>	
Pooled investments	\$ 789,722	\$ 764,349	
Separately invested	358,047	270,108	
1	\$ <u>1,147,769</u>	\$ <u>1,034,457</u>	

Assets held by trustee consists primarily of the balance of the Blanche E. Seaver Endowed Trust, of which the University is the sole irrevocable income and principal beneficiary. Assets in this trust are diversified to produce consistent and distributable investment income. Income received from this trust is recorded as a component of endowment support on the Consolidated Statement of Activities.

Investment expenses for the years ended July 31, 2018 and 2017 includes investment management fees totaling \$6.4 million and \$6.7 million, respectively.

Investment return consists of the following for the years ended July 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>	
	(In thousands)		
Investment income	\$29,154	\$ 22,807	
Realized gains	47,969	62,372	
Unrealized gains	6,179	43,378	
	\$83,302	\$ <u>128,557</u>	

Notes to Consolidated Financial Statements

7. Endowment Activities

Changes in endowment net assets for the year ended July 31, 2018 are as follows:

	Unrestricted <u>Principal</u>	Temporarily <u>Restricted</u> (In tho	Permanently <u>Restricted</u> usands)	<u>Total</u>
Endowment net assets, beginning of year	\$443,462	\$68,447	\$348,424	\$860,333
Investment income Net realized and unrealized	6,824	3,887	2	10,713
appreciation	14,232	37,539	6,744	58,515
Private gifts and grants	16	-	10,342	10,358
or Agent	-	-	2,008	2,008
Endowment support	(1,061)	(31,906)	(63)	(33,030)
Reinvestments and transfers	3,526	(144)	(2,005)	1,377
Expenditures	<u>(3,976</u>)	<u>(2,156)</u>		(6,132)
Endowment net assets, end of year	\$ <u>463,023</u>	\$ <u>75,667</u>	\$ <u>365,452</u>	\$ <u>904,142</u>

Unrestricted undistributed appropriations of endowment were \$14.1 million at July 31, 2018.

Designations of endowment funds for the year ended July 31, 2018 are as follows:

		Temporarily	Permanently	
	Unrestricted	Restricted	Restricted	Total
		(In tho	usands)	
Donor-restricted funds	\$ -	\$75,667	\$365,452	\$441,119
University-designated funds	463,023	<u>-</u>	<u>-</u>	463,023
Total	\$ <u>463,023</u>	\$ <u>75,667</u>	\$ <u>365,452</u>	\$ <u>904,142</u>

Notes to Consolidated Financial Statements

Changes in endowment net assets for the year ended July 31, 2017 are as follows:

	Unrestricted <u>Principal</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>Total</u>
		(In tho	usands)	
Endowment net assets, beginning				
of year	\$398,863	\$53,099	\$329,379	\$781,341
Investment income	5,166	2,902	3	8,071
Net realized and unrealized	,	,		,
appreciation (depreciation)	39,351	45,298	8,893	93,542
Private gifts and grants	15	56	4,448	4,519
Maturation of Assets Held as Trustee				
or Agent	-	-	2,162	2,162
Endowment support	(1,394)	(30,700)	(76)	(32,170)
Reinvestments and transfers	5,370	(4)	3,615	8,981
Expenditures	(3,909)	(2,204)		(6,113)
Endowment net assets, end of year	\$ <u>443,462</u>	\$ <u>68,447</u>	\$ <u>348,424</u>	\$ <u>860,333</u>

Unrestricted undistributed appropriations of endowment were \$12.7 million at July 31, 2017.

Designations of endowment funds for the year ended July 31, 2017 are as follows:

		Temporarily	Permanently	
	Unrestricted	Restricted	Restricted	Total
		(In th	ousands)	
Donor-restricted funds	\$ -	\$68,447	\$348,424	\$416,871
University-designated funds	443,462	_	<u>-</u> _	443,462
Total	\$ <u>443,462</u>	\$ <u>68,447</u>	\$ <u>348,424</u>	\$ <u>860,333</u>

The University has recorded deficiencies resulting from the decline in fair value of endowment funds to amounts below the original gift amount as a reduction of unrestricted net assets. Such deficiencies totaled \$1.1 million and \$2.0 million and affected 36 and 53 donor-restricted true endowment funds with a market value of \$23.9 million and \$30.5 million at July 31, 2018 and July 31, 2017, respectively.

Notes to Consolidated Financial Statements

8. Assets Held as Trustee or Agent

The University's assets held as trustee or agent consist of the following at July 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>	
	(In thousands)		
Cash and cash equivalents	\$ 1,345	\$ 1,095	
Mutual funds	82,190	79,084	
Fixed income	60	63	
Real estate	33,327	31,726	
Equities	183	179	
Other	1,748	1,126	
	\$ <u>118,853</u>	\$ <u>113,273</u>	
Pooled investments	\$ 23,345	\$ 22,164	
Separately invested	95,508	91,109	
	\$ <u>118,853</u>	\$ <u>113,273</u>	

9. Pooled Investments

The following table sets forth data for the University's investment pools at July 31, 2018 and 2017:

	2018		2	017
	Pool A	Pool D	Pool A	Pool D
Per unit fair value at end of year	\$422.24	\$142.38	\$408.32	\$133.80
Number of units owned at end of year:				
Unrestricted	1,229,029	103,151	1,252,474	121,130
Temporarily restricted	12,501	18,337	12,501	11,291
Permanently restricted	628,772	37,110	606,955	27,498
Agency	1,811		1,878	
Total units	<u>1,872,113</u>	<u>158,598</u>	<u>1,873,808</u>	<u>159,919</u>
Average annual income per unit	\$28.39	\$1.84	\$34.46	\$1.55

Notes to Consolidated Financial Statements

10. Property, Facilities and Equipment

Property, facilities and equipment consist of the following at July 31, 2018 and 2017:

	<u>2018</u>	<u> 2017</u>	
	(In thousands)		
Land	\$ 28,613	\$ 28,613	
Buildings and improvements	591,976	523,180	
Furniture, fixtures and equipment	50,506	54,296	
Construction in progress	10,116	16,141	
Total cost	681,211	622,230	
Less: accumulated depreciation	(236,397)	(<u>232,254</u>)	
-	\$ <u>444,814</u>	\$389,976	

11. Lines of Credit

At July 31, 2018, the University had a \$50.0 million committed line of credit available for general corporate purposes at Wells Fargo Bank's one-month LIBOR rate plus 0.65% per annum. The University has never drawn on the line of credit. The line expires on April 1, 2019.

12. Long-Term Obligations

Long term obligations consist of the following at July 31, 2018 and 2017:

	<u>2018</u>	<u> 2017</u>
	(In thou	sands)
CEFA Revenue Bonds (Pepperdine University) Series 2012, 3.00%-5.00% due		
2013 -2033 (Original issue amount \$50,000,000)	\$ 20,535	\$ 43,750
CEFA Revenue Bonds (Pepperdine University) Series 2014, 2.00%-5.00% due		
2015 -2044 (Original issue amount \$51,485,000)	50,625	50,900
CEFA Revenue Bonds (Pepperdine University) Series 2015, 2.00%-5.00% due		
2016 -2045 (Original issue amount \$76,455,000)	73,975	75,230
CEFA Revenue Bonds (Pepperdine University) Series 2016, 3.00%-5.00% due		
2019 -2049 (Original issue amount \$100,000,000)	100,000	100,000
Pepperdine University Taxable Bonds Series 2017A, 3.948% due 2050 -2057		
(Original issue amount \$125,000,000)	125,000	-
CEFA Refunding Revenue Bonds (Pepperdine University) Series 2017B, 3.00%-		
5.00% due 2021 -2033 (Original issue amount \$20,870,000)	20,870	
	391,005	269,880
Net premium on long-term obligations	38,190	38,703
Bond issuance costs	(3,206)	(2,644)
	\$ <u>425,989</u>	\$ <u>305,939</u>
CEFA Revenue Bonds (Pepperdine University) Series 2015, 2.00%-5.00% due 2016 -2045 (Original issue amount \$76,455,000)	73,975 100,000 125,000 20,870 391,005 38,190 (3,206)	75,230 100,000 - 269,880 38,703 (2,644)

Notes to Consolidated Financial Statements

At July 31, 2018, principal payments on the preceding obligations are due in the following fiscal years:

	(In thousands)
2019	\$ 3,350
2020	4,485
2021	4,580
2022	4,785
2023	4,995
Thereafter	<u>368,810</u>
	\$391,005

13. Net Assets

At July 31, 2018 and 2017, temporarily and permanently restricted net assets were available for the following purposes:

	20	18	20	17	
	Temporarily	Permanently	Temporarily	Permanently	
	Restricted	Restricted	Restricted	Restricted	
		(In thou	sands)		
Educational program support	\$ 62,271	\$253,407	\$ 56,402	\$238,200	
Student services and athletics	2,013	5,035	1,836	4,808	
Student loans and scholarships	39,289	117,153	35,214	114,720	
Annuities and remainder trusts	17,050	15,148	15,863	7,941	
Facilities	2,120	4,602	868	4,619	
Public service	2,057	6,646	1,052	6,525	
Other	4,623	<u>7,906</u>	4,334	<u>6,012</u>	
	\$ <u>129,423</u>	\$ <u>409,897</u>	\$ <u>115,569</u>	\$ <u>382,825</u>	

14. Operating Lease Commitments

The University leases facilities for use primarily in its graduate programs. Future minimum lease payments expiring through fiscal 2029 under these non-cancelable operating leases at July 31, 2018 are as follows:

	(In thousands)
2019	\$ 12,112
2020	12,005
2021	12,426
2022	12,963
2023	13,172
Thereafter	64,300
	\$ <u>126,978</u>

Leases on facilities contain renewal options and rent escalation clauses based on the Consumer Price Index.

15. Employee Retirement and Deferred Compensation Plans

The University participates in a defined contribution plan which provides retirement benefits for eligible employees. Benefits for the plan are funded by contributions from the University and its

Notes to Consolidated Financial Statements

employees. University contributions are non-refundable and fully vested. There are no prior service costs. The University contributed \$10.7 million and \$10.2 million to these plans for the years ended July 31, 2018 and 2017, respectively.

In July 2002 the University established deferred compensation programs for senior administrators, tenured Full Professors, highly paid and certain other employees under Sections 457(b) and 457(f) of the Internal Revenue Code. Under this plan, eligible employees may defer a limited amount of their compensation to future years. Although deferred by employees for tax purposes, amounts contributed to these plans by the University are treated as an expense in the year earned. Balances held by the University in the plans are recorded as a component of Assets Held as Trustee or Agent and Trust and Agent Obligations. University contributions to these deferred compensation plans for the years ended July 31, 2018 and 2017 were \$404,000 and \$419,000, respectively. At July 31, 2018 and 2017, balances in the plans were \$12.3 million and \$11.0 million, respectively.

16. Faculty and Staff Housing

The University sells condominium units to certain faculty and staff. The sales terms include restrictions on the buyers' eligibility and include a resale price based on a defined index that is not controlled by the University. The University has a right of first refusal to purchase the units when offered for sale by the owner. The University has historically exercised this right and then subsequently sold the units within a short period of time. For the years ended July 31, 2018 and 2017, the University sold four and six units with associated sales values of \$2.6 million and \$3.2 million, respectively. Should all 121 of the units be available for purchase at July 31, 2018 and 2017, and the University elected to exercise its right of first refusal on all of the units, the total value associated with these transactions would be \$70.2 million and \$70.4 million, respectively. At July 31, 2018 and 2017, the University held legal title to 14 and ten units with a value of \$9.4 million and \$6.3 million, respectively.

The land associated with the condominium units has been leased to the homeowner's associations for 99 years from the date of completion of the construction. Monthly rents are paid to the University for the grounds, utilities, and other services subject to adjustments based on the Consumer Price Index and on the costs of furnishing utilities and services.

At July 31, 2018, the University guaranteed the performance of \$19.0 million in mortgage loans obtained by its faculty and staff. These mortgage loans were issued by independent third-party lenders and all of the proceeds of these loans were used to facilitate the purchase of on-campus housing.

At July 31, 2018 and 2017, University-owned notes receivable from on-campus housing sales amounted to \$2.8 and \$3.5 million, respectively. These amounts are included as a component of investments on the Consolidated Statements of Financial Position. The notes bear interest at various rates ranging between 0.6% per annum and 5.5% per annum and are collateralized by deeds of trust. Interest income recognized by the University related to these notes was \$30,800 and \$56,600 for the years ended July 31, 2018 and 2017, respectively. No allowance for loan losses has been recorded against these loans based on their collateralization and prior collection history. At July 31, 2018, there were no past due amounts related to these notes receivable.

Notes to Consolidated Financial Statements

17. Supplemental Cash Flow Information

	For the year o	For the year ended July 31,		
	<u>2018</u>	<u>2017</u>		
	(In tho	usands)		
Accrued capitalized asset additions	\$12,194	\$10,820		
Cash paid during the period for interest	12,653	12,977		

18. Natural Expenses

The University's classifications of expenses in the Consolidated Statements of Activities by natural expense category are as follows:

	For the year ended July 31,			
	<u>2018</u> <u>2017</u>			
	(In thousands)			
Personnel	\$197,228	\$189,311		
Professional services	31,600	25,199		
Depreciation	23,617	21,011		
Travel and development	13,212	13,596		
Rentals	12,312	12,310		
Interest	11,899	8,510		
Maintenance	10,020	7,728		
Student meals	9,398	8,567		
Equipment	9,149	6,163		
Advertising and promotion	7,217	5,742		
Supplies	7,183	6,546		
Utilities	6,529	6,030		
Insurance	5,949	5,623		
Other	<u>6,615</u>	5,819		
	\$ <u>351,928</u>	\$322,155		

19. Commitments and Contingencies

At July 31, 2018 and 2017, \$31.9 million and \$84.5 million of the balance in cash and cash equivalents was related to funds that were restricted for specific construction projects, respectively. The University anticipates that the funds available at July 31, 2018, will be expended by December 31, 2018.

In the normal course of operations, the University is named as a defendant in lawsuits and is subject to periodic examinations by regulatory agencies. It is the opinion of management, after consultation with legal counsel, that liabilities, if any, arising from such litigation and examinations would not have a material effect on the University's consolidated financial position or change in net assets.

The University receives and expends monies under U.S. government grant programs and is subject to audits by related U.S. governmental agencies. Management believes that any liabilities resulting from such audits will not have a material impact on the University.

Notes to Consolidated Financial Statements

At July 31, 2018, the University had open commitments to invest approximately \$136.8 million with investment managers and/or limited partnerships over approximately seven years.

At July 31, 2018, the University's maximum exposure under guarantees of Guaranteed Access To Education ("GATE") student loans totaled approximately \$220,000.

At July 31, 2018, the University had outstanding commitments for capital expenditures in connection with the various construction projects of approximately \$24.2 million. The University expects to fund these costs principally through unrestricted net assets available. Accordingly, no liability has been recorded in the accompanying Consolidated Statements of Financial Position.

As discussed in Note 16, the University guarantees the performance of certain mortgages for oncampus condominiums.

20. Fair Value of Financial Instruments

Financial instruments include cash and cash equivalents, student receivables, other accounts receivable, student loans, beneficial interests and contributions receivable, investments, assets held as trustee or agent, U.S. government-funded student loans, and trust and agency obligations. The fair value of certain alternative investments, which include limited partnerships in venture capital, real estate and other private debt and equity funds, is based on valuations provided by the external investment managers or general partners, generally using NAV as a practical expedient, adjusted for receipts and disbursements of cash and distributions of securities if the date of valuation is prior to the University's fiscal year end. Such valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments, and other pertinent information. These estimates are subjective in nature and involve uncertainties and matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. In addition, the fair value estimates presented do not include the value of anticipated future operating activities and the value of assets and liabilities that are not considered financial instruments. The University uses the following methods and assumptions in estimating the fair value disclosures for its financial instruments:

Financial Assets

The carrying values of cash and cash equivalents, student receivables, other accounts receivable, student loans, beneficial interests and contributions receivable, investments, and assets held as trustee or agent are considered to approximate fair value. When possible, the fair value of investments and assets held as trustee or agent are determined by reference to quoted market prices. When quoted market prices are not available, fair value is estimated by reference to market values for similar securities or by discounting cash flows at an appropriate rate taking into consideration the varying degrees of risk specific to each financial asset. Determination of the fair value of student loans receivable, which are primarily federally sponsored student loans, could not be made without incurring excessive costs.

Derivative Financial Instruments

The fair value of interest rate caps, floors and swaps, forward treasury contracts and interest rate futures, to the extent used by the University, are based on quoted market prices. The fair values of foreign currency derivatives are based on pricing models using currency market rates. These amounts are reflected as a component of prepaid expenses, inventories, and other assets on the University's Consolidated Statements of Financial Position.

Notes to Consolidated Financial Statements

Fair Value

In accordance with ASC 820, fair value is defined as the price the University would receive to sell an asset or pay a liability in an orderly transaction between the market participants at the reporting date. ASC 820 also establishes a three-level hierarchy for presenting valuations, based on the transparency of inputs used to value investments and other relevant assets. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Valuation inputs may be observable or unobservable, and refer to the assumptions that a market participant would consider significant to value an asset or liability. The determination of "observable" requires judgment by the University. In general, the University considers observable inputs to be data that are readily available, regularly updated, reliable, and verifiable. Unobservable inputs may be used when observable inputs are not readily available or current. In this situation, one or more valuation techniques may be used including the market approach (inputs based on recent market transactions or comparables) or the income approach (discounted cash flow).

The three levels of the fair value hierarchy under ASC 820 are as follows:

- Level 1 Quoted prices available in active markets for identical investments.
- Level 2 Quoted prices in active markets for similar investments; quoted prices for identical investments in markets that are inactive; and prices based on observable inputs other than an unadjusted quoted price.
- Level 3 Prices based on significant unobservable inputs.

Notes to Consolidated Financial Statements

The following table summarizes the valuations of the University's investments and other relevant assets as of July 31, 2018, based on their placement within the fair-value hierarchy:

	Level 1	Level 2	Level 3	NAV	Total
Investments		*	n thousands	s)	
Cash and cash equivalents	\$144,749	\$ -	\$ -	\$ -	\$ 144,749
Absolute return	-	-	-	174,149	174,149
Assets held by trustee*	117,445	-	-	48,377	165,822
Mutual funds	50,993	-	-	-	50,993
Fixed income	104,715	62,585	-	-	167,300
Real estate	-	62,586	7,574	48,309	118,469
Private equity	_	-	-	124,180	124,180
Natural resources	_	-	-	108,572	108,572
Public equity	23,975	-	-	52,948	76,923
Opportunistic distressed	_	-	-	13,928	13,928
Other	822		1,862		2,684
Total investments	\$442,699	\$125,171	\$9,436	\$570,463	\$1,147,769
Assets held as trustee or agent					
Cash and cash equivalents	\$ 1,345	\$ -	\$ -	\$ -	\$ 1,345
Mutual funds	82,190	-	_	_	82,190
Fixed income	_	60	-	-	60
Real estate	-	33,280	_	47	33,327
Equities	13	-	-	170	183
Other	_	_	<u>1,461</u>	<u>287</u>	1,748
Total assets held as trustee or agent	\$ 83,548	\$ 33,340	\$ 1,461	\$ 504	\$ 118,853
Total	\$ <u>526,247</u>	\$ <u>158,511</u>	\$ <u>10,897</u>	\$ <u>570,967</u>	\$ <u>1,266,622</u>

^{*}Assets held by trustee consists primarily of the balance of the Blanche E. Seaver Endowed Trust, of which the University is the sole irrevocable income and principal beneficiary.

Notes to Consolidated Financial Statements

The following summary table illustrates the valuations of the University's investments and other relevant assets as of July 31, 2017, based on their placement within the fair value hierarchy:

	Level 1	Level 2	Level 2 Level 3		Total
Investments		(I)	n thousands)		
Cash and cash equivalents	\$155,028	\$ -	\$ -	\$ -	\$ 155,028
Absolute return	-	-	-	166,439	166,439
Assets held by trustee*	113,032	-	-	46,125	159,157
Mutual funds	50,020	-	-	-	50,020
Fixed income	13,124	62,606	-	-	75,730
Real estate	-	58,799	7,664	43,468	109,931
Private equity	-	-	-	118,009	118,009
Natural resources	-	-	-	93,855	93,855
Public equity	37,151	-	-	50,516	87,667
Opportunistic distressed	-	-	-	16,661	16,661
Other	23		<u>1,937</u>		1,960
Total investments	\$368,378	\$121,405	\$ 9,601	\$535,073	\$1,034,457
Assets held as trustee or agent					
Cash and cash equivalents	\$ 1,095	\$ -	\$ -	\$ -	\$ 1,095
Mutual funds	79,084	_	_	-	79,084
Fixed income	-	63	-	-	63
Real estate	-	31,682	-	44	31,726
Equities	13	-	-	166	179
Other	<u>-</u>	<u>-</u>	<u>848</u>	<u>278</u>	1,126
Total assets held as trustee or agent	\$ 80,192	\$ 31,745	\$ 848	\$ 488	\$ 113,273
Total	\$ <u>448,570</u>	\$ <u>153,150</u>	\$ <u>10,449</u>	\$ <u>535,561</u>	\$ <u>1,147,730</u>

^{*}Assets held by trustee consists primarily of the balance of the Blanche E. Seaver Endowed Trust, of which the University is the sole irrevocable income and principal beneficiary.

Level 1 generally includes the University's investments in mutual funds and common stock that are regularly traded in active markets where quoted prices may be easily obtained.

Level 2 generally includes the University's investments in debt securities and certain unlisted equity funds that offer a high degree of liquidity and transparency. Debt security prices are obtained from pricing services or from brokers. Real property is valued based on a number of different approaches, including third party appraisals, market comparisons, and discounted future rental revenues. Level 2 investments may also be priced using model-based valuation techniques where all assumptions are observable.

Level 3 generally includes the University's alternative investments, which consist of hedge funds, private equity funds, real estate funds, and other fund of funds. These investments do not typically transact on a regular basis, nor do they have readily determinable fair values. Oil and gas interests are valued by discounting future expected royalty revenues.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future values. In addition, while the University believes that its valuation

Notes to Consolidated Financial Statements

methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following table sets forth a reconciliation of beginning and ending balances for financial instruments designated as Level 3:

	For the year ended July 31,			
	<u>2018</u>	<u>2017</u>		
	(In thous	ands)		
Beginning balance	\$10,449	\$13,273		
Realized gains	510	115		
Unrealized losses	(75)	(933)		
Purchase cost.	1,368	1,255		
Total proceeds	(1,356)	(3,202)		
Transfers out of Level 3		(59)		
Ending balance	\$ <u>10,896</u>	\$ <u>10,449</u>		

All net realized and unrealized gains in the table above are reflected in the accompanying consolidated Statements of Activities.

Notes to Consolidated Financial Statements

The University uses the NAV to determine the fair value of all the underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. The following table lists investments in other investment companies (in partnership format) by major category for the year ended July 31, 2018:

Investment Category	<u>Strategy</u>	NAV in <u>Funds</u>	# of <u>Funds</u>	Remaining <u>Life</u>	Amount of Unfunded Commitments	Redemption Terms	Redemption Restrictions			
	(In thousands, except # of funds)									
Absolute Return	US and non-US investments in relative value, event driven, long/short, and directional strategies	\$174,317	27	Open Ended	\$ 2,220	Ranges from quarterly with 30, 45, 60 or 90 days notice, semi annual with 90 days notice, annual with 45, 60 or 90 days notice, every 36 months with 45 days notice	0.4% of NAV is locked up in side- pockets			
Assets Held by Trustee	US and non-US investments in private equity, venture capital, fixed income, relative value, event driven, long/short and directional	48,377	4	Approx 7 years to Open Ended	-	N/A	N/A			
Private Natural Resources	US and non-US Investments in upstream, midstream, and downstream natural resources	108,677	26	Approx 7 years	43,383	Redemptions are not permitted during the life of the fund	N/A			
Private Real Estate	US and non-US real estate	48,356	26	Approx 7 years	42,121	Redemptions are not permitted during the life of the fund	N/A			
Public Equity	US and non-US equity securities	52,998	3	Open Ended	-	Ranges from daily to monthly	N/A			
Opportunistic Distressed	US and non-US distressed debt securities	13,942	8	Approx 7 years	2,655	Redemptions are not permitted during the life of the fund	N/A			
Private Equity	US and non-US equity securities and venture capital	124,300	54	Approx 7 years	46,410	Redemptions are not permitted during the life of the fund	N/A			
Total		\$ <u>570,967</u>			\$ <u>136,789</u>					

Notes to Consolidated Financial Statements

The University uses the NAV to determine the fair value of all the underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. The following table lists investments in other investment companies (in partnership format) by major category for the year ended July 31, 2017:

Investment Category	Strategy	NAV in <u>Funds</u>	# of <u>Funds</u>	Remaining <u>Life</u>	Amount of Unfunded Commitments	Redemption Terms	Redemption Restrictions
Absolute Return	US and non-US investments in relative value, event driven, long/short, and directional strategies	(In the	ousands, ex	cept # of funds)		Ranges from quarterly with 30, 45, 60 or 90 days notice, semi annual with 90 days notice, annual with 45, 60 or 90 days notice, every 36 months with	0.4% of NAV is locked up in side-
	strategies	\$166,605	26	Open Ended	\$ -	45 days notice	pockets
Assets Held by Trustee	US and non-US investments in private equity, venture capital, relative value, event driven, long/short and directional	46,125	3	Open Ended	-	N/A	N/A
Private Natural Resources	US and non-US Investments in upstream, midstream, and downstream natural resources	93,949	24	Approx 7 years	39,579	Redemptions are not permitted during the life of the fund	N/A
Private Real Estate	US and non-US real estate	43,512	23	Approx 7 years	29,598	Redemptions are not permitted during the life of the fund	N/A
Public Equity	US and non-US equity securities	50,565	7	Open Ended	-	Ranges from daily to monthly	N/A
Opportunistic Distressed	US and non-US distressed debt securities	16,678	8	Approx 7 years	2,793	Redemptions are not permitted during the life of the fund	N/A
Private Equity	US and non-US equity securities and venture capital	118,127	55	Approx 7 years	46,773	Redemptions are not permitted during the life of the fund	N/A
Total		\$ <u>535,561</u>			\$ <u>118,743</u>		

Notes to Consolidated Financial Statements

21. Asset Retirement Obligations

The following table illustrates the change in conditional asset retirement obligations during the year ended July 31, 2018:

Abatement <u>Timeframe</u>	Average Abatement <u>Date</u>	Balance at <u>July 31, 2017</u>	Accretion	Costs Incurred	Balance At July 31, 2018
			(I	n thousands)	
10-20 years	2022	\$5,092	\$206	\$ -	\$5,298
21-30 years	2036	26	1	-	27
31-40 years	2044	1,237	60	(23)	1,274
41-50 years	2048	142	7	-	149
51+ years	2061	9	_ _	_	9
		\$ <u>6,506</u>	\$ <u>274</u>	\$ <u>(23)</u>	\$ <u>6,757</u>

22. Foreign Currency Transactions

For the years ended July 31, 2018 and 2017, the University recorded approximately \$66,000 in net losses and \$216,000 in net gains on foreign currency hedging transactions, respectively.

23. Subsequent Events

The University has performed an evaluation of subsequent events through November 28, 2018, which is the date these financial statements were issued. There were no subsequent events that require disclosure.