

UC Santa Barbara Foundation

Report on Financial Statements

June 30, 2017 and 2016

UC Santa Barbara Foundation
Report on Financial Statements
June 30, 2017 and 2016

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Report of Independent Auditors

To the Board of Trustees of the
UC Santa Barbara Foundation:

We have audited the accompanying financial statements of the UC Santa Barbara Foundation, a component unit of the University of California, which comprise the statements of net position as of June 30, 2017 and 2016, and the related statements of revenues, expenses, and changes in net position and of cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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 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 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 financial statements are free from material misstatement.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the UC Santa Barbara Foundation as of June 30, 2017 and 2016, respectively, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Other Matters

Required Supplementary Information

The accompanying management's discussion and analysis on pages 3-9 are required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

September 28, 2017

UC Santa Barbara Foundation

Management's Discussion and Analysis

June 30, 2017 and 2016 (Unaudited)

The following discussion and analysis presents an overview of the financial performance of the UC Santa Barbara Foundation (the "Foundation"), a component unit of the University of California, as of and for the years ended June 30, 2017 ("FYE 2017"), June 30, 2016 ("FYE 2016") and June 30, 2015 ("FYE 2015"). It should be read in conjunction with, and is qualified in its entirety by, the related financial statements and footnotes. The financial statements, footnotes and this discussion and analysis are prepared by management and are the responsibility of management.

Overview

This annual report consists of a series of financial statements prepared in accordance with the statements of the Governmental Accounting Standards Board ("GASB"). These statements focus on the financial condition of the Foundation, its changes in net position and its cash flows, taken as a whole.

One of the most important questions asked about Foundation finances is whether the Foundation is better off or worse off as a result of the year's activities. Perhaps as important is assessing the long-term financial performance of the Foundation. The key to understanding these questions are the Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position and the Statements of Cash Flows. These statements present financial information in a form similar to that used by private sector companies. The Foundation's net position (the difference between assets and liabilities) is one indicator of the Foundation's financial health. Over time, increases or decreases in net position is one indicator of the improvement or erosion of the Foundation's financial health when considered with other nonfinancial information.

The Statement of Net Position includes all assets and liabilities. The Statement of Revenues, Expenses and Changes in Net Position presents revenues earned and expenses incurred during the year. Activities are reported as either operating or non-operating, with gifts received for the benefit of, and disbursements to, The Regents of the University of California reported as operating revenues and expenses, respectively, and investment results reported as non-operating revenues or expenses. These statements are prepared using the accrual basis of accounting.

Another way to assess the financial health of the Foundation is to look at the Statement of Cash Flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of an entity during a period. The Statement of Cash Flows helps users assess an entity's ability to generate net cash flows, its ability to meet its obligations as they come due and its needs for external financing.

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Condensed Summary of Net Position

	June 30, 2017	June 30, 2016	June 30, 2015
Assets			
Current assets	\$ 21,733,743	\$ 21,417,761	\$ 27,802,478
Noncurrent assets	<u>198,551,913</u>	<u>169,271,090</u>	<u>146,546,036</u>
Total assets	<u>\$ 220,285,656</u>	<u>\$ 190,688,851</u>	<u>\$ 174,348,514</u>
Liabilities			
Current liabilities	\$ 344,012	\$ 1,209,338	\$ 1,010,910
Noncurrent liabilities	<u>3,561,728</u>	<u>4,119,454</u>	<u>4,312,864</u>
Total liabilities	<u>\$ 3,905,740</u>	<u>\$ 5,328,792</u>	<u>\$ 5,323,774</u>
Net Position			
Net investment in capital assets	\$ -	\$ 1,529	\$ 3,792
Unrestricted	1,349,946	1,334,770	1,389,379
Restricted			
Expendable	88,131,754	73,027,344	75,991,074
Nonexpendable (Endowment)	125,731,486	110,066,932	90,601,753
Nonexpendable (Trusts)	<u>1,166,730</u>	<u>929,484</u>	<u>1,038,742</u>
Total net position	<u>\$ 216,379,916</u>	<u>\$ 185,360,059</u>	<u>\$ 169,024,740</u>

Assets

FYE 2017

Total current assets increased slightly from \$21.4 million to \$21.7 million as of June 30, 2017 due primarily to cash receipts, investment timing, and an increase in current pledges. This was offset by the sale of property held at June 30, 2016 and the payoff of the promissory note held by the Foundation.

FYE 2017 noncurrent assets increased \$30 million from \$169 million to \$199 million as a result of increased pledges, gifts, and market values. This amount was slightly offset by a \$581 thousand decrease resulting from the payoff of the promissory note held by the Foundation.

Assets

FYE 2016

Total current assets decreased from \$27.8 million as of June 30, 2015 to \$21.4 million as of June 30, 2016. The decrease of \$6.4 million from FYE 2015 primarily reflects a \$10.3 million decrease in account receivables as a result of the sale of investments held by Lazard that was executed on June 30, 2015. This sale settled on July 1, 2015, thereby dropping out of the current assets total in FYE 2016. These funds were reinvested in the General Endowment Pool ("GEP") in July 2015. Offsetting the above was an

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increase of \$3.8 million in short-term investment holdings resulting primarily from several large current use gifts that had not yet been transferred to campus.

FYE 2016 total noncurrent assets increased \$23 million from June 30, 2015 as a result of transferring the FYE 2015 \$10.3 million Lazard current asset to noncurrent assets in FYE 2016. Additionally, there were principal contributions of \$21 million in FYE 2016, offset by \$4 million in payouts and \$4 million in capital losses.

Liabilities

FYE 2017

Typically, current liabilities increase or decrease when contrasted to the prior year as a function of when checks are remitted to vendors. However, this year's decrease of \$865,326 in current liabilities primarily reflects the sale of a property that had been held for sale at June 30, 2016.

The \$557,726 decrease in noncurrent liabilities from the prior year reflects the payoff of the promissory note obligation held by the Foundation. The remaining noncurrent liabilities are primarily related to trusts with small deferred gifts also included.

Liabilities

FYE 2016

Typically, current liabilities increase or decrease when contrasted to the prior year as a function of when checks are remitted to vendors. However, the continued high level of current liabilities reflects the fact that there is an asset held for sale as of June 30, 2016.

All of the liability accounts, both current and noncurrent, with the exception of accounts payable and a promissory note obligation are related to trusts and deferred gifts and are offsets to the related asset balances discussed above. The trusts administered by the Foundation are the primary factors accounting for the change in noncurrent liabilities from the prior year.

Net Position

FYE 2017

Total Net Position increased \$31 million from \$185 million at June 30, 2016 to \$216 million at June 30, 2017 resulting from increased giving and a strong market with the Foundation's Long Term Investment Pool ("LTIP") generating a 14.48% total return net of all costs for FYE 2017.

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Net Position

FYE 2016

Unrestricted Net Position decreased from \$1.39 million on June 30, 2015 to \$1.33 million at June 30, 2016. This modest level of fluctuation is normal on a year-to-year basis depending primarily on the size of restricted current use gifts received and transfers made to campus.

The categories of Restricted-Expendable and Restricted-Nonexpendable ("endowment") address both restricted current use and endowment funds. The Restricted Non-Expendable balance increased dramatically as a result of new gifts. Off-setting this, the LTIP returned a negative 3.54% net of fees for the FYE 2016, and this impacted funds functioning as endowments as they are invested in the LTIP.

Condensed Summary of Revenues, Expenses and Changes in Net Position

	<u>June 30, 2017</u>	<u>June 30, 2016</u>	<u>June 30, 2015</u>
Operating revenues	\$ 17,664,254	\$ 20,099,118	\$ 14,839,045
Operating expenses	<u>22,673,535</u>	<u>20,663,468</u>	<u>17,174,387</u>
Operating loss	(5,009,281)	(564,350)	(2,335,342)
Non-operating net revenues (expenses)	22,776,759	(4,185,032)	2,014,841
Capital contributions	<u>13,252,379</u>	<u>21,084,701</u>	<u>5,657,526</u>
Increase in net position	31,019,857	16,335,319	5,337,025
Net position, beginning of year	<u>185,360,059</u>	<u>169,024,740</u>	<u>163,687,715</u>
Net position, end of year	<u>\$ 216,379,916</u>	<u>\$ 185,360,059</u>	<u>\$ 169,024,740</u>

Revenue and Support

FYE 2017

Operating revenues decreased from \$20.1 million for FYE 2016 to \$17.7 million for FYE 2017. Fund raising, while still strong, was lower than in the prior fiscal year and accounts for this decline.

Operating expenses increased from \$20.7 million for FYE 2016 to \$22.7 million for FYE 2017. The activity includes all fund transfers from the Foundation to the campus. The Foundation once again released funds to campus in support of the Campaign for UC Santa Barbara and provided releases of funds to the campus for specific capital projects, research and service programs. The Administrative Fee collections declined by \$0.7 million with the decline in fundraising activity from FYE 2016 while other transfers to campus increased by \$2.7 million compared to FYE 2016.

The Foundation's Endowment Payout Policy, adopted in conformance with the Uniform Prudent Management of Institutional Funds Act (UPMIFA), provides prudent capital preservation for both

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endowment and designated funds. It is also intended to assure a stable flow of payouts in the face of volatile market conditions. The Foundation uses a sixty-month average share value to achieve a more stable payout flow. This year the Foundation adjusted the payout policy down to the 4.5% level for FYE 2017 from 4.65% in FYE 2016. The potential payout amount increased, however because of a \$1.44 increase in the sixty-month average share value. The Foundation continues to use an "opt-in" payout policy, wherein no distributions are made unless requested by the Fund Administrator. The concept here is to encourage Fund Administrators to expend funds already released to campus before taking additional payouts. This year, the opt-in policy reduced actual distributions to campus to about \$1.05 million below the maximum payouts that could have been made in FYE 2017, as Fund Administrators continued to expend balances on campus and left funds invested in the portfolio.

Non-operating (expenses) revenues changed dramatically from a negative \$4.2 million for FYE 2016 to a positive \$22.8 million for FYE 2017 as a result of the strong investment performance with the portfolio delivering 14.48% total return net of all fees for FYE 2017.

Capital contributions (funds placed into permanent endowments) declined from the prior fiscal year as total fundraising related to endowments dropped off and the matching fund programs offered by the UC Systemwide Office of the President expired.

Revenue and Support

FYE 2016

Operating revenues increased from \$14.8 million for FYE 2015 to \$20.1 million for FYE 2016. The primary factor for the increase was significant fundraising activity compared to the prior fiscal year, which was compounded by a prior year write-off of a large pledge receivable.

Operating expenses increased significantly for FYE 2016. The activity includes all fund transfers from the Foundation to the campus. The Foundation once again released funds to campus in support of the Campaign for UC Santa Barbara and provided releases of funds to the campus for specific capital projects, research and service programs. Additionally, the transfer of Gift Administrative Fees to campus increased by \$748,779 from the prior year with the maturation of the 6% gift fee level in addition to increased giving.

Overall distributions from endowment funds and designated funds declined by approximately \$128,400 from the prior year. The Foundation's Endowment Payout Policy, adopted in conformance with the Uniform Prudent Management of Institutional Funds Act (UPMIFA), provides prudent capital preservation for both endowment and designated funds. It is also intended to assure a stable flow of payouts in the face of volatile market conditions. The Foundation uses a sixty-month average share value to achieve a more stable payout flow. This year the Foundation adjusted the payout policy down to the 4.65% level for FYE 2016 from 4.75% in FYE 2015. The potential payout amount increased, however because of a \$2.10 increase in the sixty-month average share value. The Foundation continues to use an "opt-in" payout policy, wherein no distributions are made unless requested by the Fund Administrator. The concept here is to encourage Fund Administrators to expend funds already released to campus before taking additional payouts. This year, the opt-in policy reduced actual distributions to campus to about \$1.0 million below the maximum payouts that could have been made in FYE 2016, as Fund Administrators continued to expend balances on campus and left funds invested in the portfolio.

Non-operating (expenses) revenues changed dramatically from a positive \$2.01 million for FYE 2015 to a negative \$4.2 million for FYE 2016. This was driven by a negative 3.54% return in the LTIP for FYE 2016 as contrasted to the 2.07% total return net of fees in the LTIP for FYE 2015.

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Capital contributions (funds placed into permanent endowments) increased from the prior fiscal year as total fundraising related to endowments increased dramatically with matching fund programs offered by the UC Systemwide Office of the President.

Factors Impacting Future Periods

Management has seen both pledge payment deferral rates and also pledge default rates rise over time as the world economies continue to face sluggish rates of growth throughout FYE 2017. The Foundation Board and the management team are careful not to make programmatic commitments based on outstanding pledge balances, so the fluctuations are not material to the Foundation's financial condition.

Management is aware of GASB issued *Statement No. 81, Irrevocable Split-Interest Agreements*, effective for the Foundation's fiscal year beginning July 1, 2017. This statement addresses when irrevocable split-interest agreements constitute an asset for accounting and financial reporting purposes when the resources are administered by a third party. Management is currently collecting data on those agreements and is verifying the current market values subject to those agreements. The Foundation is evaluating the effect that Statement No. 81 will have on its financial statements.

With the increased size of the average gift being made with credit cards and cost savings resulting from a change in the third-party provider used for credit card transactions; the Foundation reduced the fees it charges to offset the costs related to credit card transactions effective July 1, 2017. The new rates are 2.0% for third-party processing/merchant fees and an added 2.0% for on-line portal fees.

The note held by the Foundation was fully paid off in June 2017 with the net proceeds of \$707,519 being moved into a fund functioning as an endowment. While the gift terms set forth in the agreement still apply, the accounting associated with the payouts will differ from the note payments that were being received and distributed.

In August 2017, a donor made an early release of \$200,000 from an existing Charitable Remainder Unitrust (CRUT) where the Foundation serves as trustee. A new \$25.4 million Charitable Remainder Annuity Trust (CRAT) was set up with the Foundation serving as trustee. This CRAT was set up with a single asset composed of a note from the UC Regents (dba UC Santa Barbara). The debt service payments on this note will cover the quarterly payments to the beneficiary and all administrative expenses of the CRAT for the twenty year duration of the CRAT. Should the donors both die prior to the twenty year duration expiring, the unpaid balance shall be forgiven.

Management is aware of the change in the funding model for the Development Office that has allowed for significant growth in both employment and compensation levels within the Development Office on the UC Santa Barbara campus over the past three years. The change in the funding model continues to provide for increases in employment within the campus' Development Office and that has resulted in increased overall fundraising performance in general terms. In addition, this change in funding models has significantly reduced the need for unrestricted gift income.

The Foundation continues with a model that has somewhat lesser endowment management responsibilities as a result of the move back to the UC Regents' General Endowment Pool. However, it is a modest reduction in the investment management workload. The workload and control requirements related to on-line giving have remained high as the contributions derived from on-line giving have begun to stabilize. The Board has continued to assess the Endowment Investment Management Cost Recovery fee of 0.55% in FYE June 30, 2018 and will consider a reduction to 0.50% for FYE June 30, 2019. The

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Foundation has also reduced the payout policy from the 4.5% factor used for FYE June 30, 2017 to a 4.25% factor for FYE June 30, 2018 and will consider a further reduction for FYE June 30, 2019. These changes are in response to lower projected returns in the LTIP. This is consistent with the conservative long-term fiscal strategy taken by management to assure the viability of endowments over time. Management will continue to assess on an annual basis whether further reductions in the UPMIFA endowment distribution policy rate are warranted.

The Foundation's 6% gift administrative fee effective in FYE June 30, 2013 has been extended for FYE June 30, 2018, and it is expected this will remain in place for the long-term. The gift fee action was done in conjunction with a parallel action by the campus on all gifts made to the UC Regents.

The investment portfolio is now invested primarily in GEP. The only remaining assets yet to be liquidated are in the Other Investments class and are being held until such time as they mature or can be sold with little or no discounting on the sale price relative to fair value. These residual investments are being managed by the Office of the University of California's Chief Investment Officer, the same office that manages the GEP, with State Street Bank & Trust providing Master Custodial services. It is anticipated that this change will continue to have the net effect of minimally reducing the staff workloads in performance reporting as referenced above.

Master Custodial Services and Investment Performance verification will both be provided by State Street Bank & Trust under a contract administered by the UC Regents. The Foundation anticipates that this structure will remain in place for the near future. The *Investment Policy Guidelines* of the Foundation will be revised at the Fall 2017 Board Meeting to reflect asset allocation changes within the UC General Endowment Pool.

In addressing the impacts of the technical changes inherent in the implementation of UPMIFA, management shifted the payout practice of the Foundation to an "opt-in" model in FYE June 30, 2010 and will continue with this model in FYE June 30, 2018. This was done to encourage Fund Administrators on campus to expend current expendable balances prior to drawing out additional funds and it has proved to be a highly effective strategy as evidenced by the continued reduction in payout draws during FYE June 30, 2017, as well as a projected reduction in payout draws for FYE June 30, 2018.

Finally, the Foundation has reaffirmed its commitment to hold all trust assets at State Street Bank & Trust's Charitable Asset Management Group. There are no anticipated changes for FYE June 30, 2018.

Management is not aware of any other factors that could have a significant impact on future periods.

UC Santa Barbara Foundation
Statements of Net Position
June 30, 2017 and 2016

	2017	2016
Assets		
Current assets		
Cash and cash equivalents	\$ 2,309,999	\$ 227,254
Short-term investments	13,202,539	14,532,215
Pledges receivable - current portion, net	6,134,156	5,498,463
Accounts receivable	87,049	259,829
Real estate held for sale	<u>-</u>	<u>900,000</u>
Total current assets	<u>21,733,743</u>	<u>21,417,761</u>
Noncurrent assets		
Pledges receivable, net	10,474,543	8,847,352
Investments held in unitrusts and charitable remainder annuity trusts	5,010,858	4,751,426
Investments	183,066,505	155,089,272
Notes and loans receivable	-	581,504
Contributed assets held for sale	7	7
Equipment net of accumulated depreciation	<u>-</u>	<u>1,529</u>
Total noncurrent assets	<u>198,551,913</u>	<u>169,271,090</u>
Total assets	<u>\$ 220,285,656</u>	<u>\$ 190,688,851</u>
Liabilities		
Current liabilities		
Accounts payable	\$ 61,612	\$ 25,346
Unearned revenue, current	-	20,794
Other deferred revenue	-	900,000
Charitable remainder trust liability	<u>282,400</u>	<u>263,198</u>
Total current liabilities	<u>344,012</u>	<u>1,209,338</u>
Noncurrent liabilities		
Unearned revenue, noncurrent	-	560,710
Charitable remainder trust liability	<u>3,561,728</u>	<u>3,558,744</u>
Total noncurrent liabilities	<u>3,561,728</u>	<u>4,119,454</u>
Total liabilities	<u>\$ 3,905,740</u>	<u>\$ 5,328,792</u>
Net position		
Invested in capital assets net of related debt	\$ -	\$ 1,529
Unrestricted	1,349,946	1,334,770
Restricted:		
Expendable		
Endowment	23,753,630	13,321,567
Funds functioning as endowments	43,808,272	36,760,754
Gifts	20,569,852	22,945,023
Nonexpendable		
Endowment	125,731,486	110,066,932
Charitable remainder trust assets	<u>1,166,730</u>	<u>929,484</u>
Total net position	<u>\$ 216,379,916</u>	<u>\$ 185,360,059</u>

The accompanying notes are an integral part of these financial statements.

UC Santa Barbara Foundation
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2017 and 2016

	2017	2016
Operating revenues		
Contributions	\$ 16,413,674	\$ 20,022,672
Other revenue	<u>1,250,580</u>	<u>76,446</u>
Total operating revenues	<u>17,664,254</u>	<u>20,099,118</u>
Operating expenses		
General operations	2,937,871	3,817,543
University programs and other designated disbursements	17,257,956	14,536,816
Scholarships and awards	<u>2,477,708</u>	<u>2,309,109</u>
Total operating expenses	<u>22,673,535</u>	<u>20,663,468</u>
Operating loss	<u>(5,009,281)</u>	<u>(564,350)</u>
Non-operating revenues (expenses), net		
Realized/unrealized gains (losses) on investments, net	21,150,416	(5,754,920)
Interest and dividends	1,389,097	1,679,146
Change in the value of charitable remainder trust liabilities	<u>237,246</u>	<u>(109,258)</u>
Total non-operating revenues (expenses), net	<u>22,776,759</u>	<u>(4,185,032)</u>
Change in net position before permanent endowment contributions	<u>17,767,478</u>	<u>(4,749,382)</u>
Other changes in net position		
Permanent endowment contributions	<u>13,252,379</u>	<u>21,084,701</u>
Change in net position	31,019,857	16,335,319
Net position		
Beginning of year	<u>185,360,059</u>	<u>169,024,740</u>
End of year	<u>\$ 216,379,916</u>	<u>\$ 185,360,059</u>

The accompanying notes are an integral part of these financial statements.

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Statements of Cash Flows
Years Ended June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities		
Receipts from contributions	\$ 13,635,964	\$ 18,031,310
Payments to campus	(19,735,665)	(16,845,924)
Payments to beneficiaries	(269,172)	(278,301)
Payments for administrative expenses	(2,937,871)	(3,817,543)
Other receipts, net	<u>2,630,326</u>	<u>3,241,043</u>
Net cash (used in) provided by operating activities	<u>(6,676,418)</u>	<u>330,585</u>
Cash flows from noncapital financing activities		
Private gifts for endowment purposes	<u>10,701,769</u>	<u>20,477,670</u>
Cash flows from investing activities		
Proceeds from sale of investments	11,819,006	146,765,026
Purchases of investments	(14,250,710)	(169,367,145)
(Sales) Purchases of real estate held for sale	(900,000)	264,934
Interest and dividends on investments	<u>1,389,097</u>	<u>1,679,146</u>
Net cash used in investing activities	<u>(1,942,607)</u>	<u>(20,658,039)</u>
Net increase in cash and cash equivalents	2,082,745	150,216
Cash and cash equivalents – beginning of year	<u>227,254</u>	<u>77,038</u>
Cash and cash equivalents – end of year	<u>\$ 2,309,999</u>	<u>\$ 227,254</u>
Reconciliation of operating loss to net cash (used in) provided by in operating activities		
Operating loss	\$ (5,009,281)	\$ (564,350)
Adjustments to reconcile operating loss to net cash (used in) provided by operating activities		
Depreciation	1,529	2,262
Noncash gifts	(514,828)	1,669,360
Changes in assets and liabilities		
Decrease (Increase) in notes receivable	581,505	(5,505)
Decrease in other current assets	900,000	-
Decrease (Increase) in accounts receivable	172,779	(221,818)
(Increase) in pledges receivable	(2,262,883)	(510,722)
Increase (Decrease) in accounts payable	36,265	(44,147)
(Decrease) Increase in unearned revenue	<u>(581,504)</u>	<u>5,505</u>
Net cash (used in) provided by operating activities	<u>\$ (6,676,418)</u>	<u>\$ 330,585</u>
Supplemental Disclosure of Noncash Gifts		
Contributions of marketable securities		
Operating	\$ 514,828	\$ 1,480,640
Endowment	2,550,609	607,031

The accompanying notes are an integral part of these financial statements.

UC Santa Barbara Foundation
Notes to Financial Statements
June 30, 2017 and 2016

1. Organization

The UC Santa Barbara Foundation (the “Foundation”), a not-for-profit organization, was formed in 1973 for the purpose of encouraging voluntary private gifts, trusts and bequests for the benefit of the University of California, Santa Barbara (the “University”). Funds raised through the Foundation on behalf of The Regents of The University of California are made directly to The Regents and are not included in the accompanying financial statements. The Foundation provides financial support for various University-related programs, including faculty research and teaching activities, student scholarships, equipment purchases and capital improvements. The Foundation transfers monies to the University, which assumes responsibility for actual disbursement.

The Foundation is governed by an independent Board of Trustees, the membership of which includes the Chancellor of University of California, Santa Barbara. The Foundation was established solely to support the mission of UCSB. Upon dissolution, liquidation or winding up of the Foundation, the assets remaining after payment, or provision for payment, of all debts and liabilities of the Foundation shall be distributed to the Regents for the benefit of UCSB, provided the Regents of the University have maintained tax-exempt status under the Internal Revenue Code and relevant California laws. Accordingly, the Foundation is considered a governmental not-for-profit organization, subject to reporting under the Governmental Accounting Standards Board (“GASB”).

The Foundation is subject to the policies and procedures of The Regents of the University of California and is a component unit of the University of California (“UC”) and as such will be included in the basic financial statements of the University of California. The University established administrative guidelines for the Foundation with regard to the Foundation’s ability to conduct operations through its Policy on Campus Foundations. The University’s policy limits the ability of the Foundation to make certain expenditures and provides a general framework for its operations. The Foundation does not have any component units.

2. Summary of Significant Accounting Policies

A summary of the significant accounting policies applied in the preparation of the accompanying financial statements are presented below:

(a) Basic of Accounting

The financial statements have been prepared in accordance with U.S. generally accepted accounting principles, using the economic resources measurement focus and the accrual basis of accounting. The Foundation follows accounting principles issued by GASB.

(b) Accounting Pronouncements

In March 2016, the GASB issued *Statement No. 81, Irrevocable Split-Interest Agreements*, effective for the Foundation’s fiscal year beginning July 1, 2017. This statement addresses when irrevocable split-interest agreements constitute an asset for accounting and financial reporting purposes when the resources are administered by a third party. The statement also provides expanded guidance for circumstances in which the government holds the assets. The Foundation is evaluating the effect that Statement No. 81 will have on its financial statements.

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of cash held in bank accounts, cash on hand and any short-term investments with original maturities of three months or less. Money market accounts are treated as investments.

(d) Investments

Investments consist mainly of stocks, alternative investments including private equity and hedge funds, bonds, U.S. Treasury notes, tax-exempt securities, certificates of deposit and money market accounts.

Investments are reported at fair value. Investments consisted principally of investments in The Regents of the University of California Short Term Investment Pool ("STIP") and the UC Santa Barbara Foundation Long Term Investment Pool ("LTIP").

Short-term investments consist primarily of STIP. Short-term investments are reported at fair value. All endowment and trust investments are classified as non-current regardless of maturity due to restrictions limiting Foundation's ability to use these investments.

Endowment funds are invested in accordance with the *Endowment Investment Spending Policies and Guidelines*, adopted by the Board of Trustees (the "Board") and the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). Investment decisions are based on a long-term investment strategy, with an objective of maximizing the endowment portfolio's long-term total return (yield plus appreciation). The Investment Committee adopted the UC Regents' General Endowment Pool ("GEP") policy and approved the revised UC Santa Barbara Investment Policy Guidelines on February 24, 2017.

The Foundation shall abide by the current Investment Policy Statement and the associated appendices for the GEP as adopted by the UC Regents. The Foundation shall abide by the current Investment Policy Benchmarks for the GEP as adopted by the UC Regents.

The primary investment vehicle for the Foundation's LTIP is GEP. The Foundation also utilizes STIP. The Accounting Policies related to GEP and STIP are as follows:

Investments are measured and recorded at fair value. Securities are generally valued at the last sale price on the last business day of the fiscal year, as quoted on a recognized exchange or utilizing an industry standard pricing service, when available. Securities for which no sale was reported as of the close of the last business day of the fiscal year are valued at the quoted bid price of a dealer who regularly trades in the security being valued. Investment in non-exchange traded debt and equity investments are valued using inputs provided by independent pricing services or by broker/dealers who actively trade in these markets. Certain securities may be valued on a basis of a price provided by a single source.

Investments also include private equities, absolute return funds, real estate, real asset and certain corporate asset-backed securities. Private equities include venture capital partnerships, buyout and international funds. Fair values for interests in private equity, absolute return partnerships and real estate partnerships are based on valuations provided by the general partners of the respective partnerships. The valuations are primarily based on the Net Asset Value ("NAV") of the underlying investments. The NAV is reported by the external investment managers, including general partners, in accordance with their policies as described in their respective financial statements and offering memoranda. The most recent NAV is adjusted for capital calls,

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distributions and significant known valuation changes, if any, of its related portfolio through June 30, 2016 and 2015, respectively. The valuation of assets referenced above is consistent with the implementation standards of GASB *Statement No. 72 Fair Value Measurement and Application*.

Interests in certain direct investments in real estate are estimated based upon independent appraisals. Because the private equity, real estate and absolute return partnerships, along with direct investments in real estate, are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ significantly from the value that would be used had a ready market for such investments existed. These investments are generally less liquid than other investments, and the value reported may differ from the values that would have been reported had a ready market for these investments existed.

For other investments, the Foundation considers various factors to estimate fair value, such as the timing of the transaction, the market in which the company operates, comparable transactions, company performance and projections as well as discounted cash flow analysis. The selection of an appropriate technique may be affected by the availability and general reliability of relevant inputs. In some cases, one valuation technique may provide the best indication of fair value while in other circumstances, multiple valuation techniques may be appropriate. Furthermore, the Foundation may review the investment's underlying portfolio as well as engage external appraisers, depending on the nature of the investment.

The Foundation exercises due diligence in assessing the external managers' use of, and adherence to, fair value principles. In conjunction with these procedures, estimated fair value is determined by consideration of a wide range of factors, including market conditions, redemption terms and restrictions and risks inherent in the inputs of the external investment managers' valuation. In situations where the information provided by the external manager is deemed to not be representative of the fair value as of the measurement date, management evaluates specific features of the investment and utilizes supplemental fair value information provided by the external manager along with any relevant market data to measure the investment's fair value.

Investments in registered investment companies are valued based upon the reported net asset value of those companies. Mortgage loans, held as investments, are valued on the basis of their future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Insurance contracts are valued at contract value, plus reinvested interest, which approximates fair value. Estimates of the fair value of interests in externally held irrevocable trusts where the Foundation is the beneficiary of either the income or the remainder that will not become a permanent endowment upon distribution to the Foundation are based upon the present value of the expected future income or, if available, the Foundation's proportional interest in the fair value of the trust assets.

Investments denominated in foreign currencies are translated into U.S. dollar equivalents using year-end spot foreign currency exchange rates. Purchases and sales of investments and their related income are translated at the rate of exchange on the respective transaction dates. Realized and unrealized gains and losses resulting from foreign currency changes are included in the Foundation's Statement of Revenues, Expenses and Changes in Net Position.

Investment transactions are recorded on the date the securities are purchased or sold (trade date). Realized gains or losses are recorded as the difference between the proceeds from the sale and the average cost of the investment sold. Dividend income is recorded on the ex-dividend date and

interest income is accrued as earned. Gifts of securities are recorded based on fair value at the date of donation.

The Foundation invests all its investments in University of California managed investment pools with the exception of some residual alternative assets that are illiquid. Securities in these investment pools are included in the University of California's security lending program.

It is the goal of the Foundation that the total return from endowment investments should be adequate to meet the following objectives:

- Preserve investment capital and its purchasing power.
- Generate sufficient resources to meet spending needs (payout).
- Attain reasonable capital appreciation through prudent acceptance of risk to enhance the future purchasing power of the investment capital.

(e) Fair Value of Investments

Fair value is defined in the accounting standards as 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. Assets and liabilities reported at fair value are organized into a hierarchy based on the levels of inputs observable in the marketplace that are used to measure fair value. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, liquidity statistics, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

Level 1 – Prices based on unadjusted quoted prices in active markets that are accessible for identical assets or liabilities are classified as Level 1. Level 1 investments include equity securities, mutual funds and other publicly traded securities.

Level 2 – Quoted prices in the markets that are not considered to be active, dealer quotations, or alternative pricing sources for similar assets or liabilities for which all significant inputs are observable, either directly or indirectly are classified as Level 2. Level 2 investments include fixed- or variable-income securities, commingled funds, certain derivatives and other assets that are valued using market information.

Level 3 – Investments classified as Level 3 have significant unobservable inputs, as they trade infrequently or not at all. The inputs into the determination of fair value of these investments are based upon the best information in the circumstance and may require significant management judgment. Level 3 investments include private equity investments, real estate and split interest agreements.

Investments whose fair value is measured at NAV are excluded from the fair value hierarchy. Investments in non-governmental entities that do not have a readily determinable fair value may be valued at NAV. Investments measured at NAV include hedge funds, private equity investments, and commingled funds. In addition, the Foundation's investments include investments in certain pools managed by the University of California (principally the GEP and STIP as discussed above). The University of California investment pools transact at share or net asset value as determined by the University of California based upon the underlying fair values of the pooled investments. Additional information on the UC investment pools can be obtained from the 2016 Annual Financial Report of the University of California.

(f) Pledges Receivable

Unconditional pledges of private gifts to the Foundation that are not endowment-related are recorded as pledges receivable and revenue in the year promised at the present value of expected cash flows. Conditional pledges, pledges of endowments, pledges to capital projects, and intentions to pledge, are recognized as receivables and revenues when the specified conditions and/or eligibility and recognition requirements, primarily time requirements, are met.

(g) Investments Held in Unitrusts and Charitable Remainder Annuity Trusts

The Foundation has been designated as the trustee for several charitable remainder trusts (the "Trusts"). The trust agreements require that the Foundation make annual payments to the trust beneficiaries. All Charitable Remainder Trust liabilities are calculated based upon the 2012-Individual Annuity Reserving (IAR) mortality table and the IRS monthly discount rate of 2.4% on June 30, 2017. Upon the death of the beneficiaries or termination of the Trusts, as defined, the remaining assets of the Trusts will become available to the Foundation, as stipulated in the trust agreements. Charitable Unitrusts are invested through an agreement with State Street Charitable Asset Management.

The Trusts are established by donors to provide income, generally for life, to designated beneficiaries. Each year, beneficiaries receive payments as specified in the trust agreement, a fixed payment (annuity trusts) or a percentage of the Trusts' fair market value (standard unitrust). The liability represents actuarially determined amounts for contractual obligations of the charitable remainder trusts.

(h) Funds Held in Trust

The Foundation has been named the irrevocable beneficiary for several charitable remainder trusts for which the Foundation is not the trustee. Upon maturity of each trust, the remainder of the trust corpus will be transferred to the Foundation.

Consistent with the Foundation's recognition policy for pledges of endowment, receivables and contribution revenue associated with these trusts are not reflected in the accompanying financial statements as the eligibility requirements have not been met. The Foundation recognizes contribution revenue when the resources are distributed to the Foundation.

(i) Properties Held for Sale

Donations of securities, real estate properties and other nonmonetary items are recorded at their fair market value at the date of gift. Real estate properties held for sale are recorded at the lower of cost or fair value.

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In April 2016, a property was gifted to the Foundation through a retained life estate. The property sold for \$1.1 million in September 2016. The net proceeds of the sale went to a Fund Functioning as an Endowment to be used for Faculty Housing Assistance.

(j) Other Deferred Gifts

Other than charitable remainder trusts, a deferred gift is recorded when a donor makes an immediate transfer of the remainder interest of an asset to the Foundation, however, the Foundation is not able to use the asset for the purposes set forth by the donor until subsequent periods. Upon the death of the donor, or as described in the agreement, the remainder interest of the asset will become contributions to the Foundation as stipulated in the agreement.

The Foundation has been notified of certain deferred gifts (intentions to give, interests in charitable annuity pools) from which it will receive assets. These deferred gifts, which are either revocable, are instances where the Foundation cannot yet meet the wishes of the donor, or are for endowment purposes, are not reflected in the accompanying financial statements.

(k) Net position

When possible, the Foundation uses restricted resources when an expense is incurred for which both restricted and unrestricted resources are available. Net position is classified as follows:

Net investment in capital assets – Invested in capital is used to account for equipment, net of accumulated depreciation.

Unrestricted– Unrestricted net positions are net positions of the Foundation that are not subject to donor-imposed restrictions.

Restricted, expendable – Net position whose use by the Foundation is subject to externally imposed restrictions that can be fulfilled by actions of the Foundation pursuant to those restrictions or that expire by the passage of time are classified as expendable net position.

Restricted, nonexpendable (endowment or otherwise permanently restricted) – Restricted net positions, nonexpendable are used to account for net position that are subject to restrictions of gift instruments requiring, in perpetuity, that the principal be invested, and permitting only a certain amount of the annual return generated by the investment to be distributed (“spending”). The spending component of restricted net position, nonexpendable is classified as restricted net position, expendable as all investment return associated with these gifts is purpose-restricted.

Restricted, nonexpendable (charitable remainder trusts) – Charitable remainder trust funds are resources acquired by the Foundation subject to an agreement whereby the assets are made available on the condition that the Foundation distribute stipulated amounts periodically to designated individuals. Payments of such amounts terminate at a time or event specific in the agreement and upon termination the principal of the remaining funds reverts to the Foundation. This category applies to trust funds when the donor has provided for the establishment of an endowment upon maturity.

(l) Classification of Revenues and Expenses

Operating revenues and expenses are distinguished from non-operating items and generally result from providing services in connection with ongoing operations and stewardship of current funds.

The principal operating revenues are derived from gifts and other fundraising activities. Operating expenses include distributions to the University and administrative expenses.

Non-operating revenues and expenses include investment income, net realized gain (loss) on the sale of investments, change in unrealized appreciation (depreciation) in the fair value of investments and change in the carrying value of charitable remainder trust obligations.

Gifts for permanent endowment purposes are classified as other changes in net position in the Statement of Revenues, Expenses and Changes in Net Position.

(m) Income Tax Status

The Foundation is an organization exempt from taxation under Section 501(c) (3) of the Internal Revenue Code and Section 23701d of the California Revenue and Taxation Code and is generally not subject to federal or state income taxes. However, the Foundation is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purpose for which it is granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the basic financial statements taken as a whole.

(n) Use of Estimates

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

(o) Split Interest Assumptions

The Regents of the University of California have legal title to annuity and life income contracts and agreements subject to life interests of beneficiaries. No significant financial benefit is now being or can be realized until the contractual obligations are released, at which time the Foundation recognizes the revenue. The costs of managing these contracts and agreements are included in unrestricted expenditures.

GASB Statement No. 81, Irrevocable Split-Interest Agreements, is effective for the Foundation's fiscal year beginning July 1, 2017. This Statement addresses when irrevocable split-interest agreements constitute an asset for accounting and financial reporting purposes when the resources are administered by a third party. The Foundation is evaluating the effect that Statement No. 81 will have on its financial statements.

The University uses the actuarial method of recording annuity and life income contracts and agreements. Under this method, when a gift is received, the present value of the aggregate annuity payable is recorded as a liability, based upon life expectancy tables, and the remainder is recorded as a contribution in the appropriate net position category. The liability account is credited with investment income and gains and is charged with investment losses and payments to beneficiaries. Periodic adjustments are made between the liability account and the net asset account for actuarial gains and losses.

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All Gift Annuity and Life Income Contracts are calculated based upon the 2012-IAR Mortality Table and the IRS monthly discount rate of 2.4% ended June 30, 2017. The minimum required reserves are derived by the University using the 2012-IAR Mortality Table that is mandated by the California Department of Insurance and a long-term total return on investments of 6% per annum for issues between January 1, 1992 and December 31, 2004. Issues from January 1, 2005 and December 31, 2016 require 4.5%.

3. Investments

The following tables summarize the investments and other assets reported at fair value within the fair value hierarchy as of June 30, 2017:

<i>(In thousands)</i>	Total	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Net Asset Value (NAV)
Equity securities	\$ 516	\$ 516	\$ -	\$ -	\$ -
Commingled funds	195,024	-	-	-	195,024
Externally held irrevocable trusts	5,011	5,011	-	-	-
Other investments	729	-	-	-	729
Total investments	\$ 201,280	\$ 5,527	\$ -	\$ -	\$ 195,753

The following tables summarize the investments and other assets reported at fair value within the fair value hierarchy as of June 30, 2016:

<i>(In thousands)</i>	Total	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Net Asset Value (NAV)
Equity securities	\$ 508	\$ 508	\$ -	\$ -	\$ -
Commingled funds	168,394	-	-	-	168,394
Externally held irrevocable trusts	4,751	4,751	-	-	-
Other investments	720	-	-	-	720
Total investments	\$ 174,373	\$ 5,259	\$ -	\$ -	\$ 169,114

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The Foundation 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 by major category for the year ending June 30, 2017 and 2016, respectively:

<i>(In thousands)</i>	Fair Value Determined Using NAV	Unfunded Commitments	Redemption terms and restrictions
Commingled Funds			
UC GEP	\$ 176,944	\$ -	Not applicable
UC STIP	13,203	-	Not applicable
Goldman Sachs	4,877	-	Not applicable
Total Commingled Funds	\$ 195,024	\$ -	
Other Investments			
Farallon	\$ 264	-	Not applicable
Lexington	465	-	Not applicable
Total Other Investments	\$ 729	\$ -	

<i>(In thousands)</i>	Fair Value Determined Using NAV	Unfunded Commitments	Redemption terms and restrictions
Commingled Funds			
UC GEP	\$ 148,873	\$ -	Not applicable
UC STIP	14,532	-	Not applicable
Goldman Sachs	4,989	-	Not applicable
Total Commingled Funds	\$ 168,394	\$ -	
Other Investments			
Farallon	\$ 257	6	Not applicable
Lexington	463	1,597	Not applicable
Total Other Investments	\$ 720	\$ 1,603	

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In 2009, the Foundation adopted the provisions contained in the Uniform Prudent Management of Institutional Funds Act (UPMIFA) in management of its endowment and similar funds. UPMIFA eliminates the concept of 'historic dollar value' and states that "the institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines to be prudent for the uses, benefits, purposes, and duration for which the endowment fund is established." Under this approach, during fiscal years 2017 and 2016 the Foundation approved an endowment payout rate of 4.5% and 4.65% respectively of the 60-month rolling average fair values of the endowment as of December 31, 2015 and 2014, respectively. To the extent that net income earned (interest and dividends reduced by investment management fees) is less than the approved endowment payout, net gains are appropriated in order to meet the approved payout rate. The payout was distributed to the University departments in September and April of the fiscal year. The actual 2017 LTIP payout distribution of \$5.8 million was \$1.4 million more than the 2016 approved payout of \$4.4 million due to new funds, a 1.4% increase in the 60-month rolling average fair value and an increase in departmental opt-ins. This amount was partially offset by the .15% decrease in the payout rate.

For the years ended June 30, 2017 and 2016, the approved endowment payout comprised the following:

	2017	2016
Investment income, net	\$ 1,002,853	\$ 1,132,768
Net gains	<u>4,838,094</u>	<u>3,289,832</u>
Approved endowment payout	<u>\$ 5,840,947</u>	<u>\$ 4,422,600</u>

As a result of previous market declines, the market value of some permanent endowments is less than the historic gift value of such endowments. Within the endowments, the amount that is below the historic gift value is approximately \$1.1 million and \$3.3 million at June 30, 2017 and 2016, respectively. At June 30, 2017 and 2016, net appreciation on donor restricted endowments of \$13.3 million and \$21.1million, respectively, is included in restricted net position in the accompanying Statements of Net Position.

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4. Cash and Investment Management

In accordance with GASB *Statement No. 40, Deposit and Investment Risk Disclosures*, (GASB 40) the Foundation's investments are reported by investment type at fair value in the composition of investments below. GASB 40 also requires the disclosure of various types of investment risks based on the type of investment, as well as stated policies adopted by the Foundation to manage those risks.

Cash and investments consist of the following as of June 30, 2017 and 2016:

	2017	2016
Cash		
Commercial banks	\$ 2,309,999	\$ 227,254
Total cash	<u>2,309,999</u>	<u>227,254</u>
Investments		
Equity securities		
Foreign	185,652	270,294
Domestic	330,524	237,229
Commingled funds		
Balanced funds	181,820,845	153,862,127
Money market funds	13,202,539	14,532,215
Externally held irrevocable trusts	5,010,858	4,751,426
Other investments	<u>729,484</u>	<u>719,622</u>
Total investments	<u>201,279,902</u>	<u>174,372,913</u>
Total cash and investments	<u>\$ 203,589,901</u>	<u>\$ 174,600,167</u>
Current assets – cash	\$ 2,309,999	\$ 227,254
Current assets – short-term investments	13,202,539	14,532,215
Noncurrent assets – investments (including assets of investments held in unitrusts and charitable remainder annuity trusts)	<u>188,077,363</u>	<u>159,840,698</u>
Total cash and investments	<u>\$ 203,589,901</u>	<u>\$ 174,600,167</u>

The Foundation deposits and maintains cash in a commercial bank to meet its operating needs and transfers the excess funds as often as necessary to its primary investment account at UCOP.

At June 30, 2015 the Foundation invested primarily in the Foundation LTIP held in custody accounts at Goldman Sachs and the UC STIP. Effective July 1, 2015 the Foundation moved the majority of its investments to the UC GEP and the UC STIP with the exception of some residual alternative investments which were either illiquid or where sale of the asset of the secondary markets would not have been beneficial to the Foundation.

The Long Term Investment Pool (LTIP) is a balanced portfolio containing equity, fixed-income and alternative investments that provide diversification and economies of scale. The primary goal is to maximize long-term total return, growth of principal, and a growing payout stream to ensure that future funding for endowment-supported activities can be maintained.

The General Endowment Pool (GEP) is a balanced portfolio containing equity and fixed-income securities that provide diversification and economies of scale. The primary goal is to maximize long-term total return, growth of principal, and a growing payout stream to ensure that future funding for endowment-supported activities can be maintained. This fund is used as the core investment vehicle for the Foundation's LTIP.

The Short Term Investment Pool (STIP) is a money market portfolio intended to allow fund participants to maximize return on their short-term cash balances by taking advantage of the economies of scale of investing in a larger pool. STIP emphasizes safety of principal and provides liquidity to meet UC campuses' cash-flow requirements. Investments authorized by The Regents for the STIP include a broad spectrum of high-quality money market and fixed-income securities with a maximum maturity of 5 ½ years. This fund is used by the Foundation as its core investment vehicle for expendable contributions.

The Foundation utilizes the following passively managed investment funds in a structure overseen and held in custody accounts at State Street Global Advisors and administered by State Street Charitable Asset Management. The standard investment vehicles for trusts includes U.S. equity funds, Non-U.S. equity, U.S. bonds, and Real Estate Investment Trusts

At the request of the trust beneficiaries, the Foundation may utilize a pre-approved set of other actively managed investment Funds. This alternative structure is also managed by State Street Global Advisors and administered by State Street Charitable Asset Management. This portfolio serves as a supplement to the passively managed core products referenced above in order to provide greater portfolio diversity. Only one trust is currently being administered in this fashion.

The investment management of all trust assets is handled by State Street Charitable Asset Management.

Change in the Fair Value of Investments

The change in the fair value of investment represents the difference between the fair value of the investments at the beginning of the fiscal year and the end of the fiscal year, taking into consideration investment purchases, sales and redemptions. The calculation of realized gains and losses on the sale of investments is independent of the calculation of the net change in the fair value of investments. Realized gains and losses on investments that had been held more than one fiscal year and sold in the current year are included as a change in the fair value of investments reported in the current year and include transactions arising from sale of contributed assets and liquidation of investment accounts during the year.

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The components of the change in fair value of investments are as follows for the fiscal years ended June 30, 2017 and 2016:

	2017	2016
Unrealized (depreciation) on investments, net	\$ 20,607,178	\$(33,364,682)
Realized gain on investments, net	<u>543,238</u>	<u>27,609,762</u>
Realized/unrealized (loss) on investments	<u>\$ 21,150,416</u>	<u>\$ (5,754,920)</u>

Investment Risk Factors

There are many factors that can affect the value of investments. Some, such as custodial risk, interest rate risk, concentration of credit risk, and foreign currency risk, may affect both equity and fixed income securities. Equity securities respond to such factors as economic conditions, individual company earnings performance, and market liquidity, while fixed income securities are particularly sensitive to credit risks and changes in interest rates. The Foundation has established investment policies for LTIP to provide the basis for the management of a prudent investment program appropriate to the particular type of investment.

(a) Credit Risk

Fixed income securities are subject to credit risk, which is the risk that a bond issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. The circumstances may arise due to a variety of factors such as financial weakness, bankruptcy, litigation and/or adverse political developments. A bond's credit quality is an assessment of the issuer's ability to pay interest on the bond, and ultimately, to pay the principal. Credit quality is evaluated by one of the independent bond rating agencies such as Moody's Investors Service or Standard & Poor's.

The lower the rating is, the greater the chance that the bond issuer will default or fail to meet its payment obligations. Generally, the lower a bond's credit rating the higher its yield should be to compensate for the additional risk.

Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have risk. The Foundation's investment in STIP is considered to be an investment in an external investment pool and is "unrated." This falls within the Foundation's *Investment Policy Guidelines*.

The credit risk profile for fixed income and comingled money market securities at June 30, 2017 and 2016 is as follows:

	2017	2016	Credit Rating
US government guaranteed	\$ 107,265	\$ 17,733	not rated
Other US dollar denominated	300	5,500	not rated
Money market funds	<u>13,202,539</u>	<u>14,532,215</u>	not rated
Total funds subject to credit risk	<u>\$ 13,310,104</u>	<u>\$ 14,555,448</u>	

(b) Custodial Credit Risk — Deposits and Investments

Custodial credit risk for deposits and investments is the risk that in the event of the failure of the custodian, the Foundation may not be able to recover the value of investment securities that are in the possession of an outside party.

The Board of Trustees of the Foundation, as the governing board, is responsible for oversight of the Foundation's investments. Pursuant to The UC Policy on Campus Foundations, the Foundation's Board of Trustees has the authority to oversee the management of its investments directly, or utilize the services and investment vehicles offered by the UC Chief Investment Officer, Goldman Sachs, and other investment firms selected by Goldman Sachs. Through June 30, 2015, the Foundation Board chose to primarily use various pooled investment vehicles managed through a contract with Goldman Sachs as its core investment for the endowment expendable funds. Effective July 1, 2015, the Foundation Board opted to move its core investment strategy to the UC Chief Investment Officer and GEP. The Foundation Board continues to use various pooled investment vehicles managed by State Street for its trusts. Although it does not have a specific policy addressing custodial risk, substantially all of the Foundation's endowment investment assets (97%) are invested with the various investment pools overseen by the UC Chief Investment Officer which complies with the risk guidelines for GEP and STIP as approved by the UC Regents. These pools are considered to be investments in external pools and are not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book entry form. Similarly, the investment accounts held at State Street Global Advisors are also externally managed pools and the assets are held in custody or trust and would not be available to State Street Global Advisor's creditors because they are excluded from the assets of the custodian and as such the custodial risk is remote.

The Foundation minimizes cash balances by sweeping available balances into investment accounts on a regular basis. The majority of the cash balance not invested is maintained in the STIP.

(c) Concentration of Credit Risk

Concentration of credit risk is the risk of loss associated with a lack of diversification of having excessive amounts invested in a few individual issuers, thereby exposing the organization to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. Securities issued or explicitly guaranteed by the U.S. government, mutual funds, external investment pools and other pooled investments are excluded from this review.

Investments in the various investment pools managed by the UC Treasurer are external investment pools and are not subject to concentration of credit risk. There is no concentration of any single individual issuer of equity or non-U.S. government fixed income securities that comprise more than five percent of total investments.

(d) Interest Rate Risk

Interest rate risk is the risk that fixed income securities will decline because of rising interest rates. The Foundation measures interest rate risk using the effective duration method. The Interest Rate Risk schedule below summarizes the average effective duration of its fixed income investments. The Foundation maintains a policy to manage interest rate risk for fixed income investments which requires, in the aggregate, the average duration of managed fixed income assets to be maintained within the range of the average duration of the current Barclays Capital US Aggregate Bond Total Return index in USD plus or minus one and one-half years. This policy does not apply to investments in the unendowed investment pool, including the STIP or other money market funds.

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The interest rate risk profile for bond and money market funds securities at June 30, 2017 and 2016 is as follows:

	2017	Effective	2016	Effective
	Fair Value	Duration	Fair Value	Duration
U.S. bond funds	\$ -	n/a	\$ -	n/a
Non-U.S. bond funds	300	0.50 years	5,500	1.45 years
Money market funds	13,202,539	1.49 years	14,532,215	1.27 years
Externally held irrevocable trusts	1,329,138	5.92 years	1,242,051	5.56 years

(e) Foreign Currency Risk

Foreign currency risk is the possibility that changes in exchange rates between the U.S. dollar and foreign currencies could adversely affect a deposit or investment's fair value. The Foundation, via its investment in the STIP, has no exposure to foreign currency risk. The Foundation's LTIP asset allocation policy includes an allocation to non-U.S. securities. The Foundation also has foreign currency exposure through its non-US equity investments managed by State Street Global Advisors and the LTIP due to the foreign-currency-denominated investments in these funds.

The components in the foreign currency risk profile as of June 30, 2017 and 2016 are as follows:

	2017	2016
Equity Securities		
Canadian Dollar	\$ 185,652	\$ 270,294
Total exposure to foreign currency risk	<u>\$ 185,652</u>	<u>\$ 270,294</u>

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5. Pledges Receivable

Included in pledges receivable at June 30, 2017 and 2016 are the following unconditional promises to give:

	2017	2016
Amount due in		
Less than one year	\$ 6,609,802	\$ 6,090,994
One to five years	11,617,069	9,814,997
Due after five years	<u>250,000</u>	<u>250,000</u>
Subtotal	<u>18,476,871</u>	<u>16,155,991</u>
Unamortized discount	(376,696)	(406,276)
Allowance for uncollectible amounts		
Current	(475,647)	(592,531)
Noncurrent	<u>(1,015,830)</u>	<u>(811,369)</u>
Total allowance	<u>(1,491,477)</u>	<u>(1,403,900)</u>
Net pledges receivable	<u>\$ 16,608,698</u>	<u>\$ 14,345,815</u>
Current pledges receivable	\$ 6,134,156	\$ 5,498,463
Noncurrent pledges receivable	<u>10,474,542</u>	<u>8,847,352</u>
Net pledges receivable	<u>\$ 16,608,698</u>	<u>\$ 14,345,815</u>

New pledges due beyond one year have been discounted at an annual rate of 1.2%, reflecting the fair value rate. Prior year pledges due beyond one year were discounted at annual rates varying between 1.2% and 4%.

6. Administration Fees

To offset a portion of the Campus' indirect costs related to the processing, accounting and expenditures of gift funds, the investment earnings on assets held in the STIP are set aside by the Foundation in a current use fund. These monies are then transferred to campus to cover a portion of the salary and benefit costs of UC employees that expend funds gifted through the Foundation to the campus. For FYE 2017 and FYE 2016, \$170,969 and \$183,989 were transferred to campus, respectively.

An annual Endowment Investment Management fee is assessed on all endowment funds and funds functioning as endowments managed by the Foundation. In both FYE 2017 and FYE 2016 this rate was 55 basis points. Endowment Investment Management fees charged by the Foundation totaled \$847,322 and \$775,931, for FYE 2017 and FYE 2016, respectively. This charge is paid out of dividend and interest earnings in LTIP. In both FYE 2017 and FYE 2016, this money was transferred to the University to cover the Foundation's investment management and accounting costs and this is reflected in the statement of revenues, expenses and changes in net position.

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On July 1, 2010, the Foundation implemented a 2% administrative fee that would be used to offset any loss of state funding. Effective July 1, 2012, the board increased this administrative fee to 6%. In FYE 2017, \$1,079,010 in fees was transferred to campus. In FYE 2016, \$1,812,969 in fees was transferred to campus.

7. Related Parties

The Foundation does not have any employees. All of the Foundation's functions and activities are conducted by employees of UC. UC employees serving Foundation functions are covered by the UC pension plan and post-retirement health care plan. In addition, the University provides facility use and maintenance, data processing, all required insurance and other services to the Foundation. The costs attributable to these services are derived based upon the direct support activities provided to the Foundation as determined by the Chief Financial Officer and totaled \$1,311,118 for FYE 2017 and \$1,371,059 for FYE 2016, respectively. These costs are covered in large part by the endowment investment management fee transfer referenced above that covers the Foundation Investment Management and Accounting staff costs, so the net portion being funded by the campus is \$463,786 for FYE 2017 and \$595,128 for FYE 2016 when controlling for this transfer of funds that supports Foundation operations.

The remaining increment is funded through the general campus budget process.

8. Subsequent Events

The Foundation has evaluated subsequent events from the net position date through September 28, 2017 the date which the financial statements were available to be issued, and identified the following events:

- In August 2017, a donor made an early release of \$200,000 from an existing Charitable Remainder Unitrust ("CRUT") where the Foundation serves as trustee.
- In August 2017, a new \$25.4 million Charitable Remainder Annuity Trust ("CRAT") was set up with the Foundation serving as trustee. This CRAT was set up with a single asset composed of a note from the UC Regents (dba UC Santa Barbara). The debt service payments on this note will cover the quarterly payments to the beneficiary and all administrative expenses of the CRAT for the twenty year duration of the CRAT. Should the donors both die prior to the twenty year duration expiring, the unpaid balance shall be forgiven.