

Consolidated Financial Statements with Report of
Independent Certified Public Accountants

San Francisco Ballet Association

June 30, 2018

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Report of Independent Certified Public Accountants

Grant Thornton LLP
101 California Street, Suite 2700
San Francisco, CA 94111

T 415.986.3900
F 415.986.3916
www.GrantThornton.com

To the Board of Trustees
San Francisco Ballet Association

We have audited the accompanying consolidated statement of financial position of the San Francisco Ballet Association (the “Ballet”) as of June 30, 2018, and the related consolidated statement of activities and changes in net assets and the consolidated statement of cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management’s responsibility

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

Auditor’s responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the San Francisco Ballet Association as of June 30, 2018, and its changes in net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating supplementary information on the 2018 consolidated statement of activities and changes in net assets is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Report on 2017 summarized comparative information

We have previously audited the Ballet's 2017 consolidated financial statements, and expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated October 18, 2017. The summarized comparative information presented herein as of and for the year ended June 30, 2017 is derived from those consolidated financial statements.

Grant Thornton LLP

San Francisco, California
October 19, 2018

San Francisco Ballet Association

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June 30, 2018

(With summarized financial information as of June 30, 2017)

(In thousands of dollars)

Consolidated statement of financial position

	<u>June 30,</u> <u>2018</u>	<u>June 30,</u> <u>2017</u>
ASSETS		
Cash and cash equivalents	\$ 10,542	\$ 11,288
Accounts receivable	219	231
Prepaid expenses and deposits	1,653	2,183
Pledges receivable, net	3,805	1,386
Receivables from split interest agreements, net	3,557	5,795
Other investments	572	683
Other assets	526	435
Restricted cash	3,947	5,877
Property and equipment, net	21,806	24,368
Endowment investments	124,398	119,021
TOTAL	<u>\$ 171,025</u>	<u>\$ 171,267</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable and accrued expenses	\$ 7,076	\$ 6,768
Current portion loans payable	1,857	1,844
Deferred compensation and postretirement benefit obligation	1,472	1,416
Deferred performance and school revenue	6,825	6,910
Gift annuity payment liability	684	1,628
Interest rate swap liability	5,015	6,419
Non-current loans payable, net	38,606	40,445
Total liabilities	<u>61,535</u>	<u>65,430</u>
NET ASSETS:		
Unrestricted	17,597	16,201
Temporarily restricted	12,914	14,670
Permanently restricted	78,979	74,966
Total net assets	<u>109,490</u>	<u>105,837</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 171,025</u>	<u>\$ 171,267</u>

See accompanying notes to consolidated financial statements.

San Francisco Ballet Association

June 30, 2018

(With summarized financial information as of June 30, 2017)

(In thousands of dollars)

Consolidated statement of activities and changes in net assets

For the year ended June 30, 2018

	Unrestricted			Total	Temporarily Restricted	Permanently Restricted	Total	For the year ended June 30, 2017
	Operating	Property	Board-Designated					
	Consolidating supplementary information							
OPERATING REVENUES:								
San Francisco performance	\$ 22,532	\$ -	\$ -	\$ 22,532	\$ -	\$ -	\$ 22,532	\$ 23,985
Touring	115	-	-	115	-	-	115	643
School and student housing, net of scholarships of \$1,342	2,456	-	-	2,456	-	-	2,456	2,283
Other income, net	484	66	2	552	-	-	552	396
Total operating revenues	25,587	66	2	25,655	-	-	25,655	27,307
OPERATING EXPENSES:								
Program services:								
Ballet production	33,635	2,406	-	36,041	-	-	36,041	32,672
Touring	117	-	-	117	-	-	117	820
School and student housing	3,228	371	-	3,599	-	-	3,599	3,193
Education and outreach	771	26	-	797	-	-	797	652
Total program services	37,751	2,803	-	40,554	-	-	40,554	37,337
Support services:								
Marketing, publicity and audience development	6,441	57	-	6,498	-	-	6,498	6,049
General and administrative	5,071	211	607	5,889	-	-	5,889	5,046
Total support services	11,512	268	607	12,387	-	-	12,387	11,095
Debt service	-	1,265	-	1,265	-	-	1,265	1,062
Total operating expenses	49,263	4,336	607	54,206	-	-	54,206	49,494
Operating revenues less operating expenses	(23,676)	(4,270)	(605)	(28,551)	-	-	(28,551)	(22,187)
SUPPORT:								
Contributions	18,145	-	239	18,384	2,798	4,259	25,441	29,261
Special events and other activities	4,521	-	-	4,521	321	-	4,842	4,454
Net assets released:								
From donor restriction	4,505	856	3,532	8,893	(8,893)	-	-	-
By appropriation	4,272	625	(4,897)	-	-	-	-	-
Total contributions in support of operations	31,443	1,481	(1,126)	31,798	(5,774)	4,259	30,283	33,715
Fundraising expenses	(2,615)	(60)	(367)	(3,042)	-	-	(3,042)	(4,114)
Fundraising expenses for special events	(1,401)	-	-	(1,401)	-	-	(1,401)	(1,332)
Costs of direct benefits to donors for special events	(627)	-	-	(627)	-	-	(627)	(502)
Support, net	26,800	1,421	(1,493)	26,728	(5,774)	4,259	25,213	27,767
CHANGE IN NET ASSETS FROM OPERATIONS	3,124	(2,849)	(2,098)	(1,823)	(5,774)	4,259	(3,338)	5,580
NON-OPERATING:								
Endowment investment income, net	-	-	2,009	2,009	4,018	104	6,131	11,811
Reclassification of Endowment gifts	-	-	350	350	-	(350)	-	-
Change in post-retirement benefit obligation	36	-	-	36	-	-	36	(31)
Net realized and unrealized gain on interest rate swap	-	824	-	824	-	-	824	1,870
INCREASE (DECREASE) IN NET ASSETS	3,160	(2,025)	261	1,396	(1,756)	4,013	3,653	19,230
NET ASSETS (DEFICIT) - Beginning of Year	7,941	(29,511)	37,771	16,201	14,670	74,966	105,837	86,607
NET ASSETS (DEFICIT) - End of Year	\$ 11,101	\$ (31,536)	\$ 38,032	\$ 17,597	\$ 12,914	\$ 78,979	\$ 109,490	\$ 105,837

See accompanying notes to consolidated financial statements.

San Francisco Ballet Association

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Year ended June 30, 2018

(With summarized financial information as of June 30, 2017)

(In thousands of dollars)

Consolidated statement of cash flows

	<u>2018</u>	<u>2017</u>
OPERATING ACTIVITIES:		
Increase in net assets	\$ 3,653	\$ 19,230
Adjustments to reconcile increase in net assets to cash (used in) operating activities:		
Permanently restricted contributions received	(5,214)	(11,023)
Depreciation	3,143	2,988
Amortization of loan issuance costs	18	18
Net realized and unrealized (gain) on investments	(1,420)	(2,755)
Limited partnership investment gains, net	(2,530)	(7,232)
Proceeds from sales of donated securities	(114)	(447)
Change in allowance for doubtful pledges receivable	171	(50)
Change in discount of pledges receivable	141	(66)
Change in fair value of the interest rate swap	(1,405)	(2,626)
Net effect of changes in:		
Accounts receivable	12	56
Prepaid expenses and deposits	530	(585)
Pledges receivable	(2,731)	1,166
Receivables from split-interest agreements	2,238	(305)
Other assets	(91)	(109)
Gift annuity payment liability	(944)	80
Deferred compensation and postretirement benefit obligation	56	142
Accounts payable and accrued expenses	323	(246)
Deferred performance and school revenue	(85)	308
Net cash used in operating activities	<u>(4,249)</u>	<u>(1,456)</u>
INVESTING ACTIVITIES:		
Purchases of endowment investments	(9,451)	(20,734)
Proceeds from sale/return of endowment investments	8,024	12,333
Increase (decrease) in operating cash in endowment portfolio	112	(23)
Decrease in restricted cash	1,930	2,520
Purchase of property and equipment	(581)	(1,040)
Net cash (used in) provided by investing activities	<u>34</u>	<u>(6,944)</u>
FINANCING ACTIVITIES:		
Proceeds from sales of donor restricted securities	114	447
Permanently restricted contributions received	5,214	11,023
Principal payments on bond payable	(1,844)	(1,831)
Principal payments on capital lease obligation	(15)	(3)
Net cash provided by financing activities	<u>3,469</u>	<u>9,636</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(746)	1,236
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>11,288</u>	<u>10,052</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 10,542</u>	<u>\$ 11,288</u>
SUPPLEMENTAL DISCLOSURES:		
Cash paid during the year for interest	<u>\$ 1,813</u>	<u>\$ 1,799</u>

See accompanying notes to consolidated financial statements.

June 30, 2018

(In thousands of dollars)

Notes to consolidated financial statements

Note 1 – Summary of significant accounting policies

Organization

San Francisco Ballet Association (the “Association”) operates both a dance company and a ballet school. As America’s oldest professional ballet company and one of the three largest ballet companies in the United States with its year-end roster of sixty-eight dancers, the Association has enjoyed a long and rich tradition of artistic “firsts” since its founding in 1933. It performed the first American productions of *Swan Lake* and *Nutcracker*, as well as the first production of *Coppélia* choreographed by an American choreographer. Guided in its early years by American dance pioneers and brothers Lew, Willam, and Harold Christensen, the Association currently presents more than 100 performances annually in San Francisco, California, and other communities in the Bay Area, as well as annual tours to domestic and international locations. San Francisco Ballet Endowment Foundation (the “Foundation”), a separate legal entity, holds the majority of the assets of the endowment for the benefit of the Association. The Association and the Foundation (collectively, the “Ballet”) are California not-for-profit corporations founded in 1933 and 1980, respectively.

Principles of consolidation

The accompanying consolidated financial statements include the statement of financial position, statement of activities and changes in net assets, and statement of cash flows of the Association and the Foundation because the Association has both control of and economic interest in the Foundation. Intercompany transactions and accounts have been eliminated in consolidation.

Basis of presentation

The accompanying consolidated financial statements are presented on the basis of unrestricted, temporarily restricted, and permanently restricted net assets.

The consolidated financial statements include certain prior-year summarized comparative information in total, but not by asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles general accepted in the United States of America (“GAAP”). Accordingly, such information should be read in conjunction with the Ballet’s consolidated financial statements for the year ended June 30, 2017, from which the summarized information was derived.

Cash and cash equivalents

Cash and cash equivalents consist of demand deposits and highly liquid investments, including certificates of deposit, with remaining maturities of three months or less.

June 30, 2018

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Pledges receivable**

Pledges receivable consist of unconditional promises to give that are expected to be collected in future years. Such receivables are recorded at the present value of their estimated future cash flows. The discount on pledges receivable pledged during the year ended June 30, 2018 utilized a risk-adjusted rate of 3.355%. For pledge receivables pledged prior to the year ended June 30, 2018, the discounts on these amounts were computed using risk-adjusted rates applicable in the years in which those promises were received ranging from 2.062% to 2.716%. Amortization of the discounts is included in contributions in the accompanying consolidated statement of activities and changes in net assets.

Receivables from split interest agreements and gift annuity payment liability

Receivables from split interest agreements represent the Ballet's irrevocable remainder interests in a pooled income fund and various trusts primarily held by third-party trustees. The pooled income fund and trusts are stated at estimated fair value, which is measured as the present value of the estimated future distributions expected to be received over the expected terms of the agreements. Trusts contributed by donors under charitable gift annuity agreements and controlled by the Ballet are recognized at estimated fair value with a corresponding liability to beneficiaries of the annuity agreements. Such liability is calculated as the present value of the estimated future cash flows to be distributed to the income beneficiaries over their expected lives. In determining the present value, the Ballet considers single or joint life expectancy for new gifts from the 2000CM Combined Healthy Mortality Table and prior gifts using the same mortality table as used in prior years, the estimated return on the invested assets during the expected term of the agreements, the contractual payment obligations under the agreements, and a discount rate reflective of current market conditions.

Other investments

Other investments consists of a fund invested in mutual funds established by a collective bargaining agreement between the American Guild of Musical Artists and the Association restricted to support dancer career transitions.

Other assets

Other assets consist of a voluntary salary deferral plan for certain highly compensated employees under Internal Revenue Code Section 457(b) (See Note 9).

Restricted cash

Restricted cash is invested in cash and cash equivalents that are held by third parties in restricted accounts in accordance with an interest rate swap agreement and requirements set forth in an agreement for collateral posting. The decrease in restricted cash during the year ended June 30, 2018, of \$1,930 relates primarily to the decrease in the interest rate swap liability.

Loan issuance costs

Loan issuance costs are being amortized over the term of the related loans payable. Costs associated with previous loan issuances are amortized in the year in which a refinancing occurs.

June 30, 2018

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Property and equipment**

Property and equipment are stated at cost. Donated property and equipment is recorded at estimated fair value at the date of receipt. The building and improvements are being depreciated on a straight-line basis over 20-40 years. Depreciation of furniture and equipment is computed on the straight-line basis over the estimated useful life of the assets, generally 3-10 years.

Fixed assets that are acquired with resources restricted for such acquisition are considered to be temporarily restricted and are released from restrictions over the estimated useful life of the asset.

Maintenance expenses and all costs for new productions, including sets, costumes, and choreography, are charged to Operating expense as incurred or in the year of initial performance with the exception of costs associated with full-length works. Full-length works are capitalized and depreciated on a straight-line basis within the Property Fund over the first two years the new works are presented. The Ballet's production of *Frankenstein* was performed in 2017 and 2018, and related assets were fully depreciated at June 30, 2018. The Ballet's production of *Nutcracker*, including the costs for sets, costumes, staging, and choreography, completed in 2005 and updated in 2007, is being depreciated on a straight-line basis over 15 years, beginning in 2005.

Endowment investments

Endowment investments consist of fixed income investments, mutual fund investments, alternative investments, real estate, and cash and cash equivalent balances restricted by donors or designated by the Association's Board of Trustees for long-term investment. Investments in fixed income investments and mutual fund investments are stated at estimated fair value. Fair value is the amount 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 (i.e., the exit price). Other investments, such as alternative investments, are also recorded at estimated fair value. The fair values of alternative investments have been estimated using the net asset value per share of the investment. Investments in real estate partnerships are based primarily on third party appraisals of the underlying real estate. Gains or losses that result from market fluctuations are recognized in the period such fluctuations occur. Dividend and interest income are recognized when earned.

Deferred compensation and postretirement benefit obligations

The Ballet's deferred compensation and postretirement benefit obligation arises from an individual contract with provisions for postretirement health benefits and salary continuance. In determining the fair value of the salary continuance, the Ballet considers the present value of expected future cash commitments. In determining the fair value of the postretirement health benefits, the Ballet considers the RP-2014 White Collar Healthy Mortality Table projected generationally with Scale MP-2016, makes assumptions about future increases in health care premiums, and employs a discount rate based on the Citigroup Pension Discount Curve. Due to uncertainties inherent in the estimation process, it is possible that future events in either the near or long term could materially affect the amounts reported in the consolidated statement of financial position.

June 30, 2018

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Deferred performance and school revenue**

Deferred performance and school revenue as of June 30, 2018 primarily consists of advance ticket sales for performances scheduled in the Ballet's 2019 repertory season, which opens in January 2019 as well as advance tuition payments for school classes to be conducted in the year ending June 30, 2019.

Derivative instruments

Derivative financial instruments are used by the Ballet on a limited basis to manage interest rate risk associated with its tax-exempt loans. Derivative financial instruments, which for the Ballet consist of one interest rate swap agreement discussed further in Note 7, are recorded at their fair market value in the liabilities section in the accompanying consolidated statement of financial position. Changes in the underlying value of derivative financial instruments are recorded in net realized and unrealized loss on interest rate swap agreement in the accompanying consolidated statement of activities and changes in net assets. The Ballet does not enter into derivative contracts for the purpose of speculation.

Unrestricted net assets

Unrestricted net assets are available to support all activities of the Ballet and are not subject to donor-imposed stipulations:

Property — The Property fund represents funds raised through loan fundraising or allocated by the Board of Trustees to acquire long-lived assets which include property and equipment assets. Assets and/or liabilities related to loan financing and derivative agreements are also included within this fund. Depreciation, amortization and debt-related activity associated with long-lived assets, loan financing and derivative agreements are incurred within the fund, including realized and unrealized gains and losses on the Ballet's interest swap agreements. Depreciation and facilities related expenses are allocated to both program and support services using the Ballet's functional expense allocation methodology as disclosed below.

Board-Designated — The Board-Designated fund represents funds designated by the Association's Board of Trustees to function as part of the endowment pool of investments. An annual allocation of funds based on 5% of the Ballet's endowment funds' average fair value over the prior twelve quarters as of June 30, preceding the fiscal year in which the distribution is planned, is made by the Foundation's Board of Directors (see Note 10). This allocation is reflected as net assets released for appropriation within Support. General and administrative support services are comprised of the operating costs of the endowment funds and bad debt expense. The Board of Trustees can approve the movement of funds from board-designated funds to other unrestricted funds in accordance with their policies and procedures.

Operating — The Operating fund represents the core operating activity of the Ballet. Revenues and expenses from performances, touring, school and student housing are earned/incurred within the operating fund.

June 30, 2018

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Temporarily restricted net assets**

Temporarily restricted net assets represent contributions whose use is limited by donor-imposed stipulations that expire by the passage of time or can be fulfilled and removed by actions of the Ballet pursuant to those stipulations. Temporarily restricted net assets also include accumulated appreciation of permanently restricted endowment funds that have not been appropriated by the Board in accordance with the California Uniform Prudent Management of Institutional Funds Act of 2008 (“UPMIFA”).

Permanently restricted net assets

Permanently restricted net assets represent contributions whose use is limited by donor-imposed stipulations that require the gift to be invested in perpetuity. The income from such invested assets, including realized and unrealized gains, is generally available to support the activities of the Ballet. Donors may also restrict all or part of the income and/or appreciation from these investments to permanently restricted net assets, resulting in increases/decreases to these net assets.

Other income

Other income is presented net of costs of approximately \$772 relating to sales and rentals for the year ended June 30, 2018.

Revenue recognition

All contributions are recognized as revenue when received or unconditionally promised to the Ballet. The Ballet classifies gifts of cash and other assets as temporarily or permanently restricted support if received with donor stipulations that limit the use of the contributions. When such restrictions expire, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restrictions. Temporarily restricted contributions are reported as unrestricted support when the restriction is met in the same period as the contribution is received or when appropriated for expenditure by the Board. Conditional promises to give are not recognized as revenue until the conditions are substantially met. Investments received as gifts are initially recorded at estimated fair value at the date of donation. The Ballet’s irrevocable interest in split interest agreements is recognized as revenue at the time such agreements are made known to the Ballet.

Contribution of services

Contributions of services are recognized when received if such services (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not donated. During the year ended June 30, 2018, the value of contributed services recognized as revenues and expenses in the accompanying consolidated financial statements was \$2,081 and consisted primarily of \$1,752 in donated advertising services and \$329 for special events and other activities. In addition, a substantial number of volunteers have donated significant amounts of time in the Ballet’s program services and fundraising activities through participation in the Auxiliary, Encore!, Allegro Circle, and BRAVO (Ballet Resource and Volunteer Organization). The value of donated volunteer services has not been recognized in the accompanying consolidated financial statements because such volunteer services do not meet the criteria described above.

June 30, 2018

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Functional expense allocations**

Expenses applicable to more than one activity, such as facilities-related depreciation, supplies, travel, personnel, and occupancy costs, are allocated among program services and support services on the basis of usage and management estimates.

Estimated fair value of financial instruments

The Ballet's financial instruments include cash, cash equivalents, investments, split-interest agreements, real estate, and a swap agreement. For cash and cash equivalents, the carrying amounts approximate fair value because of the short maturity of these items. The swap agreement is reflected at its estimated fair value using the methodology described in Note 7.

The Ballet adopted guidance, which defines fair value, establishes a framework for measuring fair value, and requires enhanced disclosures about fair value measurements. This guidance also allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value ("NAV") per share or its equivalent.

Enhanced disclosures about financial instruments that are measured and reported at fair value are required under the guidance. A fair value hierarchy has been established which prioritizes and ranks the level of market price observability used in measuring fair value. Market price observability is impacted by a number of factors, including the type of instrument, the characteristics specific to the instrument, and the state of the marketplace (including the existence and transparency of transactions between market participants). Instruments with readily available actively quoted prices, or for which fair value can be measured from actively quoted prices in an orderly market will generally have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Instruments measured and reported at fair value are classified and disclosed in one of the following categories based on inputs:

Level 1 — Quoted prices are available in active markets for identical instruments as of the reporting date. The types of instruments which would generally be included in Level 1 include listed equity securities and fixed income mutual funds. The Ballet, to the extent that it holds such instruments, does not adjust the quoted price for these instruments, even in situations where the Ballet holds a large position and a sale could reasonably impact the quoted price.

Level 2 — Pricing inputs are observable for the instruments, either directly or indirectly, as of the reporting date, but are other than quoted prices in active markets as in Level 1. Fair value is determined through observable trading activity reported at net asset value or through the use of models or other valuation methodologies. The types of instruments which would generally be included in this category include unlisted derivative financial instruments and alternative investments for which an exit price has been observed.

June 30, 2018

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)

Estimated fair value of financial instruments, continued

Level 3 — Pricing inputs are unobservable for the instrument and include situations where there is little, if any, market activity for the instrument. The inputs into the determination of fair value require significant judgment or estimation by the Ballet. The types of instruments which would generally be included in this category include split interest agreements, real estate, and limited partnerships with designated investments, lock up periods or gates extending more than three months beyond the statement of financial position date.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the determination of which category within the fair value hierarchy is appropriate for any given instrument is based on the lowest level of input that is significant to the fair value measurement. The Ballet's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the instrument.

See Note 3 for fair value measurement disclosures.

Concentrations of credit risk

Financial instruments that potentially subject the Ballet to credit risk consist primarily of cash, cash equivalents, accounts and pledges receivable, and endowment investments. The Ballet maintains cash and cash equivalents with major financial institutions. During the year ended June 30, 2018, such amounts have exceeded Federal Deposit Insurance Corporation ("FDIC") limits. The Ballet's endowment investments have been placed with a major custodian, First Republic Trust Company. The Ballet closely monitors these endowment investments and its accounts and pledges receivable and has not experienced significant credit losses. As of June 30, 2018, the following endowment investments equal or exceed 5% of the fair market value of total endowment investments:

Dodge & Cox Income Fund	13%
Dodge & Cox Global Stock Fund	7%
Dreyfus US Government Fund	7%
Generation IM Global Equity Fund	6%
Advisors Inner Circle Sands Global Fund	6%
250 Post Street LLP	6%
Cevian Capital II Ltd.	6%
D & C Osterweis Strategic Income Fund	6%
Abrams Capital Partners II, L.P. Fund	5%
Canyon Value Realization Fund	5%
Bracebridge LTD	5%
Aurelius Capital International Ltd.	5%

June 30, 2018

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Income tax status**

The Ballet follows guidance that clarifies the accounting for uncertainty in tax positions taken or expected to be taken in a tax return, including issues relating to financial statement recognition and measurement. This guidance provides that the tax effects from an uncertain tax position can only be recognized in the financial statements if the position is “more-likely-than-not” to be sustained if the position were to be challenged by a taxing authority. The assessment of the tax position is based solely on the technical merits of the position, without regard to the likelihood that the tax position may be challenged.

The Association and the Foundation are exempt from federal income tax under IRC section 501(c)(3) of the Internal Revenue Code, though it is subject to tax on income unrelated to its exempt purpose, unless that income is otherwise excluded by the Code. The Association and the Foundation are also exempt from California franchise taxes under Revenue and Taxation Code Section 23701d on its income other than unrelated business income. The Ballet has processes presently in place to ensure the maintenance of its tax-exempt status; to identify and report unrelated income; to determine its filing and tax obligations in jurisdictions for which it was nexus; and to identify and evaluate other matters that may be considered tax positions. The Ballet has determined that there are no material uncertain tax positions that require recognition or disclosure in the financial statements. Tax penalties and interest of \$1 are classified as tax expense for the year ended June 30, 2018.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. As disclosed above, estimates are used for, but not limited to, accounts and pledges receivable valuation, split interest agreement receivables and liabilities valuation, depreciable lives of property and equipment, fair value of endowment investments, postretirement benefits liabilities, and fair value of the loan and swap agreements and the related credit valuation adjustments. Actual results could differ from those estimates.

New accounting pronouncements

In June 2018, the FASB issued ASU 2018-08 – *Not-for-Profit Entities (Topic 958): Clarifying 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 amendments in the update are effective for fiscal periods beginning after June 15, 2018. The Ballet is currently evaluating the impact of this pronouncement on its financial statements.

June 30, 2018

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)

New accounting pronouncements, continued

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02 – *Leases (Topic 842)*. The amendments in this update will supersede much of the existing authoritative guidance for leases. This guidance requires lessees, among other things, to recognize right-of-use assets and liabilities on their statement of financial position for all leases with lease terms longer than twelve months. The amendments in the update are effective for fiscal years beginning after December 15, 2019 with early application permitted. The Ballet is currently evaluating the impact of this pronouncement on its financial statements.

In August 2016, the FASB issued ASU 2016-14 – *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The amendments in this update make improvements to the information provided in financial statements and accompanying notes of not-for-profit entities. The amendments set forth the FASB’s improvements to net asset classification requirements and the information presented about a not-for-profit entity’s liquidity, financial performance, and cash flows. The amendments in the update are effective for annual financial statements issued for fiscal years beginning after December 15, 2017 with early application permitted. Amendments should be applied on a retrospective basis in the year the update is first applied. The Ballet plans to apply these changes to its FY19 financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance is effective for fiscal years beginning after December 15, 2017. The Ballet is evaluating the impact this update will have on its financial statements.

Note 2 – Pledges receivable

Pledges receivable as of June 30, 2018 are due as follows:

	As of June 30, 2018
2019	\$ 3,370
2020	332
2021	300
2022	250
Total pledges receivable	<u>4,252</u>
Less allowance for doubtful pledges receivable	(259)
Less discount for amounts expected to be collected after June 30, 2018	(188)
Pledges receivable, net	<u>\$ 3,805</u>

At June 30, 2018, pledges receivable included pledges of \$2,419 from members of the Association’s Board of Trustees and the Foundation’s Board of Directors (see Note 14).

June 30, 2018

(In thousands of dollars)

Note 3 – Fair value measurements

As of June 30, 2018, the Ballet's investments are classified by levels within the valuation hierarchy as follows:

	Level 1	Level 2	Level 3	Total
Assets				
Assets held for and in split interest agreements				
Mutual funds				
Fixed income-government	\$ 308	\$ -	\$ -	\$ 308
Fixed income-US	54	-	-	54
Fixed income-global	98	-	-	98
Equity-US	368	-	-	368
Equity-global	167	-	-	167
Complementary strategies	70	-	-	70
Real Assets	35	-	-	35
Beneficial interest in charitable remainder trusts	-	-	2,233	2,233
Total assets held for and in from split interest agreements, net	<u>1,100</u>	<u>-</u>	<u>2,233</u>	<u>3,333</u>
Other Investments:				
Money market funds	\$ 93	\$ -	\$ -	\$ 93
Mutual funds				
Fixed income-government	234	-	-	234
Fixed income-other	245	-	-	245
Cash in Transit	-	-	-	-
Total other investments	<u>\$ 572</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 572</u>
Endowment Investments:				
Money market funds	\$ 4,129	\$ -	\$ -	\$ 4,129
Fixed income securities				
US Government agencies	385	430	-	815
Government bonds and notes	-	3,102	-	3,102
Corporate bonds	4,001	534	-	4,535
Foreign income securities	-	195	-	195
Mutual funds				
Fixed income	22,978	-	-	22,978
Equity-US	4,610	-	-	4,610
Equity-global	19,422	-	-	19,422
Subtotal investments	<u>\$ 55,525</u>	<u>\$ 4,261</u>	<u>\$ -</u>	<u>\$ 59,786</u>
Alternative investments				
Real estate partnership fund	\$ -	\$ -	\$ 7,471	\$ 7,471
Valued at NAV				
Credit strategies hedge fund	-	-	-	3,530
Event-driven hedge fund	-	-	-	12,593
Multi-strategy hedge fund	-	-	-	6,520
Long-biased hedge fund	-	-	-	28,220
Relative value hedge fund	-	-	-	6,278
Alternative investments valued at NAV	<u>-</u>	<u>-</u>	<u>7,471</u>	<u>64,612</u>
Total endowment investments				<u>124,398</u>
Total Assets				<u>\$ 128,303</u>
Total Liability				
Interest rate swap	\$ -	\$ 5,015	\$ -	\$ 5,015
Total liability	<u>\$ -</u>	<u>\$ 5,015</u>	<u>\$ -</u>	<u>\$ 5,015</u>

June 30, 2018

(In thousands of dollars)

Note 3 – Fair value measurements (continued)

For the year ended June 30, 2018, the changes in investments classified as Level 3 are as follows:

Level 3 rollforward	Real estate	Split interest agreements	Total
Balance- Beginning of year	\$ 7,426	\$ 2,011	\$ 9,437
Change in discount	-	222	222
Partnership unrealized gain	45	-	45
Balance- End of year	\$ 7,471	\$ 2,233	\$ 9,704

Changes in unrealized gains including investment returns relating to instruments that are classified as Level 3 still held as of June 30, 2018 are \$266.

The following schedules discusses the nature and risks of alternative investments which calculate net asset value per share or its equivalent and whether those investments are probable of being sold at amounts different from net asset value per share:

Alternative investments schedule	Fair value	Unfunded commitments	Redemption period	Redemption notice period
Event-driven (a)	\$ 6,132	-	Semi-annually	65 days
Multi-strategy (b)	6,443	-	Quarterly	60 days
Multi-strategy (c)	77	-	Anniversary annually	65 days
Relative Value (d)	6,278	-	Anniversary annually	60 days
Special Situations (e)	6,461	-	Annually	90 days
Real Estate (f)	7,471	-	n/a	n/a
Long-Only/Long-Biased (g)	5,103	-	Annually	90 days
Long-Only/Long-Biased (h)	6,904	-	Annually	90 days
Long-biased (i)	3,943	-	Annually	120 days
Long-Only/Long-Biased (j)	4,244	-	Monthly	30 days
Long-Only/Long-Biased (k)	8,026	-	Quarterly	30 days
Credit Strategies (l)	3,530	-	n/a	n/a
	\$ 64,612			

- a) This is an investment in a hedge fund focusing on perceived distressed and event-driven situations with definable catalysts, including stressed and distressed credits, equity transactions, litigation, and capital structure arbitrage. Value drivers typically revolve around legal and/or accounting issues at a given company. The fund has a diversified portfolio with moderate concentration, and distressed investments typically comprise approximately 50% of total exposure. The fund may contain some activist positions and is primarily invested in domestic companies. The fair value of the investment in this category has been estimated using the net asset value per share of the investment. The lock-up period expired on March 2015. The fund has a 10% side pocket allowance and a 30% fund-level gate restriction on available capital. Redemption requires a 65-day notification.

June 30, 2018

(In thousands of dollars)

Note 3 – Fair value measurements (continued)

- b) This is an investment in a hedge fund that seeks to generate stable, predictable returns with a low correlation to the broader debt and equity markets. The fund attempts to capitalize on perceived market inefficiencies surrounding areas like complex capital structures, businesses in transition or orphaned equities by calculating intrinsic value according to three fundamental criteria: creditworthiness, value creation and optionality. The fund will pursue this value investment strategy in primarily domestic situations in distressed debt, bank loans, high yield bonds, direct investment, turnaround equities, convertible arbitrage, and risk arbitrage. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The fund does not have a lock up period. The fund has a 100% side pocket allowance and a 25% gate restriction on available capital. Redemption requires a 60-day notification.
- c) This is an investment in a hedge fund that employs a multi-strategy approach to capture perceived inefficiencies in public and private market situations. The fund's focus is on event-oriented investing, credit/distress debt, capital structure arbitrage and equity derivatives. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. Additionally, the fund manager may impose a gate restriction on redemption at their discretion which could limit the Ballet's ability to liquidate its full investment in the fund. On March 23, 2017, the investment manager decided to return capital to shareholders and wind down operations. The fund has currently returned approximately 99% of total year-end capital.
- d) This is an investment in a hedge fund that seeks to generate consistent above-average return with limited systemic market risk. To achieve these returns, the fund seeks arbitrage opportunities in volatility, mortgage security, yield curve, intramarket bond and cash bond/future. The fund will also employ leverage to enhance return. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The last lock-up period for this investment expired March 2015. The fund has a 20% side pocket allowance, but no gate restrictions. Redemption requires a 60-day notification.
- e) This is an investment in a hedge fund that seeks to invest in equities perceived to be undervalued, event-driven securities and distressed securities. The strategy is value driven and pursues opportunities in inefficient markets where estimated intrinsic value exceeds the market price of the securities. The fair value of the investment has been estimated using the net asset value per share of the investments. The investment had a 25-month lock-up period expiring January 31, 2014. The fund has a 25% side pocket allowance, but no gate restrictions. Redemption requires a 90-day notification.
- f) This class includes a restricted interest in a limited partnership. The underlying asset of the partnership is the fair value of the retail building located on 250 Post Street in the city of San Francisco. The building is approximately 33,000 square feet and was appraised at \$86,000 in August of 2016 with a mortgage obligation balance of \$1,063 at June 30, 2018. San Francisco Ballet's interest is approximately 8.8% with fair market value of \$7,471 at June 30, 2018.

June 30, 2018

(In thousands of dollars)

Note 3 – Fair value measurements (continued)

- g) This is an investment in a long-biased hedge fund that seeks to invest in domestic U.S. equities. It has an activist-oriented investment strategy based on small- and mid-cap companies perceived to be undervalued. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The investment has a one-year lock-up period expiring December 2018 for \$1,333 of the foundation's investment and a three-year lock-up period expiring December 2019 for \$2,667 of the foundation's investment. The fund has a 10% side pocket allowance but no gate restrictions and redemption requires 90-day notification.
- h) This is an investment in a hedge fund that seeks significant appreciation by investing in companies perceived to be undervalued. Their strategy is long-biased, focusing on equities in Northern Europe. They constructively work with management teams and identify situations that have the potential to double in value over a three-year period. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The investment has a rolling three-year lock-up period which expires September 2019. The fund has a 40% side pocket allowance and a 20% fund-level gate restriction based on available capital.
- i) This pooled vehicle is long-biased and invests in equity, absolute return, and hybrid strategies that invest across the globe. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The investment has a three-year lock-up period that expired on December 31, 2017. The fund has a no gate or side pocket restrictions.
- j) This is an investment in a hedge fund that is long-only and seeks to invest in undervalued emerging market equities. Investments are generally made in companies with market caps greater than \$5,000. The fund holds its positions for an average of four to five years and seeks a minimum of 50% upside over two to three years. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The fund has a no gate or side pocket restrictions. Redemption requires a 30-day notification.
- k) This is an investment in a hedge fund that is long-only and seeks to integrate sustainability research with rigorous fundamental equity analysis. This fund specifically seeks investments in companies with management teams who recognize that economic, social, environmental, and political issues can affect business opportunities and risks. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The investment has a three-year lock-up period, which expires September 30, 2018 for the foundation's initial \$4,000 investment and December 31, 2019 for the foundation's additional \$1,000 investment. The fund has a 25% fund-level gate restriction based on available capital and no side pocket allowance. Redemption requires 30-day notice.

June 30, 2018

(In thousands of dollars)

Note 3 – Fair value measurements (continued)

- l) This investment primarily invests in the most subordinated tranches of commercial mortgage-backed securitizations. The fund plans to hold its investments for a long duration. The investment term of the fund is 12 years, subject to two consecutive one-year extensions. The fund has no gate or side pocket restrictions.

The quantitative information about significant unobservable inputs related to Level 3 alternative investments in real estate used at June 30, 2018 is as follows:

	Fair value	Valuation techniques	Unobservable inputs	Assumptions
Commercial real estate	\$ 7,471	Income capitalization	Terminal cap rate	5.50%
			Rent growth rate	3.00%

Note 4 – Property and equipment

The Ballet's property and equipment as of June 30, 2018 is as follows:

	As of June 30, 2018
Land	\$ 4,519
Buildings and improvements	34,591
Furniture and equipment	8,453
Capitalized sets and costumes	16,230
Construction in progress	47
Total property and equipment	63,840
Accumulated depreciation	(42,034)
Property and equipment, net	\$ 21,806

The Property fund on the accompanying consolidated statement of activities and changes in net assets includes the following types of depreciation expense on the Ballet productions line: \$589 allocated occupancy; \$1,526 sets and costumes; and \$291 other, primarily stage and theatrical equipment.

June 30, 2018**(In thousands of dollars)****Note 5 – Credit facilities**

The Ballet has a line of credit with First Republic Bank of \$5,500, which together with an outstanding undrawn standby letter of credit of \$300 to support its workers' compensation insurance policies (see Note 8), is secured by certain investment securities in the Foundation's portfolio and are subject to a collective limit of 85% of the market value of those securities. At June 30, 2018, that limit would not have further constrained the Ballet's secured line of credit limit. Interest on the secured line of credit is charged at the greater of the prime rate, minus 0.25% or 4%. The Ballet had no outstanding borrowings under the secured line of credit as of June 30, 2018. The secured line of credit expires on November 30, 2018, and will automatically renew for a one-year period on that date subject to the approval of the bank.

Note 6 – Loans payable

On June 6, 2013, the Ballet borrowed \$44,510 in four tax-exempt series: \$12,000 California Infrastructure and Economic Development Bank ("CIEDB") Revenue Loans Series 2013A (San Francisco Ballet Association), \$11,000 each in CIEDB Variable Rate Revenue Loans Series 2013B and 2013C (San Francisco Ballet Association), and \$10,510 CIEDB Revenue Loans Series 2013D (San Francisco Ballet Association) (collectively, \$44,510 and the "Series 2013 Loan"). First Republic Bank entered into an Assignment Agreement with CIEDB, whereby the First Republic Bank agreed to purchase CIEDB's rights in connection with the issuance of the Series 2013 Loans. The Ballet and First Republic Bank entered into a Master Loan Agreement governing the private placement.

Proceeds from the Series 2013 Loans were used to refinance the Ballet's existing indebtedness (the Series 2010 and Series 2008 Bonds) and to fund costs of issuance of the Series 2013 Loans. In connection with the Series 2013 Loans, the Ballet has agreed that it will not obtain additional financing in excess of \$250 from any lender other than First Republic Bank.

The Ballet's tax-exempt debt was originally issued for the renovation of the Ballet's headquarters building, the purchase and renovation of a warehouse and a student residence, certain technology hardware upgrades, construction of ballet sets and costumes, new theatrical equipment, the payment of interest and fees, and certain loan issuances costs.

The interest rate on the Series 2013A Loans is fixed at 3.45%. The interest rates on the Series 2013B, 2013C, and 2-13D loans reset at a LIBOR-based floating rate plus a spread. The Ballet had the option, which ultimately expired without being exercised, to convert Series 2013B, 2013C or 2013D to a fixed rate prior to July 1, 2016.

All four series had interest-only payments through and including the payment due on June 1, 2016, at which time payments due include both interest and payable.

June 30, 2018

(In thousands of dollars)

Note 6 - Loans payable (continued)

The following is a summary of each series outstanding as of June 30, 2018:

Issue name	Amount issued	Final maturity	Interest rate	Amount outstanding
Series 2013A	\$ 12,000	August 1, 2038	3.45%	\$ 11,257
Series 2013B	11,000	August 1, 2038	3.25%	10,008
Series 2013C	11,000	August 1, 2038	3.25%	10,008
Series 2013D	10,510	August 1, 2038	3.25%	9,562
Total	<u>\$ 44,510</u>			<u>40,835</u>
Loan issuance costs, net				(372)
Total loans payable, net				<u>\$ 40,463</u>

The Series 2013 Loans are secured by a continuing security interest in the Association's right, title and interest in personal property as defined in the Security Agreement with CIEDB, and are guaranteed by the Foundation, as defined in the Guaranty Agreement between the Foundation, First Republic Bank and CIEDB.

As guarantor, the Foundation guarantees the due and punctual payment of any and all amounts due pursuant to the Master Loan Agreement relating to the Series 2013 Loans among First Republic Bank, CIEDB and the Ballet.

Interest payments are payable and due on the first of each month. Interest expense related to loans payable for the year ended June 30, 2018 was approximately \$1,246. In connection with the Master Loan Agreement with First Republic Bank for the Series 2013 Loans, the Ballet was required to be and was in compliance with certain financial covenants as of June 30, 2018.

Principal amounts are due as follows:

	Series				
	2013A	2013B	2013C	2013D	Total
2019	\$ 391	496	496	474	\$ 1,857
2020	404	496	496	474	1,870
2021	420	496	496	474	1,886
2022	436	496	496	474	1,902
2023	450	496	496	474	1,916
Thereafter	9,161	7,526	7,526	7,191	31,404
	<u>\$ 11,262</u>	<u>\$ 10,006</u>	<u>\$ 10,006</u>	<u>\$ 9,561</u>	<u>\$ 40,835</u>

June 30, 2018

(In thousands of dollars)

Note 7 – Interest rate swap agreement

The Ballet utilizes an interest rate swap agreement to mitigate the risk of changes in interest rates associated with variable interest rate indebtedness. Under the terms of the agreement, the Ballet pays a fixed rate of 3.92% to the swap counterparty in exchange for a variable rate of 68.50% of 1-month LIBOR on the notional amount. The swap agreement does not qualify as a cash flow hedge, and as a result, changes in the fair value of the interest rate swap agreement during a period are recognized immediately in change in unrestricted net assets. The fair value of the interest rate swap agreement is based on quotes from the market makers and, therefore, is classified as Level 2 in the fair value hierarchy as shown in Note 3.

The fair value of the swap agreement is estimated based on mid-market rates and industry standard valuation models. A credit risk spread (in basis points) is added as a flat spread to the discount curve used in the valuation model. Each leg is discounted and the difference between the present value of each leg's cash flows equals the market value of the swap. The fair value also considers the risk of each counterparty by including a "credit valuation adjustment" determined by taking into account the nonperformance risk of each counterparty to the swap. The estimated fair value of the swap agreement was \$5,015 as of June 30, 2018, including a credit valuation adjustment of \$65, which reduced the Ballet's liability, and is included in the interest rate swap liability in the accompanying consolidated statement of financial position. Payments made to the counterparty of the swap agreement for interest were approximately \$582 during the year ended June 30, 2018. The swap agreement contains certain collateral requirements based on the credit rating of the Ballet and the current fair market value of the swap agreement. During the year ended June 30, 2018, the Ballet was required to post collateral on the swap agreement with \$3,947 posted as of June 30, 2018, and is included in restricted cash in the accompanying consolidated statement of financial position.

In August 2011, the Board of Directors of the Foundation agreed to loan the Association a portion of the Foundation's unrestricted board-designated endowment investments to assist in meeting such collateral postings. As of June 30, 2018, the loan has been paid in full.

The following table shows the outstanding notional amount of derivative instruments measured at fair value as reported in the consolidated statement of financial position as of June 30, 2018:

	Statement of financial position location	Maturity date of derivative	Notional fixed rate	Amount outstanding	Fair value
Interest rate swap	Liability under interest rate swap agreement	July 1, 2036	3.92%	\$ 22,000	\$ 5,015

June 30, 2018

(In thousands of dollars)

Note 7 – Interest rate swap agreement (continued)

Amounts reflected in the change in value of the interest rate swap agreement for the year ended June 30, 2018 was as follows:

Statements of activities and changes in net assets location		Realized and unrealized gain
	Non-operating:	
Interest rate swap agreement	Net realized and unrealized losses on interest rate swap agreements	\$ 824

Note 8 – Workers' compensation

The Ballet's workers' compensation insurance policies include self-insured retention limits and fully insured coverage above such limits. Accruals for claims under the Ballet's self-insured retention limits are recorded on a claim-incurred basis. The estimated liability for workers' compensation claims incurred but unpaid as of June 30, 2018, \$2,432 is included in accounts payable and accrued expenses in the accompanying consolidated statement of financial position. As of June 30, 2018, the Ballet had unused letters of credit totaling \$2,500 as required by the Ballet's insurance carriers.

Note 9 – Postretirement and health and welfare plans

The Ballet has a defined contribution retirement plan that covers all eligible nonunion employees and includes a 401(k) component.

Substantially all theatrical employees are covered under collective bargaining agreements that require payments to multiemployer pension, health, and welfare plans. Contributions to these plans approximated \$2,136 for the year ended June 30, 2018.

The Ballet has an agreement with a key employee to provide postretirement salary continuance and employee and spousal health benefits for a fixed period of time dependent on the number of years served under the agreement and on the absence of certain types of postretirement employment and benefits available to the employee. The fair value of the salary continuance of \$723 has been calculated based on the net present value of the expected payments. The total present value as of June 30, 2018, of the future health benefits, or the expected postretirement benefit obligation for health, is approximately \$249. The accumulated postretirement benefit obligation of the future health benefits, as of June 30, 2018, is \$249. The income for the year ended June 30, 2018, for future health benefits is \$3.

June 30, 2018

(In thousands of dollars)

Note 9 – Postretirement and health and welfare plans (continued)

The following table sets forth the health benefits agreement’s obligations, fair value of plan assets, and status as of June 30, 2018, which liability is included in the consolidated statement of financial position.

	As of June 30, 2018	
Benefit obligation	\$	249
Fair value of plan assets		-
Unfunded status – end of year	<u>\$</u>	<u>249</u>

Amounts recognized for health benefits in unrestricted net assets consist of unrecognized prior service costs of \$249 as of June 30, 2018. The periodic net benefit income for the year ended June 30, 2018 was \$3. The weighted-average assumption used to determine benefit obligations as of June 30, 2018 was 3.77%.

Assumed health care trend rates have significant effect on the amounts reported for health care premiums. A 1% change in assumed health care cost trend rates would have the following effects:

	1% Increase		1% Decrease	
Effect of the health care component on:				
Accumulated postretirement benefit obligation	\$	15	\$	(14)
Service cost and interest cost for fiscal year 2018		1		(1)
Total	<u>\$</u>	<u>16</u>	<u>\$</u>	<u>(15)</u>

For measurement purposes, a 7.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year ended June 30, 2018. This annual rate is based on market conditions for similar benefits and was assumed to decrease gradually to 5% through the year ending June 30, 2020 and remain at that level thereafter.

No benefits are expected to be paid from the postretirement benefit plan in the year ending June 30, 2019. The aggregate benefits expected to be paid in the seven years from 2018 to 2023 are approximately \$162. The expected benefits are based on the same assumptions used to measure the Ballet’s benefit obligation as of June 30, 2018 and include future employee service.

The Ballet also has a voluntary salary deferral plan for highly compensated employees under Internal Revenue Code Section 457(b). Eligible employees may elect to contribute to the plan and the Ballet may make qualified non-elective discretionary contributions. Matching contributions were made during the year ended June 30, 2018.

June 30, 2018

(In thousands of dollars)

Note 9 – Postretirement and health and welfare plans (continued)

Multiemployer pension plans

The Ballet contributes to several multiemployer defined benefit pension plans under the terms of collective bargaining agreements that cover certain union-represented employees. The Ballet’s collective bargaining agreements do not require that a minimum contribution be made to these plans. As of June 30, 2018, the Ballet contributed to union trust and charged to expense \$1,522.

The risks of participating in multiemployer pension plans are different from single employer pension plans in the following aspects:

- a) Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.
- b) If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.

If the Ballet stops participating in its multiemployer pension plan, the Ballet may be required to pay the plan an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

The Ballet’s participation in these plans for the year ended June 30, 2018 is outlined in the table below. All information in the table is as of June 30, 2018. The “EIN-PN” column provides the Employer Identification Number (“EIN”) and the Plan Number (“PN”). The Pension Protection Act (“PPA”) zone status is based on information that the Ballet received from the plan. Among other factors, generally, plans in critical status (“red”, respectively) are less than 65% funded, and plans at least 80% funded are said to be in the “green zone”. The “FIP/RP status pending/implemented” column indicates plans for which a funding improvement plan (FIP) or a rehabilitation plan (“RP”) is either pending or has been implemented by the trustees of each plan. Information related to the impact of utilization of extended amortization periods on zone status is either not available or not obtainable without undue cost and effort.

June 30, 2018

(In thousands of dollars)

Note 9 – Postretirement and health and welfare plans (continued)

Multiemployer pension plans, continued

Pension fund	EIN - PN	Expiration Date	Pension protection act zone status	Are the Company's contributions more than 5% of Total Plan Contributions as of Plan year –per Form 550	Pending / Implemented	Plan's year end	Ballet contribution as of plan year end	Surcharge on plan?	Total Plan Contributions	5% Contributions? Calculated per FE-use Form 5500
The AGMA Retirement Plan	13-3826401 - Plan No. 001	6/30/2021	Green	Yes	N/A	8/31/2017	\$ 263	No	\$ 4,730	6%
American Federation of Musicians and Employer's Pension Fund and Subsidiary	51-6120204 - Plan No. 001	11/30/2020	Yellow	No	Implemented	3/31/2017	710	Yes	66,977	1%
I.A.T.S.E. Local 16 Pension Plan	94-6296420 - Plan No. 001	6/30/2020	Green	No	N/A	12/31/2016	397	No	10,729	4%
I.A.T.S.E. Local 16 Pension Plan	94-6296420 - Plan No. 001	6/30/2021	Green	No	N/A	12/31/2016	19	No	10,729	0%
I.A.T.S.E. National Pension Fund	13-1849172 - Plan No. 001	7/31/2020	Green	No	N/A	12/31/2016	39	No	26,063	0%
I.A.T.S.E. National Pension Fund	13-1849172 - Plan No. 001	8/31/2022	Green	No	N/A	12/31/2016	39	No	26,063	0%

Note 10 – Endowment

The Ballet's endowment consists of over 200 individual funds established for a variety of purposes including both donor-restricted endowment funds and funds designated by the Board to function as endowments or Board-designated endowment funds.

The endowment consists of the following components: (a) permanently restricted investments, which represent the historic dollar value of contributions restricted by donors for permanent investment, (b) earnings on permanently restricted investments that are also permanently restricted, (c) temporarily restricted investments whose earnings have been restricted by donors for specific purposes or have not yet been appropriated for expenditure by the Board, and (d) unrestricted endowment investments, which represent funds directed for investment in the endowment by the Board, losses on underwater donor-restricted investments, and the expenses associated with raising and managing the endowment funds. The Ballet's endowment investments represent the Ballet's complete endowment fund. Pledge receivables and trust receivables are excluded from the Ballet's endowment until received.

The Ballet has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Ballet classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Ballet in a manner consistent with the standard of prudence prescribed by UPMIFA.

June 30, 2018

(In thousands of dollars)

Note 10 – Endowment (continued)

In accordance with UPMIFA, the Ballet considers the following factors in making a determination to appropriate or accumulate endowment funds :

- a) The duration and preservation of the fund
- b) The purposes of the Ballet and the donor-restricted portion of the endowment fund
- c) General economic conditions
- d) The possible effect of inflation and deflation
- e) The expected total return from income and appreciation of investments
- f) Other resources of the Ballet
- g) The investment policies of the fund

Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions. Certain Board-designated endowment funds have donor restrictions on the appropriation of the earnings generated by the fund. The principal of such gifts is considered Board-designated and the accumulated earnings are considered donor-restricted.

Endowment net asset composition by type of fund as of June 30, 2018 consists of the following:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted endowment funds	\$ (3,944)	\$ 7,303	\$ 75,776	\$ 79,135
Board-designated endowment funds	45,044	-	-	45,044
Total funds	<u>\$ 41,100</u>	<u>\$ 7,303</u>	<u>\$ 75,776</u>	<u>\$ 124,179</u>

June 30, 2018

(In thousands of dollars)

Note 10 – Endowment (continued)

Changes in endowment by net asset class for the year ended June 30, 2018 are as follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment assets, beginning of year	\$ 41,877	\$ 6,700	\$ 70,471	\$ 119,048
Investment return:				
Investment return - investment income	878	1,130	172	2,180
Net realized and unrealized appreciation	618	2,889	444	3,951
Total investment return	1,496	4,019	616	6,131
Additions to endowment funds from contributions and pledge payments	639	-	5,202	5,841
Reclassifications of Board-designated endowments	1,025	-	-	1,025
Appropriation of endowment assets for expenditure	(3,937)	(3,416)	(513)	(7,866)
Endowment assets, end of year	\$ 41,100	\$ 7,303	\$ 75,776	\$ 124,179

Totals differ from total Endowment Investments on pages 5 and 17 by approximately \$219 as they do not reflect contributions yet to be transferred from the Association to the Foundation.

Description of amounts classified as permanently restricted net assets and temporarily restricted net assets at June 30, 2018 (endowment only) are as follows:

Permanently restricted net assets

(1) The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA	\$ 75,776
Total endowment funds classified as permanently restricted net assets	<u>\$ 75,776</u>

Temporarily restricted net assets

(1) The portion of perpetual endowment funds subject to a time restriction under UPMIFA:	
Without purpose restrictions	\$ 2,537
With purpose restrictions	4,766
Total endowment funds classified as temporarily restricted net assets	<u>\$ 7,303</u>

From time to time, the fair value of assets associated with individual donor endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. Deficits associated with funds functioning as endowments, when they exist, are likewise classified as a reduction of unrestricted net assets. Deficits reported in unrestricted net assets were \$(3,944) as of June 30, 2018. These deficits resulted from unfavorable market fluctuations and continued appropriation for certain programs and expenditures that were deemed prudent. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets.

June 30, 2018

(In thousands of dollars)

Note 10 – Endowment (continued)**Return objectives and risk parameters**

The Ballet has adopted endowment investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Endowment assets include those assets of donor-restricted funds that the Ballet must hold in perpetuity or for a donor-specified period as well as the Board-Designated fund. Endowment assets are invested in a manner that is intended to produce results that exceed the total return of a benchmark composed of 60% of the MSCI All Country World Index (ACWI), and 40% of the Barclays U.S. Aggregate Bond Index, while assuming a moderate level of investment risk. The Ballet expects its endowment funds, over a complete market cycle, to provide an average annual real rate of return of approximately 5% annually. Actual returns in any given year may vary from this amount.

Strategies employed for achieving investment objectives

To achieve its long-term rate of return objectives, the Ballet relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). The Ballet targets a diversified asset allocation that places greater emphasis on investments in cash and fixed income, equities, real estate, and alternative investment strategies in a 15-40-10-35 percentage ratio, with discretion to make tactical adjustments to those ratios, to achieve its long-term objectives within prudent risk constraints.

Relationship of spending policy to investment objectives

The Ballet has a policy of appropriating for distribution each year up to a maximum of 5% of its endowment funds' average fair value over the prior twelve quarters as of June 30, preceding the fiscal year in which the distribution is planned. In establishing this policy, the Ballet considered the expected return on its endowment. Accordingly, the Ballet expects the current spending policy to allow its endowment to maintain its purchasing power by growing at a rate equal to or greater than planned payouts, plus inflation over a complete market cycle. Additional real growth will be provided through new gifts and investment returns in excess of appropriations. Depending upon market conditions and the needs and available resources of the Association, appropriations for expenditure from individual endowments may be temporarily suspended to facilitate preservation of the endowment.

June 30, 2018

(In thousands of dollars)

Note 11- Temporarily restricted net assets and net assets released from restrictions

As of June 30, 2018, temporarily restricted net assets were available for the following purposes:

New Ballet production	\$	4,392
Ballet school support		2,856
Accumulated appreciation of endowment funds not appropriated for expenditure		2,549
Property and equipment		806
Passage of time, including unpaid pledges		772
Touring		321
Special events		192
Education and outreach		944
Miscellaneous		83
Total temporarily restricted net assets	\$	<u>12,914</u>

Temporarily restricted net assets released during the year ended June 30, 2018 were as follows:

For use in ensuing fiscal years/due to expiration of time	\$	1,758
Property and equipment		894
Accumulated appreciation of endowment funds appropriated for expenditure		1,847
Unpaid Pledges		116
New Ballet production		2,909
Touring		236
Ballet school support		530
Education and outreach		133
Special events		416
Artistic and production		54
Total temporarily restricted net assets released	\$	<u>8,893</u>

Note 12 - Lease commitments

The Ballet rents performance space, office space, office equipment, and event venues under various operating leases. The following is a schedule of approximate future minimum rental payments required under the leases as of June 30, 2018, that have an initial noncancelable lease term in excess of one year:

	Year ending June 30,	
2019	\$	111
2020		86
2021		72
Total	\$	<u>269</u>

Rent expense from operating leases approximated \$881 for the year ended June 30, 2018.

June 30, 2018**(In thousands of dollars)****Note 13 – Collective bargaining agreements**

Approximately 73% (574 employees) of the Ballet's employees are covered by collective bargaining agreements. There are no agreements expiring within twelve months of June 30, 2018.

Note 14 – Related parties

As of June 30, 2018, undiscounted pledges receivable include approximately \$2,419 due from members of the Association's Board of Trustees and of the Foundation's Board of Directors.

A fixed income mutual fund managed by a member of the Association's Board of Trustees and the Foundation's Board of Directors' investment management company was valued at \$6,869 as of June 30, 2018. A member of the Association's Board of Trustees is the Chairman and Founding Chief Executive Officer of the bank with which the Association has its operating accounts, credit facilities and loans payable, First Republic Bank, of the Foundation's investment custodian, First Republic Trust Company and of the Association's investment broker, First Republic Securities.

A member of the Foundation's Board of Directors sits on a committee of the investment manager, which oversees the fixed income investment strategy, monitoring implementation of that strategy, and overseeing the research process for two of the Ballet's mutual fund holdings. This member is also a partner and shareholder of an investment firm that manages one of the Ballet's global equity holdings. The collective value of the Ballet's investments in the mutual funds and global stock fund was \$27,205 at June 30, 2018.

These transactions were subject to customary arrangements regarding fees and, for the limited partnership, allocation of investment gains.

Note 15 – Contingencies

The Ballet is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Ballet's financial position, or its changes in net assets.

Note 16 – Subsequent events

The Ballet evaluated subsequent events through October 19, 2018, the date on which the consolidated financial statements were issued and determined there were none to report.