

Financial Statements and Report of Independent
Certified Public Accountants

Duquesne University of the Holy Spirit

June 30, 2018 and 2017

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Report of Independent Certified Public Accountants

To the Board of Directors of
Duquesne University of the Holy Spirit:

Report on the financial statements

We have audited the accompanying financial statements of Duquesne University of the Holy Spirit (the "University"), which comprise the statements of financial position as of June 30, 2018 and 2017, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these 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 the auditor's 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, the auditor considers internal control relevant to the University'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 University's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 Duquesne University of the Holy Spirit as of June 30, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Philadelphia, Pennsylvania

October 9, 2018

Statements of Financial Position

June 30, 2018 and 2017

(in thousands)

	2018	2017
Assets		
Cash and cash equivalents	\$ 22,897	\$ 16,192
Accounts receivable - net	9,332	8,452
Pledges receivable - net	14,978	7,548
Deferred charges and other assets	5,839	5,887
Loans receivable - net	12,221	13,478
Investments	385,218	320,511
Property, plant, and equipment - net	283,238	306,728
Assets in escrow related to debt service and construction	11,909	3,731
Total assets	\$ 745,632	\$ 682,527
Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued expenses	\$ 28,857	\$ 25,640
Annuities payable	326	349
Deferred revenues and deposits	23,908	14,050
Accumulated postretirement benefits	7,970	8,341
Agency funds	1,033	932
Debt and lease obligations	167,309	157,180
Liabilities associated with investments	3,850	5,132
Conditional asset retirement obligations	3,373	4,489
Federal loan funds	12,605	12,452
Total liabilities	249,231	228,565
Net Assets		
Unrestricted net assets	303,432	284,417
Temporarily restricted net assets	77,987	61,968
Permanently restricted net assets	114,982	107,577
Total net assets	496,401	453,962
Total liabilities and net assets	\$ 745,632	\$ 682,527

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

Statement of Activities

Year ended June 30, 2018

(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenues				
Tuition and fees - net of financial aid of \$114,901	\$ 212,897	\$ -	\$ -	\$ 212,897
Auxiliary enterprises - net of financial aid of \$11,590	38,391	-	-	38,391
Grants and contracts	3,224	9,336	-	12,560
Gifts and pledges	2,157	14,862	-	17,019
Endowment earnings distributed for operations	4,542	5,935	-	10,477
Working capital earnings distributed for operations	1,729	-	-	1,729
Investment income	691	25	-	716
Gain from the sale of property, plant, and equipment	5,602	-	-	5,602
Other	5,005	-	-	5,005
Net assets released from restrictions	20,814	(20,814)	-	-
Total operating revenues	295,052	9,344	-	304,396
Operating expenses				
Instructional	119,525	-	-	119,525
Institutional support	52,140	-	-	52,140
Auxiliary enterprises	40,411	-	-	40,411
Academic support	39,935	-	-	39,935
Student services	17,151	-	-	17,151
Public service	5,686	-	-	5,686
Research	8,355	-	-	8,355
Total operating expenses	283,203	-	-	283,203
Excess of operating revenues over operating expenses	11,849	9,344	-	21,193
Nonoperating revenues and expenses				
Gifts and pledges	13	124	7,354	7,491
Return on investments	13,424	12,436	79	25,939
Endowment earnings distributed for operations	(4,542)	(5,935)	-	(10,477)
Working capital earnings distributed for operations	(1,729)	-	-	(1,729)
Net assets released from restrictions	-	50	(50)	-
Other	-	-	22	22
Net nonoperating revenues and expenses	7,166	6,675	7,405	21,246
Change in net assets	19,015	16,019	7,405	42,439
Net assets - beginning of year	284,417	61,968	107,577	453,962
Net assets - end of year	\$ 303,432	\$ 77,987	\$ 114,982	\$ 496,401

The accompanying notes are an integral part of this financial statement.

Statement of Activities

Year ended June 30, 2017

(in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenues				
Tuition and fees - net of financial aid of \$109,424	\$ 207,410	\$ -	\$ -	\$ 207,410
Auxiliary enterprises - net of financial aid of \$5,988	42,263	-	-	42,263
Grants and contracts	3,264	8,536	-	11,800
Gifts and pledges	174	6,935	-	7,109
Endowment earnings distributed for operations	5,225	6,013	-	11,238
Working capital earnings distributed for operations	1,870	-	-	1,870
Investment income	387	-	-	387
Other	5,383	-	-	5,383
Net assets released from restrictions	20,135	(20,135)	-	-
Total operating revenues	286,111	1,349	-	287,460
Operating expenses				
Instructional	118,428	-	-	118,428
Institutional support	48,377	-	-	48,377
Auxiliary enterprises	39,415	-	-	39,415
Academic support	40,619	-	-	40,619
Student services	16,786	-	-	16,786
Public service	5,956	-	-	5,956
Research	8,834	-	-	8,834
Total operating expenses	278,415	-	-	278,415
Excess of operating revenues over operating expenses	7,696	1,349	-	9,045
Nonoperating revenues and expenses				
Gifts and pledges	64	875	5,765	6,704
Return on investments	18,413	16,827	127	35,367
Endowment earnings distributed for operations	(5,225)	(6,013)	-	(11,238)
Working capital earnings distributed for operations	(1,870)	-	-	(1,870)
Costs associated with separation agreements	(1,062)	-	-	(1,062)
Net assets released from restrictions	-	150	(150)	-
Other	-	-	16	16
Net nonoperating revenues and expenses	10,320	11,839	5,758	27,917
Change in net assets	18,016	13,188	5,758	36,962
Net assets - beginning of year	266,401	48,780	101,819	417,000
Net assets - end of year	\$ 284,417	\$ 61,968	\$ 107,577	\$ 453,962

The accompanying notes are an integral part of this financial statement.

Statements of Cash Flows

Years ended June 30, 2018 and 2017

(in thousands)

	2018	2017
Cash flows from operating activities		
Change in net assets	\$ 42,439	\$ 36,962
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	20,651	22,375
Realized and unrealized gains on investments	(24,107)	(31,880)
Gifts restricted for long-term purposes	(17,070)	(10,720)
Provision for doubtful accounts	710	398
Gain on disposal of property, plant, and equipment	(5,638)	(20)
Changes in operating assets and liabilities:		
(Increase) decrease in receivables	(366)	191
Decrease (increase) in deferred charges and other assets	48	(1,159)
Increase (decrease) in accounts payable and accrued liabilities	3,014	(3,931)
Increase in annuities payable	61	37
Increase in deferred revenues and deposits	9,858	643
Increase in agency funds	101	201
Increase (decrease) in conditional asset retirement obligations	45	(509)
Net cash provided by operating activities	29,746	12,588
Cash flows from investing activities		
Purchases of investments	(112,967)	(196,021)
Proceeds from the sale/redemption of investments	72,367	199,867
Change in liability associated with investments	(1,282)	(1,123)
Deposits with trustee for construction	(20,032)	-
Withdrawals from trustee for construction	10,874	-
Deposits of funds held in escrow related to debt service	(142)	(556)
Withdrawals of funds held in escrow related to debt service	1,122	1,549
Receipt of federal loan funds	741	432
Payments of federal loan funds and annuities payable	(672)	(583)
Proceeds from the sale of property	24,939	-
Expenditures for land, buildings, and equipment	(20,126)	(21,108)
Net cash used in investing activities	(45,178)	(17,543)
Cash flows from financing activities:		
Proceeds from the issuance of new debt	20,032	-
Repayments of long-term borrowings	(7,568)	(7,475)
Collection of gifts restricted for long-term purposes	9,673	9,685
Net cash provided by financing activities	22,137	2,210
Increase (decrease) in cash and cash equivalents	6,705	(2,745)
Cash and cash equivalents - beginning of year	16,192	18,937
Cash and cash equivalents - end of year	\$ 22,897	\$ 16,192
Supplemental disclosures		
In-kind gifts consisting of contributed services	\$ 593	\$ 658
Interest paid	\$ 6,537	\$ 6,711
Capital lease obligations incurred	\$ 173	\$ -
Accounts payable related to construction in process	\$ 2,077	\$ 2,246

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

Notes to Financial Statements

June 30, 2018 and 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

1. Organization

Duquesne University of the Holy Spirit (the “University”) is a private, Catholic university, organized as a tax-exempt, nonprofit corporation. The University’s principal sources of revenue include student tuition and fees, auxiliary revenues, grants, and gifts.

2. Basis of Presentation

The financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Net assets, revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed stipulations. Accordingly, net assets of the University and changes therein are classified and reported as follows:

Unrestricted Net Assets - Net assets that are not subject to donor-imposed stipulations.

Temporarily Restricted Net Assets - Net assets subject to donor-imposed stipulations that may or will be met either by actions of the University and/or the passage of time.

Permanently Restricted Net Assets - Net assets subject to donor-imposed stipulations or by law that they be maintained permanently by the University. Generally, the donors of these assets permit the University to use all or part of the income earned on related investments for general or specific purposes.

3. Taxes

The University has been determined to be exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code of 1986. As a result, no provision for taxes has been made in the accompanying financial statements.

The University adopted guidance for uncertainty in income taxes, which provides criteria for the recognition and measurement of uncertain tax positions. This guidance requires that an uncertain tax position should be recognized only if it is “more likely than not” that the position is sustainable based on its technical merits. Recognizable tax positions should then be measured to determine the amount of benefit recognized in the financial statements. The University files U.S. federal, state, and local income tax returns, and no returns are currently under examination. The University continues to evaluate its tax positions pursuant to the principles of such guidance and has determined that there is no material impact on the University’s financial statements.

4. Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

5. Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with original maturities of less than three months. Cash equivalents are stated at cost, which approximates fair value.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - Continued

6. Concentration of Credit Risk

The University maintains cash and cash equivalent balances with banking institutions and brokerage companies. At June 30, 2018, the amounts on deposit at the banking institutions and the amounts on deposit at the brokerage companies exceeded the amounts that would be covered by the Federal Deposit Insurance Corporation (“FDIC”) and the Securities Investor Protection Corporation (“SIPC”), respectively. In management’s opinion, the amounts in excess of FDIC and SIPC limits do not pose significant risk to the University.

7. Risks and Uncertainties

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

8. Pledges Receivable

Pledges receivable from fund-raising campaigns are recorded by the University when the unconditional promise to give (pledge) is made and are recorded at fair value using a discount rate commensurate with the risks associated with the pledge.

The allowance for doubtful accounts on pledges receivable is based upon management’s judgement, including such factors as prior collection history and type of receivable. The University writes off receivables when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

9. Property, Plant, and Equipment

Property, plant, and equipment are stated at cost at the date of acquisition or fair value at the date of donation in the case of gifts. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets. The following table shows the estimated useful lives of property, plant, and equipment:

Land improvements	10 years
Buildings	40 years
Building improvements	10 - 40 years
Furniture and equipment	5 - 10 years

The University reviews its property, plant, and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. No impairment charges were recorded by the University in 2018 or 2017.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - Continued

10. Deferred Revenues and Deposits

Deferred revenues and deposits represent revenues currently received for programs or activities to be conducted primarily in the next fiscal year, such as summer and fall tuition and fees and room and board. Also included in deposits are commitment deposits received from certain vendors to be recognized as income over the lives of the related agreements. Also included in deferred revenue are funds received related to certain refundable grants. These amounts will be recognized as income as the funds are expended in accordance with the underlying terms of the grants.

11. Liabilities Associated with Investments

The University also invests capital on behalf of a religious entity that shares the University's Catholic ministry and educational missions. Accordingly, the University reports an equal asset and liability in the statements of financial position representing the fair value of investments managed on behalf of the entity.

12. Gifts and Grants

The University reports gifts and grants of cash and other assets as temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (i.e., when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

The University reports gifts of land, buildings, and equipment as unrestricted support, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as temporarily restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the University reports expirations of donor restrictions when donated assets are placed in service or long-lived assets are constructed.

13. Investments and Investment Income

In accordance with guidance on accounting for certain investments held by not-for-profit organizations, investments are recorded at fair value.

Interest income, unrealized gains and losses on investments, and realized gains and losses from the sale of investments are accounted for in the statements of activities in the net asset classification that holds the investments, except for income and gains and losses derived from investments of endowment and funds functioning as endowment, which are accounted for in the net asset classification designated by the donor or by law.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - Continued

Investments in marketable securities, including mutual funds, are recorded at their fair values, which are based primarily on quoted market prices as of the last business day of the fiscal year. The University holds certain investments in other funds for which the underlying assets are investments in publicly traded securities for which fair values are readily determinable. The University also holds other investments without readily determinable fair values, such as hedge funds and private equity funds. Hedge funds are actively managed funds that tend to employ more aggressive investing strategies than traditional mutual funds. Most hedge funds are established as private limited partnerships whose offering memorandum allows the fund to take risks using speculative investment strategies, including short selling, options, and the use of leverage. Private equity funds have underlying assets that are nonmarketable equities or equity-like securities. Investments without readily determinable fair values are carried at fair value as of June 30, 2018 and 2017, based on estimates developed by the management of the investment entities investing the funds. These valuations include assumptions and methods that are reviewed by University management. The University believes that the carrying amount of its investments without a readily determinable fair value is a reasonable estimate of fair value as of June 30, 2018 and 2017. As the estimated value is subject to uncertainty, the reported value may differ from the value that would have been used had a ready market existed.

14. Federal Student Loan Program

The University administers and contributes a portion of the total funds available for various student loan programs, including Perkins, Nursing, Health Profession, and Nursing Faculty Loans. The loan programs are financed primarily by the U.S. government. Loans are made to qualified students and are reported as loans receivable - net in the statements of financial position. Upon termination of the programs, the amounts representing net government advances (federal loan funds), which are reflected as a liability of approximately \$12.6 million and \$12.5 million at June 30, 2018 and 2017, will be returned to the government.

15. Fair Value

The estimated fair value of all financial instruments has been determined using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in developing fair value estimates. Accordingly, the estimates included herein are not necessarily indicative of amounts the University could realize in current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on estimated fair value amounts. The fair value of annuities payable and long-term debt (excluding lease obligations) as of June 30, 2018 and 2017, was approximately \$0.3 million and \$167.5 million and \$0.4 million and \$159.2 million, respectively, and is classified as Level 2 in the fair value hierarchy. All other financial instruments, other than investments as discussed above, are recorded at historical cost, which approximates fair value.

16. Guarantees and Commitments

In the ordinary course of business, the University enters into contracts with third parties pursuant to which the third parties provide services on behalf of the University. In many of the contracts, the University agrees to indemnify the third-party service provider under certain circumstances. The terms of the indemnity vary from contract to contract, and the amount of the indemnification liability, if any, cannot be determined. The University also has minimum purchase requirements related to certain utility contracts that have been met annually through June 30, 2018. The University anticipates meeting these minimum purchase requirements in future years.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - Continued

Pursuant to its bylaws, the University provides indemnification to directors, officers, and, in some cases, employees and agents against certain liabilities incurred as a result of their service on behalf of or at the request of the University and also advance on behalf of covered individual costs incurred in defending against certain claims, if any, subject to written undertakings by each such individual to repay all amounts so advanced if it is ultimately determined that the individual is not entitled to indemnification.

17. Insurance Liabilities

The University is self-insured through an agreement with third-party providers to provide medical coverage for all full-time University employees. A liability for estimated incurred but unreported claims has been recorded at June 30, 2018 and 2017, based upon a third-party evaluation of claims and management's analysis of past claims history. The third-party evaluation of claims includes assumptions and methods that were reviewed by University management.

The University is also self-insured for certain other activities, principally workers' compensation. Liabilities have been established based on third-party estimates using the University's historical loss experience. The self-insurance accrual is subject to periodic adjustment by the University based on actual loss experience factors.

18. Nonoperating Activities

Nonoperating activities include gifts and pledges related to endowments and funds functioning as endowments, bequests, annuity and permanently restricted loan activity, and return on investments less amounts distributed. They also include nonrecurring items such as costs associated with separation agreements.

19. Reclassifications

Certain accounts in the prior year statement of financial position have been reclassified to conform to the current year presentation. These reclassifications had no impact on total assets, total liabilities or total net assets.

20. Recently Issued Accounting Pronouncements

Accounting Standards Update ("ASU") No. 2014-09, *Revenue (Topic 606): Revenue from Contracts with Customers*, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts, whether or not written, with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of ASU 2014-09 is that an entity should recognize revenue when it transfers promised 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 by applying five steps listed in the guidance. ASU 2014-09 also requires disclosure of both quantitative and qualitative information that enables users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from customers. The new guidance is effective for fiscal years beginning after December 15, 2017. Entities have the option of using either a full retrospective or a modified retrospective approach. Early adoption is permitted. The University has not yet determined the effect the adoption of ASU 2014-09 may have on the financial statements.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - Continued

ASU 2016-02, *Leases*, requires that most leased assets be recognized on the balance sheet as assets and liabilities for the rights and obligations created by these leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. Early application is permitted. An entity is required to apply the amendments in ASU 2016-02 under the modified retrospective transition approach. This approach includes a number of optional practical expedients, which are described in the final standard. Under these practical expedients, an organization will continue to account for leases that commence before the effective date in accordance with current U.S. GAAP, unless the lease is modified. However, lessees are required to recognize on the balance sheet leased assets and liabilities for operating leases at each reporting date. The University has not yet determined the effect the adoption of ASU 2016-02 may have on the financial statements.

ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, intends to make certain improvements to the current reporting requirements for not-for-profit entities including: (1) the presentation for two classes of net assets at the end of the period, rather than the currently required three classes, as well as the annual change in each of the two classes; (2) the removal of the requirement to present or disclose the indirect method (reconciliation) when using the direct method for the statement of cash flows; and (3) the requirement to provide various enhanced disclosures relating to various not-for-profit specific topics. The new standard is effective for annual financial statements beginning after December 15, 2017. The University is evaluating the pronouncement at this time.

ASU No. 2018-08, *Not-for-profit Entities: Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, intends to clarify and improve the scope and accounting guidance for contributions received and contributions made. The amendment provides (1) a framework for determining whether a transaction should be accounted for as a contribution or as an exchange transaction, including how to evaluate whether a resource provider is receiving commensurate value in an exchange transaction, and (2) guidance to assist entities in determining whether a contribution is either conditional or unconditional. Guidance applies to both recipients and resource providers. For contributions received, the new standard is effective for annual financial statements beginning after June 15, 2018. For transactions in which the University serves as resource provider, the new standard is effective for annual financial statements beginning after December 15, 2018. The University has not determined the impact of the new standard at this time.

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE B - INVESTMENTS

A summary of the University's investments measured at fair value at June 30, 2018 and 2017, based on level within the fair value hierarchy, is as follows (in thousands):

	<u>2018</u>	<u>2017</u>
<u>Level 1 - Quoted Prices in Active Markets</u>		
Equity securities - all cap	\$ 1,939	\$ 1,633
Mutual funds:		
Money market	34,018	11,247
Large cap	66,927	68,546
Small cap	11,523	10,020
Global and international	23,550	22,142
Fixed income and bond	-	19,992
Other	<u>6,547</u>	<u>4,155</u>
	<u>144,504</u>	<u>137,735</u>
<u>Level 2 - Significant Observable Inputs</u>		
Debt securities issued by U.S. Treasury and other U.S. agencies	12,018	6,071
Debt issued by foreign governments	14	14
Corporate debt securities	8,947	8,376
Asset-backed securities	<u>272</u>	<u>315</u>
	<u>21,251</u>	<u>14,776</u>
Total investments measured at fair value	165,755	152,511
Investments measured at net asset value	<u>219,463</u>	<u>168,000</u>
Total investment assets	<u>\$ 385,218</u>	<u>\$ 320,511</u>

Investments reflected in the statements of financial position as of June 30, 2018 and 2017, are summarized as follows (in thousands):

	<u>2018</u>	<u>2017</u>
Endowment and funds functioning as endowment	\$ 305,750	\$ 269,716
Long-term working capital	67,748	39,362
Investments managed for others	3,850	5,132
Annuities	4,186	3,840
Deferred compensation and other	<u>3,684</u>	<u>2,461</u>
Total	<u>\$ 385,218</u>	<u>\$ 320,511</u>

As of June 30, 2018 and 2017, there were no significant concentrations of investments as no individual investment exceeded 10% of total assets.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE B - INVESTMENTS - Continued

In determining fair value, the University uses various approaches, including Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 820, *Fair Value Measurements*, which establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing an asset based on market data obtained from sources independent of the organization. Unobservable inputs reflect an organization’s estimates about the assumptions market participants would use in pricing an asset and are developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the observability of inputs as follows:

- Level 1 Valuations based on quoted market prices in active markets for identical assets that the organization has the ability to access. As valuations are based on quoted market prices that are readily available in an active market, valuations of these products do not entail a significant degree of judgment.
- Level 2 Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.
- Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The University also reports under the FASB update for *Investments in Certain Entities that Calculate Net Asset Value (NAV) per Share (or its Equivalent)*, which permits, as a practical expedient, the University to measure the fair value of an investment that is within the scope of the update on the basis of the net asset value per share of the investment or its equivalent determined as of the University’s fiscal year end. Under this approach, certain attributes for the investment, such as restrictions and transaction prices from principal-to-principal or brokered transactions, are not considered in measuring the fair value of an investment.

The availability of observable inputs can vary from instrument to instrument and is affected by a wide variety of factors, including, for example, the liquidity of markets and other characteristics particular to the transaction. To the extent that a valuation is based on models or inputs that are less observable in the market, the determination of fair value requires more judgment.

The University uses prices and inputs that are current as of the measurement date, which are obtained through multiple third-party custodians from independent pricing services.

Descriptions of the valuation techniques applied to the major categories of investments measured at fair value are outlined below.

The fair value of common, preferred, and foreign stocks and exchange-traded notes is valued using quoted market prices in active markets. Such actively traded securities are categorized in Level 1 of the fair value hierarchy.

Mutual funds are open-ended Securities and Exchange Commission (“SEC”) registered funds with daily quoted market prices. The mutual funds allow investors to sell their interests to the fund at the published daily quoted market prices, with no restrictions on redemptions. These mutual funds are categorized in Level 1 of the fair value hierarchy.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE B - INVESTMENTS - Continued

Government securities, government agency securities, corporate fixed-income securities, and asset-backed mortgage securities, including residential mortgage-backed securities and commercial mortgage-backed securities, are categorized in Level 2 of the fair value hierarchy as the fair value is based on multiple sources of information, which may include market data and/or quoted market prices from either markets that are not active or are for the same or similar assets in active markets.

Limited liability partnerships are partnerships created and administered by a general partner who invests either directly in a specified investment strategy or indirectly through other limited liability partnerships in so called "fund of funds." The underlying investments of these funds can be actively traded securities in the case of certain hedge fund strategies or illiquid and privately held equity investment, as in the case of private equity investments. The partnership documents outline the terms and conditions by which the general partner administers the partnership and its investments. Each limited partner owns a specified share of the partnership. These partnerships cannot be marketed to the public and are restricted, by regulation, to qualified investors. The underlying investments of these partnerships include many different types of investments, including interest rate swaps, commercial paper, foreign currency, private equity, short-term interest in common stock, and convertible bonds. The valuation of the partnership interest typically is performed at least quarterly by the general partner through unaudited statements and validated through annual audited financial statements. In certain partnerships, the readily available data on market values allows for monthly valuation of the partnership interest. As such, the fair value of these partnerships is measured using the net asset value as calculated by the custodian.

There has been no significant change in valuation techniques of investments during the year.

Interest, dividends, and realized and unrealized gains - net, are included as a component of both operating and nonoperating items.

Investment income at June 30, 2018 and 2017, exclusive of earnings on idle receipts, escrow funds, and other deposits with trustees, consisted of the following (in thousands):

	2018	2017
Interest and dividends	\$ 1,856	\$ 3,487
Realized gains on marketable securities - net	3,803	17,593
Unrealized gains on marketable securities - net	<u>20,304</u>	<u>14,287</u>
Total	<u>\$ 25,963</u>	<u>\$ 35,367</u>

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE B - INVESTMENTS - Continued

Description	Fair Value at June 30, 2018	Fair Value at June 30, 2017	Unfunded Commitment at June 30, 2018	Redemption Terms	Redemption Restrictions
Hedge funds:					
Deflation hedging	\$ 14	\$ 704	\$ -	Currently in process of redemption	None
Diversifiers - hedge funds	4,593	8,542	-	Biennial anniversary with 90-day notice	None
Diversifiers - hedge funds	5,925	5,668	-	Quarterly with 90-day notice	None
Diversifiers - hedge funds	5,542	3,662	-	Quarterly with 90-day written notice	Two-year lock-up
Diversifiers - hedge funds	5,562	4,314	-	Anniversary - annually with 60-day written notice	None
Diversifiers - hedge funds	5,382	4,274	-	Monthly with 3-day notice	None
Diversifiers - hedge funds	4,821	5,063	-	Anniversary - semi-annually with 60-day written notice	Two-year soft lock with a 5% redemption fee during lock-up
Diversifiers - hedge funds	4,655	4,235	-	Quarterly with 90-day written notice	One-year soft lock with a 6% redemption fee in the first year
Diversifiers - hedge funds	5,593	-	-	25% per calendar quarter with 90-day notice	13-month hard lock, 12-month soft lock with a 4% fee during the soft lock
Diversifiers - hedge funds	5,580	-	-	Annually with 90-day notice	None
Diversifiers - hedge funds	5,398	-	-	Quarterly with 45-day notice	12-month soft lock-up
Diversifiers - hedge funds	5,381	-	-	Monthly with 5-business-day notice	None
Diversifiers - hedge funds	5,000	-	-	Every 36 months with 60-day notice	12-month soft lock-up
Diversifiers - hedge funds	4,840	-	-	Annually with 90-day notice	24-month hard lock-up
Emerging markets	12,218	11,292	-	Monthly with 10-day written notice	None
Emerging markets	6,000	-	-	Monthly with 30-day notice	None
Global equity	16,160	15,824	-	Monthly with 6-day notice	None
Global equity	16,590	-	-	Monthly with 60-day notice	10% redemption gate
High yield - fixed income	-	13,915	-	Quarterly with 120-day notice	None

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE B - INVESTMENTS - Continued

Description	Fair Value at June 30, 2018	Fair Value at June 30, 2017	Unfunded Commitment at June 30, 2018	Redemption Terms	Redemption Restrictions
International equity	\$ 20,934	\$ 16,285	\$ -	Semi-monthly with 20-day written notice	None
International equity	19,203	16,810	-	Monthly with 30-day written notice	None
International equity	18,917	17,420	-	Semi-monthly with 15-day notice	None
Multi-strategy	-	6,720	-	Quarterly with 60-day notice	25% quarterly with remainder on anniversary date
U.S. equity	29,935	25,909	-	Daily with 15-day notice	None
Private equity:					
Private equity	2,044	1,982	598	Ineligible	Seven years remaining of ten-year lock-up
Private equity	579	785	90	Ineligible	Termination approximately December 31, 2018
Private equity	3,276	3,673	300	Ineligible	Termination approximately first quarter of 2023
Private equity	2,085	756	6,108	Ineligible	Partnership life until January 2029, subject to 2 (1-year) extensions
Private equity	300	-	1,700	Ineligible	Partnership life until 2028, subject to 2 (1-year) extensions
Private equity	792	-	2,172	Ineligible	Partnership life until 2028, subject to 1-year extension
Private equity	1,044	-	3,952	Ineligible	Partnership life until 2028, subject to 15 (1-year) extensions
Private real assets	967	-	1,971	Ineligible	Partnership life until July 2025, subject to 2 (1-year) extensions
Venture capital	133	167	-	Ineligible	Partial withdrawals not permitted; termination approximately March 2019, unless partners vote to extend to 2023
Total	<u>\$ 219,463</u>	<u>\$ 168,000</u>	<u>\$ 16,891</u>		

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE C - ENDOWMENT AND FUNDS FUNCTIONING AS ENDOWMENT

Endowment and funds functioning as endowment related activity (including permanently restricted pledge amounts) during the years ended June 30, 2018 and 2017, are as follows (in thousands):

	2018			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets - beginning of year	\$ 117,995	\$ 48,713	\$ 106,131	\$ 272,839
Investment return:				
Investment income	653	815	29	1,497
Net realized and unrealized gains	9,180	11,621	50	20,851
Total investment return	9,833	12,436	79	22,348
Contributions	-	-	7,349	7,349
Appropriation of endowment assets for expenditure	(4,498)	(5,935)	-	(10,433)
Additional authorized amounts	16,106	-	-	16,106
Net assets released from restrictions	-	45	(45)	-
Change in endowment net assets	21,441	6,546	7,383	35,370
Endowment net assets - end of year	\$ 139,436	\$ 55,259	\$ 113,514	\$ 308,209
	2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets - beginning of year	\$ 108,876	\$ 37,273	\$ 100,389	\$ 246,538
Investment return:				
Investment income	1,320	1,638	7	2,965
Net realized and unrealized gains	12,217	15,189	120	27,526
Total investment return	13,537	16,827	127	30,491
Contributions	-	476	5,765	6,241
Appropriation of endowment assets for expenditure	(5,225)	(6,013)	-	(11,238)
Additional authorized amounts	807	-	-	807
Net assets released from restrictions	-	150	(150)	-
Change in endowment net assets	9,119	11,440	5,742	26,301
Endowment net assets - end of year	\$ 117,995	\$ 48,713	\$ 106,131	\$ 272,839

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE C - ENDOWMENT AND FUNDS FUNCTIONING AS ENDOWMENT - Continued

The endowment and funds functioning as endowment net asset composition by type of fund at June 30, 2018 and 2017, is composed of the following (in thousands):

	2018			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Scholarship	\$ 39,726	\$ 26,773	\$ 56,389	\$ 122,888
Operational purposes	<u>99,710</u>	<u>28,486</u>	<u>56,866</u>	<u>185,062</u>
Total	<u>\$ 139,436</u>	<u>\$ 55,259</u>	<u>\$ 113,255</u>	<u>\$ 307,950</u>
	2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Scholarship	\$ 37,411	\$ 23,692	\$ 55,059	\$ 116,162
Operational purposes	<u>80,584</u>	<u>25,021</u>	<u>50,822</u>	<u>156,427</u>
Total	<u>\$ 117,995</u>	<u>\$ 48,713</u>	<u>\$ 105,881</u>	<u>\$ 272,589</u>

The University maintains a total return spending policy, which was 4.5% and 5.0% of the average fair market value of the previous sixteen quarters ending December 31, 2016 and 2015, for the years ended June 30, 2018 and 2017, respectively. The University has adopted PA Trust Law Act 141, which requires a release of between 2% and 7%. Separating spending policy from investment policy permits asset allocation decisions to be made independently of the need for current income. The University's investment policy has a primary objective to achieve annualized total return, through appreciation and income, equal to or greater than the rate of inflation plus any spending and administrative expenses. This allows the University to maintain purchasing power of the investment pool. The assets are managed in a manner that will meet the primary investment objective, while attempting to limit volatility in the portfolio's market value, thereby limiting volatility in the year-to-year spending. The policy allows for a range of asset classes, including global equity and debt securities, real assets and alternative investments. The University includes its interest in perpetual trusts in endowment and funds functioning as endowment. Changes in the value of the endowment and funds functioning as endowment are included in the nonoperating section of the statements of activities along with the changes in long-term working capital, value of annuities and permanently restricted loan funds.

The University is one of 15 designated institutions of higher learning and other charitable organizations named as beneficiaries of The Dietrich Foundation (the "Foundation") created by William S. Dietrich II pursuant to an Amended and Restated Declaration of Trust dated August 23, 2011. The Foundation came into existence as a Pennsylvania charitable trust on October 6, 2011 and was granted exemption from Federal income tax under Section 501(c)(3) of the Internal Revenue Code, specifically as a Type I charitable supporting organization under Section 509(a)(3). The Foundation's primary mission is to provide ongoing and increasing financial support to a number of educational institutions, largely in the greater Pittsburgh area, including the University. The Foundation is governed by a board of nine (9) trustees. Five (5) of the trustees are Educational Institutions Trustees.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE C - ENDOWMENT AND FUNDS FUNCTIONING AS ENDOWMENT - Continued

The Foundation is expected to make annual distributions that will be allocated among the pre-specified supporting organizations, which are divided into two primary groups: (a) six (6) educational institutions, which collectively shall receive 90% of the annual distribution amount, and (b) nine (9) other charitable organizations or component funds of such charitable organizations, which collectively shall receive 10% of the annual distribution amount. The University is included in the 90% group. As of June 30, 2018, the University's distribution share was 2.5%.

The distributions to the University have been recorded as permanently restricted contributions revenue as received and held in a permanently restricted endowment fund designated by Dietrich Foundation Endowment Fund. The endowed fund will be managed in accordance with the University's generally applicable investment and disbursement policies in effect for its other permanently restricted endowments. Distributions made from the endowed fund will be used for the purpose authorized by the Foundation's trustees. Distributions of approximately \$597,000 and \$577,000 were received in fiscal years 2018 and 2017, respectively.

NOTE D - RECEIVABLES

Accounts receivable at June 30, 2018 and 2017, consist of the following (in thousands):

	2018	2017
Student accounts receivable - net of allowance for doubtful accounts of \$1,849 and \$1,755 in 2018 and 2017, respectively	\$ 6,387	\$ 5,590
Grants and contracts receivable	1,424	1,260
Other accounts receivable - net of allowance for doubtful accounts of \$2,170 and \$1,488 in 2018 and 2017, respectively	<u>1,521</u>	<u>1,602</u>
Net accounts receivable	<u>\$ 9,332</u>	<u>\$ 8,452</u>

After unsuccessful collection of past-due accounts by two collections agencies for a 33-month period, the University will write the balance off.

Pledges receivable at June 30, 2018 and 2017, are due as follows (in thousands):

	2018	2017
Less than one year	\$ 3,946	\$ 2,519
One to five years	6,889	4,589
More than five years	<u>7,556</u>	<u>1,513</u>
Total pledges receivable	18,391	8,621
Less present value adjustment	<u>(2,566)</u>	<u>(468)</u>
Present value of pledges receivable	15,825	8,153
Less allowance for doubtful pledges	<u>(847)</u>	<u>(605)</u>
Net pledges receivable	<u>\$ 14,978</u>	<u>\$ 7,548</u>

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE D - RECEIVABLES - Continued

Contributions receivable over more than one year are discounted using an appropriate discount rate ranging from 1.20% to 3.25% applicable to the year in which the pledge was received.

Fund-raising costs were \$5.2 million and \$4.2 million for the years ended June 30, 2018 and 2017, respectively.

Loans Receivable

The University makes uncollateralized loans to students based on financial need. Loans are funded through federal government loan programs or institutional resources. At June 30, 2018 and 2017, student loans represented 1.6% and 2.0% of total assets, respectively.

At June 30, 2018 and 2017, student loans consisted of the following (in thousands):

	2018	2017
Federal government programs	\$ 12,728	\$ 13,946
Institutional programs	<u>587</u>	<u>658</u>
	<u>13,315</u>	<u>14,604</u>
Less allowance for doubtful loans:		
Beginning of year	(1,126)	(1,062)
Decrease (increase)	<u>32</u>	<u>(64)</u>
End of year	<u>(1,094)</u>	<u>(1,126)</u>
Loans receivable - net	<u>\$ 12,221</u>	<u>\$ 13,478</u>

The University participates in the following federal revolving loan programs: Perkins, Nursing, Health Profession, and the Nurse Faculty Loan Programs. The availability of funds for loans under these programs is dependent on reimbursements to the pool from repayments on outstanding loans. Outstanding loans canceled under the programs result in a reduction of the funds available for loans and a decrease in the liability to the government.

The past-due principal amounts under the student loan programs at June 30, 2018 and 2017, are as follows (in thousands):

	2018	2017
1 - 60 days past due	\$ 251	\$ 57
60 - 90 days past due	136	2
90+ days past due	<u>1,617</u>	<u>1,199</u>
Total past due	<u>\$ 2,004</u>	<u>\$ 1,258</u>

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE E - PROPERTY, PLANT, AND EQUIPMENT

The University's investment in property, plant, and equipment at June 30, 2018 and 2017, consists of the following (in thousands):

	<u>2018</u>	<u>2017</u>
Land and land improvements	\$ 38,760	\$ 40,738
Building and building improvements	438,038	455,927
Furniture and equipment	84,266	81,999
Construction in progress	<u>7,412</u>	<u>6,303</u>
	568,476	584,967
Less accumulated depreciation	<u>(285,238)</u>	<u>(278,239)</u>
Property, plant, and equipment - net	<u>\$ 283,238</u>	<u>\$ 306,728</u>

Depreciation expense was \$23.2 million and \$23.3 million for the years ended June 30, 2018 and 2017, respectively.

In May of 2018, the University closed on the sale of Brottier Hall and entered into a strategic partnership with Radnor Property Group ("Radnor") and Harrison Street Real Estate Capital ("Harrison Street"), which will provide an enhanced, high-quality living experience for University students living in Brottier Hall. The sale of Brottier Hall resulted in the retirement of property, plant and equipment with a net book value of \$18.1 million, the settlement of an asset retirement obligation of \$1.2 million and the recognition of a gain on sale of \$5.6 million.

Substantially, all property, plant, and equipment are pledged under the University's debt agreements. The net book value of equipment under capital leases is \$0.2 million and \$0.1 million at June 30, 2018 and 2017, respectively.

The University leases automobiles and other equipment under noncancelable operating leases. Rental expense under such lease agreements was approximately \$0.4 million at both June 30, 2018 and 2017. Future minimum lease commitments for all noncancelable operating leases at June 30, 2018, are as follows (in thousands):

<u>Year ending June 30,</u>	
2019	\$ 383
2020	309
2021	<u>36</u>
Total	<u>\$ 728</u>

The University follows guidance on accounting for conditional asset retirement obligations, which states that a conditional asset retirement obligation must meet the definition of a liability, even though uncertainty may exist about the timing or method of settlement. Under the provisions of such guidance, the University is obligated to record a liability for conditional asset retirement obligations. The University performed an analysis of such obligations and determined that asbestos remediation costs represented the University's primary source of such liabilities. The University reviewed facilities on all campus locations and determined the timing, method, and cost of asbestos remediation using a variety of assumptions and estimates.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE E - PROPERTY, PLANT, AND EQUIPMENT - Continued

The analysis included an estimated inflation factor and discount rate, which were used to determine the present value of the obligation. The reconciliation of the liability related to conditional asset retirement obligations at June 30, 2018 and 2017, is presented below (in thousands):

	2018	2017
Beginning liability balance	\$ 4,489	\$ 4,998
Liabilities settled	(230)	(592)
Accretion expense	281	312
Revisions in estimated cash flows	(6)	(229)
	45	(509)
Settlement of asset retirement obligation related to sale of property, plant and equipment	(1,161)	-
Ending liability balance	<u>\$ 3,373</u>	<u>\$ 4,489</u>

The discount rate used to determine the liability was 6.25% at both June 30, 2018 and 2017. The undiscounted liability, inclusive of inflation adjustments, was \$9.8 million and \$12.6 million at June 30, 2018 and 2017, respectively.

NOTE F - DEBT AND LEASE OBLIGATIONS

Long-term debt at June 30, 2018 and 2017, consists of the following bond issues and capitalized lease obligations (in thousands):

	Rate	2018	2017
University Revenue and Refunding Bonds:			
1998 Series Bonds due through 2020	4.25 - 5.50%	\$ 1,990	\$ 2,695
2001 Series A Bonds due through 2019	4.40 - 5.25	1,020	1,990
2008 Series Bonds due through 2033	4.00 - 5.00	-	1,275
2011 Series A Bonds due through 2031	3.00 - 5.50	10,410	11,070
2013 Series A Bonds due through 2034	2.50 - 5.00	30,680	32,815
2014 Series A Bonds due through 2033	2.00 - 5.00	32,425	34,110
2016 Series Bonds due through 2033	2.25 - 5.00	58,040	58,040
2018 Series Bonds due through 2034	5.00	17,760	-
		152,325	141,995
Capital lease obligations		209	175
Gross debt and capital lease obligations		152,534	142,170
Plus net unaccreted bond premium		15,600	15,740
Less deferred bond costs		(825)	(730)
Debt and capital lease obligations		167,309	157,180
Less debt service reserves and accounts		(1,728)	(1,728)
Less escrow deposits for 2001 Series A Bonds debt service		(1,024)	(2,003)
Net debt and capital lease obligations		<u>\$ 164,557</u>	<u>\$ 153,449</u>

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE F - DEBT AND LEASE OBLIGATIONS - Continued

Principal payments for the year ended June 30, 2018, are as follows (in thousands):

<u>Year ending June 30,</u>	
2019	\$ 7,866
2020	7,066
2021	7,403
2022	7,804
2023	8,180
Thereafter	<u>114,215</u>
Total	\$ <u>152,534</u>

University Revenue and Refunding Bonds ("1998 Series") - In March 1998, the Allegheny County Higher Education Building Authority (the "Authority") issued \$18.6 million of revenue refunding bonds to provide for the advance refunding of the remaining principal amount outstanding of the University's Revenue Bonds 1991 Series B, 1991 Series C, and the 1992 Series and to provide for bond issuance costs. These bonds are insured by Ambac.

The bonds mature annually in principal amounts ranging from \$0.7 million to \$0.9 million beginning in fiscal year 1999 and ended in fiscal year 2011, with original payments of \$1.9 million, \$3.4 million, and \$3.3 million in fiscal 2013, 2016, and 2020, respectively. The fiscal 2013, 2016, and 2020 maturities are subject to mandatory debt service payments beginning in fiscal year 2012 and ending in fiscal year 2020 in amounts ranging from \$0.6 million to \$1.3 million.

Approximately \$0.4 million of costs related to the issuance of these bonds has been deferred and is being amortized over the life of the bonds. In addition, approximately \$0.3 million of the original issue premium is being accreted over the life of the bonds. All debt issuance costs are recorded in debt and lease obligations on the statement of financial position.

In connection with the issuance of these bonds, the University has agreed to certain covenants with which it must comply. The covenants provide that (1) the University cannot incur additional debt in excess of 2% of unrestricted gross revenues, unless the maximum annual debt service requirements on all outstanding long-term debt and the long-term debt to be incurred does not exceed 12% of the unrestricted gross revenues, and (2) the debt service coverage ratio on additional long-term debt is not less than 1.15 for the preceding fiscal year. Additionally, these bond covenants provide that the University cannot incur additional long-term debt in any amount, unless (1) the sum of the total debt service payments made during the preceding fiscal year and the maximum annual debt service requirements on the new long-term debt is less than 10% of the University's unrestricted operating revenues for the preceding fiscal year, and (2) the balance of the University's endowment is greater than 50% of all outstanding and proposed long-term debt.

University Revenue Bonds ("Series A of 2001") - In January 2001, the Authority issued \$12.1 million of revenue refunding bonds to provide for the current refunding of the remaining principal amount outstanding of the University's Revenue Bonds, 1991 Series A and provide for bond issuance costs. These bonds are insured by Ambac.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE F - DEBT AND LEASE OBLIGATIONS - Continued

The bonds mature annually in principal amounts ranging from \$0.3 million to \$1.0 million beginning in fiscal year 2003 and ending in fiscal year 2019.

Approximately \$0.3 million of costs related to the issuance of these bonds has been deferred and is being amortized over the life of the bonds. In addition, approximately \$0.1 million of original issue discount is being amortized over the life of the bonds. All debt issuance costs are recorded in debt and lease obligations on the statement of financial position.

In March 2004, the Authority issued \$7.3 million of Taxable University Refunding Bonds to be used together with other funds of the University to provide for the advance refunding of the University Revenue Refunding Bonds Series A of 2001 (the "Refunded Bonds"). These bonds (2004) were redeemed in the fiscal year ended June 30, 2008. As of June 30, 2005, the covenants related to the Refunded Bonds are no longer applicable under the provisions of the prior indenture for the Refunded Bonds.

Under guidance for accounting for transfers and servicing of financial assets and extinguishments of liabilities, the funds held in escrow for the refunding of these Series A of 2001 bonds have been presented separately as an asset in the statements of financial position, rather than net against debt obligations. At June 30, 2018 and 2017, the amounts held in escrow were \$1.0 million and \$2.0 million, respectively.

University Revenue Bonds ("Series of 2008") - In June 2008, the Authority issued \$30.5 million of University Revenue Bonds to provide for a portion of (a) the costs of various capital projects in the University's capital budget for the fiscal years ended June 30, 2008 and 2009; (b) the refunding of the Authority's outstanding University Refunding Revenue Bonds, Series of 2003, University Revenue Bonds, Series C of 2005, and University Revenue Bonds, Series B of 2007; and (c) to provide for bond issuance costs.

These bonds mature annually in principal amounts ranging from \$1.1 million to \$4.1 million beginning in fiscal 2009 and ending in fiscal 2033.

Approximately \$0.1 million of costs related to the issuance of these bonds has been deferred and is being amortized over the life of the bonds. In addition, approximately \$0.2 million of original issue premium is being accreted over the life of the bonds. All debt issuance costs are recorded in debt and lease obligations on the statement of financial position.

In connection with the issuance of these bonds, the University has agreed to certain covenants with which it must comply. The covenants provide that the University cannot incur additional long-term debt in any amount, unless (1) debt service requirements on all long-term debt during the fiscal year, plus the maximum annual debt service requirements on the proposed additional long-term debt is less than 10% of the University's unrestricted operating revenues during the previous fiscal year, and (2) the University's expendable resources are greater than 50% of all outstanding and proposed long-term debt; however, that such test shall not be required to be met if the additional long-term debt is being incurred to refund existing long-term debt and the maximum annual debt service requirements on the proposed long-term debt are less than or equal to the maximum annual debt service requirements on the existing long-term debt. In May 2016, the outstanding bonds were partially defeased in connection with the Series of 2016 bonds described below.

The University Revenue Bonds Series of 2008 were retired on March 1, 2018.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE F - DEBT AND LEASE OBLIGATIONS - Continued

University Revenue Bonds ("Series A of 2011") - In February 2011, the Authority issued \$53.5 million of revenue bonds to provide for a portion of (a) constructing, equipping, and furnishing an approximately 400-bed student housing facility on the University's main campus; (b) projects comprising the first phase of the University's 10-year housing renewal plan, including the renovation and improvement of the Duquesne Towers student housing facility; (c) miscellaneous capital expenditures now being incurred and expected to be incurred at the University's main campus over the next two years; (d) funding any interest during construction; and (e) to provide for bond issuance costs.

These bonds mature annually in principal amounts ranging from \$15,000 to \$14.5 million beginning in fiscal 2013 and ending in fiscal 2031.

Approximately \$0.2 million of costs related to the issuance of these bonds has been deferred and is being amortized over the life of the bonds. In addition, approximately \$0.5 million of original issue discount is being amortized over the life of the bonds. All debt issuance costs are recorded in debt and lease obligations on the statement of financial position.

These bonds carry substantially the same covenants as the Series of 2008 bonds. In May 2016, the outstanding bonds were partially defeased in connection with the Series of 2016 bonds described below.

University Revenue Bonds ("Series A of 2013") - In March 2013, the Authority issued \$39.4 million of revenue bonds to provide for a portion of (a) renovations to the University's Duquesne Towers, St. Ann's Hall, and Libermann Hall; (b) other miscellaneous capital expenditures from the University's capital program; (c) the advance refunding of the Authority's outstanding University Revenue Bonds Series A of 2004; and (d) to provide for bond issuance costs.

These bonds mature annually in principal ranging from \$0.6 million to \$2.5 million beginning in fiscal 2014 and ending in fiscal 2034.

Approximately \$0.2 million of costs related to the issuance of these bonds has been deferred and is being amortized over the life of the bonds. In addition, approximately \$3.5 million of original issue premium is being amortized over the life of the bonds. All debt issuance costs are recorded in debt and lease obligations on the statement of financial position.

These bonds carry substantially the same covenants as the Series of 2008 bonds.

University Revenue Bonds ("Series A of 2014") - In December 2014, the Authority issued \$39.2 million of revenue bonds to provide for a portion of (a) the advance refunding of the Authority's outstanding University Revenue Bonds Series A of 2005; (b) the advance refunding of the Authority's outstanding University Revenue Bonds Series B of 2005; (c) the advance refunding of the Authority's outstanding Revenue Bonds Series A of 2007; and (d) to provide for bond issuance costs.

These bonds mature annually in principal ranging from \$1.0 million to \$3.8 million beginning in fiscal 2015 and ending in fiscal 2033.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE F - DEBT AND LEASE OBLIGATIONS - Continued

Approximately \$0.3 million of costs related to the issuance of these bonds has been deferred and is being amortized over the life of the bonds. In addition, approximately \$4.5 million of original issue premium is being amortized over the life of the bonds. All debt issuance costs are recorded in debt and lease obligations on the statement of financial position.

These bonds carry substantially the same covenants as the Series of 2008 bonds.

University Revenue Bonds ("Series of 2016") - In May 2016, the Authority issued \$58.0 million of revenue bonds to provide for a portion of (a) the advance refunding of the Authority's outstanding University Revenue Bonds Series of 2008; (b) the advance refunding of the Authority's outstanding University Revenue Bonds Series A of 2011; and (c) to provide for bond issuance costs.

These bonds mature annually in principal ranging from \$0.1 million to \$7.8 million beginning in fiscal 2019 and ending in fiscal 2033.

Approximately \$0.3 million of costs related to the issuance of these bonds has been deferred and is being amortized over the life of the bonds. In addition, approximately \$9.8 million of original issue premium is being amortized over the life of the bonds. All debt issuance costs are recorded in debt and lease obligations on the statement of financial position.

These bonds carry substantially the same covenants as the Series of 2008 bonds.

University Revenue Bonds ("Series of 2018") - In May 2018, the Authority issued \$17.8 million of revenue bonds to provide for a portion of (a) upgrades and replacements to various mechanical systems, including HVAC, elevators, electrical switchgear, pneumatic controls, fan coil units, fire protection and sprinkler systems in the Koren Building, Fisher Hall, School of Law, College Hall, Richard King Mellon Hall of Science, Rockwell Hall, Libermann Hall, Gumberg Library, Administration Building and St. Ann Hall; (b) renovations to Rockwell Hall, Assumption Hall, St. Ann Hall, Richard King Mellon Hall of Science office and the Des Places Living Learning Centers; (c) roof replacements to Duquesne Union and Trinity Hall; (d) other miscellaneous capital expenditures on the main campus of the University; (e) funding capital interest; (f) funding of any necessary reserves; and (g) to provide for bond issuance costs.

These bonds mature annually in principal ranging from \$3.6 million to \$10.0 million beginning in fiscal 2032 and ending in fiscal 2034.

Approximately \$0.2 million of costs related to the issuance of these bonds has been deferred and is being amortized over the life of the bonds. In addition, approximately \$2.5 million of original issue premium is being amortized over the life of the bonds. All debt issuance costs are recorded in debt and lease obligations on the statement of financial position.

In connection with the issuance of these bonds, the University has agreed to certain covenants with which it must comply. The covenants provide that the University cannot incur additional long-term debt in any amount, unless (1) debt service requirements on all long-term debt during the fiscal year, plus the maximum annual debt service requirements on the proposed additional long-term debt, is less than 12% of the University's unrestricted operating revenues during the previous fiscal year, and (2) the University's expendable resources are greater than 50% of all outstanding and proposed long-term debt; however, that such test shall not be required to be met if the additional long-term debt is being incurred to refund existing long-term debt.

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE G - RETIREMENT PLANS AND OTHER POSTRETIREMENT BENEFIT OBLIGATION

The University participates in single-employer contributory retirement plans, which provide for the purchase of annuities and various mutual funds for academic, administrative, salaried, and other hourly employees. The employee is responsible for a 5% pretax contribution, while the University contributes 8% on behalf of the employee. The University also participates in a multi-employer noncontributory retirement plan for certain union employees, which is funded at the rate of 87 cents per hour worked up to a maximum of 40 hours per week. The University annually funds the retirement costs under both plans, which amounted to \$8.4 million and \$8.1 million for the years ended June 30, 2018 and 2017, respectively.

The University provides certain health care benefits to certain retired employees. These postretirement benefits are unfunded and generally are based on employees' years of service and compensation levels. The University is required to make an accrual of the expected costs of these benefits over the period in which the employees render the service.

Net periodic benefit costs for the years ended June 30, 2018 and 2017, include the following components (in thousands):

	2018	2017
Service cost for fiscal year	\$ 198	\$ 209
Interest cost for fiscal year	297	288
Census and claims gain during fiscal year	(244)	(264)
Gain due to assumption changes	(474)	(424)
Change in liability due to plan experience	<u>160</u>	<u>156</u>
Net periodic costs	<u>\$ (63)</u>	<u>\$ (35)</u>
Actual postretirement benefit payments (funded on a pay-as-you-go basis)	<u>\$ 308</u>	<u>\$ 299</u>

Using a measurement date of June 30, the following assumptions at June 30, 2018 and 2017, were used to determine the periodic benefit costs:

	2018	2017
Discount rate	4.10%	3.70%
Health care trend rate (post-65)	6.00%	7.00%
Long-term trend rate	4.50%	4.50%
Terminal trend year	2025	2025

A one-percentage-point increase in the assumed medical cost trend rates for each future year increases annual postretirement benefit expense by \$500 and the accumulated postretirement benefit obligation by \$16,000. A one-percentage-point decrease in the assumed medical cost trend rates for each future year decreases annual postretirement benefit expense by \$500 and the accumulated postretirement benefit obligation by \$16,000.

(Continued)

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE G - RETIREMENT PLANS AND OTHER POSTRETIREMENT BENEFIT OBLIGATION - Continued

For the years ended June 30, 2018 and 2017, the following is a reconciliation of beginning and ending balances of the benefit obligation (in thousands):

	2018	2017
Accumulated postretirement benefit obligation - beginning of year	\$ 8,341	\$ 8,675
Service cost for fiscal year	198	209
Interest cost for fiscal year	297	288
Benefit payments for fiscal year	(308)	(299)
Expected accumulated postretirement benefit obligation - end of year	8,528	8,873
Census and claims gain during fiscal year	(244)	(264)
Gain due to assumption changes	(474)	(424)
Change in liability due to plan experience	160	156
Actual accumulated postretirement benefit obligation - end of year	<u>\$ 7,970</u>	<u>\$ 8,341</u>

Using a measurement date of June 30, the following assumptions at June 30, 2018 and 2017, were used to determine the end-of-year benefit obligation:

	2018	2017
Discount rate	4.10%	3.70%
Health care trend rate	6.00%	7.00%
Long-term trend rate	4.50%	4.50%
Terminal trend year	2025	2025

Expected benefits to be paid in future years are as follows (in thousands):

<u>Year ending June 30,</u>	
2019	\$ 512
2020	515
2021	482
2022	467
2023	471
2024 - 2027	<u>2,419</u>
Total	<u>\$ 4,866</u>

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE H - UNRESTRICTED NET ASSETS

Unrestricted net assets at June 30, 2018 and 2017, consist of the following (in thousands):

	<u>2018</u>	<u>2017</u>
Board-designated funds (quasi-endowment)	\$ 139,526	\$ 118,043
Undesignated funds	<u>163,906</u>	<u>166,374</u>
Total unrestricted net assets	<u>\$ 303,432</u>	<u>\$ 284,417</u>

NOTE I - TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets at June 30, 2018 and 2017, consist of the following (in thousands):

	<u>2018</u>	<u>2017</u>
Endowment gains	\$ <u>55,259</u>	\$ <u>48,713</u>
Restricted gifts and pledges:		
Operational purposes	11,026	8,579
Capital projects	10,660	3,824
Scholarships	<u>1,024</u>	<u>837</u>
Total restricted gifts and pledges	<u>22,710</u>	<u>13,240</u>
Restricted private grants and contracts	<u>18</u>	<u>15</u>
Total temporarily restricted net assets	<u>\$ 77,987</u>	<u>\$ 61,968</u>

Notes to Financial Statements - Continued

June 30, 2018 and 2017

NOTE J - PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets at June 30, 2018 and 2017, consist of the following (in thousands):

	<u>2018</u>	<u>2017</u>
Endowment and funds functioning as endowment	\$ 110,790	\$ 103,519
Pledges	<u>2,465</u>	<u>2,362</u>
	113,255	105,881
Annuity investments	<u>259</u>	<u>250</u>
	113,514	106,131
Loan funds	<u>1,468</u>	<u>1,446</u>
Total permanently restricted net assets	<u>\$ 114,982</u>	<u>\$ 107,577</u>

NOTE K - CONTINGENCIES

The University is a defendant in certain legal proceedings arising out of the normal conduct of its business. In the opinion of management, based upon discussion with counsel, the ultimate outcome of these matters will not have a material adverse effect on the financial position or activities of the University.

Under the terms of federal grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursement to the grantor agencies. The University's management believes disallowances, if any, will not have a material effect on the University's financial position.

NOTE L - SUBSEQUENT EVENTS

The University has evaluated subsequent events through October 9, 2018, the date the financial statements were issued. The University is not aware of any subsequent events that require recognition or disclosure in the financial statements.