

**SANTA BARBARA FOUNDATION  
AND AFFILIATES  
COMBINED AND CONSOLIDATED  
FINANCIAL STATEMENTS  
DECEMBER 31, 2016**

**SANTA BARBARA FOUNDATION AND AFFILIATES**

DECEMBER 31, 2016

TABLE OF CONTENTS

	<u>Page</u>
Independent Auditor's Report	1 – 2
Financial Statements:	
Combined and Consolidated Statement of Financial Position	3
Combined and Consolidated Statement of Activities and Changes in Net Assets	4
Combined and Consolidated Statement of Functional Expenses	5
Combined and Consolidated Statement of Cash Flows	6
Notes to Combined and Consolidated Financial Statements	7 – 25



CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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## **INDEPENDENT AUDITOR'S REPORT**

Board of Trustees  
Santa Barbara Foundation and Affiliates  
Santa Barbara, California

We have audited the accompanying combined and consolidated financial statements of the Santa Barbara Foundation and Affiliates (a non-profit organization) which comprise the combined and consolidated statement of financial position as of December 31, 2016, and the related combined and consolidated statements of activities and changes in net assets, functional expenses, and cash flows for the year then ended, and the notes to the combined and consolidated financial statements.

### **Management's Responsibility for the Financial Statements**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined and consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined and 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 combined and 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 combined and 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 combined and consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Santa Barbara Foundation and Affiliates as of December 31, 2016, and the change in its net assets and its cash flows for the year ended in accordance with accounting principles generally accepted in the United States of America.

## **Report on Summarized Comparative Information**

We have previously audited the Santa Barbara Foundation and Affiliates' 2015 combined and consolidated financial statements, and we expressed an unmodified opinion on those combined and consolidated financial statements in our report dated September 8, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2015 is consistent, in all material respects, with the audited financial statements from which it has been derived.

## **Emphasis-of-matter**

As referenced in Notes 1, 6, and 7 to the combined and consolidated financial statements, the combined and consolidated statement of financial position includes investments valued at \$131,510,712 (39% of net assets) as of December 31, 2016, whose fair market values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based upon information provided by the investment managers, third-party valuations, and appraisals, and other unobservable inputs.

*McGowan Guntermann*

Santa Barbara, California

September 14, 2017

**SANTA BARBARA FOUNDATION AND AFFILIATES**

**COMBINED AND CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

December 31, 2016

(With Comparative Totals for December 31, 2015)

<b>ASSETS</b>					(Memo)
	Unrestricted	Temporarily Restricted	Permanently Restricted	2016 Total	2015 Total
<b>Current Assets</b>					
Cash and cash equivalents	\$ 25,972,528	\$ -	\$ -	\$ 25,972,528	\$ 28,676,216
Accounts receivable	6,242	-	-	6,242	42,273
Contributions and bequests receivable, current portion	-	220,000	-	220,000	1,764,500
Student loans receivable, current portion	500,000	-	-	500,000	600,000
Notes receivable, current portion	1,500,000	-	-	1,500,000	-
Other current assets	109,743	-	-	109,743	70,242
<b>Total Current Assets</b>	<u>28,088,513</u>	<u>220,000</u>	<u>-</u>	<u>28,308,513</u>	<u>31,153,231</u>
 Investments	 234,421,740	 3,325,753	 44,310,773	 282,058,266	 236,310,582
 Property and equipment, net	 14,720,497	 -	 -	 14,720,497	 15,064,985
<b>Other Assets</b>					
Contributions and bequests receivable, net of current portion	-	167,079	-	167,079	159,087
Student loans receivable, net of current portion	1,458,530	-	-	1,458,530	1,925,870
Notes receivable, net of current portion	3,021,101	-	-	3,021,101	-
Mission related investments	373,597	-	-	373,597	-
Assets held under charitable trust agreements	-	15,744,174	132,752	15,876,926	12,026,968
Perpetual income interest	-	-	14,154,961	14,154,961	13,311,643
<b>Total Other Assets</b>	<u>4,853,228</u>	<u>15,911,253</u>	<u>14,287,713</u>	<u>35,052,194</u>	<u>27,423,568</u>
 <b>Total Assets</b>	 <u><b>\$ 282,083,978</b></u>	 <u><b>\$ 19,457,006</b></u>	 <u><b>\$ 58,598,486</b></u>	 <u><b>\$ 360,139,470</b></u>	 <u><b>\$ 309,952,366</b></u>
<b>LIABILITIES AND NET ASSETS</b>					
<b>Current Liabilities</b>					
Accounts payable and accrued expenses	\$ 593,680	\$ -	\$ -	\$ 593,680	\$ 469,155
Grants payable, current portion	350,000	-	-	350,000	355,150
Note payable, current portion	78,580	-	-	78,580	74,968
<b>Total Current Liabilities</b>	<u>1,022,260</u>	<u>-</u>	<u>-</u>	<u>1,022,260</u>	<u>899,273</u>
<b>Other Liabilities</b>					
Grants payable, net of current portion	200,000	-	-	200,000	310,000
Note payable, net of current portion	3,248,036	-	-	3,248,036	3,326,608
Liabilities under charitable trust agreements	-	1,557,600	-	1,557,600	1,769,514
Funds held on behalf of others	15,586,846	-	-	15,586,846	13,942,093
Other non-current liabilities	78,297	-	-	78,297	50,732
<b>Total Other liabilities</b>	<u>19,113,179</u>	<u>1,557,600</u>	<u>-</u>	<u>20,670,779</u>	<u>19,398,947</u>
 <b>Total Liabilities</b>	 20,135,439	 1,557,600	 -	 21,693,039	 20,298,220
 Net Assets	 <u>261,948,539</u>	 <u>17,899,406</u>	 <u>58,598,486</u>	 <u>338,446,431</u>	 <u>289,654,146</u>
 <b>Total Liabilities and Net Assets</b>	 <u><b>\$ 282,083,978</b></u>	 <u><b>\$ 19,457,006</b></u>	 <u><b>\$ 58,598,486</b></u>	 <u><b>\$ 360,139,470</b></u>	 <u><b>\$ 309,952,366</b></u>

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

**SANTA BARBARA FOUNDATION AND AFFILIATES**

**COMBINED AND CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS**

For the Year Ended December 31, 2016

(With Comparative Totals for the Year Ended December 31, 2015)

	Unrestricted	Temporarily Restricted	Permanently Restricted	2016 Total	(Memo) 2015 Total
<b>Revenue, Gains, and Other Support</b>					
Contributions and bequests	\$ 31,438,678	\$ 3,248,718	\$ 80	\$ 34,687,476	\$ 36,315,009
Less: Contributions raised on behalf of others	(2,023,751)	-	-	(2,023,751)	(1,791,426)
Total Contributions and bequests	29,414,927	3,248,718	80	32,663,725	34,523,583
Interest and dividends	4,992,757	975,483	-	5,968,240	7,153,399
Less: Interest and dividends on behalf of others	(408,168)	-	-	(408,168)	(396,534)
Total Interest and dividends	4,584,589	975,483	-	5,560,072	6,756,865
Realized gain (loss) on value of securities	(2,099,318)	(545,293)	-	(2,644,611)	965,197
Less: Realized loss (gain) on behalf of others	224,786	-	-	224,786	(14,107)
Total Realized gain (loss) on value of securities	(1,874,532)	(545,293)	-	(2,419,825)	951,090
Unrealized gain (loss) on value of securities	35,198,077	1,280,166	-	36,478,243	(25,913,014)
Less: Unrealized loss (gain) on behalf of others	(650,040)	-	-	(650,040)	578,834
Total Unrealized gain (loss) on value of securities	34,548,037	1,280,166	-	35,828,203	(25,334,180)
Change in value of interests in perpetual trusts	-	-	846,518	846,518	(583,090)
Change in value of charitable remainder trusts	-	274,794	-	274,794	(298,995)
Charitable remainder trust contributions	-	4,678,081	-	4,678,081	3,178,137
Broadcasting (net of expenses of \$0 and \$49,615)	-	-	-	-	(47,543)
Rental (net of expenses of \$606,259 and \$798,647)	(24,412)	-	-	(24,412)	(318,225)
Other income	224,367	-	-	224,367	380,986
Net assets released from restrictions	7,526,553	(7,411,011)	(115,542)	-	-
<b>Total Revenue, Gains and Other Support</b>	<b>74,399,529</b>	<b>2,500,938</b>	<b>731,056</b>	<b>77,631,523</b>	<b>19,208,628</b>
<b>Expenses</b>					
<b>Program services:</b>					
Grants, net of rescinds	22,703,904	-	-	22,703,904	27,275,929
Less: Grants made on behalf of others	(1,031,534)	-	-	(1,031,534)	(2,556,094)
Total Grants, net of rescinds	21,672,370	-	-	21,672,370	24,719,835
<b>Activities:</b>					
Grant making	1,641,887	-	-	1,641,887	1,229,745
Direct program	426,854	-	-	426,854	4,325,933
Total Program Services	23,741,111	-	-	23,741,111	30,275,513
<b>Support services:</b>					
Administrative and fund management	3,671,792	-	-	3,671,792	2,867,386
Fundraising and development	1,426,335	-	-	1,426,335	1,249,850
Total Support Services	5,098,127	-	-	5,098,127	4,117,236
<b>Total Expenses</b>	<b>28,839,238</b>	<b>-</b>	<b>-</b>	<b>28,839,238</b>	<b>34,392,749</b>
<b>Change in Net Assets</b>	<b>45,560,291</b>	<b>2,500,938</b>	<b>731,056</b>	<b>48,792,285</b>	<b>(15,184,121)</b>
Net Assets, January 1	216,388,248	15,398,468	57,867,430	289,654,146	304,838,267
<b>Net Assets, December 31</b>	<b>\$ 261,948,539</b>	<b>\$ 17,899,406</b>	<b>\$ 58,598,486</b>	<b>\$ 338,446,431</b>	<b>\$ 289,654,146</b>

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

**SANTA BARBARA FOUNDATION AND AFFILIATES**

**COMBINED AND CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES**

For the Year Ended December 31, 2016

(With Comparative Totals for the Year Ended December 31, 2015)

Expenses	Program Services			Support Services		<u>Total 2016</u>	(Memo) <u>Total 2015</u>
	<u>Grants</u>	Grant Making <u>Activities</u>	Direct Program <u>Activities</u>	<u>Administrative and Fund Management</u>	<u>Fundraising and Development</u>		
Grants, net of rescinds	\$ 21,672,370	\$ -	\$ -	\$ -	\$ -	\$ 21,672,370	\$ 24,719,835
Salaries	-	720,115	-	783,841	614,217	2,118,173	3,901,819
Contribution expense	-	-	-	980,735	-	980,735	-
Investment management fees	-	-	-	535,774	-	535,774	604,225
Unrelated business income tax	-	-	-	521,995	-	521,995	264,496
Professional services	-	86,839	-	237,047	133,950	457,836	1,176,807
Employee benefits	-	147,783	-	160,664	126,915	435,362	986,125
Direct program activities	-	-	426,854	-	-	426,854	885,296
Computer services	-	89,666	-	108,588	73,495	271,749	143,450
Provision for bad debts	-	241,826	-	-	-	241,826	27,189
Community relations	-	44,252	-	5,259	162,928	212,439	260,212
Meetings and conferences	-	58,923	-	71,421	48,210	178,554	186,998
Occupancy costs	-	56,890	-	64,781	56,694	178,365	175,739
Payroll taxes	-	53,621	-	58,352	45,736	157,709	249,007
Depreciation	-	38,825	-	42,139	43,712	124,676	149,179
Rent	-	47,021	-	36,612	24,713	108,346	230,886
Office supplies	-	17,409	-	19,626	16,713	53,748	109,428
Publications	-	12,627	-	4,209	25,254	42,090	21,751
Advertising	-	320	-	-	32,456	32,776	100,651
Insurance	-	7,430	-	18,519	6,338	32,287	98,018
Dues, subscriptions and licenses	-	9,033	-	10,949	7,390	27,372	39,484
Telephone	-	8,010	-	9,709	6,553	24,272	37,826
Equipment and maintenance	-	1,297	-	1,572	1,061	3,930	24,328
<b>Total Expenses, December 31, 2016</b>	<b><u>\$ 21,672,370</u></b>	<b><u>\$ 1,641,887</u></b>	<b><u>\$ 426,854</u></b>	<b><u>\$ 3,671,792</u></b>	<b><u>\$ 1,426,335</u></b>	<b><u>\$ 28,839,238</u></b>	
Total Expenses, December 31, 2015 (Memo)	<u>\$ 24,719,835</u>	<u>\$ 1,229,745</u>	<u>\$ 4,325,933</u>	<u>\$ 2,867,386</u>	<u>\$ 1,249,850</u>		<u>\$ 34,392,749</u>

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

**SANTA BARBARA FOUNDATION AND AFFILIATES**

**COMBINED AND CONSOLIDATED STATEMENT OF CASH FLOWS**

For the Year Ended December 31, 2016

(With Comparative Totals for the Year Ended December 31, 2015)

	2016	(Memo) 2015
Cash Flows from Operating Activities:		
Change in net assets	\$ 48,792,285	\$ (15,184,121)
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation	408,596	440,781
Loss on disposal of property and equipment	4,322	63,797
Realized loss (gain) on sale of securities	2,419,825	(951,090)
Unrealized loss (gain) on value of securities	(35,828,203)	25,334,180
Provision for bad debts	241,826	(23,580)
Contribution expense	980,735	-
Present value discount and loan forgiveness	7,992	(152,248)
Contributions restricted for long-term investment	(80)	(642,158)
Non-cash contribution of closely held stock and fixed income partnership	(17,468,896)	(16,043,188)
(Increase) decrease in:		
Accounts receivable	36,031	305,348
Contributions and bequests receivable	1,536,508	2,111,481
Other current and non-current assets	(39,501)	206,778
Assets held under charitable trust agreements	(3,849,958)	(1,714,195)
Perpetual income interest	(846,518)	583,090
Increase (decrease) in:		
Accounts payable and accrued expenses	124,525	(374,028)
Grants payable	(115,150)	(450,850)
Liabilities under charitable trust agreements	(211,914)	(143,649)
Funds held on behalf of others	1,644,753	(1,657,180)
Other non-current liabilities	27,565	14,000
Net Cash Used by Operating Activities	(2,135,257)	(8,276,832)
Cash Flows from Investing Activities:		
Purchase of property and equipment	(68,430)	(63,397)
Purchase of available-for-sale securities	(84,706,916)	(60,930,893)
Proceeds from sale of securities	89,839,706	71,696,557
Student loan repayments	507,089	654,121
Notes receivable disbursements	(5,500,000)	-
Mission related investment disbursements	(565,000)	-
Net Cash Provided (Used) by Investing Activities	(493,551)	11,356,388
Cash Flows from Financing Activities:		
Contributions restricted for long-term investment	80	642,158
Payments on long-term debt	(74,960)	(71,646)
Net Cash Provided (Used) by Financing Activities	(74,880)	570,512
<b>Net Increase (Decrease) In Cash and Cash Equivalents</b>	<b>(2,703,688)</b>	<b>3,650,068</b>
Cash and Cash Equivalents - January 1	28,676,216	25,026,148
<b>Cash and Cash Equivalents - December 31</b>	<b>\$ 25,972,528</b>	<b>\$ 28,676,216</b>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the year for interest	\$ 141,241	\$ 145,980
Cash paid during the year for unrelated business income tax	\$ 521,995	\$ 264,496

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



# SANTA BARBARA FOUNDATION AND AFFILIATES

## NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Organization

The Santa Barbara Foundation (Foundation) is a community foundation incorporated in 1928 under the laws of the state of California as a nonprofit corporation to enrich the lives of the people of Santa Barbara County through philanthropy. As one of the largest private sources of funding for area nonprofits, agencies, and college bound students, the Foundation builds and facilitates philanthropy through donor partnerships; invests in nonprofits to strengthen the nonprofit sector; and identifies and strategically addresses important community needs.

#### Principles of Combination

The Orfalea Fund (Fund) was organized in May 2003 as a supporting organization to the Santa Barbara Foundation for the specific and primary purpose of benefiting, performing functions of, and engaging in charitable activities which are consistent with the charitable purposes of the Santa Barbara Foundation. As a result, the accounts of the Fund are included in these financial statements.

The Fund was designed to accomplish ambitious goals in a concentrated timeframe; it was always the founders' intent to create sustainable results, not a perpetual organization. Following a wind down period in 2015, the Fund completed its dissolution in 2016.

Highland Santa Barbara Foundation, Inc. was organized in November 2011 as a supporting organization to the Santa Barbara Foundation for the specific and primary purpose of benefiting, performing functions of, and engaging in charitable activities which are consistent with the charitable purposes of the Santa Barbara Foundation. As a result, the accounts of Highland Santa Barbara Foundation, Inc. are included in these financial statements.

The Eric and Kelly Schwartz Charitable Trust was organized in August 2015 as a supporting organization to the Santa Barbara Foundation for the specific and primary purpose of benefiting, performing functions of, and engaging in charitable activities which are consistent with the charitable purposes of the Santa Barbara Foundation. As a result, the accounts of the Eric and Kelly Schwartz Charitable Trust are included in these financial statements.

The Foundation has eliminated all material inter-organizational accounts and transactions with supporting organizations.

#### Principles of Consolidation

1111 Chapala Street, LLC is a wholly owned subsidiary of the Foundation whose primary operating asset is a commercial building located in Santa Barbara, CA. As a result, the accounts of 1111 Chapala Street, LLC are included in these financial statements.

# SANTA BARBARA FOUNDATION AND AFFILIATES

## NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Principles of Consolidation (continued)

300 East Islay Street, LLC is a wholly owned subsidiary of the Foundation whose primary operating asset is a residential building located in Santa Barbara, CA. As a result, the accounts of 300 East Islay Street, LLC are included in these financial statements.

SBF Properties, LLC is a wholly owned subsidiary of the Foundation whose purpose is to receive gifts of real property. As a result, the accounts of SBF Properties, LLC are included in these financial statements.

The Foundation has eliminated all material inter-company accounts and transactions with subsidiaries.

#### Basis of Accounting

The accompanying financial statements of the Foundation have been prepared on the accrual basis of accounting. The Foundation reports information regarding its financial position and activities in three classes of net assets - unrestricted, temporarily restricted, and permanently restricted - based on the existence or absence of donor-imposed restrictions.

The Foundation's governing documents provide the Board of Trustees with the variance power to modify any restriction or condition placed on gifts to the Foundation if, in its sole judgment, the Board of Trustees determine that the restriction becomes in effect unnecessary, incapable of fulfillment, or inconsistent with the charitable needs of the community served.

#### Unrestricted Net Assets

Unrestricted net assets represent unrestricted resources available for current support of Foundation activities.

#### Temporarily Restricted Net Assets

Temporarily restricted net assets consist of contributions and other inflows of funds temporarily subject to donor-imposed restrictions. The restrictions are temporary in that they are expected to expire with the passage of time or be satisfied and removed by actions of the Foundation that fulfill donor stipulations. Temporarily restricted net assets generally include donations received with time restrictions, planned gifts, and contributions and bequests receivable. Earnings on temporarily restricted net assets are reported as an increase in temporarily restricted net assets. Earnings on donor-restricted endowment funds that have not yet been appropriated are also classified as temporarily restricted net assets. When a restriction expires temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as "net assets released from restrictions".

# SANTA BARBARA FOUNDATION AND AFFILIATES

## NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Basis of Accounting (continued)

##### *Permanently Restricted Net Assets*

Permanently restricted net assets consist of contributions and other inflows of funds subject to donor-imposed restrictions that neither expire by the passage of time nor can be fulfilled or otherwise removed by actions of the Foundation. Permanently restricted net assets generally include perpetual interest trusts where the Foundation is not the trustee of the assets. All income related to these trusts are reported as unrestricted contributions when received on the Statement of Activities. The change in value of the underlying assets is recorded as an unrealized gain or loss in permanently restricted net assets on the Statement of Activities. Permanently restricted net assets also consist of those donor-restricted endowments held by the Foundation as defined under the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

#### Comparative Amounts

The amounts shown for 2015 in the accompanying financial statements are included to provide a basis for comparison with 2016 and are not intended to present all information necessary for a fair presentation of the 2015 financial statements in conformity with accounting principles generally accepted in the United States of America.

#### Income Taxes

The Foundation and Affiliates are tax-exempt organizations and are not subject to federal or state income taxes, except on unrelated business income, in accordance with Section 501(a) of the Internal Revenue Code. In addition, the Foundation and Affiliates qualified for the charitable contribution deduction under Section 170(b)(1)(A) of the Internal Revenue Code and have been classified as organizations that are not private foundations. Unrelated business income tax, if any, is immaterial and no tax provision has been made in the accompanying consolidated financial statements.

The Foundation and Affiliates evaluate uncertain tax positions, whereby the effect of the uncertainty would be recorded if the outcome was considered probable and reasonably estimable. As of December 31, 2016, the Foundation and Affiliates have no uncertain tax positions requiring accrual.

The Foundation and Affiliates file tax returns in California and U.S. federal jurisdictions. The Foundation is no longer subject to U.S. federal and state tax examinations by tax authorities for years before 2013 and 2012, respectively.

#### Cash and Cash Equivalents

The Foundation considers all highly-liquid investments with an initial maturity of three months or less to be cash equivalents.

# SANTA BARBARA FOUNDATION AND AFFILIATES

## NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain amounts and disclosures. Those estimates and assumptions affect the reported amounts of assets, liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. It is at least reasonably possible that the significant estimates could change in the coming year.

Significant estimates used in the preparation of these financial statements include:

- Allocation of certain expenses by function
- Discount factors used in determining contributions and bequests receivable, student loans, notes receivable, grants payable, annuities payable by charitable trust and income interest in charitable trusts
- Allowance for uncollectible student loans and contributions and bequests receivable
- Fair market value of assets held by charitable trusts
- Fair market value of certain investments
- Depreciable lives of property and equipment

#### Contributions and Bequests

Contributions received are recorded at their fair value on the date of donation. Contributions receivable are recognized as revenue when committed and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Conditional promises to give are recognized when the conditions on which they depend are substantially met. Bequests are recorded at their estimated fair value when all the events required for the transfer of the assets from the estate of the donor to the Foundation have occurred and/or the court has issued an order to transfer the assets.

#### Donated Services

Donated goods and services received by the Foundation are recorded at fair market value at the time of the donation. For the year ended December 31, 2016, numerous volunteers gave their time and expertise to the Foundation in a wide variety of areas including: committees, administrative activities, technical and financial advice, and office and public relations activities. These contributions, despite their considerable value to the mission of the Foundation, are not reflected in the financial statements.

#### Discount to Present Value

A discount factor of 5% is applied to amounts receivable in more than one year.

# SANTA BARBARA FOUNDATION AND AFFILIATES

## NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Donated Property and Investments

Donated property and investments are recorded as contributions at their fair market value at date of receipt.

#### Financial Instruments

The Foundation carries certain financial instruments at cost, which approximates fair value.

#### Investments in Securities

The Foundation records investments in debt and equity securities with readily determinable market values at fair value. The fair value of investments in securities traded on national securities exchanges is valued at the closing price on the last business day of the year. The investments in hedge funds, partnerships and private equity, for which quoted market prices are not readily available, are determined by management in good faith with the assistance of third-party investment managers using methods they consider appropriate. The Foundation defines real assets as investments in real estate and other commodities. Realized and unrealized gains and losses are included in the change in net assets.

#### Property and Equipment

Property and equipment is stated at cost, or fair market value if donated. In general, the Foundation capitalizes assets with a cost of \$5,000 or more and an expected useful life of greater than one year. Depreciation is calculated using the straight-line method over their estimated useful lives as follows:

Building and leasehold	10 – 40 years
Office and equipment	3 – 10 years
Furniture	5 – 10 years

#### Funds Held on Behalf of Others

The Foundation receives and distributes assets under certain agency and intermediary arrangements. If a not-for-profit organization (NPO) establishes a fund at the Foundation with its own funds and specifies itself or its affiliate as the beneficiary of that fund, then the Foundation accounts for this transfer of assets by such NPO as a liability. The liability is established at the fair value of the funds, which is generally equivalent to the present value of future payments expected to be made to the NPO and is reflected under “Funds Held on Behalf of Others” on the accompanying combined and consolidated statement of financial position.

#### Grants

Grants are recorded as expenses when they are approved by the Board of Trustees. The Foundation records the rescission of grants in the year the grant is cancelled.

# SANTA BARBARA FOUNDATION AND AFFILIATES

## NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

### Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Student Loans

##### Policy

The Foundation provides financial assistance to qualified individuals through its student loan program. Students must attend an accredited two-or four-year college, university, vocational or medical school on a full-time basis. Prior to 2015, the Foundation awarded interest-free loans on need and merit with repayments beginning six months after the student graduated or left school. In 2015, the Foundation converted its student loan funds to scholarship funds for all awards made in 2015 going forward.

##### Allowances for Amounts to Be Forgiven

Prior to 2010, the Foundation forgave one-half of the majority of its student loans if the loan never became delinquent. An allowance was computed for the portion of loans outstanding that would potentially not be collected because they would be forgiven. An annual adjustment to the allowance for amounts to be forgiven reduces the prior year allowance balance by amounts forgiven during the year. In 2010, the Foundation terminated its loan forgiveness policy, with the exception of medical specialty loans, provided that the student continues to practice substantially full-time as a general/family practitioner or internist until 50% of the amount of the loan has been repaid, at which time the entire loan will be considered having been fully repaid. All other students with loans awarded in 2010 going forward will be expected to repay the full amount.

##### Allowances for Uncollectible Loans

The Foundation considers its collection history of student loans receivable and provides an allowance for doubtful accounts in the amount which is considered uncollectible. Generally any loan past due for 90 days or more is considered doubtful.

#### Subsequent Events

The Foundation has evaluated subsequent events through September 14, 2017, the date which the financial statements were available to be issued.

### Note 2 - CONTRIBUTIONS AND BEQUESTS RECEIVABLE

Unconditional promises are included in the financial statements as contributions and bequests receivable and revenue of the appropriate net asset category. At December 31, 2016, contributions and bequests receivable are expected to be realized in the following periods:

In one year or less	\$ 220,000
In more than one year	242,900
Discount to present value	<u>(75,821)</u>
Contributions and bequests receivable, net	<u>\$ 387,079</u>

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 3 - STUDENT LOANS RECEIVABLE

Student loans receivable are comprised of the following as of December 31, 2016:

Total student loan balances	\$ 3,364,168
Allowance for amounts to be forgiven	( 863,638)
Allowance for uncollectible loans	( 165,000)
Discount to present value	<u>( 377,000)</u>
Net student loans receivable	<u>\$ 1,958,530</u>

Management estimates the student loans receivable will be repaid as follows:

Receivable in less than one year	\$ 500,000
Receivable in one to seven years	1,623,530
Allowance for uncollectible loans	<u>( 165,000)</u>
Net student loans receivable	<u>\$ 1,958,530</u>

The student loans are administered by the Scholarship Foundation of Santa Barbara.

#### Note 4 - NOTES RECEIVABLE

During 2016, the Foundation made unsecured loans from a donor advised fund to a nonprofit charitable organization. Loans from donor advised funds are presented in the financial statements as notes receivable and are comprised of the following as of December 31, 2016:

Receivable in less than one year	\$ 1,500,000
Receivable in six to ten years	<u>4,000,000</u>
Total donor advised loans receivable	5,500,000
Discount to present value	<u>(978,899)</u>
Net notes receivable	<u>\$ 4,521,101</u>

The notes receivable within one year bear interest ranging from 0.61% to 0.64% and are due September 30, 2017.

The note receivable in six to ten years bears interest at a variable rate of 1-month LIBOR, 0.62 % at December 31, 2016, plus 1%. Interest is payable in semi-annual installments commencing April 15, 2017. Payments of 5% of the outstanding principal balance are due annually, commencing October 15, 2022, with the remaining principal balance due on October 15, 2026.

#### Note 5 - MISSION RELATED INVESTMENTS

During 2016, the Foundation made mission related investments in the form of loans from board designated funds to nonprofit organizations to support charitable activities consistent with the Foundation's tax exempt purpose. As of December 31, 2016, the total outstanding loan balance of \$565,000 is discounted by \$191,403 to reflect the present value of \$373,597.

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 6 - INVESTMENTS

Investments are presented in the financial statements at fair market value. Fair value is defined as the amount that would be exchanged for an asset or to transfer a liability between market participants in an orderly transaction at the balance sheet date. These amounts are not necessarily indicative of the amounts the Foundation could realize in a current market exchange. Realized and unrealized gains and losses on investments are reflected in the Statement of Activities. At December 31, 2016, investments consisted of the following:

	<u>Cost Basis</u>	<u>Market Value</u>	<u>Unrealized Gain (Loss)</u>
Domestic equities	\$ 48,196,558	\$ 58,952,708	\$ 10,756,150
International equities	28,560,695	28,840,092	279,397
Domestic fixed income	61,395,272	60,708,866	(686,406)
International fixed income	310,218	300,102	(10,116)
Fixed income (illiquid)	25,376,523	71,200,000	45,823,477
Closely held stock	30,800,777	29,181,117	(1,619,660)
Real assets	6,394,866	6,412,479	17,613
Private equity	8,350,315	12,248,494	3,898,179
Partnerships	4,415,042	3,317,420	(1,097,622)
Hedge funds	<u>10,696,771</u>	<u>10,896,988</u>	<u>200,217</u>
Total	<u>\$ 224,497,037</u>	<u>\$ 282,058,266</u>	<u>\$ 57,561,229</u>

The following summarizes the net change in unrealized gain (loss) on investments:

	<u>Cost Basis</u>	<u>Market Value</u>	<u>Unrealized Gain (Loss)</u>
Balance at end of the year	\$ 224,497,037	\$ 282,058,266	\$ 57,561,229
Balance at beginning of the year	\$ 215,227,596	\$ 236,310,582	<u>\$ 21,082,986</u>
Change in unrealized gain (loss)			<u>\$ 36,478,243</u>

The following summarizes the investment return included as unrestricted revenue and temporarily restricted revenue on endowment funds in the statement of activities for the year ended December 31, 2016:

Investment and dividend income	\$ 5,968,240
Realized loss on value of securities	(2,644,611)
Unrealized gain on value of securities	36,478,243
Less: investment return allocated to others	(833,422)
Less: investment fees	<u>(535,774)</u>
Net Investment Return	<u>\$ 38,432,676</u>

For the year ended December 31, 2016, approximately 25% of the fair market value of investments and 80% of the current year unrealized investment gains were attributable to the Highland Santa Barbara Foundation, Inc. supporting organization's illiquid fixed income position. The amounts are based upon an annual independent third-party valuation using the same techniques and variables as in prior years.



## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 7 - FAIR VALUE MEASUREMENT

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, Fair Value Measurement and Disclosures, provides the framework for measuring and disclosing the fair value of assets and liabilities. Accounting principles define fair value as the price that would be received by the Foundation to sell an asset or be paid by the Foundation to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. A fair value hierarchy has been established that prioritizes valuation inputs into three broad levels to ensure consistency and comparability. The valuation hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3) described as follows:

The standard describes three levels of inputs that may be used to measure fair value:

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

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

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities; including general partner estimates and recent third-party appraisals.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying Statement of Financial Position, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then Level 2 fair values are estimated by using pricing models quoted prices of securities with similar characteristics or discounted cash flows. The asset's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Fair market valuation of Level 3 securities is based on information provided by fund managers, external investment advisors, and other market factors to determine if the carrying value of these investments should be adjusted. Other factors may include, but are not limited to, estimates of liquidation value, prices of recent transactions in the same or similar funds, current performance, future expectations of the particular investment, and changes in market outlook and the financing environment. Because of the inherent uncertainty of valuations, however, those estimated values may differ from the values that would have been used had a ready market existed, and the differences could be material. Independent appraisals of significant real estate held for investment are conducted at frequencies as determined by the fund manager for valuation purposes. Level 3 securities can include hedge funds, private equity, special purpose vehicles, real assets, and partnerships.

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 7 - FAIR VALUE MEASUREMENT (CONTINUED)

The following table presents assets and liabilities recognized in the accompanying Statement of Financial Position measured at fair value on a recurring basis and the level in which the fair value measurements fall at December 31, 2016:

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments				
Domestic equities	\$ 58,952,708	\$ -	\$ -	\$ 58,952,708
International equities	28,840,092	-	-	28,840,092
Domestic fixed income	60,708,866	-	-	60,708,866
International fixed income	300,102	-	-	300,102
Fixed income (illiquid)	-	-	71,200,000	71,200,000
Closely held stock	-	-	29,181,117	29,181,117
Real assets	805,743	-	5,606,736	6,412,479
Private equity	-	-	12,248,494	12,248,494
Partnerships	-	-	3,317,420	3,317,420
Hedge funds	<u>940,043</u>	<u>-</u>	<u>9,956,945</u>	<u>10,896,988</u>
Total Investments	<u>150,547,554</u>	<u>-</u>	<u>131,510,712</u>	<u>282,058,266</u>
Assets held under charitable trust agreements:				
Charitable trusts, life policy	-	-	13,242,035	13,242,035
Charitable remainder trusts	1,008,861	-	-	1,008,861
Charitable gift annuities	966,079	-	-	966,079
Pooled income funds	<u>659,951</u>	<u>-</u>	<u>-</u>	<u>659,951</u>
Total Assets held under charitable trust agreements	<u>2,634,891</u>	<u>-</u>	<u>13,242,035</u>	<u>15,876,926</u>
Perpetual income interest	<u>14,154,961</u>	<u>-</u>	<u>-</u>	<u>14,154,961</u>
Total Assets measured at fair value	<u>\$ 167,337,406</u>	<u>\$ -</u>	<u>\$ 144,752,747</u>	<u>\$ 312,090,153</u>
Charitable trust liabilities measured at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,557,600</u>	<u>\$ 1,557,600</u>

The following is a description of the general classification of investments pursuant to the valuation hierarchy:

*Domestic and international equities* – includes investment in domestic and international equities of varying market capitalizations represents part of our investment portfolio. Equities are held as separate ownership shares of a specific company or in the form of mutual funds.

*Domestic and international fixed income* – includes investment in domestic and international fixed income positions as held in the investment portfolio through either individual bond holdings (treasuries, corporate, government, mortgage, etc.) or through fixed income mutual funds.

*Closely held stock* – includes shares of an S-Corporation held by a supporting organization, The Eric and Kelly Schwartz Charitable Trust. The shares are illiquid.

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 7 - FAIR VALUE MEASUREMENT (CONTINUED)

*Fixed income (illiquid)* – includes 100 participation shares in a non-controlling partnership interest composed primarily of collateralized loan obligations. 100% of this investment is held by a supporting organization, Highland Santa Barbara Foundation Inc.

*Real assets* - includes seven limited partnerships that invest in a diverse group of private real estate investment trusts or similar entities that focus on the acquisition, redevelopment, operation and management of commercial real estate properties; a real asset mutual fund and several real asset fund of funds invested in partnerships focused on natural resources: timber, mining, energy, etc. All of the real asset partnerships are illiquid and cannot be redeemed. Unfunded commitments totaled \$1,792,335.

*Private equity* – includes thirteen broadly diversified private equity partnerships with varying allocations to buyouts, distressed opportunities, venture capital, special situations, and secondary funds. Holdings are invested in diversified portfolios of investment partnerships, each of which has a defined term, typically ten to fourteen years, with no right to withdraw prior to termination of the investment partnership. Funds are called as needed by managers and distributions are received through the liquidation of the underlying assets of the fund. Unfunded commitments totaled \$8,512,055. One new private equity fund was added in 2016 with a \$2 million commitment. All of these private equity interests are illiquid and not redeemable.

*Partnerships* – includes a 24% interest in one partnership that consists of real estate holdings. Distributions from this partnership vary from year to year and are controlled by the general partner. Another partnership of which the Foundation holds a 7.7% interest is comprised of many different partnerships with both domestic and international exposure. The Foundation holds a 48.059% interest in another partnership comprised of real estate holdings. This partnership interest will terminate in June 2027. All of these partnership interests are illiquid and not redeemable.

*Hedge funds* – includes eleven separate accounts, two of which were established in 2016, eight of which were established in 2014 and one prior fund. Redemptions are in process for six existing funds. A broad range of strategies are employed by the different hedge fund managers.

The following table provides a reconciliation of assets measured at fair value using significant unobservable inputs (Level 3) for the year ended December 31, 2016:

Description	Beginning Balance	Net Gains and (Losses)	Purchases and Issuances	Sales and Settlements	Ending Balance
Fixed income (illiquid)	\$ 40,400,000	\$ 30,800,000	\$ -	\$ -	\$ 71,200,000
Closely held stock	14,466,665	(1,619,659)	17,468,896	(1,134,785)	29,181,117
Real assets	7,170,112	(191,087)	312,505	(1,684,794)	5,606,736
Private equity	14,021,962	418,368	1,294,890	(3,486,726)	12,248,494
Partnerships	3,317,420	-	-	-	3,317,420
Hedge funds	16,008,094	(288,854)	2,900,000	(8,662,295)	9,956,945
Charitable trusts/other	<u>9,126,748</u>	<u>(494,703)</u>	<u>4,419,901</u>	<u>190,089</u>	<u>13,242,035</u>
Total	<u>\$ 104,511,001</u>	<u>\$ 28,624,065</u>	<u>\$ 26,396,192</u>	<u>\$ (14,778,511)</u>	<u>\$ 144,752,747</u>

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 7 - FAIR VALUE MEASUREMENT (CONTINUED)

The Foundation has entered into certain agreements for capital commitments to various private limited partnerships investment funds to make future investments in those funds. The outstanding commitments totaled \$10,304,390 as of December 31, 2016. Hedge funds were valued at a total of \$9,956,945 at December 31, 2016. The remaining illiquid assets valued at \$121,553,767 were invested in real assets which included real estate, private equity, and private limited partnership investment funds with no ability to redeem the funds except at termination.

The following table sets forth additional disclosures of the organization's investments at Level 3 whose fair market values are estimated using net asset value per share:

<u>Investment</u>	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Fixed Income (illiquid)	\$ 71,200,000	\$ -	Non-redeemable	-
Closely held stock	29,181,117		Non-redeemable	-
Real assets	5,606,736	1,792,335	Non-redeemable	-
Private equity	12,248,494	8,512,055	Non-redeemable	-
Partnerships	3,317,420	-	Non-redeemable	-
Hedge funds:				
AG Super Fund, LP	33,846	-	In Redemption	-
Orange Capital	8,846	-	In Redemption	-
Silvercreek	390,906	-	In Redemption	-
Jana Offshore Partners	1,142,292	-	In Redemption	67 days
Adelphi Europe	2,143,001	-	In Redemption	37 days
Seminole Offshore	200,963	-	In Redemption	52 days
WNTN Dedicated	1,492,044	-	Monthly	12 days
Dymon Asia Macro	1,605,560	-	Monthly	37 days
PFM Diversified	1,534,398	-	Quarterly	52 days
Atreaus	1,375,361	-	Monthly	37 days
RD Legal	<u>29,728</u>	<u>-</u>	In Redemption	-
Total	<u>\$ 131,510,712</u>	<u>\$ 10,304,390</u>		

#### Note 8 - SPLIT-INTEREST AGREEMENTS AND DEFERRED FUNDS

A split-interest agreement is a contribution that results in the sharing of legal rights to certain assets by the nonprofit and the donor. The Foundation records such split-interest agreements held in charitable remainder trusts, charitable gift annuities, pooled income funds, and perpetual interest trusts as follows:

##### Charitable Remainder Trusts

The Foundation is named as an irrevocable remainder beneficiary of charitable trusts, which have been established by donors to provide income, generally for life, to designated beneficiaries. The Foundation is also the irrevocable remainder beneficiary of two life insurance policies. At the end of the term, or upon the death of the income beneficiaries, assets remaining in the trusts will be transferred to the Foundation. Each year, beneficiaries receive a percentage of the trust's fair market value, generally limited to net income or net income with make-up provisions.

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 8 - SPLIT-INTEREST AGREEMENTS AND DEFERRED FUNDS (CONTINUED)

##### Charitable Remainder Trusts (continued)

If the Foundation is the trustee, the fair market value of the trust is recorded in the Foundation's statement of financial position. A corresponding liability is recorded for the present value of the future payments as specified in the trust agreement using a discount rate of 5%. A contribution is recorded for the difference between the two amounts. The fair market value of these six trusts was \$1,008,861 with a corresponding payment liability for future payments of \$649,939 at December 31, 2016.

If the Foundation is not the named trustee and does not exercise control over the assets, contribution revenue and assets are recognized using the fair value of the assets less the present value of the estimated future payments to named beneficiaries. Subsequent changes to the fair value of the assets and liabilities of all trusts are recognized as changes in value of charitable remainder trusts. At December 31, 2016, the present value of these trusts where the Foundation is not the trustee was \$7,515,958 including both life insurance policies.

The Foundation is named income beneficiary for six charitable lead trusts, three of which are new this year. The present value of the expected annual payments over the remaining years of each trust is recorded. The expected cash flow from the trusts at December 31, 2016, to the Foundation was \$5,726,077.

##### Charitable Gift Annuities

Charitable gift annuity donors have contributed assets to the Foundation in exchange for a promise by the Foundation to pay a fixed amount for a specified period of time to the donor or to individuals or organizations designated by the donor. Under the terms of the agreements, no trust exists, as the assets received are held by the Foundation, and the liability is an obligation of the Foundation. The Foundation records new gifts at the fair market value of the assets, less the present value of the estimated future payments to the named beneficiaries. The present value of the payments is calculated using an IRS discount rate in effect at the time of the contract. Subsequent changes in value from prior year are recorded using the fair value of the assets less the present value of the payments expected to be made to the beneficiaries. A discount rate of 5% is used to determine the change in value. The change in value is recorded in the Statement of Activities under changes in value of charitable remainder trusts. The total fair market value of the 43 charitable gift annuities was \$966,079 with a corresponding present value liability of \$753,416 at December 31, 2016.

##### Pooled Income Funds

Pooled Income Fund donors have contributed assets to the Foundation in exchange for a net income payout for a specified period of time. Under the terms of the agreements, no trust exists, as the assets are held by the Foundation. The fair market value of the asset is recorded in the Foundation's Statement of Financial Position and a corresponding liability is recorded for the present value of the future payments to the named beneficiaries. Subsequent changes in value from prior year are recorded using the fair value of the assets less the present value of the payments expected to be made to the beneficiaries. The change in value is recorded in the Statement of Activities under changes in value of charitable remainder trusts. The fair market value of the pooled income funds at December 31, 2016, was \$659,951 with a corresponding present value liability of \$154,245.

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 8 - SPLIT-INTEREST AGREEMENTS AND DEFERRED FUNDS (CONTINUED)

##### Perpetual Income Trust Interest

The Foundation is named as an income beneficiary of seven perpetual trusts, the corpus of which is not controlled by the management of the Foundation. Under these arrangements, the Foundation has the irrevocable right to receive income earned on the underlying assets held in perpetuity. Income received from four of the trusts is discretionary, while income from one trust is restricted for student aid, and one is restricted for Lompoc area projects. The Foundation also has a future interest in the income of assets yet to be received by one of the above trusts.

Since the Foundation is a beneficiary of this stream of income in perpetuity, the Foundation's share of the fair market value of the trusts' investments is recorded as an asset, with a fair market value of \$14,154,961 at December 31, 2016. Any change in subsequent years in the fair market value of the Foundation's share of the trust investments is recorded in the Statement of Activities as a change in value of interests in perpetual trusts.

#### Note 9 - PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2016, consists of the following:

Building and leasehold improvements	\$ 13,580,225
Land	3,265,379
Office equipment	247,209
Donated artwork	17,500
Furniture	<u>277,978</u>
Total property and equipment	17,388,291
Less accumulated depreciation and amortization	<u>( 2,667,794)</u>
Property and equipment, net	<u>\$ 14,720,497</u>

#### Note 10 - NOTE PAYABLE

The Foundation has a mortgage note payable on the 1111 Chapala Street building with Montecito Bank & Trust and secured by the property at an interest rate of 4.125%. Principal and interest payments of \$18,017 are due monthly with a final balloon payment of \$2,922,823 due on October 20, 2021. Future maturities of principal obligations are as follows as of December 31, 2016:

2017	\$ 78,580
2018	81,922
2019	85,415
2020	88,694
2021	<u>2,992,005</u>
Total	<u>\$ 3,326,616</u>

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 11 - GRANTS

Future minimum grants payable are as follows as of December 31, 2016:

2017	\$ 350,000
2018	100,000
2019	<u>100,000</u>
Subtotal	\$ 550,000
Less current portion	<u>(350,000)</u>
Long-term portion	<u>\$ 200,000</u>

Grant expense is comprised of the following for the year ended December 31, 2016:

Donor advised	\$11,504,934
Competitive	5,603,128
Field of interest	2,498,122
Donor designated	1,264,577
Supporting organizations	360,000
Fiscal sponsorships	239,161
Pass-through	<u>202,448</u>
Total Grants, net of rescinds	<u>\$ 21,672,370</u>

#### Note 12 - CONCENTRATIONS AND RISKS

##### Credit Risk

The Foundation maintains cash balances at several banks insured by the Federal Deposit Insurance Corporation (FDIC). The Federal Deposit Insurance Corporation (FDIC) only insures the first \$250,000 of funds on deposit at any one institution. The Foundation had uninsured cash of approximately \$17,150,000 deposited with six different banks. In addition, the Foundation maintains significant cash balances in money market funds. Such balances are not fully insured.

##### Concentrations

For the year ended December 31, 2016, approximately 25% of the fair market value of investments and 80% of the current year unrealized investment gains were attributable to the Highland Santa Barbara Foundation, Inc. supporting organization's illiquid fixed income position.

For the year ended December 31, 2016, approximately 55% of the contribution and bequest revenue was derived from a single non-cash contribution of closely held stock. In addition, a majority of donors to the Foundation are from Santa Barbara County.

##### Market Risk

The Foundation holds its investments in a diversified portfolio. Nevertheless, these investments are exposed to various risks and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of investments will occur in the near term and that such change could materially affect the amounts reported in the combined and consolidated financial statements.

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 13 - ENDOWMENT FUNDS

##### Interpretation of Relevant Law

The Board of Trustees of the Foundation, in concurrence with the advice of legal counsel, has interpreted the California adopted Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring a long-term investment strategy designed to preserve the fair value of the original gift, as of the gift date. As a result of this interpretation, the Foundation has classified with the explicit prohibition by the donor 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 funds that are not classified in permanently restricted net assets are classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard for prudence prescribed by UPMIFA. In accordance with California UPMIFA, the organization considers the following factors in making a determination to appropriate or invest donor restricted endowment funds:

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

##### Endowment Investment and Spending Policies

The Foundation has adopted 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 long-term purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity for donor-specified purposes. The endowment assets are invested in a manner that is intended to produce results that provide a reasonable balance between the quest for growth and the need to protect principal. The investment policy calls for a diversified portfolio utilizing various asset classes with a goal of reducing portfolio volatility and risk.

The Foundation's long-term endowment is invested in a diversified portfolio of domestic equities, international equities, fixed income, and also includes a broad array of alternative investments. The portfolio employs both passive index funds and actively managed funds. The portfolio's objective is to achieve a total return equivalent to or greater than the Foundation's financial requirements over the long-term time horizon. Long-term investment strategies are used to manage risk with the goal to grow charitable dollars overtime. The Foundation also provides three other investment options for donors that have a shorter time horizon and more immediate spending needs.



**SANTA BARBARA FOUNDATION AND AFFILIATES**

NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - ENDOWMENT FUNDS (CONTINUED)

Endowment Investment and Spending Policies (continued)

The Foundation uses a total investment return methodology for determining its spending policy each year. The portfolio's total returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The spending policy calculates the amount of money annually distributed from the Foundation's various discretionary funds and other endowed funds for grant making, student aid, and administrative support. The current spending policy for the year ended December 31, 2016, for discretionary funds was 5%, while other endowed funds were 4%. These percentages are calculated based on a rolling average of the market value for the previous twelve quarters.

The spending policy is reviewed annually in light of changing market assumptions, investment returns and the rate of inflation. Accordingly, over the long term, the Foundation expects current spending policy to allow its endowment assets to grow.

Endowment Funds with Deficiencies

From time to time, the fair value of the assets associated with individual donor-restricted funds may fall below the level that current law requires the Foundation to retain for a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, these deficiencies are reported as a reduction in unrestricted net assets. Such deficiencies may result from unfavorable market fluctuations, particularly if the funds were invested in the endowment pool shortly prior to significant market declines. As of December 31, 2016, the Foundation held nine endowment funds where the principal had fallen below the original corpus due to market conditions. The amount of the shortfall totaled \$1,590,917.

Changes in endowment net assets for the year ended December 31, 2016 are as follows:

	<u>Unrestricted</u>	Temporarily <u>Restricted</u>	Permanently <u>Restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ (1,445,572)	\$ 3,434,479	\$ 44,426,235	\$ 46,415,142
Net investment income	410,350	1,226,551	-	1,636,901
Contributions	-	-	80	80
Appropriation of endowment assets for expenditure or transfer	<u>(555,695)</u>	<u>(1,335,277)</u>	<u>(115,542)</u>	<u>(2,006,514)</u>
Endowment net assets, end of year	<u>\$ (1,590,917)</u>	<u>\$ 3,325,753</u>	<u>\$ 44,310,773</u>	<u>\$ 46,045,609</u>

The Foundation did not classify any assets as board-restricted endowment funds as of December 31, 2016.

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 14 - RELATED PARTY TRANSACTIONS

A majority of trustees and committee members of the Foundation also serve as trustees of entities receiving grants and support from the Foundation. Each trustee and committee member has to complete a conflict of interest declaration form annually. Those trustees and committee members who have conflicts abstain from voting on grants if the beneficiary is one of these entities.

A board member is Executive Vice President at the bank where the Foundation maintains a long-term note payable. The board member abstained from the discussion and vote related to the note payable and the terms of the note were determined by the board of directors to be appropriate for the needs of the Foundation.

#### Note 15 - LEASES

The Foundation leases office equipment and office space under non-cancellable operating leases through September 2023. Minimum rental payments under the terms of these leases are as follows for the year ended December 31, 2016:

2017	\$	71,136
2018		71,136
2019		69,867
2020		65,575
2021		62,030
Thereafter		<u>108,444</u>
Total	\$	<u>448,188</u>

Lease expense for the year ended December 31, 2016 totaled \$28,462.

#### Note 16 - COMMITMENTS

The Foundation has entered into a consulting agreement with a former Foundation executive requiring monthly payments of \$4,000 (\$48,000 per year) for a period of ten years ending December 31, 2018. The total commitment for the consulting agreement as of December 31, 2016 was \$96,000.

#### Note 17 - RETIREMENT PLANS

Foundation employees who work at least 1,000 hours per year are eligible to participate in a deferred salary savings plan under Section 401(k) of the Internal Revenue Code after one full calendar month of services. The Foundation matches at its discretion up to 4% of the eligible salary upon participation. For eligible employees with more than one year of service the Foundation, at its discretion, contributes up to an additional 6% of the participant's eligible salary for a total of 10%. Foundation employer contributions for the year ended December 31, 2016 totaled \$174,481.

In addition, the Foundation has a non-qualified deferred compensation plan. Foundation employer contributions for the year ended December 31, 2016 totaled \$36,166.

## SANTA BARBARA FOUNDATION AND AFFILIATES

### NOTES TO COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS

#### Note 18 - NET ASSETS RELEASED FROM RESTRICTIONS

Net assets were released from donor restrictions by the passage of time or by satisfying the restricted purposes specified by donors. For the year ended December 31, 2016, net assets released from restriction totaled \$7,526,553.

#### Note 19 - RECLASSIFICATION

Certain amounts from the December 31, 2015 financial statements have been reclassified to conform to the December 31, 2016 financial statement presentation.

#### Note 20 - NET ASSETS

As of December 31, 2016, net assets consist of the following:

##### Unrestricted Net Assets

Supporting organizations	\$ 100,624,423
Undesignated funds	99,090,012
Donor-advised funds	35,932,916
Field of interest funds	11,872,500
Student aid funds	6,826,025
Board designated funds	5,477,604
Donor designated funds	3,343,737
Fiscal sponsorship	372,239
Donor-restricted endowment deficit	( 1,590,917)
Total unrestricted net assets	<u>\$ 261,948,539</u>

##### Temporarily Restricted Net Assets

Pledges and bequests receivable	\$ 387,079
Split-interest agreements	14,020,873
Life insurance gift	165,701
Un-appropriated earnings on endowments	<u>3,325,753</u>
Total temporarily restricted net assets	<u>\$ 17,899,406</u>

##### Permanently Restricted Net Assets

Perpetual income trust interest	\$ 14,154,961
Split-interest agreements	132,752
Donor-restricted endowment funds	<u>44,310,773</u>
Total permanently restricted net assets	<u>\$ 58,598,486</u>