

SANTA BARBARA FOUNDATION
CONSOLIDATED
FINANCIAL STATEMENTS
DECEMBER 31, 2018

SANTA BARBARA FOUNDATION

DECEMBER 31, 2018

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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Santa Barbara Foundation
Santa Barbara, California

We have audited the accompanying consolidated financial statements of the Santa Barbara Foundation (a non-profit organization) and its supporting organizations and affiliates which comprise the consolidated statement of financial position as of December 31, 2018, and the related consolidated statements of activities and changes in net assets, functional expenses, and cash flows for the year then ended, and the notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Emphasis-of-matter

As referenced in Notes 1, 6, and 7 to the consolidated financial statements, the consolidated statement of financial position includes investments valued at \$140,697,964 (31% of net assets) as of December 31, 2018, 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.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Santa Barbara Foundation and its supporting organizations and affiliates as of December 31, 2018, and the change in its net assets and its cash flows for the year then 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 its supporting organizations and affiliates' 2017 consolidated financial statements, and we expressed an unmodified opinion on those consolidated financial statements in our report dated August 22, 2018. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2017 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Handwritten signature in cursive script, reading "McGowan Guntermann".

Santa Barbara, California

September 12, 2019

SANTA BARBARA FOUNDATION

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

December 31, 2018

(With Comparative Totals for December 31, 2017)

	ASSETS			(Memo)
	Without Donor Restrictions	With Donor Restrictions	2018 Total	2017 Total
Current Assets				
Cash and cash equivalents	\$ 35,456,800	\$ -	\$ 35,456,800	\$ 33,950,347
Accounts receivable	-	-	-	15,960
Contributions and bequests receivable, current portion	90,000	400	90,400	370,400
Student loans receivable, current portion	300,000	-	300,000	400,000
Notes receivable, current portion	1,500,000	-	1,500,000	1,500,000
Mission related investments, current portion	-	-	-	53,000
Other current assets	150,299	-	150,299	112,570
Total Current Assets	<u>37,497,099</u>	<u>400</u>	<u>37,497,499</u>	<u>36,402,277</u>
Investments	255,820,539	45,624,059	301,444,598	326,839,438
Property and equipment, net	14,028,686	-	14,028,686	14,305,033
Other Assets				
Contributions and bequests receivable, net of current portion	47,052,772	183,323	47,236,095	74,450,084
Student loans receivable, net of current portion	912,615	-	912,615	1,191,121
Notes receivable, net of current portion	3,634,410	-	3,634,410	3,339,301
Mission related investments, net of current portion	454,301	-	454,301	417,413
Assets held under charitable trust agreements	-	63,578,937	63,578,937	65,240,296
Perpetual income interest	-	13,927,585	13,927,585	15,645,617
Total Other Assets	<u>52,054,098</u>	<u>77,689,845</u>	<u>129,743,943</u>	<u>160,283,832</u>
Total Assets	<u>\$ 359,400,422</u>	<u>\$ 123,314,304</u>	<u>\$ 482,714,726</u>	<u>\$ 537,830,580</u>
LIABILITIES AND NET ASSETS				
Current Liabilities				
Accounts payable and accrued expenses	\$ 469,327	\$ -	\$ 469,327	\$ 541,987
Grants payable, current portion	160,000	-	160,000	520,000
Note payable, current portion	86,934	-	86,934	81,922
Total Current Liabilities	<u>716,261</u>	<u>-</u>	<u>716,261</u>	<u>1,143,909</u>
Other Liabilities				
Grants payable, net of current portion	35,417	-	35,417	151,871
Note payable, net of current portion	3,079,253	-	3,079,253	3,166,153
Liabilities under charitable trust agreements	-	1,367,741	1,367,741	1,548,881
Funds held on behalf of others	19,260,851	-	19,260,851	18,545,986
Other non-current liabilities	21,889	-	21,889	72,414
Total Other Liabilities	<u>22,397,410</u>	<u>1,367,741</u>	<u>23,765,151</u>	<u>23,485,305</u>
Total Liabilities	23,113,671	1,367,741	24,481,412	24,629,214
Net Assets	<u>336,286,751</u>	<u>121,946,563</u>	<u>458,233,314</u>	<u>513,201,366</u>
Total Liabilities and Net Assets	<u>\$ 359,400,422</u>	<u>\$ 123,314,304</u>	<u>\$ 482,714,726</u>	<u>\$ 537,830,580</u>

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

SANTA BARBARA FOUNDATION

CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS

For the Year Ended December 31, 2018

(With Comparative Totals for the Year Ended December 31, 2017)

	Without Donor Restrictions	With Donor Restrictions	2018 Total	(Memo) 2017 Total
Revenue, Gains, and Other Support				
Contributions and bequests	\$ 22,472,202	\$ 761,500	\$ 23,233,702	\$ 119,409,368
Less: Contributions raised on behalf of others	<u>(4,254,212)</u>	<u>-</u>	<u>(4,254,212)</u>	<u>(1,825,940)</u>
Total Contributions and bequests	18,217,990	761,500	18,979,490	117,583,428
Investment income	(9,378,693)	(1,269,725)	(10,648,418)	39,431,800
Less: Investment income on behalf of others	<u>440,655</u>	<u>-</u>	<u>440,655</u>	<u>(2,110,992)</u>
Total Investment income (loss)	(8,938,038)	(1,269,725)	(10,207,763)	37,320,808
Change in value of bequests receivable	(25,688,607)	-	(25,688,607)	-
Change in value of charitable remainder trusts	-	(2,352,798)	(2,352,798)	2,762,313
Charitable remainder trust contributions	-	235,821	235,821	49,907,500
Change in value of interests in perpetual trusts	-	3,359	3,359	3,278
Rental (net of expenses of \$510,422 and \$604,866)	(190,321)	-	(190,321)	(68,830)
Other income	721,602	-	721,602	797,667
Net assets released from restrictions:				
Available for distribution per spending policy	2,094,541	(2,094,541)	-	-
Reclassification and other releases from restrictions	<u>1,577,335</u>	<u>(1,577,335)</u>	<u>-</u>	<u>-</u>
Total Revenue, Gains (Losses) and Other Support	<u>(12,205,498)</u>	<u>(6,293,719)</u>	<u>(18,499,217)</u>	<u>208,306,164</u>
Expenses				
Program services:				
Grants, net of rescinds	32,726,864	-	32,726,864	26,618,404
Less: Grants made on behalf of others	<u>(2,591,585)</u>	<u>-</u>	<u>(2,591,585)</u>	<u>(568,546)</u>
Total Grants, net of rescinds	30,135,279	-	30,135,279	26,049,858
Activities:				
Grant making	2,772,378	-	2,772,378	1,725,991
Direct program	<u>242,398</u>	<u>-</u>	<u>242,398</u>	<u>880,143</u>
Total Program Services	<u>33,150,055</u>	<u>-</u>	<u>33,150,055</u>	<u>28,655,992</u>
Support services:				
Administrative and fund management	1,783,058	-	1,783,058	3,163,822
Fundraising and development	<u>1,535,722</u>	<u>-</u>	<u>1,535,722</u>	<u>1,731,415</u>
Total Support Services	<u>3,318,780</u>	<u>-</u>	<u>3,318,780</u>	<u>4,895,237</u>
Total Expenses	<u>36,468,835</u>	<u>-</u>	<u>36,468,835</u>	<u>33,551,229</u>
Change in Net Assets	(48,674,333)	(6,293,719)	(54,968,052)	174,754,935
Net Assets, January 1	<u>384,961,084</u>	<u>128,240,282</u>	<u>513,201,366</u>	<u>338,446,431</u>
Net Assets, December 31	<u>\$ 336,286,751</u>	<u>\$ 121,946,563</u>	<u>\$ 458,233,314</u>	<u>\$ 513,201,366</u>

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

SANTA BARBARA FOUNDATION

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES

For the Year Ended December 31, 2018

(With Comparative Totals for the Year Ended December 31, 2017)

Expenses	<u>Program Services</u>	<u>Administrative and Fund Management</u>	<u>Fundraising and Development</u>	<u>Total 2018</u>	(Memo) <u>Total 2017</u>
Grants, net of rescinds	\$ 30,135,279	\$ -	\$ -	\$ 30,135,279	\$ 26,049,858
Salaries	751,726	870,455	728,237	2,350,418	2,690,218
Direct program activities	1,378,798	-	-	1,378,798	880,135
Professional services	242,398	370,008	175,968	788,374	724,022
Employee benefits	146,061	168,603	142,154	456,818	589,291
Community relations	101,154	4,417	151,457	257,028	194,528
Computer services	62,951	81,119	41,222	185,292	170,400
Payroll taxes	59,056	68,284	57,211	184,551	199,640
Meetings and conferences	60,701	78,555	39,277	178,533	185,472
Occupancy costs	48,413	56,355	46,020	150,788	160,155
Depreciation	42,043	47,622	43,036	132,701	132,975
Rent	27,975	29,577	14,788	72,340	75,448
Dues, subscriptions and licenses	23,010	29,777	14,889	67,676	45,284
Office supplies	22,348	26,794	17,436	66,578	53,454
Advertising	18,350	-	27,526	45,876	34,135
Publications	11,942	3,981	23,882	39,805	47,938
Telephone	12,471	16,139	8,070	36,680	43,332
Insurance	3,320	13,762	3,217	20,299	32,083
Equipment and maintenance	2,059	2,665	1,332	6,056	3,692
Contribution expense	-	-	-	-	10,062
Unrelated business income tax	-	(85,055)	-	(85,055)	1,229,107
Total Expenses, December 31, 2018	<u>\$ 33,150,055</u>	<u>\$ 1,783,058</u>	<u>\$ 1,535,722</u>	<u>\$ 36,468,835</u>	
 Total Expenses, December 31, 2017 (Memo)	 <u>\$ 28,655,992</u>	 <u>\$ 3,163,822</u>	 <u>\$ 1,731,415</u>		 <u>\$ 33,551,229</u>

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

SANTA BARBARA FOUNDATION

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Year Ended December 31, 2018

(With Comparative Totals for the Year Ended December 31, 2017)

	<u>2018</u>	<u>(Memo)</u> <u>2017</u>
Cash Flows from Operating Activities:		
Change in net assets	\$ (54,968,052)	\$ 174,754,935
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation	396,093	416,842
Loss on disposal of property and equipment	-	10,343
Realized and unrealized loss (gain) on investments	13,571,955	(32,355,582)
Provision for bad debts	(14,703)	(16,501)
Present value discount	(411,727)	(499,201)
Contributions restricted for long-term investment	(761,500)	(326,104)
Non-cash contributions of stock	(7,555,666)	(22,282,169)
(Increase) decrease in:		
Accounts receivable	15,960	(9,718)
Contributions and bequests receivable	27,502,719	(74,433,405)
Other current and non-current assets	(37,729)	(2,827)
Assets held under charitable trust agreements	1,661,359	(49,363,370)
Perpetual income interest	1,718,032	(1,493,934)
Increase (decrease) in:		
Accounts payable and accrued expenses	(72,660)	(51,694)
Grants payable	(476,454)	121,871
Liabilities under charitable trust agreements	(181,140)	(8,719)
Funds held on behalf of others	714,865	2,959,140
Other non-current liabilities	(50,525)	(5,883)
Net Cash Used by Operating Activities	<u>(18,949,173)</u>	<u>(2,585,976)</u>
Cash Flows from Investing Activities:		
Payment of lease commissions	(81,152)	-
Purchase of property and equipment	(38,594)	(11,721)
Purchase of available-for-sale securities	(180,935,495)	(229,536,695)
Proceeds from sale of securities	199,201,526	237,604,755
Student loan repayments	464,209	455,911
Return on capital shareholder distribution	1,112,520	1,791,982
Mission related investment loan repayments	53,000	12,000
Net Cash Provided by Investing Activities	<u>19,776,014</u>	<u>10,316,232</u>
Cash Flows from Financing Activities:		
Contributions restricted for long-term investment	761,500	326,104
Payments on long-term debt	(81,888)	(78,541)
Net Cash Provided by Financing Activities	<u>679,612</u>	<u>247,563</u>
Net Increase In Cash and Cash Equivalents	1,506,453	7,977,819
Cash and Cash Equivalents - January 1	<u>33,950,347</u>	<u>25,972,528</u>
Cash and Cash Equivalents - December 31	<u>\$ 35,456,800</u>	<u>\$ 33,950,347</u>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the year for interest	\$ 134,313	\$ 137,659
Cash paid during the year for unrelated business income tax	\$ -	\$ 1,227,107

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

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Santa Barbara Foundation (SBF) 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. It is the mission of SBF to mobilize collective wisdom and philanthropic capital to build empathetic, inclusive and resilient communities. SBF continues to serve as one of the largest private funding sources for area nonprofits, agencies and college bound students.

Supporting Organizations

SBF works with entities organized as supporting organizations to SBF for the specific and primary purpose of benefiting, performing functions of and engaging in activities consistent with SBF's charitable purposes. SBF appoints a majority of the members of the governing boards of the supporting organizations. Each governing board may create its own investment policy and grant guidelines. In 2018, the following supporting organizations were effectively under SBF's control and were consolidated for financial statement purposes:

Highland Santa Barbara Foundation, Inc. (HSBF) - organized in November 2011

The Eric and Kelly Schwartz Charitable Trust (EKSCT) - organized in August 2015

Affiliates

In 2018, the following affiliates were effectively under SBF's control and were consolidated for financial statement purposes:

1111 Chapala Street, LLC, whose primary operating asset is a commercial building located in Santa Barbara, CA

300 East Islay Street, LLC, whose primary operating asset is a residential building located in Santa Barbara, CA

SBF Properties, LLC, whose purpose is to receive gifts of real property

Principles of Consolidation

The accompanying financial statements as of December 31, 2018, include the financial statements of SBF and its supporting organizations and affiliates, listed above. All material inter-organizational transactions and balances have been eliminated in the consolidation.

Basis of Accounting

The accompanying financial statements of SBF have been prepared on the accrual basis of accounting.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Description of Net Assets

SBF reports information regarding its financial position and activities in two classes of net assets - with donor restrictions and without donor restrictions - based on the existence or absence of donor-imposed restrictions.

SBF's governing documents provide the Board of Trustees with the variance power to modify any restriction or condition placed on gifts to SBF 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.

Without Donor Restrictions

Net assets without donor restrictions represent net assets that are not subject to donor-imposed time or use restrictions. Net assets without donor restrictions include board designated funds.

With Donor Restrictions

Net assets with donor restrictions represent net assets that are subject to donor-imposed time or use restrictions. Net assets with donor restrictions generally include contributions and bequests receivable and planned gifts. Earnings on net assets with donor restrictions are reported as an increase in net assets with donor restrictions. Earnings on donor-restricted endowment funds that have not yet been appropriated are also classified as net assets with donor restrictions. When a restriction expires, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the Statement of Activities as "Net assets released from restrictions". Net assets with donor restrictions include perpetual income trusts for which the related income is reported as contributions without donor restrictions when received on the Statement of Activities. The change in value of the underlying assets is recorded as an unrealized gain or loss in net assets with donor restrictions on the Statement of Activities. Net assets with donor restrictions also consist of those donor-restricted endowments held by SBF as defined under the Uniform Prudent Management of Institutional Funds Act (UPMIFA).

Functional Expense Allocation

Salaries, employee benefits, and payroll taxes are allocated based on time spent in each functional area by specific employee as estimated by management. Indirect costs included in meetings and conferences, computer services, occupancy costs, depreciation, rent, and office expense and supplies are allocated based on number of employees by functional area based on time spent by specific employee as estimated by management. Certain advertising costs are allocated based on the percentage of the publication devoted to each functional area. All other costs are charged directly to the appropriate functional category.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Comparative Amounts

The amounts shown for 2017 in the accompanying financial statements are included to provide a basis for comparison with 2018 and are not intended to present all information necessary for a fair presentation of the 2017 financial statements in conformity with accounting principles generally accepted in the United States of America.

Cash and Cash Equivalents

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

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 SBF have occurred and/or the court has issued an order to transfer the assets.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Donated Services

Donated goods and services received by SBF are recorded at fair market value at the time of the donation. For the year ended December 31, 2018, numerous volunteers gave their time and expertise to SBF 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 SBF, 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.

Donated Property and Investments

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

Investments in Securities

SBF 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. SBF 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.

Income Taxes

SBF and its supporting organizations 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, SBF and its supporting organizations 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.

SBF and its supporting organizations 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, 2018, SBF and its supporting organizations and affiliates have no uncertain tax positions requiring accrual.

SBF and its supporting organizations and affiliates file tax returns in California and U.S. federal jurisdictions. SBF is no longer subject to U.S. federal and state tax examinations by tax authorities for years before 2015 and 2014, respectively.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and Equipment

Property and equipment is stated at cost, or fair market value if donated. In general, SBF 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

SBF receives and distributes assets under certain agency and intermediary arrangements. If a not-for-profit organization (NPO) establishes a fund at SBF with its own funds and specifies itself or its affiliate as the beneficiary of that fund, then SBF 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 consolidated statement of financial position.

Grants

Grants are recorded as expenses when they are approved by the Board of Trustees. A discount factor of 5% is applied to grants payable in more than one year. SBF records the rescission of grants in the year the grant is cancelled.

Student Loans

Policy

SBF 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, SBF awarded interest-free loans on need and merit with repayments beginning six months after the student graduated or left school. In 2015, SBF 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, SBF 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, SBF 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.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Student Loans (continued)

Allowances for Uncollectible Loans

SBF 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

SBF has evaluated subsequent events through September 12, 2019, 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, 2018, contributions and bequests receivable are expected to be collected as follows:

In one year or less	\$ 90,400
In more than one year	47,294,872
Discount to present value	(58,777)
Contributions and bequests receivable, net	<u>\$ 47,326,495</u>

Note 3 - STUDENT LOANS RECEIVABLE

Student loans receivable are comprised of the following as of December 31, 2018:

Total student loan balances	\$ 2,026,981
Allowance for amounts to be forgiven	(489,366)
Allowance for uncollectible loans	(91,000)
Discount to present value	<u>(234,000)</u>
Net student loans receivable	<u>\$ 1,212,615</u>

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

Receivable in less than one year	\$ 300,000
Receivable in one to ten years	1,003,615
Allowance for uncollectible loans	<u>(91,000)</u>
Net student loans receivable	<u>\$ 1,212,615</u>

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

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - NOTES RECEIVABLE

SBF has 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, 2018:

Receivable in less than one year	\$ 1,500,000
Receivable in five to nine years	<u>4,000,000</u>
Total donor advised loans receivable	5,500,000
Discount to present value	<u>(365,590)</u>
Net notes receivable	<u>\$ 5,134,410</u>

The notes receivable within one year bear interest ranging from 0.61% to 0.64% and are due December 31, 2019.

The note receivable in five to nine years bears interest at a variable rate of 1-month LIBOR, 2.50% at December 31, 2018, plus 1%. Interest is payable in semi-annual installments. 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

Mission related investments consist of loans from board designated funds to NPOs to support charitable activities consistent with SBF's tax exempt purpose. As of December 31, 2018, the total outstanding loan balance of \$500,000 is discounted by \$45,699 to reflect the present value of \$454,301.

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 SBF 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, 2018, investments consisted of the following:

	<u>Cost Basis</u>	<u>Market Value</u>	<u>Unrealized Gain (Loss)</u>
Global equities	\$ 77,317,872	\$ 72,740,341	\$ (4,577,531)
Domestic equities	5,716,876	6,160,160	443,284
International equities	1,403,446	1,384,235	(19,211)
Domestic fixed income	1,628,806	1,600,234	(28,572)
Global fixed income	76,242,419	76,012,839	(229,580)
Fixed income (illiquid)	25,376,523	65,800,000	40,423,477
Closely held stock	28,956,863	42,771,721	13,814,858
Real assets/real estate	19,318,347	18,615,704	(702,643)
Infrastructure	543,898	490,982	(52,916)
Private equity	8,514,084	11,955,170	3,441,086
Partnerships	4,415,043	3,426,646	(988,397)
Hedge funds	<u>836,384</u>	<u>486,566</u>	<u>(349,818)</u>
Total	<u>\$ 250,270,561</u>	<u>\$ 301,444,598</u>	<u>\$ 51,174,037</u>

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - INVESTMENTS (CONTINUED)

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	\$ 250,270,561	\$ 301,444,598	\$ 51,174,037
Balance at beginning of the year	\$ 257,491,788	\$ 326,839,438	\$ 69,347,650
Change in unrealized gain (loss)			<u>\$ (18,173,613)</u>

The following summarizes the investment return in the statement of activities for the year ended December 31, 2018:

Interest and dividend income	\$ 4,061,843
Realized gain on value of securities	3,615,278
Unrealized loss on value of securities	(18,173,613)
Add back: investment loss allocated to others	694,209
Less: investment fees	<u>(405,480)</u>
Net Investment Return	<u>\$ (10,207,763)</u>

As of the year ended December 31, 2018, approximately 36% of the fair market value of investments and a significant portion of the unrealized gains and losses are attributable to the two supporting organizations, HSBF and EKSCT. The fair market value of HSBF's illiquid fixed income and EKSCT's closely held stock position are based upon annual independent third-party valuations using the same techniques and variables as in prior years.

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 SBF to sell an asset or be paid by SBF 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. There are three levels of input to measure fair value. The valuation hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3).

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 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.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - FAIR VALUE MEASUREMENT (CONTINUED)

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.

Accounting Standards Update (ASU) No. 2015-07, Disclosures for Investments in Certain Entities That Calculate Net Asset Value (NAV) per Share (or Its Equivalent) requires specific investments that have fair value reported at NAV per share to no longer be classified in the fair value hierarchy. Financial instruments are considered valued at NAV when the investment (hedge funds, private equity and real asset/real estate funds) are valued at NAV based on capital statements provided by entities that calculate fair value using NAV per share or its equivalent.

SANTA BARBARA FOUNDATION

NOTES TO 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, 2018:

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>NAV</u>	<u>Total</u>
Investments					
Global equities	\$ 65,608,081	\$ 7,132,260	\$ -	\$ -	\$ 72,740,341
Domestic equities	6,160,160	-	-	-	6,160,160
International equities	1,384,235	-	-	-	1,384,235
Domestic fixed income	1,600,234	-	-	-	1,600,234
Global fixed income	38,843,893	31,445,426	5,723,520	-	76,012,839
Fixed income (illiquid)	-	-	65,800,000	-	65,800,000
Closely held stock	-	-	-	42,771,721	42,771,721
Real assets/real estate	7,823,297	-	-	10,792,407	18,615,704
Infrastructure	313,111	-	-	177,871	490,982
Private equity	-	-	-	11,955,170	11,955,170
Partnerships	-	-	3,426,646	-	3,426,646
Hedge funds	435,937	-	-	50,629	486,566
Total Investments	<u>122,168,948</u>	<u>38,577,686</u>	<u>74,950,166</u>	<u>65,747,798</u>	<u>301,444,598</u>
Assets held under charitable trust agreements:					
Charitable trusts, life policy	-	-	61,164,956	-	61,164,956
Charitable remainder trusts	943,211	-	-	-	943,211
Charitable gift annuities	849,912	-	-	-	849,912
Pooled income funds	620,858	-	-	-	620,858
Total Assets held under charitable trust agreements	<u>2,413,981</u>	<u>-</u>	<u>61,164,956</u>	<u>-</u>	<u>63,578,937</u>
Perpetual income interest	<u>13,927,585</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>13,927,585</u>
Total Assets measured at fair value	<u>\$ 138,510,514</u>	<u>\$ 38,577,686</u>	<u>\$136,115,122</u>	<u>\$ 65,747,798</u>	<u>\$ 378,951,120</u>
Charitable trust liabilities measured at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,367,741</u>	<u>\$ -</u>	<u>\$ 1,367,741</u>

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

Global equities – includes investment in domestic and international equities of varying market capitalizations selected by the investment manager. Equities are held as separate ownership shares of a specific company or in the form of mutual funds or ETFs.

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

Domestic fixed income – includes investment in domestic 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.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - FAIR VALUE MEASUREMENT (CONTINUED)

Global 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 or ETFs.

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, HSBF.

Closely held stocks (illiquid) – includes shares of an C-Corporation held by EKSCT. The shares are illiquid.

Real assets/real estate – includes six 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; several real asset mutual funds and four real asset fund of funds partnerships invested in partnerships focused on natural resources: timber, precious metals, commodities, mining, energy, etc. All of the real asset partnerships are illiquid and cannot be redeemed. Unfunded commitments in the real asset category total \$3,186,420.

Infrastructure – includes an exchange-traded fund and an open-ended core infrastructure fund that has exposure in transportation, communication, water and electricity/power/energy services. Unfunded commitments in the infrastructure category total \$1,801,115.

Private equity – includes fourteen 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 \$8,148,574. 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 SBF holds a 7.7% interest is comprised of many different partnerships with both domestic and international exposure. SBF holds a 38.44% interest in limited partnership comprised of real estate holdings. This partnership interest was extended in early 2018 and will now terminate in June 2062. All of these partnership interests are illiquid and not redeemable.

Hedge funds – includes three separate funds, which are all in the latter stages of full redemption.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - FAIR VALUE MEASUREMENT (CONTINUED)

The following table provides a reconciliation of assets measured at fair value using significant unobservable inputs (Level 3) for the year ended December 31, 2018:

Description	Beginning Balance	Net Gains and (Losses)	Purchases and Issuances	Sales and Settlements	Ending Balance
Global fixed income	\$ 5,500,000	\$ 33,520	\$ 190,000	\$ -	\$ 5,723,520
Fixed income (illiquid)	78,000,000	(12,200,000)	-	-	65,800,000
Partnerships	3,426,646	-	-	-	3,426,646
Charitable trusts/other	<u>62,592,990</u>	<u>(456,798)</u>	<u>-</u>	<u>(971,236)</u>	<u>61,164,956</u>
Total	<u>\$ 149,519,636</u>	<u>\$ (12,623,278)</u>	<u>\$ 190,000</u>	<u>\$ (971,236)</u>	<u>\$ 136,115,122</u>

Global fixed income includes \$5,500,000 of emerging market debt recategorized from Level 1 to Level 3 as of January 1, 2018, as it was determined that a component is under warrant and options, which requires that the entire investment be categorized as Level 3.

SBF 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 to these funds totaled \$13,136,109 as of December 31, 2018.

The following table sets forth additional disclosures of the organization's investments at Level 3 and NAV:

Investment	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Global fixed income	\$ 5,723,520	\$ -	Monthly	-
Fixed income (illiquid)	65,800,000	-	Non-redeemable	-
Closely held stock	42,771,721	-	Non-redeemable	-
Infrastructure	177,871	1,801,115	Non-redeemable	-
Real assets/real estate	10,792,407	3,186,420	Non-redeemable	-
Private equity	11,955,170	8,148,574	Non-redeemable	-
Partnerships	3,426,646	-	Non-redeemable	-
Hedge funds:				
AG Super Fund, LP	28,217	-	In Redemption	-
Silvercreek	19,869	-	In Redemption	-
RD Legal	<u>2,543</u>	<u>-</u>	In Redemption	-
Total	<u>\$ 140,697,964</u>	<u>\$ 13,136,109</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. SBF records such split-interest agreements held in charitable remainder trusts, charitable gift annuities, pooled income funds, and perpetual interest trusts as follows:

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Charitable Remainder Trusts

SBF 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. SBF 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.

If SBF is the trustee, the fair market value of the trust is recorded in SBF'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 \$943,211 with a corresponding payment liability for future payments of \$571,138 at December 31, 2018.

If SBF 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, 2018, the present value of these trusts where SBF is not the trustee was \$56,751,392, including both life insurance policies.

SBF is named income beneficiary for five charitable lead trusts. The present value of the expected annual payments over the remaining years of each trust is recorded. The expected cash flow from the trusts to SBF was \$6,755,062 at December 31, 2018.

Charitable Gift Annuities

Charitable gift annuity donors have contributed assets to SBF in exchange for a promise by SBF 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 SBF, and the liability is an obligation of SBF. SBF 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 42 charitable gift annuities was \$849,912 with a corresponding present value liability of \$657,011 at December 31, 2018.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Pooled Income Funds

Pooled Income Fund donors have contributed assets to SBF 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 SBF. The fair market value of the asset is recorded in SBF'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, 2018, was \$620,858 with a corresponding present value liability of \$139,592.

Perpetual Income Trust Interest

SBF is named as an income beneficiary of seven perpetual trusts, the corpus of which is not controlled by the management of SBF. Under these arrangements, SBF 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. SBF also has a future interest in the income of assets yet to be received by one of the above trusts.

Since SBF is a beneficiary of this stream of income in perpetuity, SBF's share of the fair market value of the trusts' investments is recorded as an asset, with a fair market value of \$13,927,585 at December 31, 2018. Any change in subsequent years in the fair market value of SBF'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, 2018, consists of the following:

Building and leasehold improvements	\$ 13,675,901
Land	3,265,379
Office equipment	269,545
Donated artwork	17,500
Furniture	<u>276,128</u>
Total property and equipment	17,504,453
Less accumulated depreciation and amortization	<u>(3,475,767)</u>
Property and equipment, net	<u>\$ 14,028,686</u>

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - NOTE PAYABLE

SBF 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 \$2,922,078 due on October 20, 2021. Future maturities of principal obligations are as follows as of December 31, 2018:

2019		\$ 86,934
2020		88,694
2021		<u>2,990,559</u>
Total		<u>\$ 3,166,187</u>

Note 11 - GRANTS

Future minimum grants payable are as follows as of December 31, 2018:

2019		\$ 160,000
2020		20,000
2021		<u>20,000</u>
Subtotal		200,000
Less discount		<u>(4,583)</u>
Grants Payable		195,417
Less current portion		<u>(160,000)</u>
Long-term portion		<u>\$ 35,417</u>

Grant expense is comprised of the following for the year ended December 31, 2018:

Donor advised		\$21,168,840
Competitive		4,498,207
Field of interest		2,163,076
Donor designated		1,384,657
Supporting organizations		700,000
Fiscal sponsorships		177,030
Pass-through		<u>43,469</u>
Total Grants, net of rescinds		<u>\$ 30,135,279</u>

Note 12 - CONCENTRATIONS AND RISKS

Credit Risk

SBF 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. SBF had uninsured cash of approximately \$31,800,000 deposited with six different banks. In addition, SBF maintains significant cash balances in money market funds. Such balances are not fully insured.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - CONCENTRATIONS AND RISKS (CONTINUED)

Concentrations

As of the year ended December 31, 2018, approximately 36% of the fair market value of investments and a significant portion of the unrealized gains and losses are attributable to the two supporting organizations, HSBF and EKSCT. The fair market value of HSBF's illiquid fixed income and EKSCT's closely held stock position are based upon annual independent third-party valuations using the same techniques and variables as in prior years.

Market Risk

SBF 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 consolidated financial statements.

Note 13 - ENDOWMENT FUNDS

Interpretation of Relevant Law

The Board of Trustees of SBF, 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, SBF has classified with the explicit prohibition by the donor as net assets with donor restrictions (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 are classified as net assets with donor restrictions until those amounts are appropriated for expenditure by SBF 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 SBF 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 SBF.
- (7) The investment policies of SBF.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - ENDOWMENT FUNDS (CONTINUED)

Endowment Investment and Spending Policies

SBF 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.

SBF'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 SBF'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 over time. SBF also provides four other investment options for donors that have a shorter time horizon and more immediate spending needs, including a socially responsible investment option.

SBF 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 SBF'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, 2018, 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, SBF 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 SBF 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 net assets with donor restrictions. 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, 2018 and 2017, respectively, the Foundation held six and nine endowment funds where the principal had fallen below the original corpus due to market conditions. The total fair values, original gift amounts and deficiencies related to these funds as of December 31 are as follows:

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - ENDOWMENT FUNDS (CONTINUED)

	2018	2017
Fair value of underwater endowments	\$ 27,822,189	\$ 10,931,839
Original endowment gift amount	30,431,254	11,856,160
Deficiencies of underwater endowment funds	\$ (2,609,065)	\$ (924,321)

Endowment net assets with donor restrictions totaled \$45,624,059, consisting of total original gift endowment contributions of \$45,395,873 and accumulated earnings of \$228,186 as of December 31, 2018.

There were no endowment net assets without donor restrictions or assets classified as board-restricted endowment funds as of December 31, 2018.

Note 14 - RELATED PARTY TRANSACTIONS

A majority of trustees and committee members of SBF also serve as trustees of entities receiving grants and support from SBF. 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.

Note 15 - LEASES

SBF 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, 2018:

2019	\$ 71,148
2020	70,528
2021	67,145
2022	64,502
2023	47,743
Total	\$ 321,066

Lease expense for the year ended December 31, 2018 totaled \$72,340.

Note 16 - RETIREMENT PLANS

SBF 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. SBF matches at its discretion up to 4% of the eligible salary upon participation. For eligible employees with more than one year of service SBF, 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, 2018, totaled \$194,961.

In addition, SBF has a non-qualified deferred compensation plan. There were no SBF employer contributions for the year ended December 31, 2018.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - LIQUIDITY

Financial assets available to meet cash needs for general expenditure for the following year are comprised of current assets and investments, adjusted for amounts unavailable due to illiquidity, endowments and other funds spending policy appropriations beyond one year, and current liabilities payable to vendors, financial institutions, and nonprofit organizations.

Financial assets available to meet cash needs for general expenditures within one year as of December 31, 2018:

Current assets	
Cash and cash equivalents	\$ 35,456,800
Contributions and bequests receivable, current portion	90,400
Student loans receivable, current portion	300,000
Notes receivable, current portion	1,500,000
Other current assets	<u>150,299</u>
Total Current Assets	<u>37,497,499</u>
Investments	301,444,598
Less investments unavailable for general expenditures within one year:	
Illiquid, not convertible to cash within one year	(113,820,378)
Endowments and other funds subject to spending policy appropriations beyond one year:	
Without donor restrictions	(100,740,176)
With donor restrictions	(43,546,027)
Funds held on behalf of others	<u>(19,260,851)</u>
Investments available for general expenditures within one year	<u>24,077,166</u>
Current liabilities	<u>(716,261)</u>
Financial assets available to meet cash needs for general expenditures within one year as of December 31, 2018	<u>\$ 60,858,404</u>

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, 2018, net assets released from restriction totaled \$3,671,876.

Note 19 - RECLASSIFICATION

Certain amounts from the December 31, 2017 financial statements have been reclassified to conform to the December 31, 2018 financial statement presentation.

SANTA BARBARA FOUNDATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 20 - NET ASSETS

As of December 31, 2018, net assets consist of the following:

Net Assets Without Donor Restrictions

Supporting organizations	\$ 110,032,644
Donor-advised funds	92,026,817
Undesignated funds	81,195,266
Field of interest funds	40,234,576
Donor designated funds	7,481,322
Board designated funds	3,378,986
Fiscal sponsorship	<u>1,937,140</u>
Total net assets without donor restrictions	<u>\$ 336,286,751</u>

Net Assets With Donor Restrictions

Pledges and bequests receivable	\$ 183,723
Split-interest agreements	62,043,416
Life insurance gift	167,780
Perpetual income trust interest	13,927,585
Donor restricted endowment funds	<u>45,624,059</u>
Total net assets with donor restrictions	<u>\$ 121,946,563</u>