



HOBART AND WILLIAM SMITH COLLEGES

Financial Statements

May 31, 2018 and 2017

(With Independent Auditors' Report Thereon)

HOBART AND WILLIAM SMITH COLLEGES

Financial Statements
May 31, 2018 and 2017

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KPMG LLP
515 Broadway
Albany, NY 12207-2974

Independent Auditors' Report

The Board of Trustees
Hobart and William Smith Colleges:

We have audited the accompanying financial statements of Hobart and William Smith Colleges, which comprise the statements of financial position as of May 31, 2018 and 2017, the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hobart and William Smith Colleges as of May 31, 2018 and 2017, and the changes in their net assets and their cash flows the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

November 30, 2018

HOBART AND WILLIAM SMITH COLLEGES

Statements of Financial Position

May 31, 2018 and 2017

Assets	2018	2017
Cash and cash equivalents	\$ 7,769,817	14,013,150
Short-term investments	6,625,343	6,781,325
Accounts receivable, net	2,022,432	2,745,281
Notes receivable, net	1,948,515	2,075,538
Contributions receivable, net	4,385,797	3,917,168
Other assets	1,950,844	2,548,242
Long-term investments	236,543,225	218,906,263
Land, buildings and equipment, net	156,578,919	156,020,469
Total assets	<u>\$ 417,824,892</u>	<u>407,007,436</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued liabilities	\$ 8,966,613	10,070,083
Deferred revenue and deposits	6,147,516	4,103,180
Deferred giving liabilities	1,442,265	1,488,462
Refundable advances from government loan programs	1,862,846	1,929,885
Asset retirement obligations	2,736,599	2,683,777
Fair value of swap agreement	4,995,139	6,787,172
Bonds and note payable, net	62,893,129	65,286,798
Total liabilities	<u>89,044,107</u>	<u>92,349,357</u>
Net assets:		
Unrestricted	123,130,055	125,503,175
Temporarily restricted	67,575,930	54,908,845
Permanently restricted	138,074,800	134,246,059
Total net assets	<u>328,780,785</u>	<u>314,658,079</u>
Total liabilities and net assets	<u>\$ 417,824,892</u>	<u>407,007,436</u>

See accompanying notes to financial statements.

HOBART AND WILLIAM SMITH COLLEGES

Statement of Activities

Year ended May 31, 2018

(with summarized information for the year ended May 31, 2017)

	2018			Total	2017 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
Operating revenues:					
Tuition and fees	\$ 117,754,398	—	—	117,754,398	114,233,377
Student aid	(56,799,893)	—	—	(56,799,893)	(50,282,427)
Net tuition and fees	60,954,505	—	—	60,954,505	63,950,950
Sales and services of auxiliaries	26,034,413	—	—	26,034,413	24,412,934
Government grants and contracts	2,599,254	—	—	2,599,254	2,294,288
Private gifts and grants	4,096,685	622,519	—	4,719,204	6,210,225
Endowment spending	10,027,845	711,071	—	10,738,916	9,213,623
Other investment income	218,710	—	—	218,710	244,993
Other	892,689	9,660	—	902,349	1,086,642
Net assets released from restrictions	1,276,117	(1,265,195)	(10,922)	—	—
Total operating revenues	106,100,218	78,055	(10,922)	106,167,351	107,413,655
Operating expenses:					
Instruction	35,483,757	—	—	35,483,757	36,504,523
Academic support	12,522,246	—	—	12,522,246	11,593,771
Student services	24,566,507	—	—	24,566,507	24,277,489
Institutional support	20,272,914	—	—	20,272,914	18,587,741
Auxiliaries operations	17,207,783	—	—	17,207,783	15,756,275
Total operating expenses	110,053,207	—	—	110,053,207	106,719,799
Change in net assets from operating activities	(3,952,989)	78,055	(10,922)	(3,885,856)	693,856
Nonoperating activities:					
Investment return, net of amounts designated for operations	152,072	11,286,283	242,170	11,680,525	20,352,927
Private gifts	1,513,896	2,130,888	3,410,416	7,055,200	8,999,193
Other changes, net	(1,733,926)	2,090	53,768	(1,678,068)	(446,487)
Change in value of deferred giving arrangements	—	(182,301)	104,288	(78,013)	(211,716)
Change in fair value of swap agreement	1,792,033	—	—	1,792,033	1,546,839
Realized losses on swap agreement	(763,115)	—	—	(763,115)	(922,058)
Net assets released from restrictions or reclassified	618,909	(647,930)	29,021	—	—
Change in net assets from nonoperating activities	1,579,869	12,589,030	3,839,663	18,008,562	29,318,698
Increase (decrease) in net assets	(2,373,120)	12,667,085	3,828,741	14,122,706	30,012,554
Net assets:					
Beginning of year	125,503,175	54,908,845	134,246,059	314,658,079	284,645,525
End of year	\$ 123,130,055	67,575,930	138,074,800	328,780,785	314,658,079

See accompanying notes to financial statements.

HOBART AND WILLIAM SMITH COLLEGES

Statement of Activities

Year ended May 31, 2017

	2017			Total
	Unrestricted	Temporarily restricted	Permanently restricted	
Operating revenues:				
Tuition and fees	\$ 114,233,377	—	—	114,233,377
Student aid	<u>(50,282,427)</u>	<u>—</u>	<u>—</u>	<u>(50,282,427)</u>
Net tuition and fees	63,950,950	—	—	63,950,950
Sales and services of auxiliaries	24,412,934	—	—	24,412,934
Government grants and contracts	2,294,288	—	—	2,294,288
Private gifts and grants	4,877,622	1,332,603	—	6,210,225
Endowment spending	8,225,711	987,912	—	9,213,623
Other investment income	244,993	—	—	244,993
Other	1,086,222	420	—	1,086,642
Net assets released from restrictions	<u>532,741</u>	<u>(538,750)</u>	<u>6,009</u>	<u>—</u>
Total operating revenues	<u>105,625,461</u>	<u>1,782,185</u>	<u>6,009</u>	<u>107,413,655</u>
Operating expenses:				
Instruction	36,504,523	—	—	36,504,523
Academic support	11,593,771	—	—	11,593,771
Student services	24,277,489	—	—	24,277,489
Institutional support	18,587,741	—	—	18,587,741
Auxiliaries operations	<u>15,756,275</u>	<u>—</u>	<u>—</u>	<u>15,756,275</u>
Total operating expenses	<u>106,719,799</u>	<u>—</u>	<u>—</u>	<u>106,719,799</u>
Change in net assets from operating activities	<u>(1,094,338)</u>	<u>1,782,185</u>	<u>6,009</u>	<u>693,856</u>
Nonoperating activities:				
Investment return, net of amounts designated for operations	342,776	19,747,524	262,627	20,352,927
Private gifts	3,787,027	472,131	4,740,035	8,999,193
Other changes, net	(30,121)	(43,714)	(372,652)	(446,487)
Change in value of deferred giving arrangements	—	(202,630)	(9,086)	(211,716)
Change in fair value of swap agreement	1,546,839	—	—	1,546,839
Realized losses on swap agreement	(922,058)	—	—	(922,058)
Net assets released from restrictions or reclassified	<u>12,640,749</u>	<u>(12,761,632)</u>	<u>120,883</u>	<u>—</u>
Change in net assets from nonoperating activities	<u>17,365,212</u>	<u>7,211,679</u>	<u>4,741,807</u>	<u>29,318,698</u>
Increase (decrease) in net assets	16,270,874	8,993,864	4,747,816	30,012,554
Net assets:				
Beginning of year	109,232,301	45,914,981	129,498,243	284,645,525
End of year	\$ <u>125,503,175</u>	\$ <u>54,908,845</u>	\$ <u>134,246,059</u>	\$ <u>314,658,079</u>

See accompanying notes to financial statements.

HOBART AND WILLIAM SMITH COLLEGES

Statements of Cash Flows

Years ended May 31, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Change in net assets	\$ 14,122,706	30,012,554
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation, amortization and accretion	7,113,434	7,150,379
Provision for uncollectible contributions receivable	88,798	683,059
Loss on disposal of land, buildings and equipment	—	45,002
Change in deferred giving liabilities	(46,197)	(17,115)
Change in fair value of swap agreement	(1,792,033)	(1,546,839)
Receipt of contributed securities	(2,063,597)	(569,153)
Contributions restricted for long-term investment	(4,360,949)	(9,743,968)
Interest and dividends restricted for long-term investment	(198,642)	(187,575)
Net realized and unrealized gains on investments	(18,725,611)	(26,384,779)
Changes in operating assets and liabilities that provide (use) cash:		
Accounts receivable, net	722,849	(1,071,146)
Contributions receivable	(557,427)	(1,276,399)
Other assets	597,398	(461,949)
Accounts payable and accrued liabilities	(529,996)	(82,970)
Asset retirement obligations	(70,708)	(14,780)
Deferred revenues and deposits	2,044,336	1,671,726
Net cash used in operating activities	(3,655,639)	(1,793,953)
Cash flows from investing activities:		
Acquisition of land, buildings and equipment	(8,267,998)	(7,740,761)
Notes issued	(303,500)	(318,185)
Proceeds from note collections	430,523	418,059
Proceeds from sales and maturities of investments	40,933,598	23,505,476
Purchases of investments	(39,688,966)	(24,579,696)
Net cash used in investing activities	(6,896,343)	(8,715,107)
Cash flows from financing activities:		
Proceeds from contributions for:		
Investment in endowment	4,213,178	3,656,971
Investment in plant	2,196,135	6,589,936
Investment subject to deferred giving arrangements	15,233	66,214
Interest and dividends restricted for reinvestment	198,642	187,575
Decrease in refundable advances from government loan programs	(67,039)	(12,495)
Payment of long-term debt	(2,247,500)	(2,142,500)
Net cash provided by financing activities	4,308,649	8,345,701
Net decrease in cash and cash equivalents	(6,243,333)	(2,163,359)
Cash and cash equivalents:		
Beginning of year	14,013,150	16,176,509
End of year	\$ 7,769,817	14,013,150
Supplemental data:		
Interest paid	\$ 2,055,915	1,996,251
Noncash investing activity:		
Change in construction related payables	\$ (573,475)	522,990

See accompanying notes to financial statements.

HOBART AND WILLIAM SMITH COLLEGES

Notes to Financial Statements

May 31, 2018 and 2017

(1) Summary of Significant Accounting Policies

(a) Organization

Hobart and William Smith Colleges (the Colleges) are coordinate colleges located in the Finger Lakes Region of Central New York. Hobart College for men and William Smith College for women are selective, residential liberal arts institutions. The Colleges share a single curriculum, campus, faculty and central administration, but have separate deans, student governments, and athletics organizations. The Colleges' coordinate system provides men and women opportunities for independent learning and leadership in an environment of shared resources and objectives.

(b) Basis of Presentation

The Colleges' financial statements have been prepared on the accrual basis of accounting and are presented in accordance with U.S. generally accepted accounting principles. Accordingly, net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. The net assets of the Colleges are classified as follows:

Unrestricted net assets are not subject to donor stipulations restricting their use, but may be designated for specific purposes by the board of trustees or may otherwise be limited by contractual agreements with outside parties.

Temporarily restricted net assets are subject to donor-imposed stipulations that expire by the passage of time or can be fulfilled or removed by actions pursuant to the stipulations. Temporarily restricted net assets consist primarily of gifts restricted by donors for capital projects and other operating purposes.

Permanently restricted net assets are subject to donor-imposed stipulations that they be maintained in perpetuity. Generally, donors of these assets usually permit the use of all or part of the investment return on these assets.

Contributions, including unconditional pledges, are recognized as revenue when donors' commitments are received. Conditional pledges are recognized as revenue when the conditions are substantially met. Gifts whose restrictions are met in the same fiscal year as their receipt are combined with unrestricted gifts and reported as unrestricted contribution revenue. Contributions specified for the acquisition or construction of long lived assets are reported as unrestricted net assets when the assets are placed in service.

Expenses are reported as decreases in unrestricted net assets. Expirations of donor-imposed stipulations that simultaneously increase one class of net assets and decrease another are reported as reclassifications between the applicable classes of net assets.

HOBART AND WILLIAM SMITH COLLEGES

Notes to Financial Statements

May 31, 2018 and 2017

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements. Estimates also affect the reported amount of revenues and expenses during the reporting periods. The Colleges' significant estimates made in the preparation of these financial statements include, but are not limited to, valuation of certain alternative investments, valuation of swap agreement, estimation of asset retirement obligation, useful lives of fixed assets and estimated net realizable value of accounts and contributions receivable. Actual results could differ from these estimates.

(d) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions or other highly liquid investments with a maturity of three months or less when purchased or other similar interest-bearing accounts. At certain points in time, the Colleges may maintain funds in excess of amounts insured by the Federal Depository Insurance Corporation.

(e) Short-Term Investments

Short-term investments are recorded at fair value. The Colleges periodically invest excess operating cash generally in a select fixed-income fund on a short-term basis.

(f) Accounts and Notes Receivable

Accounts and notes receivable are reported net of reserves for doubtful accounts. The receivables are recorded at their current unpaid principal balance and associated interest income, if applicable, is accrued based on the principal amount outstanding and applicable interest rates. Allowances for doubtful accounts are recorded representing amounts that, in the opinion of management of the Colleges, are necessary to account for probable losses related to the receivables. These allowances are determined based upon numerous considerations, including economic conditions, the specific composition of the receivable balance, as well as trends of delinquencies and write offs. On a periodic basis, these factors are considered and the allowances for doubtful accounts are adjusted accordingly, with a corresponding adjustment to the provision for allowances for doubtful accounts.

Allowances of approximately \$1,299,000 and \$1,292,000 at May 31, 2018 and 2017, respectively, have been provided for accounts receivable estimated to be uncollectible.

Allowances of approximately \$128,000 at May 31, 2018 and 2017 have been provided for notes receivable estimated to be uncollectible.

HOBART AND WILLIAM SMITH COLLEGES

Notes to Financial Statements

May 31, 2018 and 2017

(g) Contributions Receivable

Contributions receivable includes unconditional pledges and funds held in trust by others. Unconditional pledges are recognized at their estimated net present value, net of an allowance for uncollectible amounts, and are classified as either permanently restricted or temporarily restricted net assets. Funds held in trust by others represent resources neither in the possession nor under the control of the Colleges, but paid and administered by outside trustees, with the Colleges deriving income or a residual interest from the assets of such funds. Funds held in trust by others are recognized at the estimated fair value of the assets which approximates the net present value of the future cash flows when the irrevocable trust is established or the Colleges are notified of its existence and are subsequently adjusted for changes in the fair value annually.

(h) Long-Term Investments

Long-term investments are reported at fair value. If an investment is held directly by the Colleges and in an active market where quoted prices exists, the Colleges report the fair value as the market price of an identical security. Shares in mutual funds are based on share values reported by the funds as of the last business day of the fiscal year. The Colleges also hold shares or units in alternative investment funds involving real estate, hedge and private equity strategies. Such alternative investment funds may hold securities or other financial instruments for which a ready market exists and are priced accordingly. In addition, such funds may hold assets that require the estimation of fair values in the absence of readily determinable market values. Such valuations are determined by fund managers and generally consider variables such as operating results, comparable earnings multiples, projected cash flows, recent sales prices, and other pertinent information, and may reflect discounts for the illiquid nature of certain investments held.

The Colleges utilize the net asset value (NAV) reported by each of the alternative investment funds as a practical expedient for determining the fair value of the investment. These investments are redeemable at NAV under the original terms of the subscription agreements and operations of the underlying funds. However, it is possible that these redemption rights may be restricted or eliminated by the funds in the future in accordance with the underlying fund agreements. Due to the nature of the investments held by these funds, changes in market conditions and the economic environment, as well as the liquidity positions of the funds, may significantly impact the NAV of the funds and, consequently, the fair value of the Colleges' interests in the funds.

Endowment and investment return includes interest and dividends, realized gains and losses, and the change in unrealized appreciation (depreciation) on the associated investments. The average cost of investment securities sold is used to determine the basis for computing realized gains or losses, and the Colleges account for investment sales and purchases on a trade date basis.

(i) Land, Buildings and Equipment

Grounds, site improvements, buildings, equipment and library books are recorded at cost at the date of acquisition or their fair value at the date of donation, less accumulated depreciation, computed on a straight line basis over the estimated useful lives of the site improvements (20 years), buildings (15 – 45 years), equipment (5 – 20 years) and library books (20 years). Expenditures for maintenance, repairs, and renewals of relatively minor items are not capitalized.

HOBART AND WILLIAM SMITH COLLEGES

Notes to Financial Statements

May 31, 2018 and 2017

(j) *Deferred Giving Arrangements*

The Colleges' deferred giving arrangements consist primarily of gift annuities, pooled life income funds and charitable remainder trusts. Deferred giving assets of approximately \$3,044,000 and \$3,176,000 are included in long-term investments at their fair value as of May 31, 2018 and 2017, respectively. Contribution revenues are recognized at the date the arrangements are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or beneficiaries. The liabilities are adjusted during the term of the arrangements for changes in the value of the assets, changes in the estimated present value of future cash outflows and other changes in the estimates of future benefits. The deferred giving liabilities represent the net present value of future cash outflows over the beneficiary's life expectancy as required by the deferred gift agreements. Discount rates are used to calculate the net present value of the obligations, and are based on market rates commensurate with the beneficiary life expectancy.

(k) *Refundable Advances from Government Loan Programs*

Funds provided by the U.S. government under the Federal Perkins Loan Program are loaned to qualified students and may be reloaned after collection. These funds are ultimately refundable to the government and are reported as a liability.

(l) *Asset Retirement Obligations*

Asset retirement obligations (AROs) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, the Colleges record period-to-period changes in the ARO liability resulting from the passage of time as other changes, net. Accretion expense was approximately \$124,000 in 2018 and \$118,000 in 2017. Upon settlement of the obligation, any difference between the actual cost to settle the ARO and the liability recorded is recognized as a gain or loss in the statements of activities.

(m) *Derivative Instruments*

A derivative instrument related to the Colleges' long-term debt is included in the fair value of the swap agreement on the statements of financial position. The Colleges selected the combination of a variable rate bond issue and an interest rate swap agreement to obtain fixed rate financing at the lowest available cost at the time of the transaction. The fair value of the swap agreement is based on an evaluation of quotes provided by a financial institution of the estimated settlement amounts required of the Colleges if the agreement was terminated, taking into consideration current interest rates. The interest rate swap is categorized as Level 2 in the fair value hierarchy. The Colleges are exposed to credit loss in the event of nonperformance by the counterparty to its long term rate swap. The interest rate swap does not qualify for cash flow hedge accounting. The change in the fair value of the swap agreement is included in nonoperating activities in the statements of activities.

(n) *Taxation*

The Colleges are a not-for-profit organization as described in Section 501(c)(3) of the Internal Revenue Code and are generally exempt from income tax on related income.

HOBART AND WILLIAM SMITH COLLEGES

Notes to Financial Statements

May 31, 2018 and 2017

The Colleges recognize the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Colleges believe they have taken no significant uncertain tax positions.

(o) Revenue Recognition

Tuition, fees, room, and board revenue is recognized over the academic year as services are provided. Funds received in advance of services provided are included in deferred revenue.

(p) Operations

The statements of activities present expenses by functional classification and reflects a subtotal for the change in net assets from operations. This subtotal reflects revenues the Colleges received for operating purposes, including investment return used for operations and all expenses, including the allocation of certain expenses. Operation and maintenance of plant, depreciation and interest expense are allocated based on relative square footage of facilities used for such functions. Nonoperating activity reflects all other activity, including but not limited to the investment return, net of the amount appropriated under the Board of Trustees' approved spending formula, contributions for endowment and plant purposes, and the change in present value of deferred giving arrangements as well as other net changes during 2018. Other changes, net included expenses associated with the special and unplanned termination benefit charges incurred under the related transition and separation agreements.

(q) Reclassifications

Certain amounts in the 2017 financial statements have been reclassified to conform to 2018 presentation.

(2) Contributions Receivable

Unconditional contributions receivable at May 31, 2018 and 2017 are restricted by donors predominantly for scholarships and capital projects. They are expected to be realized within the following time periods:

	2018	2017
Less than one year	\$ 3,717,171	3,771,914
One year to five years	1,691,000	1,287,500
	5,408,171	5,059,414
Less present value discount	(8,625)	(7,869)
Allowance for uncollectible receivables	(1,693,501)	(1,749,360)
	3,706,045	3,302,185
Funds held in trust by others	679,752	614,983
	\$ 4,385,797	3,917,168

HOBART AND WILLIAM SMITH COLLEGES

Notes to Financial Statements

May 31, 2018 and 2017

(3) Investments

The investment objective of the Colleges is to invest assets in a prudent manner to achieve a long term rate of return sufficient to fund a portion of its spending and to increase investment value after inflation. The Colleges' investment strategy incorporates a diversified asset allocation approach that maintains, within defined limits, exposure to domestic and international equities, fixed income, real estate, commodities, and private equity markets. The majority of the Colleges' investments are managed in a pooled fund that consists primarily of endowment assets.

Fair value represents the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants as of the measurement date. Financial instruments measured and reported at fair value are classified and disclosed in one of the following categories:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Colleges have the ability to access at the measurement date. Assets and liabilities classified as Level 1 generally include listed equities. Level 1 also includes cash and cash equivalents given the short maturity of these investments.
- Level 2 inputs are quoted market prices for markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly. Assets and liabilities classified as Level 2 generally include trusts that hold fixed income and equity securities.
- Level 3 inputs include pricing inputs that are unobservable for the assets and reflect certain assumptions to determine fair value. The Colleges have no assets classified as Level 3.

With respect to those investments reported at NAV as a practical expedient, fair value hierarchy categorization is not required. The fair value amounts presented as NAV are intended to permit reconciliation of the fair value hierarchy disclosure to the amounts presented in the statements of financial position. As of May 31, 2018, the Colleges had no specific plans or intentions to sell investments at amounts different than NAV.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Accordingly, the inputs or methodology used for valuing or classifying investments for financial reporting purposes is not necessarily an indication of the risk associated with investing in those investments or a reflection on the liquidity of each fund's underlying assets and liabilities.

HOBART AND WILLIAM SMITH COLLEGES

Notes to Financial Statements

May 31, 2018 and 2017

The Colleges' short-term and long-term investments at May 31, 2018 are summarized in the following table by their fair value hierarchy classification:

	Total May 31, 2018	Level 1	Level 2	Investments Measured at NAV	Redemption frequency	Days notice
Investments:						
Cash and cash equivalents	\$ 9,118,666	9,118,666	—	—	Daily	Same day
Fixed income and government securities	15,028,944	15,028,944	—	—	Daily – Monthly	Same day – 10 days
Common and preferred stocks	121,431,085	55,193,921	—	66,237,164	Daily – Annual	Same day – 90 days
Hedge (c)	72,082,801	—	—	72,082,801	Monthly – Illiquid	24 days – Illiquid
Real estate (a)	8,050,677	—	—	8,050,677	Illiquid	N/A
Private equity (b)	15,273,927	—	—	15,273,927	Illiquid	N/A
Other	2,182,468	—	2,182,468	—	Illiquid	N/A
Total investments	\$ 243,168,568	79,341,531	2,182,468	161,644,569		

The College's short-term and long-term investments at May 31, 2017 are summarized in the following table by their fair value hierarchy classification:

	Total May 31, 2017	Level 1	Level 2	Investments Measured at NAV	Redemption frequency	Days notice
Investments:						
Cash and cash equivalents	\$ 12,434,433	12,434,433	—	—	Daily	Same day
Fixed income and government securities	13,019,837	13,019,837	—	—	Daily – Monthly	Same day – 10 days
Common and preferred stocks	102,963,901	50,053,978	—	52,909,923	Daily – Annual	Same day – 90 days
Hedge (c)	74,676,192	—	—	74,676,192	Monthly – Illiquid	24 days – Illiquid
Real estate (a)	8,024,367	—	—	8,024,367	Illiquid	N/A
Private equity (b)	12,513,645	—	—	12,513,645	Illiquid	N/A
Other	2,055,213	—	2,055,213	—	Illiquid	N/A
Total investments	\$ 225,687,588	75,508,248	2,055,213	148,124,127		

- (a) This category includes investments with limited partnerships or limited liability companies in commercial, residential improved and unimproved real estate primarily in the United States. The Colleges do not have redemption rights in these investments and their remaining lives are between one and ten years.
- (b) This category includes investments with limited partnerships or limited liability companies in domestic and international private sector businesses, and similar equity securities. The Colleges do not have redemption rights in these investments and their remaining lives are between one and six years.
- (c) This category includes investments with limited partnerships, limited liability companies or private investment companies that employ a multi-strategy approach. The Colleges may redeem the majority of these investments on a monthly, quarterly or annual basis with notice ranging from 24 to 95 days, however the Colleges do not have redemption rights in certain investments in this category.

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The Colleges' policy is to recognize transfers in and transfers out of different levels as of the actual date of the event or circumstance that caused the transfer. No transfers occurred for the years ended May 31, 2018 and May 31, 2017.

Liquidity

The following presents the fair value of the Colleges' investments as of May 31, 2018 and 2017 by redemption period:

	2018	2017
Investments redemption period:		
Daily	\$ 71,002,533	68,959,100
Monthly	68,780,059	59,333,835
Quarterly	18,949,061	20,566,943
Annual	31,179,268	25,881,299
Illiquid (locked-up)	53,257,647	50,946,411
Total	\$ 243,168,568	225,687,588

Investments that are in the Illiquid (locked-up) category are primarily related to certain real estate, private equity and hedge investments. The period of time until liquidation is not necessarily determinable by management, as liquidation terms are at the discretion of the applicable fund's investment manager subject to market conditions and the underlying complexities of the individual investments. These liquidity restrictions have been in effect since the initial purchase of the applicable funds.

The Colleges participate in certain limited partnership arrangements as part of the endowment portfolio. Outstanding unfunded capital commitments on these investments approximate \$20,601,000 as of May 31, 2018. The Colleges maintain sufficient liquidity in the investment portfolio to cover such commitments.

In accordance with its investment and spending policy on endowment and other investments, the Colleges' return on investments was as follows:

	2018	2017
Dividends and interest income	\$ 3,912,540	3,426,764
Net realized and unrealized gains	18,725,611	26,384,779
Total return on investments	22,638,151	29,811,543
Investment return designated for current operations (endowment spending and other investment income)	10,957,626	9,458,616
Investment return, net of amounts designated for current operations	\$ 11,680,525	20,352,927

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(4) Endowment

Endowment funds are long-term assets of the Colleges created either by donor gifts or by actions of the Board of Trustees. Their purpose is to generate, in perpetuity, operating revenue for specific activities or for the use of the Colleges. Endowment funds are invested under direction of the Board of Trustees to achieve maximum long-term total return with prudent concern for the preservation of investment capital. All investments of endowment funds are recorded in the statements of financial position as long-term investments, including cash balances held by external investment managers. Unless otherwise directed in the gift instrument or required by applicable law, both donor-restricted and board-designated endowment funds are pooled for efficient investment purposes. These pooled funds are invested in a broadly diversified portfolio designed to produce long-term returns that equal or exceed the Board-approved spending rates plus the impacts of inflation.

The Colleges follow New York Prudent Management of Institutional Funds Act (NYPMIFA) in the management of its endowments. Absent donor stipulations to the contrary, the statutory guidelines contained in NYPMIFA relate to the prudent management, investment and expenditure of donor-restricted endowment funds without regard to the original value of the gifts. However, NYPMIFA contains specific factors that must be considered prior to making investment decisions or appropriating funds for expenditure. In accordance with NYPMIFA, the Board of Trustees considers the following factors in making a determination to appropriate or accumulate endowment funds: the duration and preservation of the fund; the purposes of the Colleges and the endowment fund; general economic conditions; the possible effect of inflation and deflation; the expected total return from income and the appreciation of investments; other resources of the Colleges; where appropriate and where circumstances would otherwise warrant, alternatives to expenditure of an endowment fund, giving due consideration to the effect that such alternatives may have on the Colleges; and the investment policies of the Colleges.

The Colleges' Board of Trustees has interpreted New York State's Not-for-Profit Corporation Law, including NYPMIFA, as requiring the preservation of the fair value of the original gift as of the gift date of the donor restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Colleges classify 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. Unspent appropriations related to the donor restricted endowment fund are classified as temporarily restricted net assets until the amounts are expended by the Colleges in a manner consistent with the donor's intent. The remaining portion of the donor-restricted endowment fund that is not classified as permanently or temporarily restricted net assets is classified as unrestricted net assets.

Spending Policy

The Board of Trustees determines the appropriate amount to withdraw from endowment funds on an annual basis, to provide support for operations with prudent concern for the long-term growth in the underlying assets. The Colleges employ a total return spending policy which recognizes for spending purposes income equal to a percentage of a multi-year moving average of the unit value of pooled investments. The percentage was 5% in 2018 and 2017. During 2018, the Board of Trustees approved a one-time additional draw from the endowment of \$1,400,000. This caused the net effective spending rate to total approximately 5.5% for the year-ended May 31, 2018. In any given year, the amount availed from the pooled investments may, therefore, be greater or less than the dividend or interest yield for that year.

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Investment returns earned in excess of the spending policy are classified as nonoperating revenue; any shortfall is made up from historically earned capital appreciation.

The following tables provide the net asset composition of the endowment as of May 31, 2018 and a rollforward of the net assets from June 1, 2017 to May 31, 2018.

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted funds	\$ (74,893)	55,113,104	136,048,574	191,086,785
Funds functioning as endowment	23,260,735	—	—	23,260,735
	\$ 23,185,842	55,113,104	136,048,574	214,347,520

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Endowment net assets at beginning of year	\$ 23,451,028	43,913,333	131,528,856	198,893,217
Investment return	1,033,870	21,011,471	187,419	22,232,760
Change in funds with deficiencies	401,705	(401,705)	—	—
Private gifts	35,100	—	4,168,289	4,203,389
Other changes	56,000	—	164,010	220,010
Endowment spending	(1,791,861)	(8,009,995)	—	(9,801,856)
Special draw	—	(1,400,000)	—	(1,400,000)
Endowment net assets at end of year	\$ 23,185,842	55,113,104	136,048,574	214,347,520

The following tables provide the net asset composition of the endowment as of May 31, 2017 and a rollforward of the net assets from June 1, 2016 to May 31, 2017.

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Donor-restricted funds	\$ (476,598)	43,913,333	131,528,856	174,965,591
Funds functioning as endowment	23,927,626	—	—	23,927,626
	\$ 23,451,028	43,913,333	131,528,856	198,893,217

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	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets at beginning of year	\$ 23,271,830	24,387,565	127,347,601	175,006,996
Investment return	4,174,455	25,296,422	176,756	29,647,633
Change in funds with deficiencies	3,665,454	(3,665,454)	—	—
Private gifts	25,000	—	3,631,971	3,656,971
Other changes	(110,383)	—	372,528	262,145
Endowment spending	<u>(7,575,328)</u>	<u>(2,105,200)</u>	<u>—</u>	<u>(9,680,528)</u>
Endowment net assets at end of year	\$ <u>23,451,028</u>	<u>43,913,333</u>	<u>131,528,856</u>	<u>198,893,217</u>

Funds with Deficiencies

As a result of market declines, the fair market value of certain donor-restricted endowments was less than the historical cost value of such funds by approximately \$75,000 and \$477,000 at May 31, 2018 and 2017, respectively. To support spending from these endowment funds the Colleges utilized unrestricted accumulated investment return of approximately \$25,000 and \$137,000, in 2018 and 2017, respectively.

The unrealized losses for these endowment funds have been recorded as reductions in unrestricted net assets. Future investment return will be used to restore this deficiency in unrestricted net assets before any net appreciation above the historical cost value of such funds increases temporarily restricted net assets. While it is the intent of the Colleges to restore this deficiency from future investment return, there is no legal obligation to do so.

(5) Land, Buildings and Equipment

The components of land, buildings and equipment, as of May 31, 2018 and 2017 were as follows:

	<u>2018</u>	<u>2017</u>
Grounds	\$ 3,566,191	3,566,191
Site improvements	14,671,195	13,677,718
Buildings	202,487,688	195,565,632
Equipment	55,259,355	54,143,168
Library books	21,187,270	20,458,093
Construction in progress	<u>551,652</u>	<u>2,618,026</u>
	297,723,351	290,028,828
Accumulated depreciation	<u>(141,144,432)</u>	<u>(134,008,359)</u>
	\$ <u>156,578,919</u>	<u>156,020,469</u>

Depreciation expense amounted to \$7,136,073 and \$7,178,475 in 2018 and 2017, respectively.

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Notes to Financial Statements

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(6) Bonds and Note Payable

Bonds and note payable consist of the following at May 31:

	<u>Maturity date</u>	<u>Interest rate</u>	<u>Original issue</u>	<u>2018</u>	<u>2017</u>
City of Geneva Industrial Development Agency Revenue Bonds: Series 2007 (a)	2037	Variable	\$ 31,250,000	24,800,000	25,575,000
City of Geneva Development Corporation Refunding Bonds: Series 2012 (b)	2032	1.0 – 5.0%	26,695,000	20,910,000	21,955,000
Revenue Bonds: Series 2014 (c)	2044	3.0 – 5.25%	14,295,000	<u>13,600,000</u>	<u>13,840,000</u>
				59,310,000	61,370,000
Net bond premium				3,207,727	3,407,489
Bond issuance costs				<u>(979,098)</u>	<u>(1,032,691)</u>
				61,538,629	63,744,798
Manufacturers and Traders Trust Company: Term note (d)	2023	Variable		<u>1,354,500</u>	<u>1,542,000</u>
				<u>\$ 62,893,129</u>	<u>65,286,798</u>

- (a) Series 2007 City of Geneva Industrial Development Agency Multi-Modal Civic Facility Revenue Bonds are Variable Rate Demand bonds enhanced by a letter of credit with a financial institution. The interest rate is determined every 7 days. Interest is payable monthly and the rates paid during the fiscal year ended May 31, 2018 ranged from 0.77% to 1.84%. The bonds mature in 2037.

The letter of credit was issued in the amount of \$31,599,316 and will remain in effect until notice that the outstanding bonds have been repaid, the related bonds have been converted to an interest rate other than a Daily Rate or Weekly Rate, or a substitute Credit Agreement or Liquidity Facility has been put in place. The current letter of credit will expire on September 3, 2019, unless extended.

- (b) In June 2012, the Colleges issued \$26,695,000 of Series 2012 City of Geneva Development Corporation Refunding Bonds. The proceeds of the bonds were used for the legal defeasance of the Series 2001, 2003A and 2003B bonds. The refunding was accounted for as an early extinguishment of debt resulting in a loss recorded in the statement of activities of approximately \$301,000.
- (c) In March 2014, the Colleges issued \$14,295,000 of Series 2014 City of Geneva Development Corporation Revenue Bonds. The proceeds were used to partially fund the construction of an academic building for the performing arts program.

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- (d) Interest on the note is variable at LIBOR plus 2% until maturity in 2023. Rates during the fiscal year ended May 31, 2018 ranged from 2.995% to 3.907%.

The scheduled principal payments on bonds payable and term note for the next five years and thereafter is reflected in the following table:

	Amount
Fiscal year:	
2019	\$ 2,428,500
2020	2,563,500
2021	2,688,500
2022	2,843,500
2023	2,990,500
Thereafter	47,150,000
	60,664,500
Net bond premium	3,207,727
Bond issuance costs	(979,098)
	\$ 62,893,129

(a) Interest Rate Swap

On June 18, 2007, the Colleges entered into an interest rate swap agreement with an effective date of December 4, 2007 and a maturity date of December 1, 2037. Neither the Colleges nor the counterparty, which is a prominent financial investment institution, are required to collateralize their respective obligations under this swap. At May 31, 2018, the notional amount of the swap was \$24,800,000. Under the agreement, the Colleges will pay the counterparty interest at a fixed rate of 4% until maturity. The notional amount does not represent the amounts exchanged by the parties, and is thus not a measure of exposure of the Colleges. The amounts exchanged are based on the notional amounts and other terms of the swap. At May 31, 2018 and 2017, the Colleges have recognized \$763,115 and \$922,058, respectively, in nonoperating expenses in the statement of activities which represent the net cash payment for the difference between the Colleges' and the counterparty's payments under the swap. At May 31, 2018 and 2017, the Colleges recognized an increase in net assets of \$1,792,033 and a increase in net assets of \$1,546,839, respectively, and related change in liabilities on the statements of financial position.

(b) Line of Credit

The Colleges maintain a line of credit for \$1,000,000 which was unused during 2018 and 2017. The line of credit is renewed on an annual basis.

(c) Bond Issuance Costs

The Colleges have capitalized certain bond issuance costs and are amortizing them over the term of the related debt instruments. Amortization expense was approximately \$54,000 in 2018 and 2017.

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(7) Net Assets

Temporarily restricted net assets at May 31, 2018 and 2017 are available for the following purposes:

	<u>2018</u>	<u>2017</u>
Accumulated endowment returns	\$ 55,113,104	43,913,333
Acquisition of buildings and equipment	8,034,848	6,600,800
Deferred giving arrangements	—	26,187
Program and student support	<u>4,427,978</u>	<u>4,368,525</u>
	<u>\$ 67,575,930</u>	<u>54,908,845</u>

Permanently restricted net assets at May 31, 2018 and 2017 are available for the following purposes:

	<u>2018</u>	<u>2017</u>
Program and student support	\$ 69,337,205	67,337,507
Scholarship support	49,160,971	47,368,789
Faculty support	16,383,988	16,353,618
Deferred giving arrangements	1,684,404	1,678,777
Library support	<u>1,508,232</u>	<u>1,507,368</u>
	<u>\$ 138,074,800</u>	<u>134,246,059</u>

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(8) Retirement Plan

The Colleges participate in contributory retirement plans administered by the Teachers Insurance Annuity Association of America (TIAA) for full-time employees. The Colleges' policy is to accrue the costs of these defined contribution plans currently. Total expense charged to operations relating to these plans was approximately \$3,801,000 and \$3,741,000 for 2018 and 2017, respectively.

(9) Related Parties

From time to time, members of the Colleges' Board of Trustees and the senior management team maybe directly or indirectly associated with companies conducting business with the Colleges. Among other things, the Colleges' conflict of interest policy does not permit members of the Board of Trustees or its committees to participate in any decision in which a member (or any of their immediate family members) has a material financial interest. The Colleges require members of the Board of Trustees and the senior management team to complete an annual disclosure of significant financial interests in, or employment or consulting relationships with, entities who conduct business with the Colleges. When such financial interests or relationships are disclosed, procedures are taken to assess and address the actual or perceived conflict in order to protect the best interests of the Colleges and to ensure compliance with relevant conflict of interest laws or policy.

(10) Subsequent Events

The Colleges have performed an evaluation of subsequent events through November 30, 2018, the date on which the financial statements were issued. There were no subsequent events having a material effect on the financial statements.