

Consolidated Financial Statements with
Report of Independent Certified Public
Accountants

San Francisco Ballet Association

June 30, 2019

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Trustees
San Francisco Ballet Association

We have audited the accompanying consolidated statement of financial position of the San Francisco Ballet Association and the San Francisco Ballet Endowment Foundation (collectively known as the "Ballet") as of June 30, 2019, and the related consolidated statement of activities and changes in net assets, the consolidated statement of functional expenses, and the consolidated statement of cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's responsibility

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the San Francisco Ballet Association and the San Francisco Ballet Endowment Foundation as of June 30, 2019, and the changes in their net assets, their functional expenses, and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on 2018 summarized comparative information

We have previously audited the Ballet's 2018 consolidated financial statements, and expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated October 19, 2018. The summarized comparative information presented herein as of and for the year ended June 30, 2018 is derived from those consolidated financial statements.



San Francisco, California
October 21, 2019

San Francisco Ballet Association

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June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Consolidated statement of financial position

	June 30, 2019	June 30, 2018 (as restated)
ASSETS		
Cash and cash equivalents	\$ 8,883	\$ 10,542
Accounts receivable	171	219
Prepaid expenses and deposits	1,429	1,653
Pledges receivable, net	2,724	3,805
Receivables from split interest agreements, net	2,079	3,557
Other investments	586	572
Other assets	665	526
Restricted cash	5,447	3,947
Property and equipment, net	20,204	21,806
Endowment investments	124,446	124,398
Total assets	<u>\$ 166,634</u>	<u>\$ 171,025</u>
LIABILITIES AND NET ASSETS		
LIABILITIES:		
Accounts payable and accrued expenses	\$ 7,136	\$ 7,076
Current portion loans payable	1,870	1,857
Deferred compensation and postretirement benefit obligation	1,916	1,472
Deferred performance and school revenue	7,094	6,825
Gift annuity payment liability	745	684
Interest rate swap liability	6,525	5,015
Non-current loans payable, net	36,753	38,606
Total liabilities	<u>62,039</u>	<u>61,535</u>
NET ASSETS:		
Without donor restrictions	20,645	24,305
With donor restrictions	83,950	85,185
Total net assets	<u>104,595</u>	<u>109,490</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 166,634</u>	<u>\$ 171,025</u>

See accompanying notes to consolidated financial statements.

San Francisco Ballet Association

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June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Consolidated statement of activities and changes in net assets

	For the year ended June 30, 2019			For the year ended June 30, 2018
	Without donor restrictions	With donor restrictions	Total	
REVENUE AND SUPPORT:				
San Francisco performance	\$ 22,080	\$ -	\$ 22,080	\$ 22,532
Touring	652	-	652	115
School and student housing, net of scholarships of \$1,429	2,894	-	2,894	2,456
Other income	1,418	-	1,418	1,324
Contributions	17,281	2,448	19,729	25,441
Special events and other activities	4,756	128	4,884	4,842
Net assets released from donor restrictions	6,004	(6,004)	-	-
Total revenue and support	55,085	(3,428)	51,657	56,710
EXPENSES:				
Program services:				
Ballet production and touring	36,572	-	36,572	36,158
School and student housing	4,243	-	4,243	3,599
Education and outreach	791	-	791	797
Support Services:				
Marketing, publicity and audience development	6,088	-	6,088	7,270
General and administrative	6,560	-	6,560	7,154
Fundraising expenses	5,733	-	5,733	5,070
Total expenses	59,987	-	59,987	60,048
CHANGE IN NET ASSETS FROM OPERATIONS	(4,902)	(3,428)	(8,330)	(3,338)
NON-OPERATING:				
Endowment investment income, net	3,676	2,193	5,869	6,131
Change in post-retirement benefit obligation	(408)	-	(408)	36
Net realized and unrealized (gain)/loss on interest rate swap	(2,026)	-	(2,026)	824
(DECREASE) INCREASE IN NET ASSETS	(3,660)	(1,235)	(4,895)	3,653
NET ASSETS - Beginning of Year, as restated	24,305	85,185	109,490	105,837
NET ASSETS - End of Year	\$ 20,645	\$ 83,950	\$ 104,595	\$ 109,490

See accompanying notes to consolidated financial statements.

San Francisco Ballet Association

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June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Consolidated statement of functional expenses

	Program Services						Support Services				FY19	FY18
	Ballet Production	Touring	Ballet Production and Touring	School and Student Housing	Education and Outreach	Total Programs	Marketing, publicity and audience development	General and Administrative	Fundraising	Total Support Services	Total Expenses	Total Expenses
SALARIES, PAYROLL TAXES AND BENEFITS												
Salaries and benefits	\$ 21,173	\$ 389	\$ 21,562	\$ 1,783	\$ 554	\$ 23,899	\$ 1,307	\$ 2,517	\$ 1,946	\$ 5,770	\$ 29,669	\$ 28,535
Payroll taxes and benefits	6,483	123	6,606	396	76	7,078	249	431	416	1,096	8,174	8,269
	<u>27,656</u>	<u>512</u>	<u>28,168</u>	<u>2,179</u>	<u>630</u>	<u>30,977</u>	<u>1,556</u>	<u>2,948</u>	<u>2,362</u>	<u>6,866</u>	<u>37,843</u>	<u>36,804</u>
OTHER EXPENSES												
Advertising	-	-	-	25	-	25	1,621	1	38	1,660	1,685	1,618
Dance medical services	365	21	386	1	-	387	-	-	-	-	387	310
Depreciation and amortization	1,277	-	1,277	380	26	1,683	69	295	61	425	2,108	3,162
Events and cultivation	18	-	18	3	14	35	136	18	1,387	1,541	1,576	1,614
Information technology expense	-	-	-	16	-	16	300	406	7	713	729	586
In-kind expenses	2	-	2	-	-	2	572	131	726	1,429	1,431	2,081
Interest expense	626	-	626	404	32	1,062	74	221	77	372	1,434	1,246
License, permits and fees	729	62	791	107	1	899	10	526	68	604	1,503	1,087
Marketing and shop expenses - other	-	21	21	-	-	21	138	-	-	138	159	222
Miscellaneous expense	451	21	472	258	9	739	25	134	45	204	943	974
Occupancy	377	6	383	530	13	926	67	200	60	327	1,253	1,269
Other expense	-	-	-	-	-	-	751	-	-	751	751	772
Printed materials, postage and mailing	96	3	99	8	5	112	322	8	266	596	708	612
Production expense	1,633	1,081	2,714	34	5	2,753	-	-	41	41	2,794	3,024
Professional services	148	-	148	80	27	255	389	1,270	145	1,804	2,059	2,420
Receivable write-off	3	-	3	21	-	24	-	108	2	110	134	327
Scholarship expense	-	-	-	11	-	11	-	-	-	-	-	78
Shoes and lights	390	-	390	10	-	401	-	-	-	-	401	388
Taxes	40	-	40	10	1	51	5	27	12	44	95	9
Theater-space rental	251	-	251	-	1	252	10	-	171	181	433	473
Travel and entertainment	103	443	546	78	21	645	32	128	252	412	1,057	538
Utilities and telephone	134	3	137	98	6	241	11	139	13	163	404	434
	<u>6,643</u>	<u>1,661</u>	<u>8,304</u>	<u>2,064</u>	<u>161</u>	<u>10,529</u>	<u>4,532</u>	<u>3,612</u>	<u>3,371</u>	<u>11,515</u>	<u>22,044</u>	<u>23,244</u>
TOTAL EXPENSES	<u>\$ 34,299</u>	<u>\$ 2,173</u>	<u>\$ 36,472</u>	<u>\$ 4,243</u>	<u>\$ 791</u>	<u>\$ 41,506</u>	<u>\$ 6,088</u>	<u>\$ 6,560</u>	<u>\$ 5,733</u>	<u>\$ 18,381</u>	<u>\$ 59,887</u>	<u>\$ 60,048</u>

See accompanying notes to consolidated financial statements.

Year ended June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Consolidated statement of cash flows

	2019	2018
OPERATING ACTIVITIES:		
(Decrease) increase in net assets	\$ (4,895)	\$ 3,653
Adjustments to reconcile (decrease) increase in net assets to net cash used in operating activities:		
Contributions received for perpetual endowment	(1,950)	(5,214)
Depreciation	2,090	3,143
Amortization of loan issuance costs	18	18
Gain on disposal of property and equipment	(303)	-
Net realized and unrealized (gain) on investments	(3,004)	(1,420)
Limited partnership investment (gains)/losses, net	1,118	(2,530)
Proceeds from sales of donated securities	(299)	(114)
Change in allowance for doubtful pledges receivable	(60)	171
Change in discount of pledges receivable	(39)	141
Change in fair value of the interest rate swap	1,510	(1,405)
Net effect of changes in:		
Accounts receivable	48	12
Prepaid expenses and deposits	224	530
Pledges receivable	1,180	(2,731)
Receivables from split-interest agreements	1,478	2,238
Other assets	(139)	(91)
Gift annuity payment liability	61	(944)
Deferred compensation and postretirement benefit obligation	444	56
Accounts payable and accrued expenses	69	323
Deferred performance and school revenue	269	(85)
Net cash used in operating activities	(2,180)	(4,249)
INVESTING ACTIVITIES:		
Purchases of endowment investments	(9,937)	(9,451)
Proceeds from sale/return of endowment investments	11,775	8,024
(Increase) decrease in operating cash in endowment portfolio	(13)	112
(Increase) decrease in restricted cash	(1,500)	1,930
Purchase of property and equipment	(185)	(581)
Net cash provided by investing activities	140	34
FINANCING ACTIVITIES:		
Proceeds from sales of donor restricted securities	299	114
Contributions received for perpetual endowment	1,950	5,214
Principal payments on bond payable	(1,858)	(1,844)
Principal payments on capital lease obligation	(9)	(15)
Net cash provided by financing activities	382	3,469
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,658)	(746)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	10,542	11,288
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 8,883	\$ 10,542
SUPPLEMENTAL DISCLOSURES:		
Cash paid during the year for interest	\$ 1,942	\$ 1,813

See accompanying notes to consolidated financial statements.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Notes to consolidated financial statements

Note 1 – Summary of significant accounting policies

Organization

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

Principles of consolidation

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

Basis of presentation

In August 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-14 – *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The new standard amends the current reporting model for not-for-profit organizations and requires additional disclosures. Significant changes reflected in the FY19 consolidated financial statements include:

- a) Requiring the presentation of two net asset classes: 1) net assets without donor restrictions, and 2) net assets with donor restrictions;
- b) Modifying the presentation of underwater endowment funds and related disclosures;
- c) Requiring the use of the placed-in-service approach to recognize gifts used to acquire long-lived assets;
- d) Requiring an analysis of expenses by function and nature; and
- e) Requiring disclosure of quantitative and qualitative information on liquidity.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Basis of presentation, continued**

As a result, the consolidated statement of activities has been formatted to conform to the consolidated statement of functional expenses.

The Ballet classifies its net assets in the following categories:

Net Assets Without Donor Restrictions

Net assets that are not subject to donor-imposed restrictions that may be used for any purpose at the discretion of the Board of Trustees and management.

Net Assets With Donor Restrictions

Net assets subject to stipulations imposed by donors, and grantors. Some donor restrictions are temporary in nature, which are met by actions of the Ballet or by the passage of time. Other donor restrictions are perpetual in nature, where donor-imposed restrictions require funds be maintained in perpetuity.

The consolidated financial statements include certain prior year summarized comparative information in total, but not by asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles general accepted in the United States of America ("U.S. GAAP"). Accordingly, such information should be read in conjunction with the Ballet's consolidated financial statements for the year ended June 30, 2018, from which the summarized information was derived.

Cash and cash equivalents

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

Pledges receivable

Pledges receivable consist of unconditional promises to give that are expected to be collected in future years. Such receivables are recorded at the present value of their estimated future cash flows. The discount on pledges receivable pledged during the year ended June 30, 2019 utilized a risk-adjusted rate of 3.651%. For pledges receivable pledged prior to the year ended June 30, 2019, the discounts on these amounts were computed using risk-adjusted rates applicable in the years in which those promises were received ranging from 2.062% to 3.355%. Amortization of the discounts is included in contributions in the accompanying consolidated statement of activities and changes in net assets.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Receivables from split interest agreements and gift annuity payment liability**

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

Other investments

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

Other assets

Other assets consist of a voluntary salary deferral plan for certain highly-compensated employees under Internal Revenue Code ("IRC") Section 457(b) (See Note 10).

Restricted cash

Restricted cash is invested in cash and cash equivalents that are held by third parties in restricted accounts in accordance with an interest rate swap agreement and requirements set forth in an agreement for collateral posting. The increase in restricted cash during the year ended June 30, 2019, of \$1,500, relates primarily to the increase in the interest rate swap liability.

Loan issuance costs

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

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

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

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

Maintenance expenses and all costs for new productions, including sets, costumes, and choreography, are charged to Operating expense as incurred or in the year of initial performance with the exception of costs associated with full-length works. Full-length works are capitalized and depreciated on a straight-line basis within the property fund over the first two years the new works are presented. The Ballet's production of *Frankenstein* was performed in 2017 and 2018, and related assets were fully depreciated at June 30, 2018. The Ballet's production of *Nutcracker*, including the costs for sets, costumes, staging, and choreography, completed in 2005 and updated in 2007, was depreciated on a straight-line basis over 15 years beginning in 2005 and ending in 2019.

Endowment investments

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

Deferred compensation and postretirement benefit obligations

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

Deferred performance and school revenue

Deferred performance and school revenue as of June 30, 2019, primarily consists of advance ticket sales for performances scheduled in the Ballet's 2020 repertory season, which opens in January, 2020 as well as advance tuition payments for school classes to be conducted in the year ending June 30, 2020.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Derivative instruments**

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

Net assets without donor restrictions

Net assets without donor restrictions are available to support all activities of the Ballet and are not subject to donor-imposed stipulations and consist of net investment in property and equipment purchased or constructed. Assets and/or liabilities related to loan financing and derivative agreements are also included in this net asset category. Depreciation, interest, and facilities related expenses associated with these purchases are allocated to both program and support services using the Ballet's functional expense allocation methodology as disclosed below.

Net assets with donor restrictions

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

Revenue recognition

All contributions are recognized as revenue when received or unconditionally promised to the Ballet. The Ballet classifies gifts of cash and other assets as donor restricted support if received with donor stipulations that limit the use of the contributions. When such restrictions expire, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, assets are reclassified to net assets without donor restriction and reported as net assets released from restrictions. Conditional promises to give are not recognized as revenue until the conditions are substantially met. Investments received as gifts are initially recorded at estimated fair value at the date of donation. The Ballet's irrevocable interest in split interest agreements is recognized as revenue at the time such agreements are made known to the Ballet.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Contribution of services**

Contributions of services are recognized when received if such services (a) create or enhance nonfinancial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not donated. During the year ended June 30, 2019, the value of contributed services recognized as revenues and expenses in the accompanying consolidated financial statements was \$1,431 and consisted primarily of \$445 in donated advertising services and \$986 for special events and other activities. In addition, a substantial number of volunteers have donated significant amounts of time in the Ballet's program services and fundraising activities through participation in the Auxiliary, Encore!, Allegro Circle, and BRAVO (Ballet Resource and Volunteer Organization). The value of donated volunteer services has not been recognized in the accompanying consolidated financial statements because such volunteer services do not meet the criteria described above.

Functional expense allocations

Expenses applicable to more than one activity, such as facilities, interest, warehouse-related depreciation, and occupancy costs including supplies, travel, and personnel, are allocated based on square footage and thus allocated between program and support services. license, permits and fees include credit card fees and music rentals and royalties. Miscellaneous expense includes insurance, delivery services, dues and subscriptions, t-shirts for the students, and immigration services. Production expense reflects choreographer fees, travel and housing, costume construction and rental, and trucking costs.

Estimated fair value of financial instruments

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

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

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

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)**Estimated fair value of financial instruments, continued**

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

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

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

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

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

See Note 3 for fair value measurement disclosures.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)

Estimated fair value of financial instruments, continued

Concentrations of credit risk

Financial instruments that potentially subject the Ballet to credit risk consist primarily of cash, cash equivalents, accounts and pledges receivable, and endowment investments. The Ballet maintains cash and cash equivalents with major financial institutions. During the year ended June 30, 2019, such amounts have exceeded Federal Deposit Insurance Corporation (“FDIC”) limits. The Ballet’s endowment investments have been placed with a major custodian, First Republic Trust Company. The Ballet closely monitors these endowment investments and its accounts and pledges receivable and has not experienced significant credit losses. As of June 30, 2019, the following endowment investments equal or exceed 5% of the fair market value of total endowment investments:

Dodge & Cox Income Fund	13%
Dodge & Cox Global Stock Fund	8%
Dreyfus US Government Fund	7%
Generation IM Global Equity Fund	7%
Advisors Inner Circle Sands Global Fund	7%
250 Post Street LLP	6%
Abrams Capital Partners II, L.P. Fund	6%
Canyon Value Realization Fund	5%
Cevian Capital II Ltd.	5%
Bracebridge LTD	5%
D & C Osterweis Strategic Income Fund	5%
Dreyfus US Govt Prime Cash Mgt	5%

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

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

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

The Association and the Foundation are exempt from federal income tax under IRC Section 501(c)(3) of the IRC, though it is subject to tax on income unrelated to its exempt purpose, unless that income is otherwise excluded by the IRC. The Association and the Foundation are also exempt from California franchise taxes under Revenue and Taxation Code Section 23701d on its income other than unrelated business income. The Ballet has processes presently in place to ensure the maintenance of its tax-exempt status; to identify and report unrelated income; to determine its filing and tax obligations in jurisdictions for which it was nexus; and to identify and evaluate other matters that may be considered tax positions. The Ballet has determined that there are no material uncertain tax positions that require recognition or disclosure in the consolidated financial statements. Tax penalties and interest of \$1 are classified as tax expense for the year ended June 30, 2019.

Use of estimates

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

New accounting pronouncements

In June 2018, the FASB issued ASU 2018-08 – *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The amendments in this update should assist entities in: (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) within the scope of Topic 958, *Not-for-Profit Entities*, or as exchange (reciprocal) transactions subject to other guidance; and (2) determining whether a contribution is conditional. The amendments in the update are effective for fiscal periods beginning after December 15, 2018. The Ballet is currently evaluating the impact of this pronouncement on its consolidated financial statements.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 1 – Summary of significant accounting policies (continued)

New accounting pronouncements, continued

In February 2016, the FASB issued ASU 2016-02 – *Leases (Topic 842)*. The amendments in this update will supersede much of the existing authoritative guidance for leases. This guidance requires lessees, among other things, to recognize right-of-use assets and liabilities on their statement of financial position for all leases with lease terms longer than twelve months. The amendments in the update are effective for fiscal years beginning after December 15, 2020 with early application permitted. The Ballet is currently evaluating the impact of this pronouncement on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09 - *Revenue from Contracts with Customers (Topic 606)*. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance is effective for fiscal years beginning after December 15, 2018. The Ballet is evaluating the impact this update will have on its consolidated financial statements.

As of June 30, 2019, the Ballet has adopted the provisions of ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*, and applied the amendments retrospectively. A presentation of net assets as previously reported as of June 30, 2018, and as required under ASU 2016-14, is as follows:

	June 30, 2018			
	Presentation under ASU 2016-14			
	As previously presented	Without donor restrictions	With donor restrictions	Total
NET ASSETS				
Unrestricted	\$ 17,597	\$ 17,597	\$ -	\$ 17,597
Temporarily restricted	12,914	-	12,914	12,914
Permanently restricted	78,979	-	78,979	78,979
Total net assets	<u>\$ 109,490</u>	<u>17,597</u>	<u>91,893</u>	<u>109,490</u>
Restatement due to change in accounting for releases of donor restricted net assets for capital expenses		2,764	(2,764)	-
Restatement due to change in accounting for underwater endowments		3,944	(3,944)	-
Net assets as restated in accordance with ASU 2016-14		<u>\$ 24,305</u>	<u>\$ 85,185</u>	<u>\$ 109,490</u>

Prior to adopting ASU 2016-14, the Ballet released gifts restricted for property and equipment as depreciation costs were incurred. In accordance with the provisions, the restatements restore net assets without donor restrictions and reduce net assets with donor restrictions for the accumulation of net assets, which represented the capital assets yet to be depreciated. Underwater endowment funds were also impacted by ASU 2016-14 and were reclassified as outlined above to reduce net assets with donor restrictions and restore net assets without donor restrictions.

San Francisco Ballet Association

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June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 2 – Pledges receivable

Pledges receivable as of June 30, 2019 are due as follows:

	As of June 30, 2019
2020	\$ 2,194
2021	427
2022	351
2023	100
Total pledges receivable	3,072
Less allowance for doubtful pledges receivable	(199)
Less discount for amounts expected to be collected after June 30, 2019	(149)
Pledges receivable, net	\$ 2,724

At June 30, 2019, pledges receivable included pledges of \$1,756 from members of the Association's Board of Trustees and the Foundation's Board of Directors (see Note 15).

San Francisco Ballet Association

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June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 3 – Fair value measurements

As of June 30, 2019, the Ballet's investments are classified by levels within the valuation hierarchy as follows:

	Level 1	Level 2	Level 3	Total
Assets				
Assets held for and in split interest agreements				
Mutual funds	\$ 1,484	\$ -	\$ -	\$ 1,484
Beneficial interest in charitable remainder trusts	-	-	595	595
Total assets held for and in from split interest agreements, net	<u>\$ 1,484</u>	<u>-</u>	<u>595</u>	<u>\$ 2,079</u>
Other Investments:				
Money market funds	\$ 86	\$ -	\$ -	\$ 86
Mutual funds				
Fixed income-government	247	-	-	247
Fixed income-other	253	-	-	253
Cash in Transit	-	-	-	-
Total other investments	<u>\$ 586</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 586</u>
Endowment Investments:				
Money market funds	\$ 7,155	\$ -	\$ -	\$ 7,155
Fixed income securities				
US Government agencies	259	620	-	879
Government bonds and notes	-	3,575	-	3,575
Corporate bonds	3,604	130	-	3,734
Foreign income securities	-	48	-	48
Mutual funds				
Fixed income	22,241	-	-	22,241
Equity-US	4,893	-	-	4,893
Equity-global	21,015	-	-	21,015
Subtotal investments	<u>\$ 59,167</u>	<u>\$ 4,373</u>	<u>\$ -</u>	<u>\$ 63,540</u>
Alternative investments				
Real estate partnership	\$ -	\$ -	\$ 7,350	\$ 7,350
Valued at NAV				
Credit strategies hedge fund	-	-	-	4,231
Event-driven hedge fund	-	-	-	7,354
Multi-strategy hedge fund	-	-	-	6,659
Long-biased hedge fund	-	-	-	28,894
Relative value hedge fund	-	-	-	6,418
Alternative investments valued at NAV	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,350</u>	<u>\$ 60,906</u>
Total endowment investments				<u>124,446</u>
Total Assets				<u>\$ 127,111</u>
Total Liability				
Interest rate swap	\$ -	\$ 6,525	\$ -	\$ 6,525
Total liability	<u>\$ -</u>	<u>\$ 6,525</u>	<u>\$ -</u>	<u>\$ 6,525</u>

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 3 – Fair value measurements (continued)

For the year ended June 30, 2019, the changes in investments classified as Level 3 are as follows:

Level 3 rollforward	Real estate	Split interest agreements	Total
Balance- Beginning of year	\$ 7,471	\$ 2,233	\$ 9,704
Change in discount	-	81	81
Bequest conversion	-	(1,719)	(1,719)
Partnership unrealized loss	(121)	-	(121)
Balance- End of year	<u>\$ 7,350</u>	<u>\$ 595</u>	<u>\$ 7,945</u>

Changes in unrealized gains including investment returns relating to instruments that are classified as Level 3 still held as of June 30, 2019 are \$121.

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

Alternative investments schedule	Fair value	Unfunded commitments	Redemption period	Redemption notice period
Multi-strategy (a)	\$ 6,648	-	Quarterly	60 days
Multi-strategy (b)	11	-	Anniversary annually	65 days
Relative Value (c)	6,418	-	Anniversary annually	60 days
Special Situations (d)	7,354	-	Annually	90 days
Real Estate (e)	7,350	-	n/a	n/a
Long-Only/Long-Biased (f)	5,281	-	Annually	90 days
Long-Only/Long-Biased (g)	6,597	-	Annually	90 days
Long-biased (h)	3,876	-	Annually	120 days
Long-Only/Long-Biased (i)	4,105	-	Monthly	30 days
Long-Only/Long-Biased (j)	9,035	-	Quarterly	30 days
Credit Strategies (k)	4,231	-	n/a	n/a
	<u>\$ 60,906</u>			

- a) This is an investment in a hedge fund that seeks to generate stable, predictable returns with a low correlation to the broader debt and equity markets. The fund attempts to capitalize on perceived market inefficiencies surrounding areas like complex capital structures, businesses in transition or orphaned equities by calculating intrinsic value according to three fundamental criteria: creditworthiness, value creation and optionality. The fund will pursue this value investment strategy in primarily domestic situations in distressed debt, bank loans, high-yield bonds, direct investment, turnaround equities, convertible arbitrage, and risk arbitrage. The fair value of the investment in this category has been estimated using the net asset value per share of the investments. The fund does not have a lock-up period. The fund has a 100% side-pocket allowance and a 25% gate restriction on available capital. Redemption requires a 60-day notification.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 3 – Fair value measurements (continued)

- b) This is an investment in a hedge fund that employs a multi-strategy approach to capture perceived inefficiencies in public and private market situations. The fund's focus is on event-oriented investing, credit/distress debt, capital structure arbitrage and equity derivatives. The fair value of the investment in this category has been estimated using the NAV per share of the investments. Additionally, the fund manager may impose a gate restriction on redemption at their discretion which, could limit the Ballet's ability to liquidate its full investment in the fund. On March 23, 2017, the investment manager decided to return capital to shareholders and wind down operations. The fund has currently returned approximately 99% of total year-end capital.
- c) This is an investment in a hedge fund that seeks to generate consistent above-average return with limited systemic market risk. To achieve these returns, the fund seeks arbitrage opportunities in volatility, mortgage security, yield curve, intramarket bond and cash bond/future. The fund will also employ leverage to enhance return. The fair value of the investment in this category has been estimated using the NAV per share of the investments. The last lock-up period for this investment expired March 2015. The fund has a 20% side pocket allowance, but no gate restrictions. Redemption requires a 60-day notification.
- d) This is an investment in a hedge fund that seeks to invest in equities perceived to be undervalued, event-driven securities and distressed securities. The strategy is value driven and pursues opportunities in inefficient markets where estimated intrinsic value exceeds the market price of the securities. The fair value of the investment has been estimated using the NAV per share of the investments. The fund has a 25% side pocket allowance, but no gate restrictions. Redemption requires a 90-day notification.
- e) This class includes a restricted interest in a limited partnership. The underlying asset of the partnership is the fair value of the retail building located on 250 Post Street in the city of San Francisco. The building is approximately 33,000 square feet and was appraised at \$86,000 in August of 2016. The Partnership refinanced the mortgage obligation in December 2018 and the balance is \$2,443 at June 30, 2019. San Francisco Ballet's interest is approximately 8.8% with fair market value of \$7,350 at June 30, 2019.
- f) This is an investment in a long-biased hedge fund that seeks to invest in domestic U.S. equities. It has an activist-oriented investment strategy based on small- and mid-cap companies perceived to be undervalued. The fair value of the investment in this category has been estimated using the NAV per share of the investments. The investment has a three-year lock-up period expiring December 2019 for \$2,667 of the Ballet's investment. The fund has a 10% side pocket allowance but no gate restrictions and redemption requires 90-day notification.
- g) This is an investment in a hedge fund that seeks significant appreciation by investing in companies perceived to be undervalued. Their strategy is long-biased, focusing on equities in Northern Europe. They constructively work with management teams and identify situations that have the potential to double in value over a three-year period. The fair value of the investment in this category has been estimated using the NAV per share of the investments. The investment has a rolling three-year lock-up period, which expires September 2019. The fund has a 40% side-pocket allowance and a 20% fund-level gate restriction based on available capital.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 3 – Fair value measurements (continued)

- h) This pooled vehicle is long-biased and invests in equity, absolute return, and hybrid strategies that invest across the globe. The fair value of the investment in this category has been estimated using the NAV per share of the investments. The investment has a three-year lock-up period that expired on December 31, 2017. The fund has a no gate-or side-pocket restrictions.
- i) This is an investment in a hedge fund that is long-only and seeks to invest in undervalued emerging market equities. Investments are generally made in companies with market caps greater than \$5,000. The fund holds its positions for an average of four to five years and seeks a minimum of 50% upside over two to three years. The fair value of the investment in this category has been estimated using the NAV per share of the investments. The fund has a no gate-or side-pocket restrictions. Redemption requires a 30-day notification.
- j) This is an investment in a hedge fund that is long-only and seeks to integrate sustainability research with rigorous fundamental equity analysis. This fund specifically seeks investments in companies with management teams who recognize that economic, social, environmental, and political issues can affect business opportunities and risks. The fair value of the investment in this category has been estimated using the NAV per share of the investments. The investment has a lock-up period, which expires December 31, 2019 for \$1,000 of the Ballet's investment. The fund has a 25% fund-level gate restriction based on available capital and no side-pocket allowance. Redemption requires 30-day notice.
- k) This investment primarily invests in the most subordinated tranches of commercial mortgage-backed securitizations. The fund plans to hold its investments for a long duration. The investment term of the fund is 12 years, subject to two consecutive one-year extensions. The fund has no gate-or side-pocket restrictions.

The quantitative information about significant unobservable inputs related to Level 3 alternative investments in real estate used at June 30, 2019, is as follows:

	Fair value	Valuation techniques	Unobservable inputs	Assumptions
Commercial real estate	\$ 7,350	Income capitalization	Terminal cap rate	5.50%
			Rent growth rate	3.00%

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 4 – Property and equipment

The Ballet's property and equipment as of June 30, 2019 is as follows:

Land	\$	4,519
Buildings and improvements		34,648
Furniture and equipment		8,361
Capitalized sets and costumes		16,230
Construction in progress		266
Total property and equipment		64,024
Accumulated depreciation		(43,820)
Property and equipment, net	\$	20,204

Note 5 – Credit facilities

The Ballet has a line of credit with First Republic Bank of \$5,500, which together with an outstanding undrawn standby letter of credit of \$150 to support its workers' compensation insurance policies (see Note 9), is secured by certain investment securities in the Foundation's portfolio and are subject to a collective limit of 90% of the market value of those securities. At June 30, 2019, that limit would not have further constrained the Ballet's secured line of credit limit. Interest on the secured line of credit is charged at the greater of the prime rate minus 0.25% or 4%. The Ballet had no outstanding borrowings under the secured line of credit as of June 30, 2019. The secured line of credit expires on November 30, 2019 and will automatically renew for a one-year period on that date subject to the approval of the bank.

June 30, 2019**(With summarized financial information as of June 30, 2018)****(In thousands of dollars)****Note 6 – Loans payable**

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

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

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

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

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

San Francisco Ballet Association

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June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 6 – Loans payable (continued)

The following is a summary of each series outstanding as of June 30, 2019:

Issue name	Amount issued	Final maturity	Interest rate	Amount outstanding
Series 2013A	\$ 12,000	August 1, 2038	3.45%	\$ 10,866
Series 2013B	11,000	August 1, 2038	3.69%	9,511
Series 2013C	11,000	August 1, 2038	3.69%	9,511
Series 2013D	10,510	August 1, 2038	3.69%	9,088
Total	<u>\$ 44,510</u>			<u>38,976</u>
Loan issuance costs, net				<u>(353)</u>
Total loans payable, net				<u>\$ 38,623</u>

The

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

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

Interest payments are payable and due on the first of each month. Interest expense related to loans payable for the year ended June 30, 2019 was approximately \$1,434. In connection with the Master Loan Agreement with First Republic Bank for the Series 2013 Loans, the Ballet was required to be and was in compliance with certain financial covenants as of June 30, 2019.

Principal amounts are due as follows:

	Series				
	2013A	2013B	2013C	2013D	Total
2020	\$ 404	\$ 496	\$ 496	\$ 474	\$ 1,870
2021	420	496	496	474	1,886
2022	436	496	496	474	1,902
2023	450	496	496	474	1,916
2024	465	496	496	474	1,931
Thereafter	8,694	7,030	7,030	6,717	29,471
	<u>\$ 10,869</u>	<u>\$ 9,510</u>	<u>\$ 9,510</u>	<u>\$ 9,087</u>	<u>\$ 38,976</u>

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 7 – Interest rate swap agreement

The Ballet utilizes an interest rate swap agreement to mitigate the risk of changes in interest rates associated with variable interest rate indebtedness. Under the terms of the agreement, the Ballet pays a fixed rate of 3.92% to the swap counterparty in exchange for a variable rate of 68.50% of 1-month LIBOR on the notional amount. The swap agreement does not qualify as a cash flow hedge, and as a result, changes in the fair value of the interest rate swap agreement during a period are recognized immediately in changes in net assets without donor restrictions. The fair value of the interest rate swap agreement is based on quotes from the market makers and, therefore, is classified as Level 2 in the fair value hierarchy as shown in Note 3.

The fair value of the swap agreement is estimated based on mid-market rates and industry standard valuation models. A credit risk spread (in basis points) is added as a flat spread to the discount curve used in the valuation model. Each leg is discounted and the difference between the present value of each leg's cash flows equals the market value of the swap. The fair value also considers the risk of each counterparty by including a "credit valuation adjustment" determined by taking into account the nonperformance risk of each counterparty to the swap. The estimated fair value of the swap agreement was \$6,525 as of June 30, 2019, including a credit valuation adjustment of \$70, which reduced the Ballet's liability, and is included in the interest rate swap liability in the accompanying consolidated statement of financial position. Payments made to the counterparty of the swap agreement for interest were \$516 during the year ended June 30, 2019. The swap agreement contains certain collateral requirements based on the credit rating of the Ballet and the current fair market value of the swap agreement. During the year ended June 30, 2019, the Ballet was required to post collateral on the swap agreement with \$5,447 posted as of June 30, 2019 and is included in restricted cash in the accompanying consolidated statement of financial position.

The following table shows the outstanding notional amount of derivative instruments measured at fair value as reported in the consolidated statement of financial position as of June 30, 2019:

	Statement of financial position location	Maturity date of derivative	Notional fixed rate	Amount outstanding	Fair value
Interest rate sw ap	Liability under interet rate sw ap agreement	July 1, 2036	3.92%	<u>\$ 22,000</u>	<u>\$ 6,525</u>

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 7 – Interest rate swap agreement (continued)

Amounts reflected in the change in value of the interest rate swap agreement for the year ended June 30, 2019 was as follows:

Statement of activities and changes in net assets location		Realized and unrealized gain/(loss)
Non-operating:		
Interest rate swap agreement	Net realized and unrealized gain/(loss) on interest rate swap agreements	\$ (2,026)

Note 8 – Liquidity and availability of resources

The Ballet's financial assets available within one year of the consolidated statement of financial position date for general expenditures were as follows:

Financial assets	
Cash and cash equivalents	\$ 8,883
Accounts receivable	171
Pledges receivable, net	2,724
Other investments	586
Other assets	665
Restricted cash	5,447
Endowment investments	124,446
Total financial assets available within one year	142,922
Less:	
Pledges receivable collectible beyond one year	(878)
Defined benefit plan asset	(562)
Restricted cash	(5,447)
Investments not convertible to cash within the next 12 months	(4,231)
Financial assets with donor restrictions	(80,658)
Total financial assets available within one year	\$ 51,146

The Ballet's cash cycle is consistent year-over-year, driven by the seasonality of performance expense, ticket sales, and contributed revenue. The Association's average cash balance is approximately \$7,000, with its FY19 seasonal low taking place in late April 2019 at \$4,800. The Ballet also maintains a \$3,000 line of credit linked to its First Republic Bank operating checking account, which it has not used for the past seven years.

In addition to maintaining liquidity to meet operational requirements, the Ballet must also meet its debt covenants that require it to maintain liquid assets equal to or greater than \$25,000 so long as the outstanding principal balance on the loans is greater than \$25,000, or 50% of the then-outstanding principal balance of the loans, once the outstanding principal balance on the loans is \$25,000 or less. The Ballet meets this covenant with unrestricted assets held in its Endowment, as well as cash and cash equivalents within the Association's accounts. As of June 30, 2019, the Ballet had almost twice the required coverage in terms of unrestricted Endowment assets and Association cash.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 9 – Workers' compensation

The Ballet's workers' compensation insurance policies include self-insured retention limits and fully insured coverage above such limits. Accruals for claims under the Ballet's self-insured retention limits are recorded on a claim-incurred basis. The estimated liability for workers' compensation claims incurred but unpaid as of June 30, 2019, of \$1,818 is included in accounts payable and accrued expenses in the accompanying consolidated statement of financial position. As of June 30, 2019, the Ballet had unused letters of credit totaling \$2,350 as required by the Ballet's insurance carriers.

Note 10 – Postretirement and health and welfare plans

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

Substantially all theatrical employees are covered under collective bargaining agreements that require payments to multiemployer pension, health, and welfare plans. Contributions to these plans approximated \$2,205 for the year ended June 30, 2019.

The Ballet has an agreement with a key employee to provide postretirement salary continuance and employee and spousal health benefits for a fixed period of time dependent on the number of years served under the agreement and on the absence of certain types of postretirement employment and benefits available to the employee. The fair value of the salary continuance of \$1,130 has been calculated based on the net present value of the expected payments. The total present value as of June 30, 2019, of the future health benefits, or the expected postretirement benefit obligation for health, was approximately \$230. This amount is equal to the accumulated postretirement benefit obligation of the future health benefits, as of June 30, 2019. The loss for the year ended June 30, 2019, affecting future health benefits was \$10. Salary and benefit continuance are included in the liability on the consolidated statement of financial position.

The following table sets forth the health benefits agreement's obligations, fair value of plan assets, and status as of June 30, 2019, which liability is included in the consolidated statement of financial position.

	As of June 30, 2019
Benefit obligation	\$ 230
Unfunded status – end of year	\$ 230

Amounts recognized for health benefits in net assets without donor restrictions consist of unrecognized prior service costs of \$230 as of June 30, 2019. The periodic net benefit loss for the year ended June 30, 2019 was \$10. The weighted-average assumption used to determine benefit obligations as of June 30, 2019 was 2.89%.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 10 – Postretirement and health and welfare plans (continued)

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

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

For measurement purposes, a 7.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for the year ended June 30, 2019. This annual rate is based on market conditions for similar benefits and was assumed to decrease gradually to 4.5% through the year ending June 30, 2020 and remain at that level thereafter.

No benefits are expected to be paid from the postretirement benefit plan in the year ending June 30, 2019. The aggregate benefits expected to be paid in the five years from 2019 to 2023 are approximately \$150. The expected benefits are based on the same assumptions used to measure the Ballet's benefit obligation as of June 30, 2019 and include future employee service.

The Ballet also has a voluntary salary deferral plan for highly-compensated employees under IRC Section 457(b). Eligible employees may elect to contribute to the plan and the Ballet may make qualified non-elective discretionary contributions. Matching contributions were made during the year ended June 30, 2019.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 10 – Postretirement and health and welfare plans (continued)**Multiemployer pension plans**

The Ballet contributes to several multiemployer defined benefit pension plans under the terms of collective bargaining agreements that cover certain union-represented employees. The Ballet's collective bargaining agreements do not require that a minimum contribution be made to these plans. For the year ended June 30, 2019, the Ballet contributed to multiple union trusts and charged to expense \$1,502.

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

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

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

The Ballet's participation in these plans for the year ended June 30, 2019, is outlined in the table below. All information in the table is as of June 30, 2019. The "EIN-PN" column provides the Employer Identification Number ("EIN") and the Plan Number ("PN"). The Pension Protection Act ("PPA") zone status is based on information that the Ballet received from the plan. Among other factors, generally, plans in critical status ("red") are less than 65% funded, and plans at least 80% funded are said to be in the "green zone". The "FIP/RP status pending/implemented" column indicates plans for which a funding improvement plan ("FIP") or a rehabilitation plan ("RP") is either pending or has been implemented by the trustees of each plan. Information related to the impact of utilization of extended amortization periods on zone status is either not available or not obtainable without undue cost and effort.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 10 – Postretirement and health and welfare plans (continued)

Multiemployer pension plans, continued

Pension fund	EIN - PN	Expiration Date	Pension protection act zone status	Are the Company's contributions more than 5% of Total Plan Contributions as of Plan year –per Form 550	Pending / Implemented	Plan's year end	Ballet contribution as of plan year end	Surcharge on plan?	Total Plan Contributions	5% Contributions? Calculated per FE-use Form 5500
The AGMA Retirement Plan	13-3826401-Plan No. 001	6/30/2021	Green	Yes	N/A	8/31/2018	\$ 301	No	\$ 4,579	7%
American Federation of Musicians and Employer's Pension Fund and Subsidiary	51-6120204 - Plan No. 001	11/30/2020	Yellow	No	Implemented	3/31/2018	686	Yes	68,204	1%
I.A.T.S.E. Local 16 Pension Plan	94-6296420 - Plan No. 001	6/30/2020	Green	No	N/A	12/31/2017	364	No	9,949	4%
I.A.T.S.E. Local 16 Pension Plan	94-6296420 - Plan No. 001	6/30/2021	Green	No	N/A	12/31/2017	21	No	9,949	0%
I.A.T.S.E. National Pension Fund	13-1849172 - Plan No. 001	7/31/2020	Green	No	N/A	12/31/2017	45	No	28,999	0%
I.A.T.S.E. National Pension Fund	13-1849172 - Plan No. 001	8/31/2022	Green	No	N/A	12/31/2017	47	No	28,999	0%

Note 11 – Endowment

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

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

The Ballet has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Ballet classifies as perpetual endowment: (a) the original value of gifts donated to the perpetual endowment, (b) the original value of subsequent gifts to the perpetual endowment, and (c) accumulations to the perpetual 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 endowment fund that is not classified in perpetual endowment is classified as time or purpose restricted net assets until those amounts are appropriated for expenditure by the Ballet in a manner consistent with the standard of prudence prescribed by UPMIFA.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 11 – Endowment (continued)

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

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

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

Endowment net asset composition by type of fund as of June 30, 2019, consists of the following:

	Total
Donor-restricted endowment funds	\$ 74,258
Accumulated appreciation	6,400
Total funds	<u>\$ 80,658</u>

While the Board does not designate endowment net assets, the Board-designated endowment assets as of June 30, 2019 is \$43,788 (see table below).

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 11 – Endowment (continued)

Changes in endowment by net asset class for the years ended June 30, 2019 and 2018, are as follows:

	2019			2018		
	Without donor restrictions	With donor restrictions	Total	Without donor restrictions	With donor restrictions	Total
Endowment assets, beginning of year	\$ 45,044	\$ 79,135	\$ 124,179	\$ 41,877	\$ 77,171	\$ 119,048
Investment return:						
Investment return - investment income	1,257	1,997	3,254	878	1,302	2,180
Net realized and unrealized appreciation	1,036	1,672	2,708	618	3,333	3,951
Total investment return	2,293	3,669	5,962	1,496	4,635	6,131
Restatement due to change in accounting for underwriter endowments	-	-	-	3,944	(3,944)	-
Additions to endowment funds from contributions and pledge payments	808	1,708	2,516	639	5,202	5,841
Reclassifications of Board-designated endowments	(815)	-	(815)	1,025	-	1,025
Appropriation of endowment assets for expenditure	(3,542)	(3,854)	(7,396)	(3,937)	(3,929)	(7,866)
Endowment assets, end of year	\$ 43,788	\$ 80,658	\$ 124,446	\$ 45,044	\$ 79,135	\$ 124,179

FY18 totals differ from total Endowment Investments on page 5 by approximately \$219 as they do not reflect contributions yet to be transferred from the Association to the Foundation.

From time to time, the fair value of assets associated with individual donor endowment funds may fall below the value of the initial and subsequent donor gift amounts deficit. When donor endowment deficits exist, they are classified as a reduction of assets without donor restrictions. Deficits associated with funds functioning as endowments, when they exist, are likewise classified as a reduction of assets without donor restrictions. These deficits resulted from unfavorable market fluctuations and continued appropriation for certain programs and expenditures that were deemed prudent. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in assets without donor restrictions. Deficiencies of this nature are reflected in the consolidated financial statements and are as follows:

	2019	2018
Fair Value of Endowment Funds	\$ 19,353	\$ 19,347
Historical Gift Value of Endowment Funds	22,598	23,291
Total underwriter deficiency of endowment funds	\$ (3,245)	\$ (3,944)

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 11 – Endowment (continued)**Return objectives and risk parameters**

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

Strategies employed for achieving investment objectives

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

Relationship of spending policy to investment objectives

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

San Francisco Ballet Association

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June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 12 – Net assets with donor restrictions and net assets released from restrictions

As of June 30, 2019, net assets with donor restrictions were available for the following purposes:

New Ballet production	\$	3,181
Ballet school support		2,827
Accumulated appreciation of endowment funds not appropriated for expenditure (time restricted portion)		1,849
Resources for property and equipment		299
Passage of time, including unpaid pledges		295
Touring		280
Special events		119
Education and outreach		751
Perpetual endowment		74,258
Miscellaneous		91
Total net assets with donor restrictions	\$	<u>83,950</u>

Net assets released during the year ended June 30, 2019, were as follows:

For use in ensuing fiscal years/due to expiration of time	\$	2,380
Property and equipment		47
Accumulated appreciation of endowment funds (time restricted portion) appropriated for expenditure		1,975
Pledge payment		4
New Ballet production		491
Touring		55
Ballet school support		509
Education and outreach		215
Special events		321
Artistic and production		7
Total releases	\$	<u>6,004</u>

Note 13 – Lease commitments

The Ballet rents performance space, office space, office equipment, and event venues under various operating leases. The following is a schedule of approximate future minimum rental payments required under the leases as of June 30, 2019, that have an initial noncancellable lease term in excess of one year:

	Year ending June 30, 2019	
2020	\$	86
2021		72
Total	\$	<u>158</u>

Rent expense from operating leases approximated \$880 for the year ended June 30, 2019.

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 13 – Lease commitments (continued)

During FY19, the Ballet entered into a sublease agreement to rent out the location that is no longer in use. Expected rental income for the duration of the above lease term are as follows:

	Year ending June 30, 2019	
2020	\$	79
2021		71
Total	\$	150

Note 14 – Collective bargaining agreements

Approximately 76% (623 employees) of the Ballet's employees are covered by collective bargaining agreements. One agreement, Local 16 I.A.T.S.E, expires within twelve months of June 30, 2019.

Note 15 – Related parties

As of June 30, 2019, undiscounted pledges receivable includes approximately \$1,756 due from members of the Association's Board of Trustees and of the Foundation's Board of Directors.

A fixed income mutual fund managed by a member of the Association's Board of Trustees and the Foundation's Board of Directors' investment management company was valued at \$6,073 as of June 30, 2019. A member of the Association's Board of Trustees is the Chairman and Founding Chief Executive Officer of the bank with which the Association has its operating accounts, credit facilities and loans payable, First Republic Bank, of the Foundation's investment custodian, First Republic Trust Company and of the Association's investment broker, First Republic Securities.

A member of the Foundation's Board of Directors sits on a committee of the investment manager, which oversees the fixed income investment strategy, monitoring implementation of that strategy, and overseeing the research process for two of the Ballet's mutual fund holdings. This member is also a partner and shareholder of an investment firm that manages one of the Ballet's global equity holdings. The collective value of the Ballet's investments in the mutual funds and global stock fund was \$27,414 at June 30, 2019.

Of the value of contributed services recognized as revenues in the accompanying consolidated financial statements, \$223 was received from related parties, primarily for legal services.

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

June 30, 2019

(With summarized financial information as of June 30, 2018)

(In thousands of dollars)

Note 16 – Contingencies

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

Note 17 – Subsequent events

The Ballet evaluated subsequent events through October 21, 2019, the date on which the consolidated financial statements were issued and determined there were none to report.