

SAN FRANCISCO
CONSERVATORY OF MUSIC

JUNE 30, 2020

INDEPENDENT AUDITORS' REPORT

AND

CONSOLIDATED FINANCIAL STATEMENTS

San Francisco Conservatory of Music

Independent Auditors' Report and Consolidated Financial Statements

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A Century Strong

Independent Auditors' Report

THE BOARD OF TRUSTEES
SAN FRANCISCO CONSERVATORY OF MUSIC
San Francisco, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of **SAN FRANCISCO CONSERVATORY OF MUSIC (SFCM)** which comprise the consolidated statement of financial position as of June 30, 2020, and the related consolidated statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of SFCM as of June 30, 2020, and the consolidated changes in its net assets and its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited SFCM's June 30, 2019 consolidated financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated November 12, 2019. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2019, is consistent, in all material respects, with the consolidated audited financial statements from which it has been derived.

Hood & Strong LLP

San Francisco, California
November 10, 2020

San Francisco Conservatory of Music

Consolidated Statement of Financial Position (in thousands)

| <i>June 30, 2020 (with comparative totals for 2019)</i> | 2020 | 2019 |
|---|-------------------|-------------------|
| Assets | | |
| Cash and cash equivalents | \$ 7,554 | \$ 2,149 |
| Restricted cash | 113 | 204 |
| Receivables: | | |
| Accounts receivable (less allowance for doubtful accounts of \$16 for 2020 and \$14 for 2019) | 2,307 | 2,463 |
| Notes receivable (less allowance for doubtful accounts of \$94 for 2020 and \$96 for 2019) | 1,161 | 1,260 |
| Contributions and grants, net | 31,925 | 42,346 |
| Trusts | 225 | 267 |
| Investments | 54,806 | 41,882 |
| Other assets | 1,195 | 925 |
| Property, plant and equipment, net | 213,693 | 122,030 |
| Total Assets | \$ 312,979 | \$ 213,526 |
| Liabilities and Net Assets | | |
| Liabilities: | | |
| Accounts payable | \$ 12,104 | \$ 6,584 |
| Accrued expenses and other liabilities | 9,701 | 2,887 |
| Deposits and deferred income | 2,933 | 2,727 |
| Line of credit | 500 | 3,000 |
| Loans, net of financing issuance costs | 63,538 | 2,771 |
| Paycheck Protection Program loan | 2,639 | - |
| Accumulated postretirement medical benefit obligation | 4,847 | 4,441 |
| Government advances for loan program | 522 | 691 |
| Total liabilities | 96,784 | 23,101 |
| Net Assets: | | |
| Without donor restrictions: | | |
| Undesignated | 25,501 | 7,322 |
| Designated - Quasi endowment | 88 | 92 |
| Federal loan fund | 185 | 180 |
| Investment in plant | 45,201 | 45,067 |
| Total net assets without donor restrictions | 70,975 | 52,661 |
| With donor restrictions: | | |
| Purpose and time restrictions | 101,810 | 94,579 |
| Appreciation on endowment funds | 376 | 921 |
| Underwater endowment funds | (4,676) | (3,030) |
| Restricted in perpetuity - endowment funds | 47,710 | 45,294 |
| Total net assets with donor restrictions | 145,220 | 137,764 |
| Total net assets | 216,195 | 190,425 |
| Total Liabilities and Net Assets | \$ 312,979 | \$ 213,526 |

See accompanying notes to financial statement.

San Francisco Conservatory of Music

Consolidated Statement of Activities (in thousands)

Year Ended June 30, 2020 (with comparative totals for 2019)

| | 2020 | | | 2019 Total |
|--|-------------------------------|----------------------------|------------|---------------|
| | Without Donor Restrictions | With Donor Restrictions | Total | |
| Operating Revenue and Support: | | | | |
| Tuition and fees | \$ 24,172 | | \$ 24,172 | \$ 22,999 |
| Less: Scholarships | (12,166) | | (12,166) | (11,288) |
| Net tuition and fees | 12,006 | | 12,006 | 11,711 |
| Private contributions and government grants | 8,022 | \$ 1,217 | 9,239 | 5,924 |
| Other educational revenue | 250 | | 250 | 324 |
| Board release from fund for special purposes | 1,400 | | 1,400 | |
| Fundraising events | 511 | | 511 | 601 |
| Auxiliary services | 3,050 | | 3,050 | 3,443 |
| Net investment and endowment income | 154 | 2,513 | 2,667 | 2,579 |
| Net assets released - endowment draw | 2,513 | (2,513) | - | - |
| Net assets released from restrictions | 1,330 | (1,330) | - | - |
| Total operating revenue and support | 29,236 | (113) | 29,123 | 24,582 |
| Expenses: | | | | |
| Program services: | | | | |
| Instruction | 14,488 | | 14,488 | 13,489 |
| Student services | 1,848 | | 1,848 | 1,591 |
| Academic support | 1,493 | | 1,493 | 1,306 |
| Public programs | 370 | | 370 | 484 |
| Auxiliary services | 3,280 | | 3,280 | 3,194 |
| Total program services | 21,479 | | 21,479 | 20,064 |
| Fundraising: | | | | |
| General fundraising | 1,340 | | 1,340 | 867 |
| Fundraising events | 156 | | 156 | 218 |
| Total fundraising | 1,496 | | 1,496 | 1,085 |
| General and administration | 5,939 | | 5,939 | 4,880 |
| Total expenses (including depreciation of \$1,247) | 28,914 | | 28,914 | 26,029 |
| Change in net assets from operations | 322 | (113) | 209 | (1,447) |
| Nonoperating Activities: | | | | |
| Endowment contributions | - | 2,422 | 2,422 | 1,019 |
| Unrestricted contributions designated by Board | 20,000 | | 20,000 | |
| Release from Board designated fund | (1,400) | | (1,400) | |
| Capital Campaign contributions | | 8,244 | 8,244 | 16,814 |
| Independent operation revenues | 106 | | 106 | 141 |
| Independent operation expenses | (144) | | (144) | (492) |
| Capital Campaign fundraising expenses | (940) | | (940) | (870) |
| Loss on sale of assets | (166) | | (166) | (23) |
| Investment income (loss), net of fees | | (2,151) | (2,151) | (612) |
| Change in value of trust receivable | | (6) | (6) | 5 |
| Net assets released from restriction | 940 | (940) | - | - |
| Postretirement medical benefit plan obligation | (404) | | (404) | (767) |
| Change in net assets from nonoperating activities | 17,992 | 7,569 | 25,561 | 15,215 |
| Total Change in Net Assets | 18,314 | 7,456 | 25,770 | 13,768 |
| Net Assets, beginning of year | 52,661 | 137,764 | 190,425 | 176,657 |
| Net Assets, end of year | \$ 70,975 | \$ 145,220 | \$ 216,195 | \$ 190,425 |

See accompanying notes to financial statement.

San Francisco Conservatory of Music

Consolidated Statement of Functional Expenses (in thousands)

Year Ended June 30, 2020

| | Operating | | | | | | | | | Non-operating | | Total Expenses |
|--|------------------|------------------|------------------|-----------------|--------------------|----------------------------|--------------------|-----------------|------------------|-----------------------|------------------------------|------------------|
| | Instruction | Student Services | Academic Support | Public Programs | Auxiliary Services | General and Administration | Fundraising Events | Fundraising | Total | Independent Operation | Capital Campaign Fundraising | |
| Salaries and wages | \$ 9,916 | \$ 1,011 | \$ 880 | \$ 156 | \$ 12 | \$ 3,241 | \$ 2 | \$ 813 | \$ 16,031 | | \$ 450 | \$ 16,481 |
| Benefits | 1,547 | 200 | 174 | 15 | 1 | 656 | | 110 | 2,703 | | 165 | 2,868 |
| Purchased services | 379 | 66 | 35 | 6 | 5 | 148 | 48 | 58 | 745 | | 7 | 752 |
| Professional and artistic fees | 550 | 67 | 88 | 144 | 19 | 647 | 1 | 12 | 1,528 | \$ 11 | 122 | 1,661 |
| Repairs and maintenance | 142 | 11 | 22 | 2 | | 17 | | 8 | 202 | | | 202 |
| Supplies | 207 | 33 | 128 | 1 | 11 | 66 | 2 | 14 | 462 | | 1 | 463 |
| Depreciation | 764 | 81 | 70 | 11 | 1 | 258 | | 62 | 1,247 | | | 1,247 |
| Interest expense | 155 | 16 | 14 | 2 | | 52 | | 13 | 252 | | | 252 |
| Insurance | 147 | 16 | 14 | 2 | | 50 | | 12 | 241 | | | 241 |
| Utilities and telephone | 247 | 28 | 23 | 4 | 97 | 94 | | 22 | 515 | | 2 | 517 |
| Travel/mileage/meals | 143 | 83 | 3 | 26 | 6 | 83 | 87 | 26 | 457 | 2 | 29 | 488 |
| Software | 80 | 128 | 24 | | | 26 | | 48 | 306 | | | 306 |
| Advertising | 6 | 63 | | | | 149 | | 30 | 248 | | 7 | 255 |
| Facility rentals | 51 | 4 | 1 | | 3,127 | 177 | | 1 | 3,361 | 131 | 60 | 3,552 |
| Awards and contributions (non tuition) | 89 | 13 | | | | 125 | | | 227 | | | 227 |
| Other expenses | 65 | 28 | 17 | 1 | 1 | 150 | 16 | 111 | 389 | | 97 | 486 |
| Total Expenses | \$ 14,488 | \$ 1,848 | \$ 1,493 | \$ 370 | \$ 3,280 | \$ 5,939 | \$ 156 | \$ 1,340 | \$ 28,914 | \$ 144 | \$ 940 | \$ 29,998 |

See accompanying notes to financial statement.

San Francisco Conservatory of Music

Consolidated Statement of Functional Expenses (in thousands)

Year Ended June 30, 2019 (presented for comparative purposes)

| | Operating | | | | | | | | | Non-operating | | Total Expenses |
|--------------------------------|------------------|------------------|------------------|-----------------|--------------------|----------------------------|--------------------|---------------|------------------|-----------------------|------------------------------|------------------|
| | Instruction | Student Services | Academic Support | Public Programs | Auxiliary Services | General and Administration | Fundraising Events | Fundraising | Total | Independent Operation | Capital Campaign Fundraising | |
| Salaries and wages | \$ 8,939 | \$ 834 | \$ 794 | \$ 202 | \$ 12 | \$ 2,291 | \$ 2 | \$ 517 | \$ 13,591 | | \$ 560 | \$ 14,151 |
| Benefits | 1,377 | 164 | 139 | 16 | 1 | 568 | | 46 | 2,311 | | 197 | 2,508 |
| Purchased services | 657 | 90 | 52 | 12 | 21 | 194 | 71 | 49 | 1,146 | | | 1,146 |
| Professional and artistic fees | 422 | 47 | 35 | 182 | 17 | 655 | 19 | 24 | 1,401 | \$ 94 | 68 | 1,563 |
| Repairs and maintenance | 74 | 4 | 13 | 1 | 4 | 17 | | 2 | 115 | 36 | | 151 |
| Supplies | 247 | 39 | 46 | 2 | 7 | 106 | 2 | 9 | 458 | 21 | 6 | 485 |
| Depreciation | 811 | 78 | 73 | 17 | 1 | 224 | | 44 | 1,248 | 158 | | 1,406 |
| Interest expense | 139 | 13 | 13 | 3 | | 39 | | 8 | 215 | 2 | | 217 |
| Insurance | 140 | 14 | 13 | 3 | | 39 | | 8 | 217 | | | 217 |
| Utilities and telephone | 216 | 23 | 19 | 5 | 80 | 93 | | 14 | 450 | | | 450 |
| Travel/mileage/meals | 215 | 70 | 3 | 36 | 5 | 121 | 43 | 28 | 521 | | 9 | 530 |
| Software | 139 | 110 | 30 | 1 | | 39 | | 40 | 359 | | | 359 |
| Advertising | 26 | 40 | 1 | | | 133 | | 3 | 203 | | 7 | 210 |
| Facility rentals | 7 | 5 | | | 3,045 | 148 | | | 3,205 | 181 | | 3,386 |
| Other expenses | 80 | 60 | 75 | 4 | 1 | 213 | 81 | 75 | 589 | | 23 | 612 |
| Total Expenses | \$ 13,489 | \$ 1,591 | \$ 1,306 | \$ 484 | \$ 3,194 | \$ 4,880 | \$ 218 | \$ 867 | \$ 26,029 | \$ 492 | \$ 870 | \$ 27,391 |

See accompanying notes to financial statement.

San Francisco Conservatory of Music

Consolidated Statement of Cash Flows (in thousands)

| <i>Year Ended June 30, 2020 (with comparative totals for 2019)</i> | 2020 | 2019 |
|--|-----------------|-----------------|
| Operating Activities: | | |
| Change in net assets | \$ 25,770 | \$ 13,768 |
| Adjustments to reconcile change in net assets to net cash provided (used) by operating activities: | | |
| Depreciation | 1,247 | 1,406 |
| Net realized and unrealized loss on investments | 1,167 | 314 |
| Loss on disposal of assets | 166 | 23 |
| Contributions of equipment | (1,755) | (71) |
| Contributions received for long-term investment and acquisition of long lived assets | (21,421) | (18,165) |
| Financing issuance costs amortization | 136 | 136 |
| Changes in operating assets and liabilities: | | |
| Receivables | 10,718 | (342) |
| Other assets | (270) | (29) |
| Accounts payable | (5,900) | (824) |
| Accrued expenses, other liabilities and postretirement obligation | 7,220 | 3,290 |
| Deposits and deferred income | 206 | (19) |
| Government advances for loan program | (169) | 2 |
| Net cash provided (used) by operating activities | 17,115 | (511) |
| Investing Activities: | | |
| Property and equipment: | | |
| Proceeds from sales | 225 | 18 |
| Purchases and capital expenditures | (80,126) | (26,199) |
| Investments: | | |
| Proceeds from sales | 6,758 | 4,510 |
| Purchases | (20,849) | (7,420) |
| Net cash used by investing activities | (93,992) | (29,091) |
| Financing Activities: | | |
| Contributions received for long-term investment and acquisition of long lived assets | 21,421 | 18,165 |
| Line of credit proceeds | 1,500 | 3,500 |
| Line of credit payments | (4,000) | (2,250) |
| Loan proceeds | 63,270 | 167 |
| Net cash provided by financing activities | 82,191 | 19,582 |
| Net Change in Cash and Equivalents and Restricted Cash | 5,314 | (10,020) |
| Cash and Cash Equivalents and Restricted Cash, beginning of year | 2,353 | 12,373 |
| Cash and Cash Equivalents and Restricted Cash, end of year | \$ 7,667 | \$ 2,353 |
| Supplemental Cash Flow Information: | | |
| Interest paid | \$ 1,455 | \$ 246 |
| Construction in progress costs included in accounts payable | \$ 11,420 | \$ 6,189 |

See accompanying notes to financial statement.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Note 1 - Organization and Operations:

San Francisco Conservatory of Music (SFCM) is an independent college of music located in San Francisco, California. SFCM offers undergraduate and graduate degree programs, music instruction for adults and children and other public programs.

SFCM's operations are primarily funded through revenue generated by tuition and fees. Private contributions received from donors increase SFCM's ability to provide instruction.

SFCM assists students in the financing of their education through private and institutional scholarships as well as federally funded student aid programs.

SFCM is accredited by the Western Association of Schools and Colleges (WASC). Federally funded student aid programs require the accreditation to be maintained. This accreditation is subject to periodic review and renewal.

Note 2 - Significant Accounting Policies:

SFCM's significant accounting policies include the following:

a. Basis of Presentation and Description of Net Assets

The accompanying consolidated financial statements include the accounts of SFCM and its single member LLCs (collectively, "SFCM") after elimination of intercompany accounts and transactions.

SFCM's financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles for not-for-profit organizations which utilize classifications for presentation based on the existence or absence of donor-imposed restrictions.

Net assets without donor restrictions represent unrestricted resources that are not subject to donor-imposed restrictions and are available to support all activities of SFCM. Net assets without donor restrictions include Board designated net assets for endowment (see Note 14).

Net assets with donor restrictions represent contributions that are limited in use by SFCM in accordance with donor-imposed stipulations that either expire with the passage of time or can be fulfilled and removed by activities conducted by SFCM pursuant to those stipulations. Other donor-imposed restrictions represent contributions to be held as investments in perpetuity as directed by the original donor.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

b. Revenue Recognition

Student tuition receivables are recorded when students are billed. Tuition revenue is recorded as the performance obligation is met (earned) on a pro rata basis over the applicable teaching period. Payments received for tuition for future periods are reported as deferred revenue. Collection or development of payment plans for tuition is required prior to registration for the following term.

All contributions and grants, whether or not restricted, are recognized as revenue when they are received by or unconditionally pledged to SFCM. SFCM classifies gifts of cash and other assets as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When such donor restrictions expire, that is, when stipulated time restrictions end or purpose restrictions are accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the accompanying statement of activities as net assets released from restrictions.

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

Contributions of services are recorded as revenue and recognized when received if the services create or enhance nonfinancial assets, or if they require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation. Corresponding amounts are also recorded as expenses.

Contributions of assets other than cash are recorded at their estimated fair value. Contributions and grants receivable represent amounts committed by donors that have not been received by SFCM. Contributions and grants expected to be received beyond one year, are discounted at an applicable rate at the time of contribution.

c. Cash Equivalents

SFCM considers all instruments with a maturity of three months or less at the time of purchase to be cash equivalents for the purposes of the statement of cash flows, except for cash equivalents included in and managed with SFCM's investments.

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Notes to Consolidated Financial Statements

d. Restricted Cash

Restricted cash represents cash in the SFCM's Perkins loan program.

e. Investments

Marketable securities are recorded at fair value based on quoted market prices. The fair value of alternative investments has been estimated using the net asset values (NAV) as reported by the fund managers. SFCM believes the carrying amount of these investments is a reasonable estimate of its fair value. The timing of the ultimate liquidation of this investment is restricted to certain time periods, and is limited to sale by the fund. Due to inherent uncertainty of valuation of such investment, the estimated value may differ significantly from the value that would have been used had a ready market for such funds existed.

Other investments, primarily real estate interests are carried at cost basis. Investments received as gifts are recorded at estimated fair value at the date of the donation. Gains and losses that result from market fluctuations are recognized in the period such fluctuations occur. Realized gains or losses resulting from sales or maturities are calculated on an adjusted cost basis. Adjusted cost is the estimated fair value of the security at the beginning of the year, or the cost if purchased during the year.

Dividend and interest income are accrued when earned.

f. Fair Value Measurements

Fair value is the price 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. SFCM reports certain investments using the NAV per share as determined by investment managers under the so-called "practical expedient." The practical expedient allows net asset value per share to represent fair value for reporting purposes when the criteria for using this method are met.

SFCM classifies its financial assets and liabilities measured at fair value on a recurring basis based on a fair value hierarchy with three levels of inputs. Level 1 values are based on unadjusted quoted prices in active markets for identical securities. Level 2 values are based on significant observable market inputs, such as quoted prices for similar securities and quoted prices in active markets. Level 3 values are based on significant unobservable inputs that reflect SFCM's determination of assumptions that market participants might reasonably use in valuing the securities. The valuation levels are not necessarily an indication of the risk or liquidity associated with the assets and liabilities measured at fair value.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

g. Endowment Funds

SFCM's endowments include donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Uniform Prudent Management of Funds Act (UPMIFA)

The Board of Trustees of SFCM has interpreted California's 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, SFCM classifies as donor restricted net assets (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 donor-restricted endowment fund that is not classified as net assets with donor restrictions in perpetuity is classified as donor restricted net assets of a time nature until those amounts are appropriated for expenditure by SFCM in a manner consistent with the standard of prudence prescribed by California's UPMIFA. In accordance with California's UPMIFA, SFCM considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- 1) The duration and preservation of the fund
- 2) The purposes of SFCM and the donor-restricted endowment fund
- 3) General economic conditions
- 4) The possible effect of inflation and deflation
- 5) The expected total return from income and the appreciation of investments
- 6) Other resources of SFCM
- 7) The needs of SFCM and the fund to make distributions and to preserve capital
- 8) The expected tax consequences
- 9) The role that each investment or course of action plays within the overall fund
- 10) The investment policies of SFCM

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Investment Objectives and Spending Policy

SFCM has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, as approved by the Board of Trustees, the performance of the endowment fund shall be measured by total return.

SFCM's Endowment Investment has a long-term spending goal of 4% of a 3-year average. However, the specific draw shall be determined by the Board on an annual basis considering the performance of the endowment and the needs of SFCM. A protective collar is utilized as an overlay to the spending policy. The protective collar calculations will be based on the value of the endowment at the end of each fiscal year. The application of the collar will mitigate the effects of extreme market outcomes and limit the amount of money that can be distributed from the endowment if there is a one year or a period of years of underperformance or negative performance. Under this collar, the SFCM takes into consideration the market value of the endowment at the most recent fiscal year-end. The collar states that the draw must fall within a range that is at least 4% and not more than 6% of the Endowment Market Value at year end, even if the amount that could be drawn is higher or lower under the 3-year moving average calculation. This is consistent with SFCM's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, SFCM relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). SFCM's endowment fund is invested in a portfolio of stocks, bonds and other investments which shall provide maximum flexibility and safety through diversification of investments.

From time to time, the fair value of assets associated with individual donor-restricted funds may fall below the level that the donor or UPMIFA requires SFCM to retain as a fund of perpetual duration, underwater endowments. At June 30, 2020, SFCM had 123 funds with deficiencies totaling \$4,676,000 with fair market values of \$34,093,000 and original endowment gift amounts of \$38,769,000. These deficiencies resulted from unfavorable market fluctuations and continued appropriation for programs that were deemed prudent by the Board of Trustees.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

h. Accounts Receivable and Notes Receivable

Accounts receivable consist principally of student accounts receivable that are carried at the unpaid balance of the original amount billed to students. Notes receivable include Federal student loans which bear interest of 3 to 5 percent annually. Receivables are less an estimate made for doubtful accounts based on SFCM's past experience with the accounts. The allowance for doubtful accounts are disclosed in the statement of financial position.

Student accounts receivable are written off when deemed uncollectible and student loans receivable may be assigned to the U.S. Department of Education. Late fees are charged on student accounts receivable after the posted registration dates.

After a student is no longer enrolled in an institution of higher education and after a grace period, interest is charged on student loans receivable and is recognized as it is charged. Late charges are charged if payments are not paid by the payment due date and are recognized as they are charged. Student loans receivable are considered to be past due if a payment is not made within 90 days of the payment due date. After receivables become past due, the accrual of late charges is suspended. Students may be granted a deferment, forbearance or cancellation of their student loan receivable based on eligibility requirements defined by the U.S. Department of Education.

i. Trusts Receivable

Trusts receivable are gifts and bequests held by SFCM or a trustee of which the income is paid to a beneficiary specified by the donor during the beneficiary's lifetime. Upon maturation, the principal becomes available for use by SFCM in accordance with the donor's specified purpose. Currently all recorded trusts contain provisions permanently restricting the corpus of the trust, at maturity. Trusts receivable include charitable remainder trusts, which are carried at the estimated net present value of SFCM's remainder interest in irrevocable trusts. The net present value was actuarially determined using a rate of 2%.

j. Property, Plant and Equipment

Property, plant and equipment are stated at cost, if purchased, or fair market value at date of receipt, if donated. Depreciation is recorded using the straight-line method over estimated useful lives of 80 years for buildings, 20-40 years for building improvements, and 3-10 years for all other depreciable assets. Included in property and plant assets are musical instruments SFCM maintains and records as a collection, and accordingly, no depreciation is recognized in operations.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

k. Collections

SFCM has capitalized its collection of musical instruments since its inception. If purchased, items accessioned into the collection are capitalized at cost, and if donated, they are capitalized at their fair value on the accession date. Gains or losses on the deaccession of collection items are classified on the statement of activities depending on donor restrictions, if any, placed on the item at the time of accession.

l. Deposits and Deferred Income

Deposits and deferred income represent tuition that has not been earned at year-end and will be recognized in subsequent periods.

m. Government Advances for Loan Program

SFCM records the portion of federally funded student loan payments received as refundable advances. The amount includes principal and interest earned on the loans less certain allowable costs.

n. Non-Operating Revenue and Gains

Non-operating revenue and gains includes gifts and grants restricted or designated for endowment or plant and the related investment income and net realized gains on investments in excess of the allocated income under the endowment spending policy.

o. Advertising Expenses

SFCM's policy is to expense advertising costs as they are incurred. Advertising expense incurred, for the purpose of generating tuition revenue, in the year ended June 30, 2020 was \$138,000.

p. Functional Expense Allocations

Certain expenses, such as depreciation and amortization expense, building services, and interest, are allocated among program services and supporting services based primarily on direct payroll charges and other direct expenses.

q. Income Taxes

SFCM operates as a not-for-profit corporation and is exempt from income taxes on related income under provisions of the U.S. Internal Revenue Code, Section 501(c)(3) and the California Tax Code. Accordingly, no provision for income taxes has been reflected in these financial statements.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

As of June 30, 2020, management evaluated SFCM's tax positions and concluded that SFCM had maintained its tax-exempt status and had taken no uncertain tax positions that require adjustment to the financial statements. Therefore, no provision or liability for income taxes has been included in the financial statements.

r. Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

s. Comparative Financial Statements

The consolidated financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information and certain disclosures do not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the SFCM's financial statements for the year ended June 30, 2019, from which the information was derived.

t. Collective Bargaining Agreement

Approximately 3.2% of full-time staff and faculty are covered by a collective bargaining agreement as of June 30, 2020. The current bargaining agreement expires on August 31, 2023.

u. Recent Accounting Pronouncements

Adopted

In June 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made (Topic 958)*. These amendments clarify and improve the scope and accounting guidance around contributions of cash and other assets received and made by not-for-profit organizations. The ASU clarifies and improves current guidance about whether a transfer of assets, or the reduction, settlement, or cancellation of liabilities, is a contribution or an exchange transaction. It also provides a more robust framework for determining whether a contribution is conditional or unconditional, and for distinguishing a donor-imposed condition from a donor-imposed restriction. The ASU was adopted as of July 1, 2019. The impact of adopting this guidance is reflected in the financial statements and did not have a significant impact on the financial statement disclosures.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Pronouncements Effective in the Future

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. Under the new guidance, lessees will be required to recognize, at commencement date, a lease liability representing the lessee's obligation to make payments arising from the lease and a right-of-use asset representing the lessee's right to use, or control the use of, a specified asset for the lease term. This guidance is effective for fiscal years beginning after December 15, 2021. SFCM is currently evaluating the impact the new standard will have on its financial statements.

v. Subsequent Events

SFCM evaluated subsequent events from June 30, 2020 through November 10, 2020, the date these financial statements were available to be issued, and has determined that no adjustments are necessary to the amounts reported in the accompanying financial statements and no subsequent events have occurred the nature of which would require disclosure, except as described in Note 18.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Note 3 - Availability of Financial Assets and Liquidity:

SFCM's financial assets available within one year of the June 30, 2020 year end for general expenditures are as follows:

| | |
|---|--------------|
| Financial assets at year-end: | |
| Cash and cash equivalents and restricted cash | \$ 7,667,000 |
| Contributions receivable, net | 31,925,000 |
| Accounts receivable, net | 2,307,000 |
| Investments | 54,806,000 |
| Trusts receivable | 225,000 |

| | |
|------------------------|------------|
| Total financial assets | 96,930,000 |
|------------------------|------------|

| | |
|--|--------------|
| Less amounts not available to be used within one year: | |
| Pledge receivables for capital campaign and projects | (27,166,000) |
| Pledge receivables for restricted projects | (271,000) |
| Pledge receivables for endowment | (277,000) |
| Accounts receivable for restricted purposes | (56,000) |
| Trusts receivable for restricted purposes | (225,000) |
| Cash held for restricted purposes | (882,000) |
| Cash held for endowment | (1,442,000) |
| Investments held for endowment | (40,126,000) |
| Investments in non-liquid assets | (163,000) |
| Restricted cash | (113,000) |

| | |
|--|-----------|
| Plus amounts available to be used within one year: | |
| Purpose restrictions to be met in one year | 768,000 |
| Payout on endowment assets – spending draw | 2,495,000 |

(67,458,000)

| | |
|--|---------------|
| Financial assets available to meet general expenditures over the next twelve months | \$ 29,472,000 |
|--|---------------|

SFCM regularly monitors liquidity required to meet its operating needs and other contractual commitments, while also striving to maximize the investment of its available funds. SFCM has various sources of liquidity at its disposal, including cash and cash equivalents, marketable debt and equity securities and a line of credit. See Note 9 for information about SFCM's loan facilities that are intended for the construction of the new student residence hall and educational center. In addition, at June 30, 2020, SFCM had approximately \$88,000 of board-designated endowments that, with the Board's approval, could be made available for operations.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

For purposes of analyzing resources available to meet general expenditures over a 12-month period, SFCM considers all expenditures related to its ongoing mission related activities as well as the conduct of services undertaken to support those activities to be general expenditures. Student loans receivable are not considered to be available to meet general expenditures because principal and interest on these loans are used solely to make new loans and are, therefore, not available to meet current operating needs.

In addition to financial assets available to meet general expenditures over the next 12 months, SFCM operates with a balanced budget and anticipates collecting sufficient revenue to cover general expenditures not covered by donor-restricted resources. Refer to the statement of cash flows which identifies the sources and uses of SFCM's cash.

Note 4 - Notes Receivable:

At June 30, 2020, notes receivable consisted of the following:

| | Real Estate Loan | Perkins Loans |
|---------------------------------------|---------------------|------------------|
| Notes receivable | \$ 560,000 | \$ 695,000 |
| Less allowance for doubtful accounts: | | |
| Beginning of year | | (96,000) |
| Decrease | | 2,000 |
| <hr/> | | |
| End of year | | (94,000) |
| <hr/> | | |
| Notes receivable, net | \$ 560,000 | \$ 601,000 |

Funds advanced for the Perkin Loan program, by the Federal government of \$522,000 at June 30, 2020 are ultimately refundable to the government and are classified as liabilities in the statement of financial position. Outstanding loans cancelled under the program result in a reduction of the funds available for loan and a decrease in the liability to the government. Loans are no longer allowed to be advanced to students under the program and collections on loans will be periodically remitted to the Federal government until the program is closed.

The principal amount past due under the Perkins loan program was approximately \$165,000 at June 30, 2020.

See Note 6 for information on the real estate loan made to a faculty member.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Note 5 - Contributions and Grants Receivable:

Contributions and grants receivable are expected to be collected as follows at June 30:

| | 2020 | 2019 |
|---|---------------|---------------|
| Within one year | \$ 13,758,000 | \$ 17,119,000 |
| One to five years | 19,978,000 | 27,746,000 |
| | <hr/> | <hr/> |
| | 33,736,000 | 44,865,000 |
| Discount on multi-year contributions | (708,000) | (1,129,000) |
| Allowance for uncollectible contributions | (1,103,000) | (1,390,000) |
| | <hr/> | <hr/> |
| Contributions and grants receivable, net | \$ 31,925,000 | \$ 42,346,000 |

Receivables include approximately \$27,166,000 for the capital campaign (Note 17), net of allowance and discount at June 30, 2020. See Note 15 for related party contribution receivables.

In addition to the pledge balances reflected in these financial statements at June 30, 2020, SFCM has a \$500,000 conditional pledge from a Foundation for the Capital Campaign. The pledge will be recognized when the donor specified conditions and milestone events have been met by SFCM.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Note 6 - Investments:

SFCM's investments consist of the following at June 30:

| | 2020 | | 2019 | |
|---|---------------|---------------|---------------|---------------|
| | Fair Value | Cost | Fair Value | Cost |
| Cash and equivalents | \$ 14,735,000 | \$ 14,735,000 | \$ 405,000 | \$ 405,000 |
| Domestic equities and funds | 17,585,000 | 17,268,000 | 18,401,000 | 17,574,000 |
| International mutual and commingled trust funds | 9,452,000 | 11,420,000 | 10,023,000 | 11,300,000 |
| Domestic fixed income funds | 10,058,000 | 9,400,000 | 10,152,000 | 9,899,000 |
| International fixed income funds | 1,893,000 | 1,883,000 | 1,909,000 | 1,843,000 |
| Partnerships | 163,000 | 36,000 | 72,000 | 72,000 |
| | 53,886,000 | 54,742,000 | 40,962,000 | 41,093,000 |
| Other investments: | | | | |
| Real estate – interest | 245,000 | 245,000 | 245,000 | 245,000 |
| Real estate – participation agreement | 675,000 | 675,000 | 675,000 | 675,000 |
| | \$ 54,806,000 | \$ 55,662,000 | \$ 41,882,000 | \$ 42,013,000 |

Total investment return for the year ended June 30, 2010 is comprised of net realized and unrealized loss of \$1,167,000, dividends and interest income of \$1,795,000, and investment fees of \$163,000 which is reflected in operating and non-operating revenue in the statement of activities.

On July 6, 2018, SFCM invested in real estate for the benefit of a faculty member. The transaction consists of two parts: 1) 30-year loan held by SFCM in the amount of \$607,500 included in notes receivable and 2) joint ownership of the property which includes an equity participation agreement with a cost basis of \$675,000. The loan is collateralized by the property, bears an interest rate of 4%, and principal and interest are payable monthly to SFCM.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Note 7 - Fair Value Measurements:

The table below presents the assets and liabilities measured at fair value at June 30, 2020 on a recurring basis.

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>NAV</u> | <u>Total</u> |
|--|----------------------|-------------------|---------------------|-------------------|----------------------|
| Assets: | | | | | |
| Investments: | | | | | |
| Cash and equivalents | \$ 14,735,000 | | | | \$ 14,735,000 |
| Domestic equities and funds | 17,568,000 | \$ 17,000 | | | 17,585,000 |
| International funds | 9,452,000 | | | | 9,452,000 |
| Domestic fixed income funds | 10,058,000 | | | | 10,058,000 |
| International fixed income funds | 1,893,000 | | | | 1,893,000 |
| Net Asset Value Funds (a) | | | | \$ 163,000 | 163,000 |
| Other Assets: | | | | | |
| Trusts receivable | | 225,000 | | | 225,000 |
| Total assets measured at fair value | \$ 53,706,000 | \$ 242,000 | \$ - | \$ 163,000 | \$ 54,111,000 |
| Liabilities: | | | | | |
| Post-retirement medical benefit obligation (Note 12) | | | \$ 4,847,000 | | \$ 4,847,000 |
| Total liabilities measured at fair value | | | \$ 4,847,000 | | \$ 4,847,000 |

(a) In accordance with FASB ASC Subtopic 820-10, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy.

SFCM uses the net asset value to determine the fair value of all the underlying investments which do not have readily determinable fair value. The following table lists investments by major category as of June 30, 2020:

| Strategies | # of Funds | Valuation | Unfunded Commitment | Redemption Frequency | Redemption Notice Period |
|-------------------------------|------------|------------|---------------------|----------------------|--------------------------|
| Venture capital fund (a) | 1 | \$ 157,000 | None | None | N/A |
| Real estate mortgage fund (b) | 1 | 6,000 | None | None | N/A |
| | 2 | \$ 163,000 | | | |

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

- (a) The fund is a limited partnership that invests in a portfolio consisting primarily of securities of privately held technology companies. The term of the partnership was scheduled to terminate on December 31, 2014. Liquidity is expected in the form of distributions from the fund when the underlying assets are sold.
- (b) The fund is a limited partnership which makes loans secured primarily by first and second deeds of trust on California real property. The partnership is scheduled to terminate in 2032, unless sooner terminated, as provided in the partnership agreement. There are substantial restrictions on transferability of units and accordingly an investment in the partnership is non-liquid. After the one-year lock-up period, limited partners may withdraw all or part of their capital accounts from the partnership in four quarterly installments beginning on the last day of the calendar quarter following the quarter in which the notice of withdrawal is given, subject to a 10% early withdrawal penalty. However, in March 2009, due to the distress in the financial markets, the partnership suspended capital liquidations and is not accepting new liquidation requests until further notice.

Note 8 - Property, Plant and Equipment:

Property, plant and equipment consist of the following at June 30:

| | 2020 | 2019 |
|--|-----------------------|-----------------------|
| Land | \$ 23,253,000 | \$ 23,253,000 |
| Building and improvements | 66,315,000 | 66,284,000 |
| Books, furnishings and equipment | 7,171,000 | 7,022,000 |
| Musical instrument collection | 6,753,000 | 4,758,000 |
| | <u>103,492,000</u> | <u>101,317,000</u> |
| Less accumulated depreciation and amortization | (21,784,000) | (20,558,000) |
| | <u>81,708,000</u> | <u>80,759,000</u> |
| Construction in progress | 131,985,000 | 41,271,000 |
| | <u>\$ 213,693,000</u> | <u>\$ 122,030,000</u> |

Land and building are pledged as collateral for the credit agreement (see Note 9).

Depreciation expense was approximately \$1,247,000 and \$1,406,000 for the years ended June 30, 2020 and 2019, respectively.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Construction in progress, above, represents construction costs, capitalized interest, architectural and design and other entitlement costs for the residence hall project (Note 17).

Note 9 - Credit Agreement:

On June 28, 2018, SFCM entered into loan agreements with First Republic Bank and the California Enterprise Development Authority (CEDA) which provide up to \$113 million of tax exempt and taxable financing. The proceeds of the loans will be used to finance the construction of SFCM's new student residence, educational and performance facility (See Note 17).

CEDA and First Republic Bank Tax Exempt Series A & B: The \$100 million tax exempt financing is comprised of a 30-year \$75 million permanent loan (Series A) and a 6-year \$25 million bridge loan (Series B).

Series A loan bears an interest rate of 3.9%. It is interest only through June 1, 2021, payable monthly. Payments of principal and interest on the loan (payable monthly) begin July 1, 2021 through June 1, 2048. As of June 30, 2020, \$64,924,000 was outstanding on the loan.

Series B bears interest at LIBOR Index Rate plus 1.5% per annum with a minimum rate of 2.5% (2.5% as of June 30, 2020), payable monthly. It has a maturity date of June 1, 2024. As of June 30, 2020, \$0 was outstanding on the loan.

Series C is a \$10 million taxable bridge loan and bears an interest at the Western Edition of the Wall Street Journal U.S. Prime Rate plus negative 35 hundredths percent (-0.35%), (2.90% as of June 30, 2020). It has a maturity date of June 28, 2021. As of June 30, 2020, \$0 was outstanding on the loan.

The Line of Credit is a \$3 million revolving line of credit and is used for ongoing expenses and working capital needs. The line of credit bears interest at the Western Edition of the Wall Street Journal U.S. Prime Rate plus one-quarter of one percent (0.25%), (3.50% as of June 30, 2020). The maturity date is June 28, 2020. As of June 30, 2020, \$500,000 was outstanding on the loan. SFCM is currently in discussion with First Republic Bank concerning the line of credit agreement.

Financing issuance costs totaled \$1,386,000 and are classified as a reduction to loans payable on the statement of financial position. The costs will be amortized over the term of the loans.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

The Series A, B, C and Line of Credit agreements contain certain restrictive covenants, including maintenance of certain financial ratios, restrictions on additional borrowings, level of lease commitments, sales of assets and certain asset levels. SFCM's property, land and unrestricted personal properties are pledged as collateral. The Line of Credit includes a clean down restriction. SFCM is required to reduce the outstanding principal balance of the Line of Credit to no greater than \$0 for thirty (30) consecutive days during each 12-month period.

The initial proceeds of these loans along with capital campaign funds were used to pay off the balances of an existing line of credit and term loan with Union Bank.

Total interest expense incurred including amortization of cost of issuance for the fiscal year ending June 30, 2020 was approximately \$1,590,000 and of this approximately \$1,338,000 was capitalized to construction in progress.

Future minimum principal payments on the outstanding Series A loan as of June 30, 2020 are as follows:

| | |
|----------------------|---------------|
| Year ending June 30: | |
| 2021 | \$ - |
| 2022 | 1,375,000 |
| 2023 | 1,430,000 |
| 2024 | 1,481,000 |
| 2025 | 1,547,000 |
| Thereafter | 59,091,000 |
| | <hr/> |
| | \$ 64,924,000 |

In April 2020, SFCM received a Paycheck Protection Program (PPP) loan through First Republic Bank in the amount of \$2,638,800. It is the intent of the School to seek forgiveness of the loan under the provisions of PPP. If any portion of the loan is not forgiven the unforgiven balance will be payable in 17 installments beginning November 24, 2020. The interest rate is 1% and interest is accrued from the date of funding.

Note 10 - Retirement Plans:

Employees of SFCM are covered under the Teachers Insurance and Annuity Association and College Retirement Equity Fund Retirement Plan, a defined-contribution plan. Contributions to the Plan are made by the employees and SFCM matches 5% of employee's eligible earnings. SFCM contributed approximately \$368,000 for the year ended June 30, 2020.

SFCM implemented a 457(b) plan for certain management personnel. The employees may elect to defer a certain portion of their salary. SFCM contributed approximately \$19,000 during the fiscal year 2020.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

With respect to certain employees, SFCM contributes to a multiemployer pension plan for employees covered by a collective bargaining agreement (Note 11). This plan is not administered by SFCM and contributions are determined in accordance with provisions of negotiated labor contracts. The Multiemployer Pension Plan Amendments Act of 1980 (The Act) significantly increased the pension responsibilities of participating employers. Under the provisions of The Act, if the plan terminates or SFCM withdraws, SFCM could be subject to a substantial “withdrawal liability.” Management has no intention of undertaking any action which could subject SFCM to this obligation. The total pension expense related to these employees was approximately \$78,000 for the year ended June 30, 2020.

Note 11 - Multiemployer Pension Plan:

The multiemployer defined benefit pension plan is under the terms of collective-bargaining agreements that cover its union-represented employees which are approximating 3.2% of total full-time faculty and staff of SFCM at June 30, 2020. The risks of participating in these multiemployer plans are different from single-employer plans in the following aspects:

1. Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.
2. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
3. If SFCM chooses to stop participating in some of its multiemployer plans, SFCM may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

SFCM’s participation in this plan for the annual period ended December 31, 2019, is outlined in the table below. The “EIN/Pension Plan Number” column provides the Employer Identification Number (EIN) and the three-digit plan number. The most recent Pension Protection Act (PPA) zone status available in 2020 and 2019 is for the plan years ending in 2019 and 2018, respectively. The zone status is based on information that SFCM received from the plan. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow and orange zones are less than 80% funded, and plans in the green zone are at least 80% funded. The Plan was not certified as endangered or critical status at the beginning of the year for the full plan year. The last column lists the expiration date of the collective-bargaining agreements to which the plans are subject.

| Pension Fund | EIN/Pension Plan Number | Pension Protection Act Zone Status | | FIP/RP Status Pending or Implemented | The SFCM Contributions | | Expiration Date of Collective Bargaining Agreement |
|---|-------------------------|------------------------------------|-------|--------------------------------------|------------------------|-----------|--|
| | | 2019 | 2018 | | 2020 | 2019 | |
| Stationary Engineers Local 39 Trust Funds | 94-6118939/001 | Green | Green | N/A | \$ 78,000 | \$ 73,000 | 8/31/23 |

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

There have been no other significant changes that affect the comparability of 2020 and 2019 contributions.

SFCM has not received information from the plans' administrators to determine its share of unfunded vested benefits. SFCM does not, however, anticipate withdrawal from the plan, nor is SFCM aware of any expected plan terminations.

SFCM did not provide more than 5% of the total contributions to the plan during 2019 or 2018, the date of the plan's most recently available annual reports. Additionally, there were no surcharges in effect for any of the plan.

Note 12 - Postretirement Health Benefit Plan:

SFCM adopted an unfunded noncontributory postretirement health benefit plan effective July 1, 1997. All qualifying employees will receive a fixed benefit of the cost of health insurance premiums for the individual at age 65 and beyond under the plan. Effective May 1, 2010, the Plan's service requirement for benefit eligibility was changed from 10 years to 20 years. The valuation of the accumulated benefit obligation and accrued benefit costs are as follows:

| | |
|---|--------------|
| Accumulated benefit obligation at beginning of year | \$ 4,441,000 |
| Service cost | 253,000 |
| Interest cost | 154,000 |
| Actuarial loss | 59,000 |
| Benefits paid | (65,000) |
| Participant contribution | 5,000 |
| <hr/> | |
| Accumulated benefit obligation at end of year | \$ 4,847,000 |
| <hr/> | |
| Unfunded status of the plan at end of year | \$ 4,847,000 |

The benefits expected to be paid from SFCM's noncontributory postretirement health benefit plan in each of the next five years, and in aggregate for the five years thereafter are as follows:

| | |
|---------------------|--------------|
| Year Ended June 30, | |
| 2021 | \$ 71,000 |
| 2022 | 79,000 |
| 2023 | 90,000 |
| 2024 | 104,000 |
| 2025 | 114,000 |
| Thereafter | 774,000 |
| <hr/> | |
| Total | \$ 1,232,000 |

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Weighted average assumptions as of June 30, 2020:

Discount Rate 2.67%

SFCM's projected medical cost trend rate related to its noncontributory postretirement health benefit plan in 2020 was 7.5% (Hartford/Kaiser). The assumed medical cost trend rate is expected to gradually decrease in subsequent years to 4.5% in 2039 and thereafter.

Health Care Trend Rate Sensitivity for Fiscal 2020

| | <u>1% Increase</u> | <u>1% Decrease</u> |
|--|-----------------------|-----------------------|
| APBO as of June 30, 2020: | \$ 1,060,000 / 21.87% | \$ (820,000) / 16.92% |
| Service and Interest Cost for fiscal 2020: | \$ 141,000 / 41.59% | \$ (102,000) / 30.09% |

SFCM may decide at any future date to terminate the plan or amend the benefits offered.

Note 13 - Concentrations of Risk:

The primary concentrations of market risk exist in the cash and investment areas.

Financial instruments, which potentially subject SFCM to credit risk, consist primarily of cash, cash equivalents, and investments. SFCM maintains cash and cash equivalents with major financial institutions. Cash equivalents include investments in money market funds and short-term commercial paper. At times, such amounts may exceed FDIC limits.

To address concentration of market risk in the investment area, SFCM maintains a formal investment policy which sets out performance criteria, investment guidelines and requires review of the investment manager's performance. Investments are managed by two investment managers, who have the responsibility for investing the funds in various investment alternatives, and are maintained by a bank trust department.

SFCM received 54% of its contributions for the year ended June 30, 2020 and 4% of its pledges receivable as of June 30, 2020 from one donor.

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Note 14 - Net Assets:

Net assets consisted of the following at June 30:

| | 2020 | | | | 2019 Total |
|-------------------------------|-------------------------------|--------------------------------|-------------------------------|----------------|----------------|
| | Without Donor Restrictions | With Donor Restrictions | | Total | |
| | | Purpose & Time Restrictions | Restrictions in Perpetuity | | |
| Endowment: | | | | | |
| Quasi-endowment funds | \$ 88,000 | | | \$ 88,000 | \$ 92,000 |
| True endowment funds: | | | | | |
| General purpose | | \$ (549,000) | \$ 8,203,000 | 7,654,000 | 7,910,000 |
| Scholarship | | (3,205,000) | 29,737,000 | 26,532,000 | 25,905,000 |
| Faculty support | | (538,000) | 8,613,000 | 8,075,000 | 8,038,000 |
| Other program support | | (12,000) | 977,000 | 965,000 | 1,138,000 |
| Retirement of indebtedness | | 4,000 | 180,000 | 184,000 | 194,000 |
| True endowment funds | | (4,300,000) | 47,710,000 | 43,410,000 | 43,185,000 |
| Total endowment funds | 88,000 | (4,300,000) | 47,710,000 | 43,498,000 | 43,277,000 |
| Other | 70,887,000 | 101,810,000 | | 172,697,000 | 147,148,000 |
| Total net assets | \$ 70,975,000 | \$ 97,510,000 | \$ 47,710,000 | \$ 216,195,000 | \$ 190,425,000 |

Net assets with donor restrictions for purpose and time at June 30, 2020 are as follows:

| | |
|----------------------------|----------------|
| Capital Campaign (Note 17) | \$ 100,319,000 |
| Other projects & programs | 475,000 |
| Time restriction | 1,016,000 |
| | \$ 101,810,000 |

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Net assets with donor restrictions were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors as follows for the year ended June 30, 2020:

| | |
|---|---------------------|
| Utilized for scholarships | \$ 1,635,000 |
| Utilized for capital campaign | 940,000 |
| Utilized for faculty salaries | 472,000 |
| Utilized for capital expenditures | 11,000 |
| Utilized for other project and program purposes | 1,461,000 |
| <u>Expiration of time restrictions</u> | <u>264,000</u> |
| | |
| <u>Total released operating and non-operating</u> | <u>\$ 4,783,000</u> |

Changes in endowment net assets for the year ended June 30, 2020:

| | Without Donor Restrictions | With Donor Restrictions | | Total |
|--|-------------------------------|--------------------------------|-------------------------------|----------------------|
| | | Purpose & Time Restrictions | Restrictions in Perpetuity | |
| Net assets, beginning of year | \$ 92,000 | \$ (2,109,000) | \$ 45,294,000 | \$ 43,277,000 |
| Investment return: | | | | |
| Investment income | 5,000 | 1,632,000 | | 1,637,000 |
| Net realized and unrealized (loss) on investments and trusts | (3,000) | (1,316,000) | (6,000) | (1,325,000) |
| <u>Total investment return</u> | <u>2,000</u> | <u>316,000</u> | <u>(6,000)</u> | <u>312,000</u> |
| | | | | |
| New gifts | | | 2,422,000 | 2,422,000 |
| <u>Appropriation of endowment</u> | <u>(6,000)</u> | <u>(2,507,000)</u> | | <u>(2,513,000)</u> |
| | | | | |
| <u>Net assets, end of year</u> | <u>\$ 88,000</u> | <u>\$ (4,300,000)</u> | <u>\$ 47,710,000</u> | <u>\$ 43,498,000</u> |

San Francisco Conservatory of Music

Notes to Consolidated Financial Statements

Note 15 - Related Party Transactions:

SFCM received contributions from members of its Board of Trustees and related entities of approximately \$3,338,000 for the fiscal year ended June 30, 2020. Contributions receivable related to current and prior years' contributions from board members totaled approximately \$19,626,000 at June 30, 2020. These board members have no other relationship or business dealings with SFCM.

In April 2013, SFCM signed an agreement with the Harris Guitar Foundation (the Foundation). The Foundation is the supporting organization of SFCM and Bay Area OMNI Foundation for the Performing Arts Inc. On June 26, 2020, the Harris Guitar Foundation was dissolved. Upon its dissolution, the assets of the Foundation were transferred to SFCM. This included a guitar collection valued at \$571,000.

In July 2018, SFCM entered into a real estate transaction with a faculty member (see Note 6).

Note 16 - Commitment and Contingencies:

a. Operating Leases

SFCM leases equipment, parking and student dormitory spaces under non-cancelable leases, which expire at various dates through 2028.

Future minimum lease payments for all operating leases in excess of one year as of June 30, 2020, are as follows:

| | |
|-------------|--------------|
| Year ending | |
| June 30: | |
| 2021 | \$ 583,000 |
| 2022 | 132,000 |
| 2023 | 132,000 |
| 2024 | 132,000 |
| 2025 | 132,000 |
| Thereafter | 286,000 |
| <hr/> | |
| Total | \$ 1,397,000 |

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Notes to Consolidated Financial Statements

b. Other

SFCM receives funds from and administers various federal government funded programs which are subject to audit by the cognizant governmental agencies. SFCM management believes that the outcome of any such audits will not have a significant effect on the financial position or results of activities of SFCM.

As of June 30, 2020, the SFCM was a party to a construction contract and remaining commitments totaling approximately \$8,900,000 in connection with the new student resident hall.

Note 17 - Capital Campaign:

SFCM has embarked on a capital campaign for a new student residence hall. The facility will provide the physical capacity necessary to sustain a world-class professional educational environment. The building will house the majority of students, furnish practice rooms and include social and study spaces. It will also feature a street-level café, recital halls, a recording studio, and housing for guest artists and scholars as well as 28 residential rental units. See Notes 5, 8, 9 and 16 for additional information on the campaign contributions, construction contracts and financing arrangements.

Note 18 - COVID-19 and Subsequent Events:

On March 11, 2020, the World Health Organization publicly characterized COVID-19 as a pandemic. States of emergency have been declared in many federal, state and local jurisdictions and shelter in place orders have been instituted in many cities and states, including California, which impacts general business operations in most industries and sectors.

SFCM delayed the start of fall 2020 classes and is offering a hybrid learning model with both on-line and in-person instruction where possible. SFCM has experienced an impact on its operations which includes a lower Fall enrollment and student housing participation than expected. In addition, financial markets volatility has significantly increased and a decline in market valuations may negatively impact the value of investment portfolios and endowment income draws held by SFCM. During calendar year 2020, SFCM experienced a difficult first quarter with its investments due to the market reaction to the uncertainty of the global impact of COVID-19. It has since appreciated a modest gain during quarter two as global markets recovered. Other financial impacts could occur though such potential impact is unknown at this time.

Subsequent to year end SFCM created a single member LLC which entered into a Purchase Agreement and a secured promissory note with a for-profit entity. The Purchase Agreement requires certain conditions and events occur for the transaction to close. The promissory note has been amended to reflect a current outstanding balance of \$1,621,000.