

# The Annie E. Casey Foundation, Inc. and Subsidiaries

Consolidated Financial Statements as of and for the Years  
Ended December 31, 2017 and 2016, and  
Independent Auditors' Report

# THE ANNIE E. CASEY FOUNDATION, INC. AND SUBSIDIARIES

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## **INDEPENDENT AUDITORS' REPORT**

To the Board of Trustees of  
The Annie E. Casey Foundation, Inc.  
Baltimore, Maryland

We have audited the accompanying consolidated financial statements of The Annie E. Casey Foundation, Inc. and its subsidiaries (the "Foundation"), which comprise the consolidated statements of financial position as of December 31, 2017 and 2016, and the related consolidated statements of activities and cash flows for the years 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 Foundation'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 Foundation'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 Annie E. Casey Foundation, Inc. and its subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

May 18, 2018

# THE ANNIE E. CASEY FOUNDATION, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31, 2017 AND 2016

|  | 2017                    | 2016                    |
|--|-------------------------|-------------------------|
| <b>ASSETS</b>                                      |                         |                         |
| CASH   | \$ 3,223,108            | \$ 3,798,354            |
| RESTRICTED CASH                                    | <u>23,264,251</u>       | <u>-</u>                |
| INVESTMENTS  | <u>2,690,884,259</u>    | <u>2,561,730,814</u>    |
| PROGRAM RELATED INVESTMENTS, net                   | <u>36,860,940</u>       | <u>36,122,111</u>       |
| OTHER ASSETS:                                      |                         |                         |
| Collateral under securities lending program        | 14,124,730              | 18,160,279              |
| Security sales receivable                          | 2,070,699               | 2,494,910               |
| Interest and dividends receivable                  | 2,415,818               | 3,302,013               |
| Note receivable                                    | 17,886,950              | -                       |
| Property and equipment, net                        | 24,448,303              | 12,292,419              |
| Beneficial interest in charitable remainder trusts | 35,390,428              | 32,024,851              |
| Other assets                                       | <u>4,291,998</u>        | <u>5,901,929</u>        |
| Total other assets                                 | <u>100,628,926</u>      | <u>74,176,401</u>       |
| TOTAL  | <u>\$ 2,854,861,484</u> | <u>\$ 2,675,827,680</u> |
| <b>LIABILITIES AND NET ASSETS</b>                  |                         |                         |
| LIABILITIES:                                       |                         |                         |
| Accounts payable and other liabilities             | \$ 12,096,168           | \$ 11,620,449           |
| Debt   | 39,333,826              | 5,000,000               |
| Payable under securities lending program           | 14,124,730              | 18,160,279              |
| Security purchases payable                         | 298,976                 | 1,492,663               |
| Deferred federal excise tax                        | 16,450,715              | 13,255,872              |
| Postretirement benefit obligation                  | <u>118,319,000</u>      | <u>108,701,000</u>      |
| Total liabilities                                  | <u>200,623,415</u>      | <u>158,230,263</u>      |
| NET ASSETS:  |                         |                         |
| Unrestricted                                       | 2,618,847,641           | 2,485,572,335           |
| Temporarily restricted                             | <u>35,390,428</u>       | <u>32,025,082</u>       |
| Total net assets                                   | <u>2,654,238,069</u>    | <u>2,517,597,417</u>    |
| TOTAL  | <u>\$ 2,854,861,484</u> | <u>\$ 2,675,827,680</u> |

See notes to consolidated financial statements.

# THE ANNIE E. CASEY FOUNDATION, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF ACTIVITIES FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

|   | 2017                    | 2016                    |
|---|-------------------------|-------------------------|
| CHANGES IN UNRESTRICTED NET ASSETS:                         |                         |                         |
| REVENUE AND SUPPORT:  |                         |                         |
| Donations and grants  | \$ 914,924              | \$ 2,155,154            |
| Charitable remainder trusts released from restrictions      | 492,962                 | 2,444,838               |
| Interest and dividends                                      | 20,097,244              | 25,241,078              |
| Realized gains on sales of investments                      | 60,614,785              | 104,548,731             |
| Unrealized appreciation on investments                      | 164,722,215             | 35,777,744              |
| Other investment income                                     | 78,772,793              | 55,921,813              |
| Total revenue and support                                   | <u>325,614,923</u>      | <u>226,089,358</u>      |
| GRANTS AND OTHER EXPENSES:                                  |                         |                         |
| Grants and direct charitable activities                     | 115,821,148             | 117,508,335             |
| Administrative and grants management expenses:              |                         |                         |
| General   | 48,188,285              | 49,103,905              |
| Postretirement benefit cost                                 | 13,059,000              | 15,008,000              |
| Total administrative and grants management expenses         | <u>61,247,285</u>       | <u>64,111,905</u>       |
| Other expenses:   |                         |                         |
| Postretirement changes other than net periodic benefit cost | (398,926)               | (14,657,383)            |
| Unrealized loss on swap                                     | 73,714                  | -                       |
| Interest and swap expense                                   | 365,377                 | 27,868                  |
| Investment expense  | 9,588,077               | 8,674,136               |
| Federal excise and other tax expense                        | 5,642,942               | 4,440,534               |
| Total grants and other expenses                             | <u>192,339,617</u>      | <u>180,105,395</u>      |
| CHANGES IN UNRESTRICTED NET ASSETS                          | <u>133,275,306</u>      | <u>45,983,963</u>       |
| CHANGES IN TEMPORARILY RESTRICTED NET ASSETS:               |                         |                         |
| Change in value of charitable remainder trusts              | 3,858,308               | 3,805,313               |
| Charitable remainder trusts released from restrictions      | <u>(492,962)</u>        | <u>(2,444,838)</u>      |
| CHANGES IN TEMPORARILY RESTRICTED NET ASSETS:               | <u>3,365,346</u>        | <u>1,360,475</u>        |
| CHANGES IN NET ASSETS                                       | 136,640,652             | 47,344,438              |
| NET ASSETS—Beginning of year                                | <u>2,517,597,417</u>    | <u>2,470,252,979</u>    |
| NET ASSETS—End of year                                      | <u>\$ 2,654,238,069</u> | <u>\$ 2,517,597,417</u> |

See notes to consolidated financial statements.

# THE ANNIE E. CASEY FOUNDATION, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

|  | 2017                 | 2016                |
|--|----------------------|---------------------|
| CASH FLOWS USED IN OPERATING ACTIVITIES:   |                      |                     |
| Changes in net assets  | \$ 136,640,652       | \$ 47,344,438       |
| Adjustments to reconcile changes in net assets to net cash used in operating activities: |                      |                     |
| Depreciation and amortization of fixed assets  | 2,185,725            | 1,914,250           |
| Loss on disposal of assets   | 226,608              | 484,140             |
| Net realized and unrealized gain on investments  | (223,604,838)        | (140,173,961)       |
| Change in provision for losses on program related investments                            | (1,732,162)          | (152,514)           |
| Decrease (increase) in interest and dividends receivable                                 | 886,195              | (192,616)           |
| Increase in note receivable  | (17,886,950)         | -                   |
| Increase in charitable remainder trusts  | (3,365,577)          | (1,360,475)         |
| Decrease (increase) in other assets  | 1,609,931            | (159,139)           |
| Increase in payables and other liabilities   | 475,719              | 3,907,772           |
| Increase (decrease) in deferred federal excise tax                                       | 3,194,843            | (903,907)           |
| Increase (decrease) in postretirement benefit obligation                                 | <u>9,618,000</u>     | <u>(2,630,000)</u>  |
| Net cash used in operating activities  | <u>(91,751,854)</u>  | <u>(91,922,012)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES:  |                      |                     |
| Proceeds from sales of investments and cash distributions                                | 618,364,185          | 637,998,853         |
| Purchases of investments   | (526,374,739)        | (549,383,539)       |
| Loans disbursed for program related investments  | (9,422,209)          | (5,157,218)         |
| Repayments of program related investments  | 12,108,013           | 10,380,395          |
| Capital expenditures   | <u>(14,568,217)</u>  | <u>(3,752,968)</u>  |
| Net cash provided by investing activities  | <u>80,107,033</u>    | <u>90,085,523</u>   |
| CASH FLOWS FROM FINANCING ACTIVITIES:  |                      |                     |
| Debt proceeds  | 39,790,000           | 5,000,000           |
| Repayment of debt  | <u>(5,456,174)</u>   | <u>-</u>            |
| Net cash provided by financing activities  | <u>34,333,826</u>    | <u>5,000,000</u>    |
| NET INCREASE IN CASH AND RESTRICTED CASH   | 22,689,005           | 3,163,511           |
| CASH AND RESTRICTED CASH—Beginning of year   | <u>3,798,354</u>     | <u>634,843</u>      |
| CASH AND RESTRICTED CASH—End of year   | <u>\$ 26,487,359</u> | <u>\$ 3,798,354</u> |

See notes to consolidated financial statements.

# THE ANNIE E. CASEY FOUNDATION, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

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### 1. ORGANIZATION OF THE FOUNDATION

The Annie E. Casey Foundation, Inc. and subsidiaries' (the "Foundation") work focuses on strengthening families, building stronger communities and ensuring access to opportunity, because children need all three to succeed.

The Annie E. Casey Foundation, Inc. is a not-for-profit organization founded in 1948 devoted to developing a brighter future for children at risk of poor educational, economic, social and health outcomes across the country.

AECF Atlanta Realty LLC ("Atlanta Realty") is a limited liability company organized under the laws of the State of Georgia. Atlanta Realty was formed on November 12, 2005 and the Foundation is its sole member. Atlanta Realty maintains 31 acres of undeveloped real property in the Neighborhood Planning Unit V ("NPU-V") in the City of Atlanta, Georgia. On December 15, 2015, Atlanta Realty established a wholly owned nonprofit subsidiary, 352 University Avenue Associates LLC ("Atlanta 352"), a limited liability company organized under the laws of the State of Georgia. Atlanta 352 works to address the unemployment and underemployment within NPU-V. During 2017, Atlanta Realty established a wholly-owned nonprofit subsidiary, UA Associates I LLC ("UA"). UA's purpose is to develop 13.2 acres of the land transferred to it by Atlanta Realty. This development is financed with a New Market Tax Credit ("NMTC") transaction.

AECF Atlanta Homes LLC ("Atlanta Homes") is a limited liability company organized under the laws of the State of Georgia. Atlanta Homes was formed on December 6, 2012 and the Foundation is its sole member. Atlanta Homes was formed to own, hold and manage real property in NPU-V in the City of Atlanta, Georgia.

In 2017, AECF-ECLF Leverage Lender I LLC ("Leverage Lender") was established as a joint venture through total capital contributions of \$10,000. The entity is owned 95% by the Foundation and 5% by Enterprise Community Loan Fund, a nonprofit organization. Leverage Lender's sole purpose is to provide a leveraged loan in the NMTC transaction. The joint venture is consolidated in the Foundation's consolidated financial statements. The non-controlling interest of \$500 is not considered significant and is included in unrestricted net assets on the Consolidated Statement of Financial Position.

The Annie E. Casey Foundation's subsidiaries are included in the accompanying consolidated financial statements. These subsidiaries are engaged primarily to support program activities.

### 2. SIGNIFICANT ACCOUNTING POLICIES

**Basis of Accounting** — The Foundation's consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP").

**Principles of Consolidation** — The accompanying consolidated financial statements include the accounts of the Foundation and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

**Cash** — Cash consists of funds held in commercial interest-bearing accounts for operating purposes.

**Restricted Cash** — Restricted cash consists of amounts set aside by contractual agreements as it relates to the NMTC transaction (as described in Note 7).

**Investments** — Investments are stated at fair value where a readily determinable fair value exists. Fair value is determined using the closing prices for investments traded on any global stock exchange. The Foundation utilizes a practical expedient for the estimation of the fair value of investments in limited partnerships and similar interests, with no readily determinable fair value. The practical expedient used by the Foundation to value private investments is the net asset value (“NAV”) per share, or its equivalent. However, the recorded value could differ from the value that would have been used had a readily available market existed for such investments.

Realized gains and losses on sales of investments in United Parcel Service, Inc. (“UPS”) common stock, if any, are calculated based on the specific identification method. The realized gains and losses for other investments are calculated based on the first-in, first-out method.

**Program Related Investments** — The Foundation makes program related investments (“PRIs”) that advance philanthropic purposes. These investments consist of various partnerships, loans and bonds. The partnerships, loans and bonds are stated at estimated fair value. At December 31, 2017 and 2016, the partnerships were valued at \$6,774,845 and \$5,082,375 with unfunded commitments totaling \$5,524,219 and \$7,555,352, respectively. The total par value of bonds outstanding was \$23,595,000 and \$26,694,481, with a fair value of \$5,898,750 and \$7,448,491 at December 31, 2017 and 2016 respectively. The interest rate for the bonds is 9% and principal is scheduled to be paid in full to the Foundation at the maturity date of September 2039.

The total amount of loans outstanding was \$28,276,779 and \$27,863,102 with unfunded commitments of \$200,000 and \$0 as of December 31, 2017 and 2016, respectively. Interest rates range from 1% to 5.4% and principal is scheduled to be paid in full to the Foundation at the maturity dates ranging from July 2018 through October 2026. The Foundation records a reserve for potentially uncollectible loans based on an analysis of its historical experience, quarterly and annual financial reports received, and the entity’s ability to meet financial covenants. Management has reviewed all program related investments and for the years ended December 31, 2017 and 2016, has recorded a reserve for potentially uncollectible loans in the amount of \$4,089,434 and \$4,271,857, respectively.

**Charitable Remainder Trusts** — The Foundation is the beneficiary of charitable remainder trusts that are administered by third parties and are temporarily restricted until the termination of the trust. At December 31, 2017 and 2016, the Foundation recognized these trusts at their net present value based upon actuarially determined calculations using a discount rate of 6%. The discount rate used is commensurate with the risks involved.

Under the terms of these trusts, payments of income are made from the trusts to the donees or other specified parties over the terms of the trusts. Upon termination of the trusts, the remaining net assets will be transferred to the Foundation for its unrestricted use. For the years ended December 31, 2017 and 2016, \$492,962 and \$2,444,838 was transferred to the Foundation, respectively.

**Property and Equipment** — Property and equipment, which consists primarily of buildings and building improvements, is recorded at cost. Depreciation of property is calculated using straight-line methods over 10 to 25 years for buildings and improvements, 5 years for furniture and fixtures, and 3 years for computer and equipment. Leasehold improvements are depreciated over the shorter of their estimated useful lives or lease terms. Repairs and maintenance costs are expensed as incurred. Property and equipment is assessed annually for impairment. Gains and losses on disposals of property and equipment are recorded in the period incurred and are included in general administrative expenses.

**Derivatives** — At December 31, 2017, the Foundation was a counterparty to an interest rate swap to manage interest cost and risk. As a not-for-profit organization, the Foundation is not allowed to use cash flow hedge accounting. In accordance with authoritative guidance, the interest rate swap agreement was recorded in the consolidated statements of financial position at fair value with the related gains and losses reflected in the consolidated statements of activities in the period of change.



The Foundation could be exposed to losses in the future in the event of nonperformance by the counterparty in the interest rate swap agreement. The Foundation monitors the financial condition of the firm used for this contract in order to minimize the risk of loss. The Foundation does not expect to record any losses as a result of counterparty default.

**Use of Estimates** — The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Management made significant estimates and assumptions in the valuation of certain investments, postretirement benefit costs and valuation allowances. Actual results could differ from those estimates.

**Reclassifications** — Certain amounts from the prior year were reclassified to conform to current year presentation. These reclassifications had no effect on net assets as previously reported.

**Recent Accounting Pronouncements** — In August 2016, the Financial Accounting Standards Board (“FASB”) issued ASU 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities which is effective for fiscal years beginning after December 15, 2017. The primary impacts of ASU 2016-14 are as follows: a) Net Asset Classification: The three categories of net assets will be condensed to two categories: Without Donor Restrictions and With Donor Restrictions. Not-for-profits may choose to disaggregate net assets further within the two categories. b) Board-Designated Net Assets: Not-for-profits will need to disclose the amount, purpose, and type of board designations either on the face of the financials or in the notes to the financial statements. Board-designated net assets remain a subgroup of net assets without donor restrictions. c) Underwater Endowment Assets: Although the underwater calculation remains unchanged, instead of classifying the underwater portion against unrestricted net assets, it will go against the Net Assets With Donor Restrictions. There are also certain additional disclosures such as any board policy or actions taken regarding appropriation from such funds. d) Cash Flow Statement: Not-for-profits will still have the option of presenting operating cash flows using the direct method or the indirect method. If the direct method is chosen, the indirect reconciliation is not required. e) Expenses: Expenses will be required to be presented both by function and by nature, but it is flexible as to how (in statement form vs. in the footnotes). A qualitative disclosure about how costs are allocated by function will also be required. External and internal direct investment expenses will be netted against investment return on the statement of activities. Disclosure of investment return components will no longer be required. f) Liquidity and Availability: The ASU will require (1) quantitative disclosure about availability of financial assets to meet cash needs for general expenditures within one year of the statement of financial position date, and (2) qualitative disclosure about liquidity, presented in the notes, including information about liquidity risk and how the liquid available resources are managed. Management has chosen not to early adopt ASU 2016-14 but will assess the impact on future consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost which is effective for fiscal years beginning after December 15, 2018. ASU 2017-07 requires entities to (1) disaggregate the current-service-cost component from the other components of net benefit cost (“other components”) and present it with other current compensation costs for related employees in the income statement and (2) present the other components elsewhere in the income statement and outside of income from operations if such a subtotal is presented. The ASU also requires entities to disclose the income statement lines that contain the other components if they are not presented on appropriately described separate lines. Management has chosen not to early adopt ASU 2017-07 but will assess the impact on future consolidated financial statements.

### 3. INVESTMENTS

The Foundation’s assets are invested in various asset classes that are expected to produce a sufficient level of diversification and investment return over the long-term and BNY Mellon is the custodian. The investment goal is to exceed the assumed rate of return over the long-term within reasonable and prudent levels of risk. Through consultation with the Foundation’s investment management team and outside investment advisers, management

develops expected long-term returns for each of the strategic asset classes. In addition to the Foundation's historical investment performance, several factors are considered, including current market data such as yields/price-earnings ratios, historical market returns over long periods and periodic surveys of investment managers' expectations.

The Foundation's custodian maintains a securities lending program on behalf of the Foundation and maintains collateral at all times in excess of the value of securities on loan. Under the terms of its securities lending agreement, the Foundation requires collateral of a value at least equal to 102% of the fair value of loaned investments. Securities lending is not subject to a master netting arrangement. Loaned investments consist of equity and exchange traded securities. Securities loaned are fully collateralized. Investment of this collateral is in accordance with specified guidelines. The funds are part of a collateral pool that invests in high quality debt securities with a managed short-term duration. The Foundation maintains effective control of the loaned securities during the term of the arrangement wherein they may be recalled at any time. As of December 31, 2017 and 2016, the Foundation had loaned securities with a total market value of approximately \$13,721,392 and \$18,565,449, respectively and received related collateral of \$14,124,730 and \$18,160,279, respectively. In accordance with authoritative guidance, the collateral amount is shown as both an asset and a liability on the consolidated statements of financial position.

**Concentration of Risk** — The Foundation is a holder of Class A and B UPS stock. The price per share of the Class A stock is equal to Class B stock. As of December 31, 2017, the market value of UPS Class B common stock was \$119.15 per share. UPS stock represented approximately 16.5% and 17% of the market value of the Foundation's investment portfolio at December 31, 2017 and 2016, respectively.

#### 4. FAIR VALUE MEASUREMENTS

The Foundation accounts for assets and liabilities measured at fair value using ASC Topic 820, *Fair Value Measurements and Disclosures*. Under ASC Topic 820, fair value refers to 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. The guidance enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. Investments with readily available actively quoted prices, or for which fair value can be measured from actively quoted prices, generally, will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value. In the absence of actively quoted prices and observable inputs, the Foundation estimates prices based on available historical data and near-term future pricing information that reflects its market assumptions. The guidance requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

*Level 1* – Quoted market prices in active markets for identical assets and liabilities.

*Level 2* – Observable market-based inputs or unobservable inputs that are corroborated by market data.

*Level 3* – Unobservable inputs that are not corroborated by market data.

Level 1 investments include equities and UPS common stock. The value is based on quoted market prices in active markets.

Level 2 investments include short-term investments such as certificates of deposits, fixed income securities, and repurchase agreements. The fair value is estimated using third-party quotations. Level 2 investments also include interest rate swaps that are valued by referencing yield curves derived from observable interest rates and spreads to project and discount swap cash flows to present value.

Level 3 investments include bonds for which quoted market prices are not readily available.

For investments with little or no market data available, the determination of fair value is based on the best information available in the circumstances and incorporates management's own assumptions, including appropriate risk adjustments. Due to the fact that a quoted market exchange does not exist for the Level 2 and Level 3 investments, the fair value is generally based on management's estimate of fair value in the most advantageous exit market. Management gives consideration to the reasonableness of the investee company's methodology for measuring fair value and reviews the investee company's interim and audited financial statements as well as post period transactions. Because of the inherent uncertainty of valuation, the estimated fair values of the investments presented could differ significantly from the value that would have been determined had a ready market existed, and it is reasonably possible that the difference could be material. As such, there is no assurance that upon liquidation, the Foundation will realize the fair values presented therein.

ASC Topic 820 permits the estimation of the fair value of an investment using net asset value per share (or its equivalent) for certain investments that do not have readily determinable fair values. The inputs to value these investments may include the Foundation's capital accounts for its partnership interests in various alternative investments, including hedge funds, public equity, private equity, real estate and commodities. The various partnerships are investment companies, which record their underlying investments at fair value based on fair value policies established by management of the underlying fund. Fair value policies at the underlying fund generally require the fund to utilize pricing/valuation information from third-party sources, including independent appraisals. However, in some instances, current valuation information for illiquid securities or securities in markets that are not active may not be available from any third-party source or fund management may conclude that the valuations that are available from third-party sources are not reliable. In these instances, fund management may perform model-based analytical valuation that may be used as an input to value these investments. As disclosed in Note 2, *Significant Accounting Policies*, these investments are measured at fair value using NAV (or its equivalent) as a practical expedient and are not included in the fair value hierarchy.

At December 31, 2017, the redemption frequency for hedge funds is: quarterly (33%), semiannually (12%), monthly (9%), annually (33%) and other (13%). With redemption notice periods ranging from 5 to 90 days, the Foundation has the ability to redeem 93% of these funds through the end of 2018 and 1% through the end of 2019. An additional 6% are held in side pockets or restricted assets with no redemption rights. The hedge funds had additional unfunded capital commitments to various partnerships of \$0 as of December 31, 2017.

At December 31, 2016, the redemption frequency for hedge funds is: quarterly (30%), semiannually (12%), monthly (10%), annually (33%) and other (15%). With redemption notice periods ranging from 5 to 180 days, the Foundation has the ability to redeem 75% of these funds through the end of 2017, 15% through the end of 2018, and 3% through the end of 2019. An additional 7% are held in side pockets or restricted assets with no redemption rights. The hedge funds had additional unfunded capital commitments to various partnerships of \$6,000,000 as of December 31, 2016.

At December 31, 2017, the redemption frequency for public securities measured at NAV is: daily (6%), monthly (38%), quarterly (31%), annually (8%) and other (17%). With redemption notice periods ranging from 0 to 120 days, the Foundation has the ability to redeem 86% of these funds through the end of 2018, 11% through the end of 2019 and 3% through the end of 2020.

At December 31, 2016, the redemption frequency for public securities measured at NAV is: daily (17%), monthly (22%), quarterly (36%), annually (10%) and other (15%). With redemption notice periods ranging from 0 to 90 days, the Foundation has the ability to redeem 100% of these funds through the end of 2016.

The private securities are not subject to redemption, however certain funds may be sold or transferred with general partner approval. Due to the nature of these investments, the fund values are reduced through distributions that are received from liquidation of the underlying assets. For the years ended December 31, 2017 and 2016, it is estimated that the underlying assets of these funds will be liquidated over a period of approximately 15 years. As of December 31, 2017 and 2016, the private securities had unfunded capital commitments to various partnerships of \$332,855,034 and \$328,086,348, respectively.

The following tables present the fair value of the Foundation's financial instruments for each level at December 31, 2017 and 2016:

| <b>Fair Value Measurement at December 31, 2017</b> |                       |                       |                     |  |                         |
|--|-----------------------|-----------------------|---------------------|--|-------------------------|
|  | <b>Level 1</b>        | <b>Level 2</b>        | <b>Level 3</b>      | <b>Investments<br/>Measured at<br/>NAV<sup>1</sup></b> | <b>Total</b>            |
| <b>ASSETS:</b>                                     |                       |                       |                     |  |                         |
| Public Securities:                                 |                       |                       |                     |  |                         |
| U.S. Securities:                                   |                       |                       |                     |  |                         |
| Large Cap  | \$ 445,682,958        | \$ -                  | \$ -                | \$ 263,276,576   | \$ 708,959,534          |
| Fixed Income Fund                                  | -                     | 173,331,158           | -                   | -  | 173,331,158             |
| Small Cap  | 69,868,206            | -                     | -                   | -  | 69,868,206              |
| Natural Resources                                  | -                     | -                     | -                   | 20,195,428   | 20,195,428              |
| Real Estate  | 19,194,638            | -                     | -                   | -  | 19,194,638              |
| Foreign Securities:                                |                       |                       |                     |  |                         |
| Emerging Markets                                   | -                     | -                     | -                   | 266,948,891  | 266,948,891             |
| Developed Countries                                | 143,722,139           | -                     | -                   | 104,499,843  | 248,221,982             |
| Global Securities:                                 |                       |                       |                     |  |                         |
| Developed Countries                                | -                     | -                     | -                   | 28,235,517   | 28,235,517              |
| Natural Resources                                  | 9,131,819             | -                     | -                   | -  | 9,131,819               |
|  | <u>687,599,760</u>    | <u>173,331,158</u>    | <u>-</u>            | <u>683,156,255</u>                                     | <u>1,544,087,173</u>    |
| Private Securities:                                |                       |                       |                     |  |                         |
| Venture  | -                     | -                     | -                   | 315,300,369  | 315,300,369             |
| Real Estate  | -                     | -                     | -                   | 64,145,874   | 64,145,874              |
| Buyout   | -                     | -                     | -                   | 97,576,458   | 97,576,458              |
| Natural Resources                                  | -                     | -                     | -                   | 80,772,093   | 80,772,093              |
| Private Credit                                     | -                     | -                     | -                   | 52,821,063   | 52,821,063              |
| Opportunistic                                      | -                     | -                     | -                   | 24,629,151   | 24,629,151              |
| Secondary  | -                     | -                     | -                   | 4,502,464  | 4,502,464               |
|  | <u>-</u>              | <u>-</u>              | <u>-</u>            | <u>639,747,472</u>                                     | <u>639,747,472</u>      |
| Hedge Funds:                                       |                       |                       |                     |  |                         |
| Long/Short   | -                     | -                     | -                   | 174,259,944  | 174,259,944             |
| Opportunistic                                      | -                     | -                     | -                   | 66,974,993   | 66,974,993              |
| Diversified Arbitrage                              | -                     | -                     | -                   | 54,928,283   | 54,928,283              |
| Tactical Trading                                   | -                     | -                     | -                   | 57,660,755   | 57,660,755              |
| Distressed/Credit                                  | -                     | -                     | -                   | 69,599,003   | 69,599,003              |
|  | <u>-</u>              | <u>-</u>              | <u>-</u>            | <u>423,422,978</u>                                     | <u>423,422,978</u>      |
| Short-Term Investments                             | <u>-</u>              | <u>83,626,636</u>     | <u>-</u>            | <u>-</u>   | <u>83,626,636</u>       |
| Total Investments                                  | <u>687,599,760</u>    | <u>256,957,794</u>    | <u>-</u>            | <u>1,746,326,705</u>                                   | <u>2,690,884,259</u>    |
| Program Related Investments:                       |                       |                       |                     |  |                         |
| Bonds  | -                     | -                     | 5,898,750           | -  | 5,898,750               |
| Private Securities:                                |                       |                       |                     |  |                         |
| Venture Cap  | -                     | -                     | -                   | 4,673,765  | 4,673,765               |
| Private Credit                                     | -                     | -                     | -                   | 2,101,080  | 2,101,080               |
|  | <u>-</u>              | <u>-</u>              | <u>5,898,750</u>    | <u>6,774,845</u>                                       | <u>12,673,595</u>       |
| TOTAL ASSETS                                       | <u>\$ 687,599,760</u> | <u>\$ 256,957,794</u> | <u>\$ 5,898,750</u> | <u>\$ 1,753,101,550</u>                                | <u>\$ 2,703,557,854</u> |
| <b>LIABILITIES:</b>                                |                       |                       |                     |  |                         |
| Notes Payable                                      | \$ -                  | \$ 39,333,826         | \$ -                | \$ -   | \$ 39,333,826           |
| Interest Rate Swaps                                | -                     | 73,714                | -                   | -  | 73,714                  |
| TOTAL LIABILITIES                                  | <u>\$ -</u>           | <u>\$ 39,407,540</u>  | <u>\$ -</u>         | <u>\$ -</u>  | <u>\$ 39,407,540</u>    |

<sup>1</sup> Amounts are comprised of certain investments measured at fair value using NAV (or its equivalent) as a practical expedient. These investments have not been classified in the fair value hierarchy.

**Fair Value Measurement at December 31, 2016**

|                              | Level 1               | Level 2               | Level 3             | Investments<br>Measured at<br>NAV <sup>1</sup> | Total                   |
|------------------------------|-----------------------|-----------------------|---------------------|--|-------------------------|
| <b>ASSETS:</b>               |                       |                       |                     |  |                         |
| Public Securities:           |                       |                       |                     |  |                         |
| U.S. Securities:             |                       |                       |                     |  |                         |
| Large Cap                    | \$ 486,544,096        | \$ -                  | \$ -                | \$ 241,102,534                                 | \$ 727,646,630          |
| Fixed Income Fund            | -                     | 172,287,013           | -                   | -  | 172,287,013             |
| Small Cap                    | 59,895,989            | -                     | -                   | -  | 59,895,989              |
| Natural Resources            | -                     | -                     | -                   | 18,534,977                                     | 18,534,977              |
| Real Estate                  | 17,966,006            | -                     | -                   | -  | 17,966,006              |
| Foreign Securities:          |                       |                       |                     |  |                         |
| Emerging Markets             | 43,738,794            | -                     | -                   | 183,620,287                                    | 227,359,081             |
| Developed Countries          | 113,251,787           | -                     | -                   | 70,448,652                                     | 183,700,439             |
| Global Securities:           |                       |                       |                     |  |                         |
| Developed Countries          | -                     | -                     | -                   | 27,567,983                                     | 27,567,983              |
| Natural Resources            | 8,027,982             | -                     | -                   | -  | 8,027,982               |
|                              | <u>729,424,654</u>    | <u>172,287,013</u>    | <u>-</u>            | <u>541,274,433</u>                             | <u>1,442,986,100</u>    |
| Private Securities:          |                       |                       |                     |  |                         |
| Venture                      | -                     | -                     | -                   | 263,196,018                                    | 263,196,018             |
| Real Estate                  | -                     | -                     | -                   | 74,195,973                                     | 74,195,973              |
| Buyout                       | -                     | -                     | -                   | 77,906,529                                     | 77,906,529              |
| Natural Resources            | -                     | -                     | -                   | 71,824,761                                     | 71,824,761              |
| Private Credit               | -                     | -                     | -                   | 57,625,989                                     | 57,625,989              |
| Opportunistic                | -                     | -                     | -                   | 29,892,873                                     | 29,892,873              |
| Secondary                    | -                     | -                     | -                   | 5,765,375                                      | 5,765,375               |
|                              | <u>-</u>              | <u>-</u>              | <u>-</u>            | <u>580,407,518</u>                             | <u>580,407,518</u>      |
| Hedge Funds:                 |                       |                       |                     |  |                         |
| Long/Short                   | -                     | -                     | -                   | 177,558,680                                    | 177,558,680             |
| Opportunistic                | -                     | -                     | -                   | 55,673,119                                     | 55,673,119              |
| Diversified Arbitrage        | -                     | -                     | -                   | 53,195,133                                     | 53,195,133              |
| Tactical Trading             | -                     | -                     | -                   | 58,200,322                                     | 58,200,322              |
| Distressed/Credit            | -                     | -                     | -                   | 63,510,572                                     | 63,510,572              |
|                              | <u>-</u>              | <u>-</u>              | <u>-</u>            | <u>408,137,826</u>                             | <u>408,137,826</u>      |
| Short-Term Investments       | <u>-</u>              | <u>130,199,370</u>    | <u>-</u>            | <u>-</u>                                       | <u>130,199,370</u>      |
| Total Investments            | <u>729,424,654</u>    | <u>302,486,383</u>    | <u>-</u>            | <u>1,529,819,777</u>                           | <u>2,561,730,814</u>    |
| Program Related Investments: |                       |                       |                     |  |                         |
| Bonds                        | -                     | -                     | 7,448,491           | -  | 7,448,491               |
| Private Securities:          |                       |                       |                     |  |                         |
| Venture Cap                  | -                     | -                     | -                   | 3,683,493                                      | 3,683,493               |
| Private Credit               | -                     | -                     | -                   | 1,398,882                                      | 1,398,882               |
|                              | <u>-</u>              | <u>-</u>              | <u>7,448,491</u>    | <u>5,082,375</u>                               | <u>12,530,866</u>       |
| TOTAL ASSETS                 | <u>\$ 729,424,654</u> | <u>\$ 302,486,383</u> | <u>\$ 7,448,491</u> | <u>\$ 1,534,902,152</u>                        | <u>\$ 2,574,261,680</u> |

<sup>1</sup> Amounts are comprised of certain investments measured at fair value using NAV (or its equivalent) as a practical expedient. These investments have not been classified in the fair value hierarchy.

There were no transfers between levels for the years ended December 31, 2017 and 2016. Level 3 activity included the removal of \$1,549,741 in Program Related Investment Bonds as of December 31, 2017 and the addition of \$25,356 in Program Related Investment Bonds as of December 31, 2016.

The tables above do not reflect the data associated with the securities lending program as there is no net impact on fair value. The collateral and securities on loan under this program are classified as Level 1 assets under ASC Topic 820.

## 5. PROPERTY AND EQUIPMENT

Property and equipment consists of the following at December 31:

|  | 2017                 | 2016                 |
|--|----------------------|----------------------|
| Land   | \$ 3,572,697         | \$ 921,800           |
| Buildings and improvements                                 | 34,087,833           | 23,036,353           |
| Leasehold improvements                                     | 214,274              | 214,274              |
| Furniture and fixtures                                     | 733,122              | 477,687              |
| Computer and office equipment                              | 5,220,277            | 7,620,476            |
| Capital projects in process                                | <u>1,547,933</u>     | <u>3,125,102</u>     |
|  | 45,376,136           | 35,395,692           |
| Less accumulated depreciation, amortization and impairment | <u>(20,927,833)</u>  | <u>(23,103,273)</u>  |
| Total property and equipment, net                          | <u>\$ 24,448,303</u> | <u>\$ 12,292,419</u> |

In 2016, the Foundation began renovations of office space in two locations. The renovations resulted in disposals of various property and equipment. During the years ended December 31, 2017 and 2016, the Foundation wrote off \$4,587,773 and \$4,997,920, respectively, in property and equipment, of which \$4,361,164 and \$4,513,780 was fully depreciated, respectively.

## 6. DEBT AND DERIVATIVE

On August 14, 2015, the Foundation entered in to a line of credit agreement with BNY Mellon. The agreement has a credit limit of \$90 million and interest is payable based on the one-month floating LIBOR plus 50 basis points (2.06% and 1.27% at December 31, 2017 and 2016, respectively). There were \$0 and \$5,000,000 in borrowings outstanding on the line of credit at December 31, 2017 and 2016, respectively. Interest expense related to this line of credit was \$76,693 and \$7,868 at December 31, 2017 and 2016, respectively.

On June 1, 2017, the Foundation entered into a note payable agreement (the "note") with Compass Mortgage Corporation. The debt proceeds were used solely to finance the renovation of the Foundation's two office buildings in Baltimore, Maryland. The note has a principal balance of \$13,943,826 at December 31, 2017 and matures on June 1, 2032. Interest is payable based on 1.12% plus 65% of the one-month LIBOR (2.13% at December 31, 2017).

As of December 31, 2017, scheduled annual principal payments on the note are as follows:

|            | <u>Amount</u>        |
|------------|----------------------|
| 2018       | \$ 967,202           |
| 2019       | 967,202              |
| 2020       | 967,202              |
| 2021       | 967,202              |
| 2022       | 967,202              |
| Thereafter | <u>9,107,816</u>     |
|            | <u>\$ 13,943,826</u> |

The Foundation manages its interest rate exposure on the note with an interest rate swap agreement (the “swap”). The Foundation’s swap with BBVA Compass Bank exchanges the one-month LIBOR for the fixed rate of 2.66% and expires June 1, 2032. Interest and swap expense related to this note was \$144,055 at December 31, 2017.

For the year ended December 31, 2017, the outstanding notional amount of the swap was \$15,874,827. As of December 31, 2017, the Foundation recorded a swap liability of \$73,714. This liability was included in accounts payable and other liabilities. The Foundation’s two buildings located in Baltimore, MD are pledged as collateral for the note payable and related swap.

## 7. NEW MARKET TAX CREDIT TRANSACTION

During 2017, the Foundation entered into a debt transaction to make additional funds available to it through the New Market Tax Credit (NMTC) Program. As part of this transaction, the Foundation created a new entity named UA Associates I LLC (as described in Note 1). The NMTC Program permits taxpayers to claim a credit against federal incomes taxes for Qualified Equity Investments (QEIs) in designated Community Development Entities (CDEs). These designated CDEs must use substantially all (85%) of the proceeds to make Qualified Low-Income Community Investments (QLICs). The investor is provided with a tax credit, which is claimed over a seven-year period. The credit is equal to 5% of the total amount paid for the capital investment over the first three years and 6% annually for the final four years.

On December 21, 2017, the Foundation loaned \$17,876,950 to AECF-ECLF Leverage Lender I LLC (the Fund) (as described in Note 1). The Fund then made QEIs, totaling \$17,886,950, in ENMP 73 LP (Enterprise), Brownfield Revitalization 50 (Brownfield), LLC and AEMI Fund XVIII, LLC (AEMI)(collectively, CDEs). Finally, the CDEs made loans to UA Associates I LLC.

Notes payable balances as December 31, 2017, consisted of the following:

|                     | <b>2017</b>          |
|---------------------|----------------------|
| AEMI Note A         | \$ 4,474,550         |
| AEMI Note B         | 1,895,450            |
| Brownfield Note A   | 7,464,369            |
| Brownfield Note B   | 2,825,631            |
| Enterprise Note A   | 5,948,031            |
| Enterprise Note B   | <u>2,781,969</u>     |
| Total notes payable | <u>\$ 25,390,000</u> |

The loans between UA Associates I LLC and the CDEs require interest to be paid at the rate of 1% per annum, commencing on December 22, 2017. The full amount of the unpaid principal is required to be paid on December 1, 2047. There are no scheduled principal payments due on the note payable balances until December 1, 2025. The Foundation is the guarantor of these debt obligations.

Total interest expense on loans totaled \$6,347 for the year ended December 31, 2017. Total interest income on the loan totaled \$6,222 and was classified in investment income for the year ended December 31, 2017.

The Foundation has recorded the above loans receivable and payable in the consolidated financial statements of the Foundation at the face value of the notes, which is the amount of cash that was exchanged. The Foundation is recording interest income and expense as incurred.

As a part of the loan agreements, the Foundation is required to obtain approval from the CDEs prior to the payment of any costs, fees and other expenses. In 2017, the Foundation obtained approval to expend a portion of the debt proceeds for related project costs. The remaining debt proceeds of \$23,264,251 comprise the restricted cash presented on the balance sheet as of December 31, 2017.

## 8. FEDERAL EXCISE TAX

The Foundation qualifies as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code and, accordingly, is not subject to federal income tax. However, the Foundation is classified as a private foundation and is subject to a federal excise tax of 1% or 2% on investment income less investment expenses, and on net realized taxable gains on capital transactions. For the years ended December 31, 2017 and 2016, the Foundation's federal excise tax rate was 2%. The total amount of cash paid for excise taxes was \$3,095,000 and \$2,510,000 for the years ended December 31, 2017 and 2016, respectively. In addition, during 2017 and 2016, the Foundation paid taxes on unrelated business income incurred through certain partnership investments. These taxes were not material to the consolidated financial statements as a whole.

Deferred federal excise tax arises from timing differences between consolidated financial statement and tax reporting related to investment income and the difference between the cost basis and market value of investments. Current income tax expense was \$2,448,099 and \$5,344,442, respectively, for the years ended December 31, 2017 and 2016. The deferred income tax expense was \$3,194,843 for 2017 and the deferred income tax benefit was \$903,907 for 2016.

## 9. DEFINED CONTRIBUTION AND OTHER POSTRETIREMENT PLANS

The Foundation maintains defined contribution plans for its employees. The Foundation recorded \$2,710,781 and \$2,624,196 in expense for the years ended December 31, 2017 and 2016, respectively.

In addition, the Foundation provides postretirement medical and dental benefits to all eligible employees. The benefit obligation for 2017 and 2016 is summarized as follows:

|   | 2017                    | 2016                    |
|---|-------------------------|-------------------------|
| Benefit obligation at December 31   | \$ 118,319,000          | \$ 108,701,000          |
| Fair value of plan assets at December 31  | <u>-</u>                | <u>-</u>                |
| Funded status and accrued benefit cost recognized<br>in the consolidated statements of financial position | <u>\$ (118,319,000)</u> | <u>\$ (108,701,000)</u> |



The following amounts not yet reflected in net periodic benefit cost are included in net assets as of December 31, 2017 and 2016:

|                        | <b>2017</b>            | <b>2016</b>            |
|------------------------|------------------------|------------------------|
| Net prior service cost | \$ (9,474,732)         | \$ (12,887,732)        |
| Accumulated loss       | <u>(41,727,903)</u>    | <u>(38,739,440)</u>    |
| Change in net assets   | <u>\$ (51,202,635)</u> | <u>\$ (51,627,172)</u> |

Assumptions used to determine the postretirement benefit obligation as of December 31, 2017 and 2016, are as follows:

|   | <b>2017</b> | <b>2016</b> |
|---|-------------|-------------|
| Weighted-average assumptions            |             |             |
| Discount rate (benefit obligation)      | 3.5 %       | 4.0 %       |
| Discount rate (net periodic costs)      | 4.0 %       | 4.2 %       |
| Expected return on plan assets          | N/A         | N/A         |
| Health care cost trend rate assumptions |             |             |
| Initial trend rate                      | 6.6 %       | 6.8 %       |
| Ultimate trend rate                     | 5.0 %       | 5.0 %       |
| Year ultimate trend rate is reached     | 2028        | 2026        |

The initial trend rate gradually grades down to the ultimate trend rate.

Benefit information for the years ended December 31, 2017 and 2016, is summarized as follows:

|                                  | <b>2017</b>          | <b>2016</b>          |
|----------------------------------|----------------------|----------------------|
| Benefit cost                     | <u>\$ 13,059,000</u> | <u>\$ 15,008,000</u> |
| Employer contributions           | \$ 3,016,463         | \$ 2,949,820         |
| Plan participants' contributions | <u>210,066</u>       | <u>239,342</u>       |
| Total benefits paid              | <u>\$ 3,226,529</u>  | <u>\$ 3,189,162</u>  |

The Foundation expects to make the following benefit disbursements:

|             |              |
|-------------|--------------|
| 2018        | \$ 4,720,000 |
| 2019        | 4,826,000    |
| 2020        | 4,965,000    |
| 2021        | 4,942,000    |
| 2022        | 5,315,000    |
| 2023 - 2027 | 28,745,000   |

## 10. LEASES

The Foundation leases office facilities at various locations. As of December 31, 2017, future minimum annual lease payments required are as follows:

### December 31

|      |                   |
|------|-------------------|
| 2018 | 523,216           |
| 2019 | <u>416,292</u>    |
|      | <u>\$ 939,508</u> |

Rent expense for 2017 and 2016 was \$602,751 and \$497,492, respectively.

## 11. GRANT ALLOCATIONS

As of December 31, 2017, the Foundation has approved grant funds for payments to various organizations and projects of up to approximately \$125 million, contingent upon the organizations' performance of obligations specified in the grant agreements. Accordingly, grant expense is recorded when the obligations are substantially met and the resulting payments made. Such payments are expected to be made during the period January 1, 2018 through December 31, 2018.

## 12. SUBSEQUENT EVENTS

The Foundation has evaluated the impact of significant subsequent events. There have been no subsequent events through May 18, 2018, the date that the Foundation's consolidated financial statements were available to be issued, that require recognition or disclosure.

\* \* \* \* \*