

COMBINED FINANCIAL STATEMENTS

Loma Linda University and LLUH-SB, Inc.
Year Ended June 30, 2018
With Report of Independent Auditors

Ernst & Young LLP



Loma Linda University and LLUH-SB, Inc.

Combined Financial Statements

Year Ended June 30, 2018

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Report of Independent Auditors

The Board of Trustees
Loma Linda University and LLUH-SB, Inc.

We have audited the accompanying combined financial statements of Loma Linda University and LLUH-SB, Inc., which comprise the combined statement of financial position as of June 30, 2018, and the related combined statements of activities and cash flows for the year then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the combined financial position of Loma Linda University and LLUH-SB, Inc. at June 30, 2018, and the combined results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The accompanying combining statement of financial position, combining statement of activities, and combining schedule of expenses by natural classification of Loma Linda University and LLUH-SB, Inc. on pages 41 through 44 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Ernst & Young LLP

June 19, 2019

Loma Linda University and LLUH-SB, Inc.

Combined Statement of Financial Position
(Amounts are presented in thousands)

June 30, 2018

Assets

Cash and cash equivalents	\$ 7,022
Restricted cash	20,745
Assets whose use is limited	8,714
Accounts receivable, net of allowance for doubtful accounts of \$2,840	40,063
Student loans receivable, net of allowance for doubtful accounts of \$678	45,027
Pledges receivable	6,974
Deferred rent	1,203
Irrevocable trusts	43,071
Investments	1,052,401
Advances to related parties	8,558
Inventories, prepaid expenses, and other assets	8,541
Net investment in direct financing lease	2,639
Property, plant, and equipment, net	355,899
Total assets	<u>\$ 1,600,857</u>

Liabilities and net assets

Liabilities:

Accounts payable and accrued expenses	\$ 44,087
Deferred revenue	33,686
Investments held on behalf of others	456,145
Liabilities due under annuity and split-interest agreements	24,626
Advances from related parties	13,545
Debt, net	239,149
Other liabilities	26,593
Total liabilities	<u>837,831</u>

Net assets:

Unrestricted – undesignated	59,240
Unrestricted – administration designated	91,535
Unrestricted – board designated	44,171
Total unrestricted	<u>194,946</u>
Temporarily restricted	284,246
Permanently restricted	283,834
Total net assets	<u>763,026</u>
Total liabilities and net assets	<u>\$ 1,600,857</u>

See accompanying notes.

Loma Linda University and LLUH-SB, Inc.

Combined Statement of Activities

(Amounts are presented in thousands)

Year Ended June 30, 2018

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and support:				
Tuition and fees	\$ 163,542	\$ —	\$ —	\$ 163,542
Less student aid	(8,864)	—	—	(8,864)
Net tuition and fees	154,678	—	—	154,678
Gifts and subsidies	17,634	7,404	6,348	31,386
Sponsored support	23,321	75	—	23,396
Investment income	22,312	12,393	558	35,263
Sales and service income	27,729	—	—	27,729
Clinic and auxiliary income	48,629	—	—	48,629
Student loan interest and other	458	3,063	—	3,521
Net assets released from restriction	4,700	(4,700)	—	—
Total revenue and support	299,461	18,235	6,906	324,602
Operating expenses:				
Instruction	144,552	—	—	144,552
Research	24,294	—	—	24,294
Public service	4,946	—	—	4,946
Academic support	25,440	—	—	25,440
Student services	5,485	—	—	5,485
Institutional administration	43,130	—	—	43,130
Physical plant	19,875	—	—	19,875
Student financial support	4,708	—	—	4,708
Independent operations	35,674	—	—	35,674
Total operating expenses	308,104	—	—	308,104
Change in net assets from operating activities	(8,643)	18,235	6,906	16,498
Unrealized (losses) gains on investments	(8,091)	6,602	16,141	14,652
Change in net assets	(16,734)	24,837	23,047	31,150
Net assets, beginning of year	211,680	259,409	260,787	731,876
Net assets, end of year	\$ 194,946	\$ 284,246	\$ 283,834	\$ 763,026

See accompanying notes.

Loma Linda University and LLUH-SB, Inc.

Combined Statement of Cash Flows
(Amounts are presented in thousands)

Year Ended June 30, 2018

Cash flows from operating activities

Change in net assets	\$ 31,150
Adjustments to reconcile changes in net assets to net cash provided by operating activities:	
Depreciation and amortization expense	21,017
Contribution of land	(34)
Allowance for doubtful accounts	2,158
Unrealized (gains) losses on investments	(14,652)
Changes in operating assets and liabilities:	
Accounts receivable	11,498
Pledges receivable	4,626
Deferred rent	(1,203)
Irrevocable trust agreements	2,288
Inventories, prepaid expenses and other assets	9,343
Advances to related parties	(8,558)
Advances from related parties	13,545
Accounts payable and accrued expenses	(28,082)
Liabilities due under annuity and split-interest agreements	3,138
Deferred revenue	(1,434)
Other liabilities	(3,707)
Net cash provided by operating activities	<u>41,093</u>

Cash flows from investing activities

Proceeds from sales of investments	143,127
Purchases of investments	(237,161)
Repayments of loans from students	(6,089)
Disbursements of loans to students	7,763
Investments held on behalf of others	50,963
Change in restricted cash	36,153
Net investment in direct financing lease	(2,639)
Purchases of property, plant and equipment	(32,029)
Net cash used in investing activities	<u>(39,912)</u>

Cash flows from financing activities

Payments made under split-interest agreements	(761)
Trust liabilities distribution	(3,960)
Proceeds from debt	7,000
Payments on debt	(5,126)
Net cash used in financing activities	<u>(2,847)</u>
Changes in cash and cash equivalents	(1,666)
Cash and cash equivalents, beginning of year	8,688
Cash and cash equivalents, end of year	<u>\$ 7,022</u>

Supplemental cash flow information

Cash paid for interest	<u>\$ 11,071</u>
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See accompanying notes.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements

June 30, 2018

1. Nature of Organization

Loma Linda University (LLU) is a Seventh-day Adventist educational health-sciences institution with approximately 4,500 students located in Southern California. Eight schools and the Faculty of Graduate Studies comprise LLU's organization. More than 55 programs are offered by the schools of Allied Health Professions, Behavioral Health, Dentistry, Medicine, Nursing, Pharmacy, Public Health, and Religion. Curricula offered range from certificates of completion and associate in science degrees to doctor of philosophy and professional doctoral degrees. Students from more than 80 countries around the world and virtually every state in the nation are represented in LLU's student body. LLU also offers distance education.

As its mission, LLU seeks to further the healing and teaching ministry of Jesus Christ "to make man whole" by:

- Educating ethical and proficient Christian health professionals and scholars through instruction, example, and the pursuit of truth;
- Expanding knowledge through research in the biological, behavioral, physical, and environmental sciences and applying this knowledge to health and disease;
- Providing comprehensive, competent, and compassionate health care for the whole person through faculty, students, and alumni.

The activities of LLU are conducted within two major divisions for financial reporting purposes.

- a) Educational Division – includes the operations and related activities of the academic functions.
- b) Foundation – includes endowments, trust agreements, annuities, independent operations, and other nonacademic activities.

LLUH-SB, Inc. (LLUH-SB) was incorporated on December 3, 2014, for purpose to deliver and maintain the land, buildings, and infrastructure necessary for the successful operation of a community clinic and educational facilities in San Bernardino, California. LLUH-SB is a whollyowned subsidiary of Loma Linda University Health (LLUH). LLU's intent is to financially support LLUH-SB in order to carry out its purpose necessary for the operation of a community health clinic and education facilities. Due to LLUH-SB's fiscal dependence on LLU, its financial statements are reported as a division of LLU's combined financial statements. See supplemental schedules.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

1. Nature of Organization (continued)

LLUH is a religious nonprofit corporation that serves as the sole member of the University. Other corporations of which LLUH is the sole member include the Loma Linda University Medical Center (LLUMC), a religious nonprofit corporation, and the Loma Linda University Behavioral Medicine Center, a religious nonprofit corporation. LLUH also serves as a member of Loma Linda University Health Care, a religious nonprofit corporation.

2. Summary of Significant Accounting Policies

Principles of Combination

The combined financial statements include the accounts of LLU and LLUH-SB (collectively referred to as the “University”). All significant transactions between entities have been eliminated in the combined financial statements.

Basis of Presentation

To ensure compliance with restrictions placed on the resources available to the University, the University’s accounts are maintained in accordance with the principles of fund accounting. This is the procedure by which resources are classified for accounting and reporting into funds established according to their nature and purpose. In the combined financial statements, funds that have similar characteristics are combined into three net asset categories: unrestricted, temporarily restricted, and permanently restricted.

Unrestricted net assets are not restricted by donors, or the donor-imposed restrictions have expired.

Temporarily restricted net assets contain donor-imposed restrictions that permit the University to use or expend the assets as specified. These restrictions are satisfied either by the passage of time or when the purpose has been met.

Permanently restricted net assets contain donor-imposed restrictions and stipulate that the resources be maintained in perpetuity but permit the University to use or expend part or all of the income derived from the donated assets for either specified or unspecified purposes and in accordance with the law.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition and Deferred Revenue

Revenues consist primarily of tuition and fees derived from courses taught in the University. Revenues from tuition and fees are recognized prorata (on a straight-line basis) over a relevant period attended by the student of the applicable course or program. If a student withdraws from a course or program, the paid but unearned portion of the student's tuition may be subject to refunds. Refunds are calculated and paid in accordance with applicable federal, state, and University refund policies. Deferred revenue is the portion of payments received but not earned and is reflected as a liability on the accompanying combined statement of financial position as such amounts are expected to be earned within the next year. In addition, the University records gifts and subsidies as revenue when they are received unconditionally at their fair value. Conditional contributions are recognized as revenue when the conditions on which they depend have been met. Sponsored support is recognized as related expenses are incurred or administrative fees are earned. Contributions are included under the gifts and subsidies on the combined statement of activities. Sales and service income are derived from various University services such as food service, membership and wellness, events, and royalties. Clinic and auxiliary income are derived from medical and dental services provided to general public. Revenues are recognized when services are provided.

Cash and Cash Equivalents and Restricted Cash

Cash and cash equivalents include amounts held in certificates of deposit and money market accounts with original maturities of three months or less, except that such instruments purchased with endowment, annuity, or life income assets are classified as investments. Restricted cash is the reserve amount required by the bond agreement; see Note 9 – Debt, Net.

Assets Whose Use Is Limited

Certain proceeds of the serial bonds (see Note 9 – Debt, Net) held by trustees are limited as to use in accordance with the requirements of the trust agreements. The assets whose use is limited are comprised of investments on debt securities.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable, Net

Accounts receivable, net include tuition receivable, non-student receivables (employee education notes, mortgage loans) and third-party receivables. They are stated at the amount management expects to collect from outstanding balances on accounts. Collectability of accounts receivable is reviewed both individually and in the aggregate. Management provides for probable uncollectible amounts through a provision for doubtful accounts and an adjustment to a valuation allowance using a modified percentage of receivables approach and the assessment of the current status of individual accounts. The allowance for uncollectible receivables amounted to \$5.2 million at June 30, 2018.

Student Loans Receivable, Net

Student loans receivable, net consist of private donated and federal funds loaned to students. Private donated funds are recorded in accordance with the restrictions set by the donors. Federal funds are recorded as federal student loan obligations in the combined statement of financial position. Balances are recorded to the provision for doubtful accounts based on the aging of the receivables and are written off when deemed uncollectible. The University follows federal guidelines for determining when student loans are delinquent or past due for both private donated and federal funds. The provision for doubtful accounts amounted to \$678 thousand at June 30, 2018.

Pledges Receivable

Unconditional promises to give are recorded as receivables and gift revenues and require the University to distinguish between contributions received for each net asset category in accordance with donor-imposed restrictions. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved and recorded in their respective net asset categories. An allowance for uncollectible pledges receivable may be provided based upon management's judgment, including such factors as prior collection history, type of contribution, and nature of fundraising activity. No allowance was considered necessary at June 30, 2018.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Inventories

Inventories are valued at the lower of cost or market and accounted for on a first-in, first-out basis and are substantially made up of finished goods. The inventories primarily consisted of supplies to be used for dental clinic, food services, housekeeping, property maintenance, and printing.

Deferred Rent

Deferred rent is the cumulative difference between the rental income or payments required by a lease agreement and the rental income or expense recognized on a straight-line basis, in which use or benefit is granted or derived from the leased property, expected to be recognized in income or expense, by the lessor or lessee, respectively, more than one year after the balance sheet date (amounts in thousands).

	June 30, 2018
Deferred rent – third party	\$ 399
Deferred rent – affiliate	804
Total deferred rent	<u>\$ 1,203</u>

Net Investment in Direct Financing Lease

At lease commencement, the University records an investment in direct financing leases equal to the total future lease rental payments and the estimated residual value of the leased equipment, less unearned lease income. The unearned lease income is the difference between the cost of the equipment plus initial direct costs capitalized and the total future lease rentals plus the estimated residual value of the leased equipment. Initial direct costs consist primarily of salaries, commissions, legal fees, and other initial costs attributed to commencing a lease transaction, which are deferred for direct financing leases as a reduction of unearned income. Residual value is the estimated proceeds from the sale or re-lease of the asset at the end of the initial lease term. Amortization of unearned income is recognized using the interest method.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Property, Plant, and Equipment, Net

Plant facilities are stated at cost at the date of acquisition or at fair value (appraised value) at the date of donation in the case of gifts. Capital equipment at the University is tangible personal property having a useful life of one year or more and an acquisition cost of \$5 thousand or more per unit. Land and buildings are always capitalized. Depreciation is computed using the straight-line method over estimated useful lives of 5 to 15 years for land improvements, 10 to 40 years for buildings, 5 to 20 years for building improvements, and 3 to 5 years for equipment and vehicles.

The costs and accumulated depreciation of assets sold or retired are removed from the accounts and the related gains and losses are included in the combined statement of activities. The half-year convention method of determining when assets are depreciated is utilized in the Educational Division. For the Foundation, assets are depreciated beginning in the next month following the acquisition date. Leasehold improvements are amortized over the lesser of their useful lives or the lives of the lease. Maintenance and repairs are charged to expense as incurred. Land and construction in progress are non-depreciable assets.

Asset retirement obligations include obligations associated with the retirement of long-lived assets. These liabilities are recorded at fair value when incurred and are capitalized by increasing the carrying amount of the associated long-lived asset. The fair value of the obligation is measured based on the present value of estimated future retirement costs. Asset retirement costs are depreciated on a straight-line basis through the estimated date of retirement. Subsequent to the initial recognition, period-to-period changes in the carrying amount of the liability are recorded due to the passage of time and revisions to either the timing or amount of the original estimated cash flows. Liabilities are released when the related obligations are settled. The asset retirement obligation amounted to \$3.2 million at June 30, 2018, and is recorded in other liabilities on the combined statement of financial position.

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows (undiscounted and without interest) expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured at the amount by which

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

the carrying amount of the assets exceeds the fair value, less selling costs. During the year ended June 30, 2018, there were no events or changes in circumstances indicating that the carrying amount of long-lived assets may not be recoverable.

Annuity and Split-Interest Agreements

Annuities are paid to individuals who have entered into annuity and split-interest agreements with the University. Standard annuity tables are used to estimate the present value of future payments due to annuitants based on the annuitant's age and gender, the frequency and amount of payment, and the principal amount of the annuity. The University uses mortality rates based on the Internal Revenue Service (IRS) life expectancy table at an 8% discount rate.

The University is the beneficiary in a number of split-interest arrangements with donors. Under these arrangements, the University controls donated assets and may share with the donor or the donor's designee income generated from those assets until such time as stated in the arrangement (usually upon the death of the donor or donor's designee) at which time the remaining assets are available for the University's use. When the University receives such assets, the fair value of the assets is recorded as irrevocable trust assets. Irrevocable trust assets have been recorded using the same investment valuation techniques as similar investments held by the University (see Note 5 – Investments, Irrevocable Trusts, and Fair Value Measurements). The University's policy is to record the contribution of these gifts in its combined financial statements as temporarily or permanently restricted net assets (at fair value) if the assets are controlled by the University as indicated by the donor. At the time of the gift, the University records contribution income and a liability for amounts payable to income beneficiaries using an actuarial calculation, adjusted annually. The estimated net present value of the payments to beneficiaries is recorded as liabilities due under annuity and split-interest agreements, and the estimated net present value of the payments that will be made to other remaindermen trusts is also recorded as liabilities due under annuity and split-interest agreements. The annual payments to the beneficiaries are payable from the trust assets' investment earnings or in some cases, to the extent that amount is deficient, from principal. If the trust assets' investment earnings exceed the payments to the benefactor, such excess is added to the trust principal. The University uses mortality rates based on the IRS life expectancy table at an 8% discount rate.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Board and Administration Designated Net Assets

The Board of Trustees and administration of the University have designated certain unrestricted net asset balances at June 30, 2018, to be used for operating endowments, instruction, research, student aid, and other areas.

Expiration of Donor-Imposed Restrictions

The expiration of a donor-imposed restriction on net assets is recognized in the period in which the restriction expires and at that time the related resources are reclassified to unrestricted net assets. Restrictions expire when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. Net assets are released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of events specified by the donors or by the change of restrictions specified by the donors.

Contributions of land, building, and equipment without donor stipulations concerning the use of such long-lived assets are reported in unrestricted gifts and subsidies. Contributions of cash or other assets to be used to acquire land, buildings, and equipment with such donor stipulations are reported in temporarily restricted gifts and subsidies. The restrictions are considered to be released at the time of acquisition of such long-lived assets. Contributions that are identified to support LLUH-SB's current period's activities are recorded as unrestricted revenue and support.

Fair Values of Financial Instruments

The carrying value of the following financial instruments approximates their fair value: accounts receivable, net, student loans receivable, net, and liabilities due under annuity and split-interest agreements.

Investments and Investment Income

Investments are generally held at fair value and some are held at cost. Investment-related expenses of \$7.5 million is netted against investment income displayed on the combined statement of activities.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the Uniform Prudent Management of Institutional Funds Act (UPMIFA) requires the University to retain as a fund of perpetual duration. Deficiencies of \$41 thousand were reported on June 30, 2018, because the market value of the assets is below cost.

Return Objectives and Risk Parameters

The University 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. Endowment assets include those assets of donor-restricted funds that the University must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. Under these policies, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the Standard & Poor's 500 index, while assuming a moderate level of investment risk. The University expects its endowment funds, over time, to provide an average rate of return of approximately 9% annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the University 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). The University targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy

The University has a policy of allowing for distributions of up to 5% of the average fair value of the permanently restricted endowments as of the previous three calendar year-ends preceding the fiscal year of distribution. In establishing this policy, the University considered the long-term expected return on its endowment, which it expects to grow at an average of 4% annually after

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

distributions. This is consistent with the University'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.

Endowment

The Board of Trustees of the University interpret the UPMIFA to state that the University, in the absence of explicit donor stipulations to the contrary, may appropriate for expenditure or accumulate so much of an endowment fund as the University determines prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the value of gifts donated to the endowment, (b) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund, and (c) appreciation and (or) depreciation in fair value of the related financial instrument in accordance with the original donor restriction. The remaining portion of the donor restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA.

In accordance with UPMIFA, the University 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 mission of the University 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 the University
- (7) The investment policies of the University

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Fundraising Activities

The University has included fundraising costs in institutional administration expenses in the accompanying combined statement of activities. The University incurred \$2.2 million of fundraising costs in the fiscal year ended June 30, 2018.

Concentration of Credit Risk

The University maintains its cash accounts in financial institutions. Accounts at these institutions are insured by the Federal Deposit Insurance Corporation up to \$250 thousand. The University performs ongoing evaluations of these institutions to limit its concentration risk exposure.

The University invests excess cash in various types of investments. Balances in the University's investment accounts exceed the Securities Investors Protection Corporation insured limit of up to \$500 thousand. The University has established guidelines relative to diversification and maturities that maximize safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates.

A substantial portion of tuition is paid through the students' participation in federally funded financial aid programs. Transfers of funds from the financial aid programs to the University are made in accordance with U.S. Department of Education (ED) requirements. The financial aid and assistance programs are subject to political and budgetary considerations. The University's administration of these programs is periodically reviewed by various regulatory agencies.

If the University were to lose its eligibility to participate in federal student financial aid programs, the students at the University would lose access to funds derived from those programs and would have to seek alternative sources of funds to pay their tuition and fees. Students obtain access to federal student financial aid through an ED prescribed application and eligibility certification process. Student financial aid funds are generally made available to students at prescribed intervals throughout their predetermined expected length of study. Students typically apply the funds received from federal financial aid programs to pay their tuition and fees.

Accounts receivable from students and patients are reported net of an allowance for doubtful accounts. The allowance is an estimate by management based upon an analysis of delinquent amounts and the respective student's/patient's ability and intent to repay. These estimated

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

uncollectible amounts can be affected by changes in the student's/patient's economic circumstances. As a result, it is reasonably possible that the allowance for doubtful accounts could change in the near term.

Use of Estimates

The preparation of combined financial statements in conformity with United States Generally Accepted Accounting Principles (U.S. GAAP) requires management to make estimates and assumptions that affect the amounts reported in the combined financial statements and accompanying notes. Actual results could differ from those estimates. The University's significant accounting estimates include investment valuation, useful life of plant and equipment, allowances for uncollectible accounts for accounts receivable, student loans, pledges receivable, trust liabilities and annuities payable, and functional allocation of expenses.

Functional Allocation of Expenses

The costs of providing the various programs and activities have been summarized in the combined statement of activities on a functional basis. Accordingly, certain costs have been allocated among the program and supporting services benefited.

Income Tax Status

The IRS has ruled that LLU and LLUH-SB qualify under Section 501(c)(3) of the Internal Revenue Code (IRC) and are therefore not subject to income taxes for activities related to their exempt programs. Management is not aware of any event that would cause the University to be disqualified in operation. LLU had no unrecognized tax benefits at June 30, 2018. The University files an exempt organization return and applicable unrelated business income tax return in the U.S. federal jurisdiction and with the California Franchise Tax Board.

For LLUH-SB, the year ended June 30, 2018, no provision for unrelated business income tax is required. LLUH-SB had no unrecognized tax benefits or liabilities at June 30, 2018. LLUH-SB files an exempt organization return and applicable unrelated business income tax return in the U.S. federal jurisdiction and with the California Franchise Tax Board.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Adoption of New Accounting Pronouncements

Periodically, the Financial Accounting Standards Board (FASB) issues updates to the Accounting Standards Codification, (ASC) which impact the University's financial reporting and related disclosures. The paragraphs that follow summarize a number of relevant updates. Unless otherwise noted, the University is currently evaluating the impact that these updates will have on the combining financial statements.

In August 2018, the FASB issued Accounting Standards Update (ASU) No. 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The amendments help entities evaluate the accounting for implementation costs paid by a customer in a cloud computing arrangement by providing guidance for determining when the service contract includes a software license. The University is evaluating the impact of this guidance, which will be effective in 2022.

In July 2018, the FASB issued ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*, which enhances ASU No. 2016-02, *Leases (Topic 842)*. The guidance of these ASUs requires the rights and obligations arising from the lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet and allows for an option to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements. The ASUs are effective July 1, 2019, and the University elected the practical expedient to initially apply the new leasing standard at the adoption date. The University is finalizing its analysis of certain key assumptions that will be utilized at the transition date, including the incremental borrowing rate. The primary effect of the new standard will be to record right-of-use assets and obligations for current operating leases, which will have a material impact on the combined statement of financial position and significant incremental disclosures in the notes to the combined financial statements. The standard is not expected to have a material effect on the University's combined statement of activities.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. The University is evaluating the impact of this guidance, which will be effective for the year ended June 30, 2019. The standard is not expected to have a material effect on the University's combined statement of financial position.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which superseded virtually all revenue recognition guidance in U.S. GAAP. This guidance is intended to improve, converge, and replace existing revenue recognition guidance, including industry-specific guidance, and requires revenue to be recognized in an amount that reflects the consideration the entity expects to be entitled to in an exchange of goods or services. The University is evaluating the impact of this guidance, which will be effective July 1, 2018. The adoption of the new standard is not expected to have an impact on recognition of total operating revenues for any periods, but is expected to result in expanded footnote disclosures.

3. Credit Quality of Student Loans Receivable

The University issues uncollateralized loans to students based on financial need. Student loans are funded through federal government loan programs or institutional resources. Student loans receivable are carried at the amount of unpaid principal less an estimate for doubtful accounts. Allowances for doubtful accounts are established based on prior collection experience. At June 30, 2018, student loans represented 2.81% of total assets.

Student loans consist of the following (amounts in thousands):

	<u>June 30, 2018</u>
Federal government programs	\$ 21,641
Institutional programs	24,064
	<u>45,705</u>
Less allowance for doubtful accounts	(678)
Student loans receivable, net	<u><u>\$ 45,027</u></u>

Funds advanced by the federal government of approximately \$21,641 thousand at June 30, 2018, are ultimately refundable to the government and are classified as other liabilities on the combined statement of financial position.

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. Student loans receivable through the loan programs are considered to be past due if a payment is not made within 30 days of the payment due date, at which time late charges are charged and recognized. The

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

3. Credit Quality of Student Loans Receivable (continued)

Federal Perkins Loan Program receivables may be assigned to the ED. Students may be granted a deferment, forbearance, or cancellation of their student loan receivable based on eligibility requirements defined by the ED.

The following amounts were past due under student loan programs (amounts in thousands):

June 30, 2018				
1–30 Days	31–60 Days	61–90 Days	91+ Days	Total
\$ 23	\$ 17	\$ 11	\$ 6,496	\$ 6,547

4. Pledges Receivable

The pledges receivable, net of estimated uncollectible amounts, are discounted to present value at rates of 0.65% to 3.99% based on the pledged gift date. Based on the University's collection history, management determined that no allowance for doubtful accounts was necessary for pledges receivable at June 30, 2018.

Pledges receivable are as follows (amounts in thousands):

	<u>June 30, 2018</u>
Gross unconditional pledges receivable	\$ 7,449
Less unamortized discounts	<u>(475)</u>
	<u>\$ 6,974</u>
Unconditional promises expected to be collected in:	
Less than one year	\$ 2,060
One to five years	<u>4,914</u>
	<u>\$ 6,974</u>

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

5. Investments, Irrevocable Trusts, and Fair Value Measurements

Investments and irrevocable trusts are pooled together when permitted by gift agreement and applicable government regulations. Pooled investments and allocation of income are accounted for using the unit market method. A portion of the assets held in pooled investments is held for others with a corresponding liability recorded in the accompanying combined financial statements.

Investment strategies for certain investments include the use of margin and other forms of leverage, including taking short positions, swaps, futures, options, warrants, private placements, forward contracts, trade claims and credit default swaps, and real estate instruments, when deemed appropriate by the fund managers. Other strategies include macroanalysis, merger arbitrage, distressed securities, and special situations.

The University's policy is to recognize transfers in and transfers out at the end of the reporting period. This policy includes transfers in and transfers out of Level 1, Level 2, and Level 3. There were no transfers to or from Levels during the period presented.

Investments are measured at fair value on the combined statement of financial position. Fair value is defined as 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. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in unrestricted revenue and support unless the income or loss is restricted by donor or law.

U.S. GAAP establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

U.S. GAAP describes three levels of inputs that may be used to measure fair value:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

5. Investments, Irrevocable Trusts, and Fair Value Measurements (continued)

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized on the accompanying combined statement of financial position, as well as the general classification of such instruments pursuant to the valuation hierarchy. Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include equities, debt securities, and U.S. government securities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Level 2 securities include debt securities on U.S. government agencies, U.S. state and local, mortgage-backed, corporate bonds, and commercial real estate. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

As part of the Level 3 securities valuation process, the Investment Management Committee, under the supervision of the University's Board of Trustees, determines the fair value measurement policies and procedures in consultation with the University's third-party investment advisors. These policies and procedures are reassessed periodically to determine if the current valuation techniques are still appropriate. At that time, the unobservable inputs used in the fair value measurements are evaluated and adjusted, as necessary, based on the current market conditions and other third-party information.

Securities classified within Level 3 include a closely held entity and other assets for which valuations generally consider variables such as financial performance of investments, recent sales prices of investments, and other pertinent information.

Securities accounted for at Net Asset Value (NAV) include equity securities, hedge funds, private equity investments, and real estate partnerships. NAV amounts provided by external investment managers are adjusted for receipts and disbursements of cash and securities subsequent to the most recently available NAV date.

The following presents information about the level in the fair value hierarchy for the University's assets and liabilities that are reported at fair value as of June 30, 2018. For most financial assets and financial liabilities the carrying amount equals fair value. The University has California Education Facilities Authority (CEFA) Revenue bonds that are reported at an amortized cost of \$187.7 million as of June 30, 2018, on the combined statement of financial position. The CEFA Revenue bonds have an approximate fair value of \$190.8 million as of June 30, 2018. The University determined CEFA Revenue bonds to be Level 2 measurements in the fair value hierarchy and is based on estimated discounted future cash flows.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

5. Investments, Irrevocable Trusts, and Fair Value Measurements (continued)

Certain notes receivable in investments are reported at carrying value.

Investments consist of the following (amounts in thousands):

	June 30, 2018				
	Level 1	Level 2	Level 3	NAV	Total
Cash equivalents	\$ 47,302	\$ —	\$ —	\$ —	\$ 47,302
Investments –					
redeemable securities					
Equity securities:					
Real estate					
industry	1,493	—	—	—	1,493
Oil and gas					
industry	29,521	—	—	—	29,521
Domestic	103,344	—	—	44,334	147,678
International	30,998	—	—	19,375	50,373
Total equity securities	165,356	—	—	63,709	229,065
Debt securities:					
U.S. government	31,089	—	—	—	31,089
U.S. government					
agencies	—	831	—	—	831
U.S. state and local					
government	—	4,196	—	—	4,196
Mortgage-backed	—	20,987	—	—	20,987
Corporate bonds	—	45,588	—	—	45,588
Total debt securities	31,089	71,602	—	—	102,691
Hedge funds	—	—	—	29,503	29,503
First trust deeds					
(mortgages)	—	71,946	—	—	71,946
Total redeemable securities	243,747	143,548	—	93,212	480,507

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

5. Investments, Irrevocable Trusts, and Fair Value Measurements (continued)

	Level 1	Level 2	Level 3	NAV	Total
	<i>(In thousands)</i>				
Investments – nonredeemable securities					
Private equity investments:					
Distressed debt	\$ –	\$ –	\$ –	\$ 8,255	\$ 8,255
Oil and energy	–	–	–	17,994	17,994
International	–	–	–	8,578	8,578
Domestic capital investments	–	–	–	9,724	9,724
Others	–	–	–	9,309	9,309
Total private equity investments	–	–	–	53,860	53,860
Real estate partnerships	–	–	–	45,049	45,049
Commercial real estate	–	387,562	–	–	387,562
Other	–	–	–	31,875	31,875
Total nonredeemable securities	–	387,562	–	130,784	518,346
Investments at fair value	\$ 243,747	\$ 531,110	\$ –	\$ 223,996	\$ 998,853
Notes receivable at cost					62,262
Total investments					<u>\$ 1,061,115</u>

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

5. Investments, Irrevocable Trusts, and Fair Value Measurements (continued)

	Level 1	Level 2	Level 3	Total
Irrevocable trusts – redeemable securities				
Equity securities:				
Domestic mutual funds	\$ 41,136	\$ –	\$ –	\$ 41,136
Bonds	55	–	–	55
Stocks	46	–	–	46
Total equity securities	41,237	–	–	41,237
U.S. treasury and government money market debt securities	747	–	–	747
Total irrevocable trusts – redeemable securities	41,984	–	–	41,984
Irrevocable trusts – nonredeemable securities				
Commercial real estate	–	298	–	298
Others	–	–	789	789
Total irrevocable trusts – nonredeemable securities	–	298	789	1,087
Total irrevocable trusts	\$ 41,984	\$ 298	\$ 789	\$ 43,071

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

5. Investments, Irrevocable Trusts, and Fair Value Measurements (continued)

Investments managed by external advisors include investments in private equity and real estate. The majority of these investments are not readily marketable and are reported at fair value utilizing the most current information provided by the external advisor. In situations where the information provided by the external advisor is deemed to not be representative of fair value as of the measurement date, the University will utilize the supplemental information provided by external advisor along with any relevant data to measure the investment's fair value as of that date. Distributions from each fund will be received as the underlying investments of the funds are liquidated, estimated at June 30, 2018, to be over the next 5 to 20 years.

Fair value measurements of investments in certain entities that calculate NAV per share (or its equivalent) are as follows:

	Fair Value at June 30, 2018	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Equity Funds ^(a)	\$ 63,709	\$ —	30–90 days	60 days
Hedge funds ^(b)	29,503	—	60–90 days	30–60 days
Private equity: ^(c)				
Distressed debt	8,255	5,919	Nonredeemable	None
Oil and energy	17,994	6,238	Nonredeemable	None
International	8,578	322	Nonredeemable	None
Domestic capital investments	9,724	—	Nonredeemable	None
Alternative strategies	9,309	2,950	Nonredeemable	None
Real estate partnership ^(d)	45,049	856	Nonredeemable	None
Other	31,875	—	Nonredeemable	None
Totals	<u>\$ 223,996</u>	<u>\$ 16,285</u>		

^(a) Unlisted equity fund investing in global equities.

^(b) Absolute return strategies seeking to achieve capital appreciation employing event-driven investment strategies that generate attractive risk-adjusted returns, and long/short equity strategies seeking to outperform the broader market averages while minimizing volatility and risk by investing in businesses trading at attractive valuations and short selling stocks in poorly performing, overvalued businesses.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

5. Investments, Irrevocable Trusts, and Fair Value Measurements (continued)

- (c) Diversified investments in various portfolio companies at different stages, industries, or regions, providing venture capital and/or restructuring expertise and subsequently selling the company to generate returns.
- (d) Investments in residential and commercial real estate that seek to achieve high levels of consistent income along with capital appreciation over a full market cycle.

6. Property, Plant, and Equipment, Net

Property, plant, and equipment, net consist of the following (amounts in thousands):

	<u>June 30, 2018</u>
Land improvements	\$ 38,308
Vehicles	1,515
Equipment	127,987
Buildings and improvements	<u>419,362</u>
	587,172
Less accumulated depreciation	<u>(325,169)</u>
Net plant and equipment	262,003
Land	30,998
Construction-in-progress	<u>62,898</u>
Plant and equipment, net	<u><u>\$ 355,899</u></u>

The University has various construction-in-progress projects open as of June 30, 2018, for the construction of facilities and other improvements.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

7. Net Investment in Direct Financing Lease

Net investment in direct financing lease consists of the following at June 30, 2018:

Gross investment	\$ 6,035
Less unearned income	(2,356)
Less deferred rent	(350)
Less elimination entry	(690)
Net investment in direct financing lease	<u>\$ 2,639</u>
 Estimated unguaranteed residual value	 <u>\$ 735</u>

The estimated unguaranteed residual value represents the estimated amount to be received at lease termination from the disposition or re-lease of equipment under leases not classified as operating leases and in which the University has an ongoing economic interest, discounted using the internal rate of return related to each specific direct financing lease. Actual results may differ from estimated amounts.

As a condition of the financing arrangements, customers are required to maintain insurance on the underlying collateral. These credit policies and procedures enable the University to monitor and control its risks and exposures on the lease receivables. At June 30, 2018, there were no nonaccrual leases.

8. Trusts

Revocable Trust Agreements

At June 30, 2018, the University held, as trustee, a total of 21 revocable trust agreements, of which the University has a significant beneficial interest. These trust agreements had total assets amounting to \$6.5 million (unaudited) in 2018. Revocable trust agreements with assets totaling \$1.2 million in 2018 became irrevocable due to the passing of the surviving trustor. The University's policy is to recognize as contributions revenue the trust gift when the agreement becomes irrevocable.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

8. Trusts (continued)

Other Unrecorded Trusts

The University has beneficial or remainder interest in a number of irrevocable and revocable trusts, life income agreements, and estates held by various Conferences of the Seventh-day Adventist Church or third-party trustees, such as banks. LLU does not have access to the number or value of these trusts, so they will not be reflected in the combined financial statements until such gifts are received by the University.

9. Debt, Net

Debt, net consists of the following at June 30, 2018 (amounts in thousands):

	<u>2018</u>
CEFA Revenue Bonds, Series 2017A	\$ 132,795
CEFA Revenue Bonds, Series 2017B	41,345
Secured note to bank at 4.50%, principal and interest monthly, matures February 17, 2030	16,637
Secured note to bank at 4.25%, principal and interest monthly, matures February 7, 2032	544
Secured note to bank at 4.25%, principal and interest monthly, matures February 7, 2032	722
Secured notes to individuals at fixed interest rate of 7.50%, principal and interest monthly, matures in 2033 and upon the death of individuals	1,103
Line of Credit at LIBOR plus 1.50%, interest monthly, collateralized by marketable securities	7,000
Notes to bank at 1.00%, interest monthly, matures January 29, 2045	9,800
Notes to bank at 1.00%, interest monthly, matures June 1, 2045	8,160
Notes to bank at 1.00%, interest monthly, matures August 21, 2045	11,000
Total outstanding debt, net	<u>229,106</u>
Capitalized finance costs	(3,592)
CEFA Revenue Bonds, Series 2017A Premium	13,635
Total debt, net	<u><u>\$ 239,149</u></u>

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

9. Debt, Net (continued)

Aggregate principal maturities of debt, net for the years ending June 30, 2018, are as follows:

2019	\$ 11,282
2020	4,433
2021	4,605
2022	5,977
2023	6,112
2024 and thereafter	196,697
	<u>\$ 229,106</u>

Interest related to the debt, net was \$11.6 million for the year ended June 30, 2018.

The University has a \$20.0 million unsecured line of credit with a financial institution, with interest at LIBOR plus 1.50%, which was approximately 3.59% at June 30, 2018. As part of the unsecured line of credit agreement, the University is required to meet certain financial and nonfinancial covenants. The loan balance is \$7.0 million as of June 30, 2018. The University was in compliance with all such financial covenants in 2018, except the reporting requirement, which requires submission of audited financial statements on December 31, 2018. The University has obtained a waiver on the reporting requirement, which extended the line of credit to expire on July 1, 2019.

The University has received a secured commercial loan from a financial institution at a fixed rate of 4.50% payable in 15 years beginning February 24, 2015 until February 17, 2030. The balance of the loan is \$16.7 million as of June 30, 2018. The University was in compliance with all such financial covenants in 2018, except the reporting requirement, which requires submission of audited financial statements. The University has obtained a waiver on the reporting requirement, which extended the line of credit to expire on June 30, 2019.

Secured loans from private individuals were also obtained by the University at a fixed interest rate of 7.50% payable in 25 years. The loans will mature in 2033 or upon the death of the private individuals. The loan balance is \$1.1 million as of June 30, 2018.

The University has obtained two secured commercial loans from a financial institution, which were executed on February 7, 2017, at a fixed rate of 4.25% for both loans. The loans are payable in 15 years beginning on February 7, 2018, and maturing on February 7, 2032. The loan balances as of June 30, 2018 are \$722 thousand and \$544 thousand, respectively.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

9. Debt, Net (continued)

The three notes to a bank at 1.00% are New Market Tax Credit loans with an aggregate balance of \$28.9 million as of June 30, 2018, which qualify as qualified loan-income community investments under Section 45D of the IRC. These loans provide tax credits to investors under this program, which are indemnified by the University. LLUH-SB must operate a qualifying business in the financed facilities, meet certain additional operating covenants, and submit annual reports to lenders. Additional borrowing, including the loan from affiliate, may not exceed \$36.6 million as of June 30, 2018. The loans are unsecured. LLUH-SB was in compliance with all such financial covenants in 2018, except the reporting requirement, which requires submission of audited financial statements. Per the terms of the debt agreement, this failure will become an event of default 30 days after LLUH-SB receives a written notice specifying such failure and requesting that it be remedied. Such notice has not been received resulting in no event of default on the outstanding debt for LLUH-SB.

The California Educational Facilities Authority (CEFA) Act as a public instrumentality of the State of California pursuant to Chapter 2 of Part 59 of Division 10 of Title 3 of the Education Code of the State of California authorized the University to issue the CEFA Revenue Bonds Series 2017A and 2017B on March 1, 2017.

The University has obtained CEFA Revenue Bonds Series 2017A in the amount of \$134.9 million payable in 30 years beginning April 1, 2017, until April 1, 2047, at a fixed rate of 5.00% per annum and the CEFA Revenue Bond Series 2017B in the amount of \$43.4 million payable in 15 years beginning April 1, 2018 until April 1, 2033, at a rate starting at 1.97% in the first year to a maximum of 4.75% at maturity. The outstanding loan balance is \$174.1 million as of June 30, 2018. The University was in compliance with all such financial covenants in 2018, except the reporting requirement, which requires submission of audited financial statements. Per the terms of the debt agreement, this failure will become an event of default 60 days after the University receives a written notice specifying such failure and requesting that it be remedied. Such notice has not been received resulting in no event of default on the outstanding debt for the University.

On July 23, 2018, the University obtained a \$40 million line of credit from a financial institution, which had no draws at June 30, 2018.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

9. Debt, Net (continued)

Prepayments

The University may at any time prepay all or any part of the base loan payments. All such prepayments shall be deposited in the optional redemption account within the bond fund and credited against the base loan payments in the order of their due date or at the election of the University in accordance with the indenture. Notwithstanding any such prepayment, the University shall not be relieved of this obligation under the agreement until all of the bonds have been fully paid and retired.

Optional Redemption Revenue Bonds Series 2017A

The Series 2017A bonds maturing on or after April 1, 2028, are subject to optional redemption by the University prior to their stated maturities pursuant to the agreement at the principal amount thereof plus accrued interest, if any, to the date of redemption.

Mandatory Redemption from Sinking Fund Payments

The Series 2017A bonds maturing on April 1, 2042, amounting to \$38.6 million are subject to redemption, in part or by lot, from mandatory sinking fund payments pursuant to the indenture, on each April 1, from and after April 1, 2038, at the principal amount thereof plus accrued interest, if any, to the date of redemption (without premium).

The Series 2017A bonds maturing on April 1, 2047, amounting to \$49.3 million are subject to redemption, in part or by lot, from mandatory sinking fund payments pursuant to the indenture, on each April 1, from and after April 1, 2043, at the principal amount thereof plus accrued interest, if any, to the date of redemption (without premium).

Optional Redemption Revenue Bonds Series 2017B

The Series 2017B bonds maturing on April 1, 2033, in the amount of \$19.6 million are subject to optional redemption prior to their stated maturity pursuant to the agreement at the principal amount thereof plus accrued interest, if any, to the date of redemption.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

9. Debt, Net (continued)

Mandatory Redemption from Sinking Fund Payments

The Series 2017B bonds maturing on April 1, 2033, in the amount of \$19.6 million are subject to redemption, in part or by lot, from mandatory sinking fund payments pursuant to the indenture, on each April 1, from and after April 1, 2028, at the principal amount thereof plus accrued interest, if any, to the date of redemption (without premium).

10. Deferred Compensation

The University maintains a nonqualified deferred compensation plan for the benefit of certain doctors associated with various medical groups. The plan is an unsecured promise to pay income in the future. As of June 30, 2018, the plan liabilities totaled \$2.4 million. The assets are included in inventories, prepaid expenses and other assets and the liabilities are included in accounts payable and accrued expenses on the accompanying combined statement of financial position.

11. Nature and Amount of Temporarily and Permanently Restricted Net Assets

Temporarily and permanently restricted net assets are available for the following purposes:

	June 30, 2018	
	Temporarily Restricted Net Assets	Permanently Restricted Net Assets
Restricted for specific purposes	\$ 156,580	\$ —
Student loans	46,820	—
Endowment	55,282	276,902
Annuity and life income agreements	25,564	6,932
	<u>\$ 284,246</u>	<u>\$ 283,834</u>

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

12. Endowment

The net assets of the University include permanent endowment and funds functioning as endowment (collectively, the endowment). Permanent endowment funds are subject to the restrictions of gift instruments requiring that the principal be invested and the income only be utilized as provided under the California Uniform Prudent Management of Institutional Funds Act. While certain funds have been established by the Board of Trustees to function as endowment, any portion of such funds may be expended.

Changes in the University's endowment excluding permanently restricted trusts for the year ended June 30, 2018, were as follows (amounts in thousands):

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2018
Investment returns:				
Investment income from pooled funds	\$ (522)	\$ 463	\$ 835	\$ 776
Net amount appropriated for operation	(522)	463	835	776
Change in realized/unrealized net appreciation of investments	—	4,138	16,121	20,259
Net return in pooled investment fund	(522)	4,601	16,956	21,035
Total net investment returns	(522)	4,601	16,956	21,035
Other changes in endowed equity:				
Gifts	2,561	77	5,685	8,323
Net change in endowed equity	2,039	4,678	22,641	29,358
Endowed equity, beginning of year	52,805	50,604	254,261	357,670
Endowed equity, end of year	\$ 54,844	\$ 55,282	\$ 276,902	\$ 387,028

The endowment net asset composition excludes permanently restricted trusts, and consists of the following (amounts in thousands):

	June 30, 2018			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2018
Investments	\$ 54,844	\$ 55,282	\$ 276,902	\$ 387,028
Total endowed equity	\$ 54,844	\$ 55,282	\$ 276,902	\$ 387,028

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

12. Endowment (continued)

The endowment net asset composition by type of fund consists of the following (amounts in thousands):

	<u>June 30, 2018</u>
Total unrestricted endowment (board designated)	\$ 54,844
Temporarily restricted endowment:	
Portion of perpetual endowment fund subject to a time restriction under UPMIFA:	
Without purpose restriction	—
With purpose restriction	<u>55,282</u>
Total temporarily restricted endowment funds	55,282
Permanently restricted endowment	<u>276,902</u>
Total endowment (<i>excludes permanently restricted trusts</i>)	<u><u>\$ 387,028</u></u>

13. Related-Party Transactions

The University receives capital and operating appropriations, as well as various other special appropriations, from the General Conference of Seventh-day Adventists (the “GC”). Revenue received from the GC in unrestricted gifts and subsidies for the year ended June 30, 2018, was \$7.8 million.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

13. Related-Party Transactions (continued)

Revenue transactions occurring between LLU and various affiliated organizations consist of various service-related items, including pharmacy and clinical services, audiovisual services, cafeteria, and rent and are summarized as follows for the year ended June 30, 2018 (amounts in thousands):

LLUMC and affiliates	\$ 19,940
Loma Linda University Shared Services (LLUSS)	3,868
Loma Linda University Health Care (LLUHC)	267
Loma Linda Inland Empire Consortium for Healthcare Education (LLIECHE)	9
LLUH	49
Related faculty medical groups	5
	<u>\$ 24,138</u>

Expenses to LLUMC consist primarily of various service-related items, including pharmacy and clinical services, audiovisual services, cafeteria, and rent. Expenses paid to LLUHC consist primarily of medical director fees and rent. Expenses paid to LLUH are primarily composed of management fees and legal fees. Expenses paid to LLUSS are composed of shared services provided to the core entities within LLUH, including human resources management, payroll, information technology, security, telecommunications, construction, dispatch, mail services, and grants management, as well as other support services. In total, approximately 50 departments are supported by LLUSS. Expenses paid to LLIECHE include purchased labor for medical residents. Expenses paid to related faculty medical groups include medical director fees, resident director fees, and fees paid to service chiefs. Expense transactions occurring between LLU and various affiliated organizations are summarized as follows for the year ended June 30, 2018 (amounts in thousands):

LLUMC and affiliates	\$ 4,132
LLUSS	23,718
LLUHC	1,688
LLIECHE	2
LLUH	2,127
Related faculty medical groups	8,687
	<u>\$ 40,354</u>

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

14. Retirement Plans

Defined Benefit Plans

The University participates in a noncontributory defined benefit pension plan known as the “Seventh-day Adventist Retirement Plan for the North America Division.” This plan, which covers substantially all employees of the University, is administered by the GC in Silver Spring, Maryland, and is exempt from the Employee Retirement Income Security Act of 1974 (ERISA) as a multiple-employer plan of a church-related agency.

The University also participates in a noncontributory, defined benefit health plan known as the “Health Care Assistance Plan for Participants in the Seventh-day Adventist Retirement Plan of the North American Division.” This plan, which covers substantially all employees of the University, is administered by the GC in Silver Spring, Maryland, and is exempt from ERISA as a multiple-employer plan of a church-related agency.

The University contributed \$3.9 million to these plans (for retiree pension and retiree health care benefits) for the year ended June 30, 2018.

These plans are defined by the FASB as multiple-employer plans. As such, it is not required, nor is it possible, to determine the actuarial present value of accumulated benefits or plan net assets for employees of the University apart from other plan participants.

The North American Division Committee voted to freeze the accrual of service credit in these plans effective December 31, 1999, except for employees who choose the career completion option, and to start a new defined contribution plan effective January 1, 2000. The University continues to make contributions (at a reduced rate) to the frozen plans after December 31, 1999. Certain employees will continue to be eligible for future benefits under these plans.

Defined Contribution Plan

The University participates in a defined contribution retirement plan known as “The Adventist Retirement Plan.” This plan, which covers substantially all employees of the University, is administered by the GC in Silver Spring, Maryland, and is exempt from ERISA as a multiple-employer plan of a church-related agency. The University makes a basic contribution to this plan for covered employees at a stated percentage of the employee’s wage. The University also makes

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

14. Retirement Plans (continued)

matching contributions at a stated percentage of additional contributions made by covered employees. Investment management of the accumulated contributions designated for each employee is provided under an agreement between the GC and Variable Annuity Life Insurance Company. The University contributed \$3.2 million for the year ended June 30, 2018.

Faculty do not participate in the retirement plan that is administered by the GC, but participate in the Teachers Insurance and Annuity Association and the College Retirement Equities Fund. Under this defined contribution plan, the University and plan participants make annual payments to purchase individual annuities, fixed or variable, equivalent to retirement benefits earned. Vesting provisions are full and immediate. Benefits commence upon retirement, and pre-retirement survivor death benefits are also provided. Charges to unrestricted net assets for the University's share of costs were \$4.7 million during the year ended June 30, 2018.

15. Self-Insurance Plans

The University is covered through the Risk Management division of LLUH for employee and student health care, state disability benefits, auto, physical damage, unemployment benefits, and workers' compensation benefits.

The University is also covered by the LLUH Professional and General Liability Trust for professional and general liability exposures up to a limit of \$4 million per occurrence. University Insurance Company of Vermont, a captive insurance company wholly owned by LLUH, provides excess liability coverage with limits of \$25 million per occurrence and annual aggregate in excess of \$4 million. Risk Management has purchased additional insurance from commercial carriers to cover claims in excess of \$29 million and up to \$200 million per occurrence and in the aggregate.

16. Conditional Pledges

On August 1, 1995, the United States Government conditionally deeded 6.5 acres of land, including buildings from the former Norton Air Force Base, to LLU for the sum of one dollar. This property and facility are restricted for educational purposes and are subject to certain operational conditions and inspections by the government for a period of 30 years. The University will record the contribution at its fair value at the end of the 30-year period when all conditions to the transfer are met. The property and the facility are currently being used by the Social Action Community Health System clinic.

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

17. Commitments and Contingencies

The University has guaranteed to the State of California the payment of all workers' compensation liabilities of LLUMC, LLUBMC, and Faculty Practice Groups. For 2018, the total current funding of all these groups exceeds the estimated future liability.

The University is involved in legal actions in the normal course of business, some of which seek monetary damages, including claims for punitive damages, which are not covered by insurance. These actions, when finally concluded and determined, will not, in the opinion of management based in part on consultation with the University's legal counsel, have a material adverse effect on the University's combined financial position, change in net assets, or cash flows.

18. Leasing Operations

LLUH-SB leases space to a community health clinic under a noncancelable operating lease with an initial rate of \$2.80 per square foot. The lease rate increases by fixed and indexed amounts over an initial term of 20 years, and the lease agreement includes two options to extend for an additional five years.

Future minimum cash rental to be collected from leases with an unrelated tenant for the years ending June 30 are as follows (amounts in thousands):

2019	\$	4,199
2020		4,409
2021		4,409
2022		4,631
2023		4,631
Thereafter		60,089
	\$	<u>82,368</u>

Loma Linda University and LLUH-SB, Inc.

Notes to Combined Financial Statements (continued)

19. Subsequent Events

Subsequent events are events or transactions that occur after the combined statement of financial position date but before the combined financial statements are available to be issued. The University recognizes in the combined financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the combined statement of financial position, including the estimates inherent in the process of preparing the combined financial statements. The University's combined financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the combined statement of financial position but arose after the combined statement of financial position date and before the combined financial statements are available to be issued.

The University has evaluated subsequent events through June 19, 2019, which is the date the accompanying combined financial statements are available for issuance. There were no subsequent events that need disclosure.

Supplemental Schedules

Loma Linda University and LLUH-SB, Inc.

Combining Statement of Financial Position

June 30, 2018

	Educational				
	Division	Foundation	LLUH-SB	Eliminations	Total
Assets					
Cash and cash equivalents	\$ 5,744	\$ 1,106	\$ 172	\$ —	\$ 7,022
Restricted cash	20,302	—	443	—	20,745
Assets whose use is limited	8,714	—	—	—	8,714
Accounts receivable, net	38,573	1,253	237	—	40,063
Student loans receivable, net	45,027	—	—	—	45,027
Pledges receivable	3,605	3,369	—	—	6,974
Deferred rent	—	—	1,596	(393)	1,203
Irrevocable trusts	—	43,071	—	—	43,071
Investments	18,588	1,052,401	—	(18,588)	1,052,401
Due from interdivision	43,406	46,832	—	(90,238)	—
Advances to related parties	23,917	436	—	(15,795)	8,558
Advances to affiliate	(3,159)	—	3,310	(151)	—
Inventories, prepaid expenses, and other assets	6,864	1,677	—	—	8,541
Net investment in direct financing lease	—	—	3,329	(690)	2,639
Property, plant, and equipment, net	311,051	43,740	60,715	(59,607)	355,899
Total assets	\$ 522,632	\$ 1,193,885	\$ 69,802	\$ (185,462)	\$ 1,600,857

Loma Linda University and LLUH-SB, Inc.

Combining Statement of Financial Position (continued)

	Educational				
	Division	Foundation	LLUH-SB	Eliminations	Total
Liabilities and net assets					
Liabilities:					
Accounts payable and accrued expenses	\$ 58,879	\$ 300	\$ 696	\$ (15,788)	\$ 44,087
Deferred revenue	33,679	7	—	—	33,686
Investments held on behalf of others	—	456,145	—	—	456,145
Liabilities due under annuity and split-interest agreements	—	24,626	—	—	24,626
Due to interdivision	46,832	61,994	—	(108,826)	—
Advances from related parties	11,827	1,718	—	—	13,545
Advances from affiliate	43,925	—	20,604	(64,529)	—
Debt, net	193,117	18,360	27,672	—	239,149
Other liabilities	24,530	2,063	—	—	26,593
Total liabilities	412,789	565,213	48,972	(189,143)	837,831
Net assets:					
Unrestricted – undesignated	(578)	35,307	20,830	3,681	59,240
Unrestricted – administration designated	—	91,535	—	—	91,535
Unrestricted – board designated	—	44,171	—	—	44,171
Total unrestricted	(578)	171,013	20,830	3,681	194,946
Temporarily restricted	110,421	173,825	—	—	284,246
Permanently restricted	—	283,834	—	—	283,834
Total net assets	109,843	628,672	20,830	3,681	763,026
Total liabilities and net assets	\$ 522,632	\$ 1,193,885	\$ 69,802	\$ (185,462)	\$ 1,600,857

Loma Linda University and LLUH-SB, Inc.

Combining Statement of Activities

Year Ended June 30, 2018

	Educational Division				Foundation Division				LLUH-SB				All Divisions	
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Eliminations	Total June 30, 2018
Revenue and support:														
Tuition and fees	\$ 163,542	\$ –	\$ –	\$ 163,542	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –	\$ 163,542
Less student aid	(8,864)	–	–	(8,864)	–	–	–	–	–	–	–	–	–	(8,864)
Net tuition and fees	154,678	–	–	154,678	–	–	–	–	–	–	–	–	–	154,678
Gifts and subsidies	8,929	718	–	9,647	8,705	9,707	6,348	24,760	40	(3,021)	–	(2,981)	(40)	31,386
Sponsored support	23,321	75	–	23,396	–	–	–	–	–	–	–	–	–	23,396
Investment income	1,007	9,460	–	10,467	20,970	2,933	558	24,461	426	–	–	426	(91)	35,263
Sales and service income	27,101	–	–	27,101	–	–	–	–	5,981	–	–	5,981	(5,353)	27,729
Clinic and auxiliary income	38,508	–	–	38,508	10,121	–	–	10,121	–	–	–	–	–	48,629
Student loan interest and other	458	3,063	–	3,521	–	–	–	–	–	–	–	–	–	3,521
Net assets released from restriction	3,670	(1,876)	–	1,794	1,030	(2,824)	–	(1,794)	–	–	–	–	–	–
Total revenue and support	257,672	11,440	–	269,112	40,826	9,816	6,906	57,548	6,447	(3,021)	–	3,426	(5,484)	324,602
Expenses:														
Instruction	144,552	–	–	144,552	–	–	–	–	–	–	–	–	–	144,552
Research	24,294	–	–	24,294	–	–	–	–	–	–	–	–	–	24,294
Public service	4,946	–	–	4,946	–	–	–	–	–	–	–	–	–	4,946
Academic support	25,440	–	–	25,440	–	–	–	–	–	–	–	–	–	25,440
Student services	5,485	–	–	5,485	–	–	–	–	–	–	–	–	–	5,485
Institutional administration	37,427	–	–	37,427	6,876	–	–	6,876	–	–	–	–	(1,173)	43,130
Physical plant	24,660	–	–	24,660	1,670	–	–	1,670	1,537	–	–	1,537	(7,992)	19,875
Student financial support	4,708	–	–	4,708	–	–	–	–	–	–	–	–	–	4,708
Independent operations	25,976	–	–	25,976	8,632	–	–	8,632	1,066	–	–	1,066	–	35,674
Total operating expenses	297,488	–	–	297,488	17,178	–	–	17,178	2,603	–	–	2,603	(9,165)	308,104
Change in net assets from operating activities	(39,816)	11,440	–	(28,376)	23,648	9,816	6,906	40,370	3,844	(3,021)	–	823	3,681	16,498
Unrealized (losses) gains on investments	37	–	–	37	(8,128)	6,602	16,141	14,615	–	–	–	–	–	14,652
Change in net assets	(39,779)	11,440	–	(28,339)	15,520	16,418	23,047	54,985	3,844	(3,021)	–	823	3,681	31,150
Net assets, beginning of year	39,201	98,981	–	138,182	155,493	157,407	260,787	573,687	16,986	3,021	–	20,007	–	731,876
Net assets, end of year	\$ (578)	\$ 110,421	\$ –	\$ 109,843	\$ 171,013	\$ 173,825	\$ 283,834	\$ 628,672	\$ 20,830	\$ –	\$ –	\$ 20,830	\$ 3,681	\$ 763,026

Loma Linda University and LLUH-SB, Inc.

Combining Schedule of Expenses by Natural Classification

Year Ended June 30, 2018

	Educational Division	Foundation	LLUH-SB	Eliminations	Total
Salaries and benefits	\$ 161,695	\$ 1,616	\$ 40	\$ –	\$ 163,351
Plant repairs and replacements	6,966	2,511	27	(3,955)	5,549
Supplies and printing services	23,743	272	35	–	24,050
Professional development/training	2,163	–	–	–	2,163
Travel and entertainment	5,224	–	–	–	5,224
Purchased services	29,490	1,561	169	–	31,220
Cost of goods sold	1,610	–	–	–	1,610
Technology and telecommunications	3,954	28	–	–	3,982
Utilities	7,399	1,109	380	–	8,888
General expenses	22,307	6,902	30	–	29,239
Interest and taxes	11,501	1,509	336	(1,535)	11,811
Depreciation and amortization	21,436	1,670	1,586	(3,675)	21,017
Total expenses	<u>\$ 297,488</u>	<u>\$ 17,178</u>	<u>\$ 2,603</u>	<u>\$ (9,165)</u>	<u>\$ 308,104</u>

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