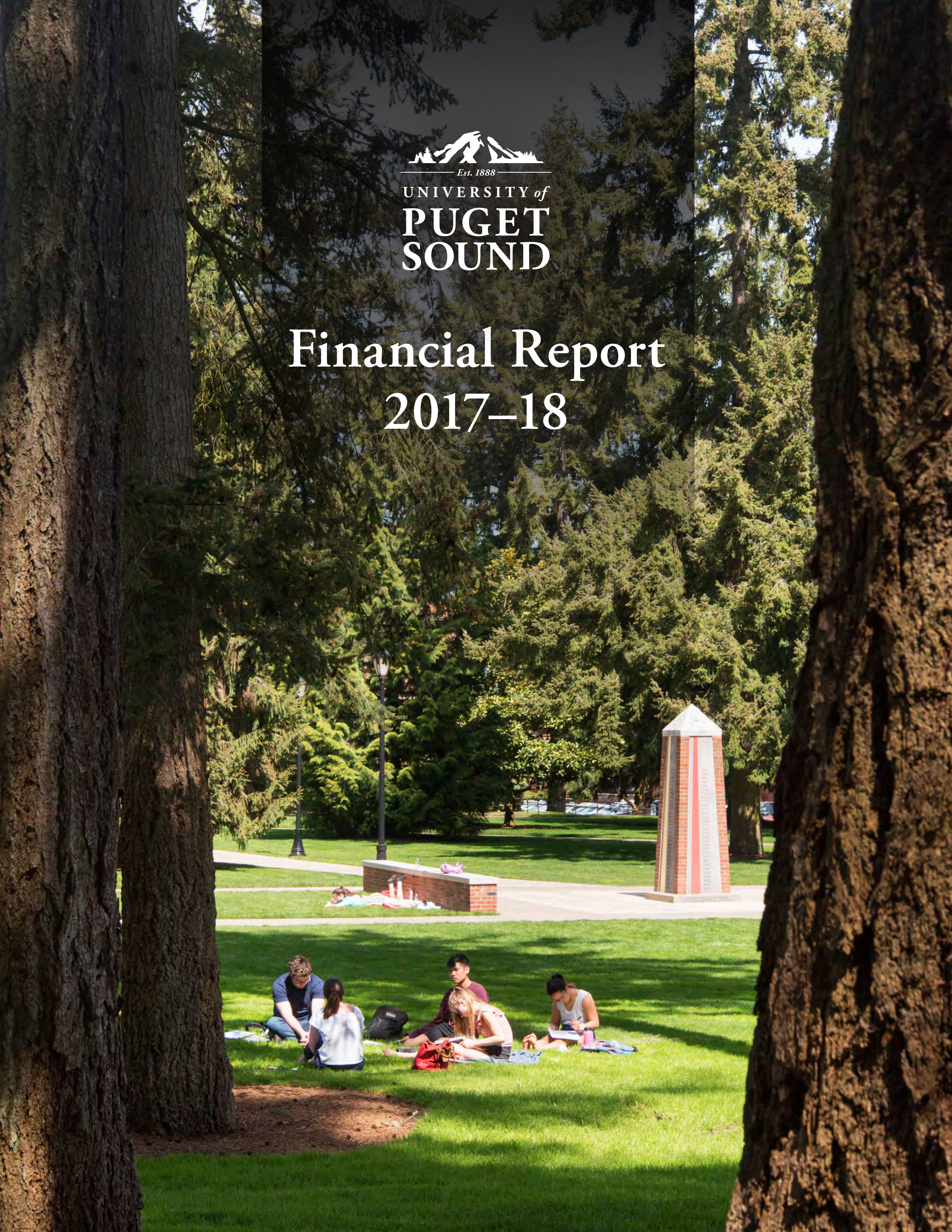
Est. 1888
UNIVERSITY of PUGET SOUND

Financial Report 2017–18



Mission Statement

University of Puget Sound is an independent, predominantly residential, undergraduate liberal arts college with selected graduate programs building effectively on a liberal arts foundation. The university, as a community of learning, maintains a strong commitment to teaching excellence, scholarly engagement, and fruitful student-faculty interaction.

The mission of the university is to develop in its students capacities for critical analysis, aesthetic appreciation, sound judgment, and apt expression that will sustain a lifetime of intellectual curiosity, active inquiry, and reasoned independence. A Puget Sound education, both academic and cocurricular, encourages a rich knowledge of self and others; an appreciation of commonality and difference; the full, open, and civil discussion of ideas; thoughtful moral discourse; and the integration of learning, preparing the university's graduates to meet the highest tests of democratic citizenship. Such an education seeks to liberate each person's fullest intellectual and human potential to assist in the unfolding of creative and useful lives.

Est. 1888
UNIVERSITY of
PUGET
SOUND

OFFICE OF FINANCE AND ADMINISTRATION

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UNIVERSITY OF PUGET SOUND | JUNE 30, 2018

2017–18 Financial Report

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Financial Statements

REPORT OF THE PRESIDENT

Isiaah Crawford

University of Puget Sound looks to the future in a strong position and poised to deepen our service to students, contributions to scholarship and engagement with our community as one of the finest liberal arts colleges in the country.

With discipline and a focus on putting the needs of our students first, Puget Sound ended the fiscal year within our budgeted resources and realized important gains in securing funding for major initiatives to advance our educational program and make available additional high impact, experiential learning opportunities such as internships, research, field placements and study away programs.

We strengthened our curriculum with a gift that made possible The Suzanne Barnett Chair in Contemporary China Studies, and sent another intrepid group of students abroad for a full year as part of the Pacific Rim/Asia Study-Travel Program (PacRim); received grant funding for development of a Center for Speech and Effective Advocacy; welcomed a visit by the Washington State Supreme Court, which heard several cases on campus and engaged in open fora with students; launched an immersive sophomore experience that combines classroom education with summer internships that help students build career-related skills; and saw 93% of our most recent graduating class gainfully employed, attending graduate school, participating in prestigious postgraduate fellowships, or engaged in service within seven months following graduation.

In a very competitive and challenging time for higher education throughout the United States, particularly for liberal arts colleges, we were pleased to have Moody's Investors Service and S&P Global Ratings affirm our long-term ratings of A1 and A+, respectively, with stable outlooks, and we have advanced our plans to build a new Welcome Center. The new center is a significant component of our enrollment strategy and will provide prospective students and their families with the best possible reception and orientation to Puget Sound. While fall of 2017 saw an entering first-year class that fell below our budgeted projections—a reality that will be with us over the next four years—we exceeded our projected headcount for the incoming class of fall 2018 and saw growth in several key sectors, including increases in new graduate student enrollment, students transferring from other institutions, and students who identify as underrepresented minorities and first generation college students, in addition to continued growth in the numbers of students who make their homes here in the Puget Sound region.

Strong support from our alumni is also a critical part of the university's success, and this was especially evident in the

implementation in April of our first "Logger Day Challenge," a one-day online giving event celebrating the university's 130th anniversary.

In terms of ensuring the university's long-term financial health and stability, our most significant undertaking of the past year has been the development of *Leadership for a Changing World*, a student-centered strategic plan that sets forth our institutional goals and aspirations for the coming decade. Our planning has been informed by strong engagement from trustees, campus community members, alumni, parents, community partners, and other key constituents and friends of the university who have identified ways in which we can make a Puget Sound education even more meaningful, relevant, accessible and distinctive. Our vision is clear: To challenge and support our students as they become broadly and deeply educated lifelong learners, prepared to create and serve the future and to become the world's next generation of visionary leaders. More information will be available in the coming year about this innovative plan that seeks to capitalize on what we do well and leverage entrepreneurial opportunities to advance the college.

Like other institutions of higher education, we compete for students in a dynamic and crowded market where shifts in demographics, affordability, government regulation, technology, the political environment, and more require us to be increasingly strategic and adaptive in not only responding to but anticipating change. On the following pages, you will see evidence of our ability to meet these challenges from a position of strength as we seek to reach our next level of distinction and success in service to our academic mission.

REPORT OF THE EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER

Sherry B. Mondou

Since its founding in 1888, Puget Sound has been educating and preparing students for our complex and ever-changing world. Over these 130 years, Puget Sound has emerged as one of only 40 colleges in the nation included in "Colleges That Change Lives." A strong financial position is an essential ingredient in this important work. I offer the following commentary on the university's financial position as a companion to the enclosed financial statements for the year ending June 30, 2018.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

Assets

Total assets were valued at $668.4 million at June 30, 2018, providing a sound financial base to support Puget Sound's mission. Total assets increased 4% in fiscal 2018 and 35% over the past decade (Figure 1), reflecting healthy growth in endowment and strategic investment in campus facilities that will serve the university well in the future. Liquid resources, endowment investments, and campus facilities comprised 94% of total assets and are discussed below.

- *Liquid resources:* Cash, cash equivalents, and short-term investments totaled $56.5 million and comprised 8% of total assets, at June 30, 2018, providing ample liquidity to meet operating, capital, and debt service requirements. These liquid resources are invested in accordance with policy established by the finance and facilities committee of the board of trustees and in a manner that preserves capital as a top priority, aligns liquidity with cash flow needs, and seeks to maximize investment return within appropriate risk constraints.

- *Endowment investments:* Accumulated over the university's long history through the generosity of donors, reinvestment of operating surpluses, and prudent investment management, the endowment grew to $369 million as of June 30, 2018, a net increase of 7% from the prior year and 51% greater than a decade ago (Figure 2). This important and substantial asset serves Puget Sound's educational mission by providing annual funding for student financial aid, faculty compensation, faculty and student research and other operating costs. Endowment policies are established by the finance and facilities committee of the board of trustees and executed by its investment subcommittee in collaboration with Perella Weinberg Partners, Puget Sound's outsourced chief investment officer and co-fiduciary. Individual endowments are pooled for investment purposes to achieve broad diversification and economies of scale. As shown in Figure 3, the endowment has become increasingly more diversified as it has grown in value.

- *Campus facilities:* Puget Sound's 97-acre campus offers green spaces, stands of fir trees, Tudor Gothic architecture, ivy-covered brick, and 1.5 million square feet of built space designed to support an integrated and inspiring living and learning environment. It is among the top factors students identify as attracting them to Puget Sound. Funded by a combination of generous gifts, strategic use of debt, and unrestricted funds, the university invested $124.5 million in academic, residential and athletics facilities over the last ten years (Figure 4) as it continued progress to implement its campus master plan, responsibly maintain its facilities and respond to programmatic changes. The book value of campus facilities, net of depreciation, was $200.4 million as of June 30, 2018. The university's average age of plant (accumulated depreciation divided by annual depreciation expense), a measure rating agencies use to gauge deferred maintenance and operating efficiency of campus facilities, is 12.1 years as compared to the 2017 median of 16.9 years for Puget Sound's national peer comparison group and 15.7 years for Moody's small A-rated private colleges.

Liabilities

Puget Sound's liabilities totaled $117.6 million at June 30, 2018, a reduction of $3.4 million or 3% from the prior year. The university's largest liability is its long-term debt of $72.3 million. Long-term debt consists primarily of tax-exempt bonds issued to finance strategic projects in alignment with the campus master plan, and is discussed below and in Note 6 to the financial statements.

FIGURE 2 **Sources of Endowment Growth**

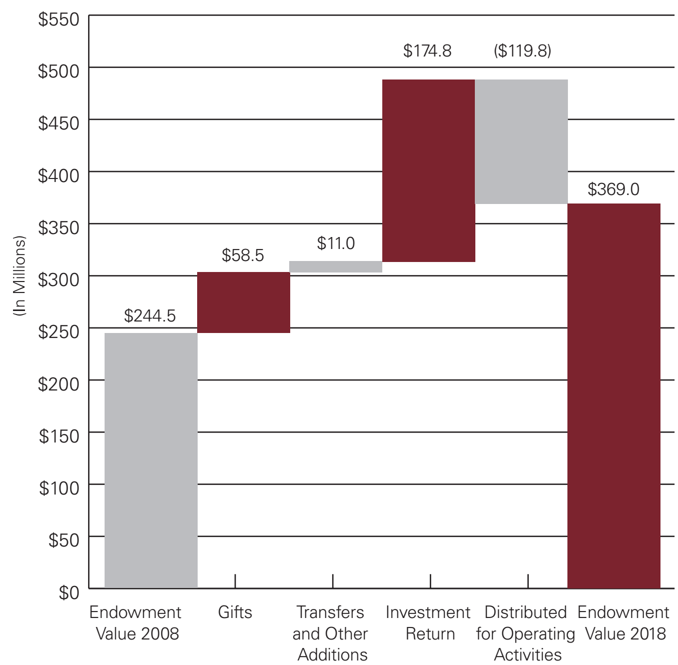


FIGURE 1 **Asset Growth Over Time**

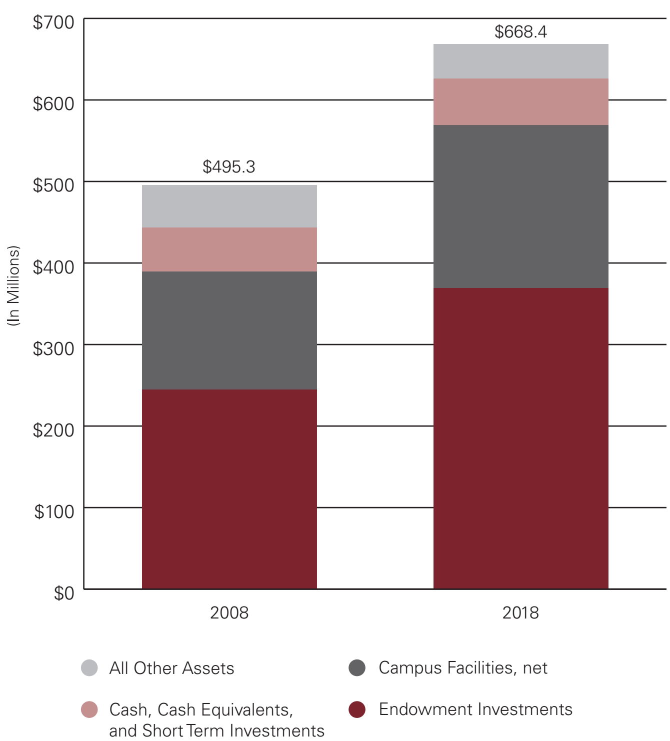
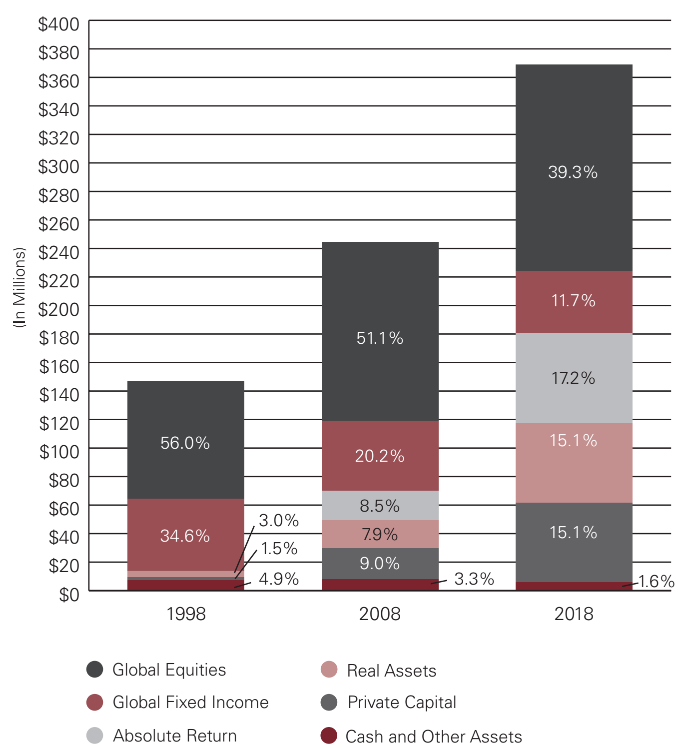


FIGURE 3 **Endowment Value and Diversification**



- At a time when rating agencies assigned a negative outlook to the U.S. higher education sector, Moody's Investors Service and Standard & Poor's Global Ratings affirmed the university long-term ratings of A1 and A+, respectively, with stable outlooks, on its publicly traded tax-exempt bonds. These strong ratings help the university access affordable cost of capital and avoid overly restrictive debt covenants.

- The university has been prudent in its use of debt, which is guided by the board of trustees' debt policy. Puget Sound's 2018 debt service as a percentage of operating expenses was 3.9%, as compared to the 2017 median of 5.4% for its national peer comparison group and 4.8% for Moody's small A-rated private colleges. Puget Sound's 2018 expendable cash and investments-to-total debt ratio was 4:1, as compared to its 2017 national peer comparison group median of 2.2:1 and Moody's small A-rated private colleges of 2.4:1 (Figure 5).

- Just over half of the tax-exempt debt portfolio was issued as traditional fixed-rate debt, with the balance synthetically fixed using interest rate swap agreements. The university's swap counterparties, The Bank of New York Mellon and Societe Generale, are rated Aa2/AA- and A1/A, respectively. Interest rates have risen, but are still lower than when the university entered the swap agreements. This results in unrealized mark-to-market valuations shown as a liability in the Statements of Financial Position in the amount of $7.5 million, down from $10.1 million in the prior year and down from $16.1 million as of June 30, 2012. One of the university's three swap agreements became "orphaned" when a portion of variable-rate debt was converted to traditional fixed-rate debt as part of a restructuring in 2012. The orphaned swap had an exit price estimated at $1.8 million as of June 30, 2018. An ad hoc bond committee of the board of trustees is actively assessing options for managing the orphaned swap, which could result in its full or partial termination.

Net Assets

Total Net Assets increased $32.1 million or 6% to $550.8 million at June 30, 2018, of which 52% was unrestricted and designated for various purposes, 22% was temporarily restricted and 26% was permanently restricted.

CONSOLIDATED STATEMENTS OF ACTIVITIES

Operating Revenues

Operating revenues and gains totaled $125.7 million, a decrease of 0.4% over the prior year. Figure 6 provides an overview of funding sources that support operations, which is comparable to the prior year.

- *Net tuition, fees, room and board:* 77% of 2018 operating revenues were derived from net tuition and fees, room and board, which is comparable to the range of 77% to 79% in the past five years.
  - Tuition and fees, net of financial aid, totaled $75.2 million, a decline of $2.6 million or 3.4% from the prior year. Contributing factors were a rise in discount rate

FIGURE 4 **Funding Sources of Campus Facilities Additions**

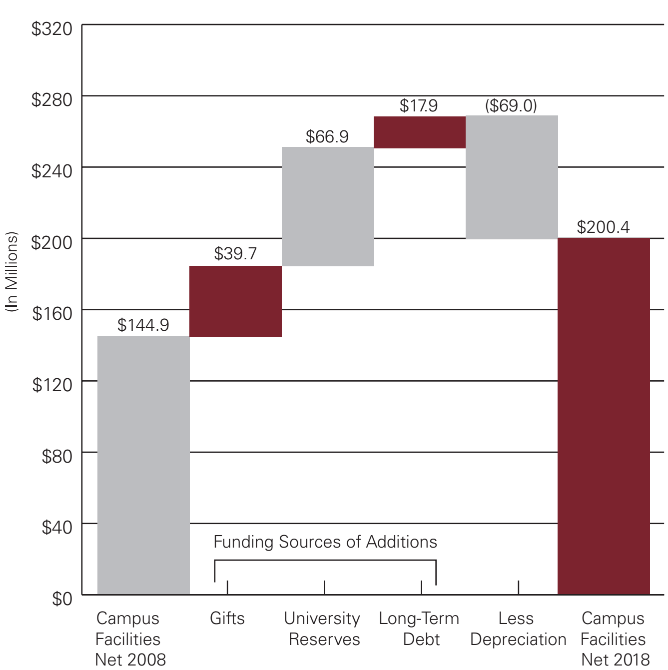
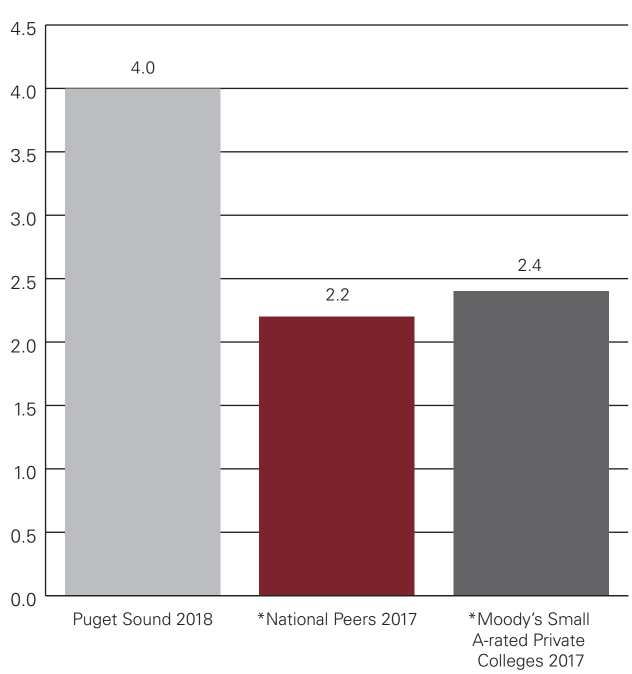


FIGURE 5 **Spendable Cash and Investments-to-Total Debt**



*2017 is most current comparative data available and 93 fewer full-time-equivalent students, reflective of the competitive environment in which Puget Sound operates. Despite this variance, the university ended the year with an operating surplus.

- Student room and board revenues declined 1% due to lower enrollment discussed above. Collectively, 68% of undergraduate students lived on campus in 2018, with the remainder typically living within a few blocks of campus, many of whom voluntarily purchased a meal plan.

• *Endowment and gift support for operations:* Operating support from endowment distributions and donor contributions has a significant and positive impact on financial accessibility for students and the quality and financial health of the university. Revenues from these sources accounted for 16.3% of total operating revenues in 2018 and served to subsidize the cost of education for all students and provide funding for student financial aid awards (Figure 7).

- Endowment distributions of $14.5 million provided 11% of operating revenues in 2018, up modestly from a decade ago. The endowment distribution was based on a board-approved spending formula that applied a 5% spending rate to a 36-month average endowment market value in a look-back period of July 2013 to June 2016, which resulted in an effective spending rate (distribution divided by beginning of the year market value) of 4.2% for 2018. Puget Sound's ten-year average effective spending rate is 4.5%.

- Contributions of $5.9 million were up $1.2 million, or 27%, over the prior year and accounted for 5% of operating revenues.

Interest Income: Rising interest rates contributed to a 59.1% increase in interest income from cash, cash equivalents and short-term investments, which totaled $1.2 million in 2018.

Operating Expenses
Operating expenses totaled $121.6 million in 2018, of which $99.4 million, or 82%, are expenses of educational and general activities and $22.2 million, or 18%, are expenses of auxiliary operations. Figure 8 shows Puget Sound's allocation of educational and general expenses by major functional category in comparison to the most recently available data for its national peer comparison group. Puget Sound's allocations are within two to three percentage points of the allocations of its national peer comparison group.

Operating expenses increased 2.8% over the prior year, with educational and general expenses up 3.2% and auxiliary expenses up 1.2%. A high quality liberal arts education is a labor-intensive undertaking and, as such, compensation is the university's single largest expenditure. Within educational and general expenses, instruction and academic support increased a combined 4.7% due largely to compensation increases, while student services expenses increased just

FIGURE 6 **Operating Revenues**

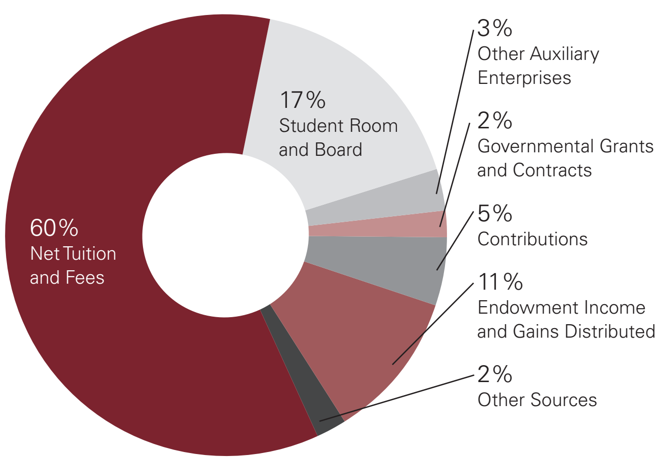
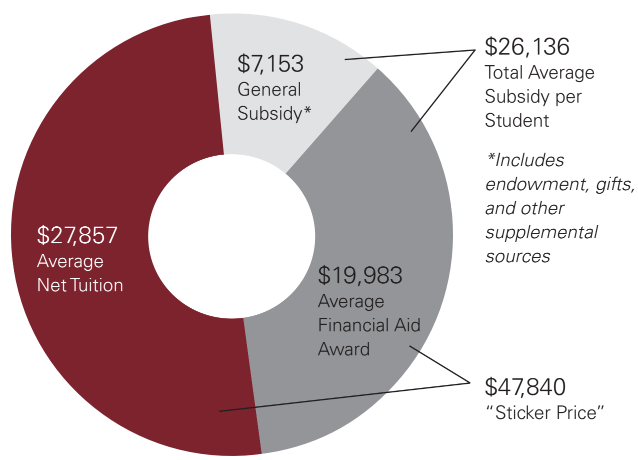


FIGURE 7 **Keeping Undergraduate Tuition Affordable**



1.1% and institutional support expenses were essentially flat in comparison to the prior year.

Increase in Net Assets from Operating Activities

Operating revenues and gains exceeded expenses by $4.2 million, resulting in an operating margin of 3.3%, as compared to Puget Sound's five-year average of 4.5%.

Nonoperating Activities

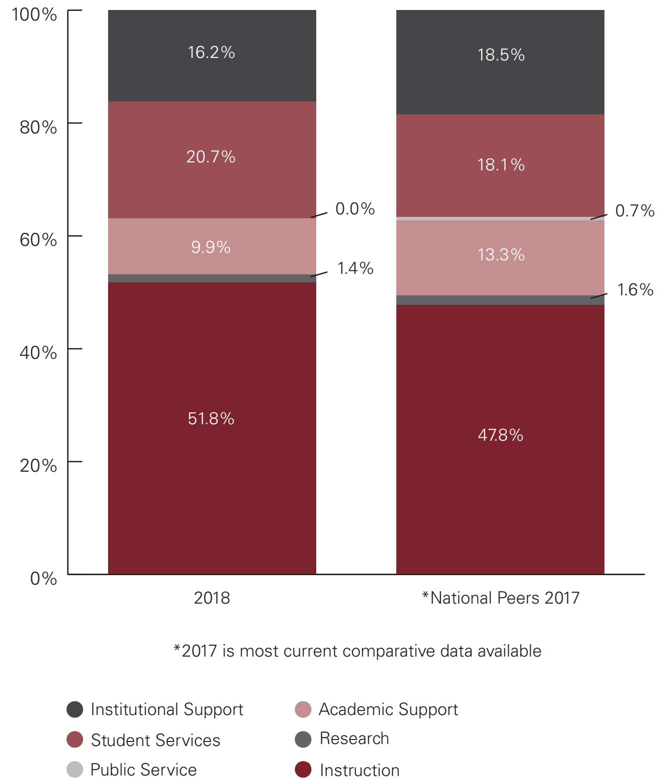
Nonoperating activities totaled $27.9 million in 2018. Key components included:

- $18.5 million from endowment returns in excess of the $14.5 million distributed for current year operations. The pooled endowment net investment return was 9.58% in 2018 vs. a benchmark of 7.88%.
- $5.2 million in donor contributions restricted to facilities and endowment.
- $2.5 million in unrealized gain on interest rate swap agreements.

Closing Remarks

Puget Sound has a long history of fiscal responsibility and balanced operating budgets. It has a track record of developing and implementing strategic plans that continuously strengthen the educational experience offered to its students and the financial foundation required for its success. The university is poised to advance this essential work through implementation of Puget Sound's 2018-2028 strategic plan, "Leadership for a Changing World."

FIGURE 8 **Educational and General Expenses**



MOSSADAMS

Report of Independent Auditors

The Board of Trustees
University of Puget Sound

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the University of Puget Sound and subsidiaries (the University), which comprise the consolidated statement of financial position as of June 30, 2018, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the 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.

Auditor's 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 audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the University as of June 30, 2018, and the consolidated changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information
Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Mission Statement, Report of the President, and Report of the Executive Vice President and Chief Financial Officer listed in the table of contents have not been subjected to the auditing procedures applied in the audit of the consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Report on Summarized Comparative Information
We have previously audited the University's 2017 consolidated financial statements, and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated November 20, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2017 is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

Supplementary Information
Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidated supplemental schedule of changes in endowment investments, is presented for purposes of additional analysis and is not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Moss Adams LLP

Yakima, Washington
November 9, 2018

UNIVERSITY OF PUGET SOUND Consolidated Statements of Financial Position

As of June 30, 2018 (With Comparative Financial Information as of June 30, 2017) (Dollars in Thousands)

	2018	2017
ASSETS:		
Cash and cash equivalents (Note 1)	$ 27,563	$ 19,114
Short-term investments	28,892	32,018
Receivables, net	1,882	2,121
Contributions receivable, net (Notes 1 and 2)	3,421	2,620
Inventories (Note 1)	535	576
Prepaid expenses and other assets	4,194	4,200
Student loans receivable, net (Note 1)	12,950	12,819
Beneficial interest in outside trusts (Notes 1 and 3)	1,199	1,607
Assets held under split-interest agreements (Notes 1 and 3)	5,711	5,275
Endowment investments (Notes 3 and 4)	369,038	344,560
Intangibles, net (Notes 1 and 5)	9,086	9,391
Assets restricted for investment in campus facilities	3,504	2,915
Campus facilities, net (Notes 1 and 5)	200,380	202,409
Total assets	$ 668,355	$ 639,625
LIABILITIES AND NET ASSETS:		
Liabilities:		
Accounts payable	$ 2,793	$ 3,063
Accrued payroll and other liabilities (Note 8)	16,733	15,886
Advance deposits from students (Note 1)	2,222	2,328
Liabilities under split-interest agreements (Note 1)	2,937	2,749
Government advances for student loans (Note 1)	11,393	11,672
Asset retirement obligation (Notes 1 and 5)	1,679	1,615
Interest rate swap agreements (Notes 3 and 6)	7,515	10,066
Long-term debt, net (Note 6)	72,315	73,595
Total liabilities	$ 117,587	$ 120,974
Net Assets:		
Unrestricted:		
Available for operations	$ 3,037	$ 3,006
Invested in or designated for campus facilities	131,820	132,737
Endowment (Note 4)	123,207	115,604
Designated for other specific purposes	29,386	22,301
Total unrestricted	287,450	273,648
Temporarily restricted (Note 7)	121,582	108,754
Permanently restricted (Note 7)	141,736	136,249
Total net assets	550,768	518,651
Total liabilities and net assets	$ 668,355	$ 639,625

The accompanying notes are an integral part of the consolidated financial statements

UNIVERSITY OF PUGET SOUND Consolidated Statements of Activities

For the Year Ended June 30, 2018 (With Summarized Financial Information for the Year Ended June 30, 2017) (Dollars in Thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals 2018	Totals 2017
Operating:					
Revenues and gains:					
Student tuition and fees	$ 123,314			$ 123,314	$ 123,599
Less student financial aid	(48,139)			(48,139)	(45,788)
Net tuition and fees	75,175			75,175	77,811
Student room and board	21,172			21,172	21,385
Other auxiliary enterprises	4,164			4,164	4,081
Governmental grants and contracts	283	$ 1,987		2,270	2,201
Contributions	3,341	2,552		5,893	4,649
Endowment income and gains distributed (Note 4)	4,706	9,835		14,541	14,052
Interest income	648	512		1,160	729
Other sources	1,358	10		1,368	1,317
Total operating revenues and gains	110,847	14,896		125,743	126,225
Expenses:					
Educational and general:					
Instruction	52,789			52,789	50,387
Academic support	9,867			9,867	9,433
Student services	20,586			20,586	20,359
Institutional support	16,141			16,141	16,129
Total educational and general expenses	99,383			99,383	96,308
Auxiliary enterprises	22,184			22,184	21,919
Total operating expenses	121,567			121,567	118,227
Net assets released from restrictions	13,854	(13,854)		-	-
Increase in net assets from operating activities	3,134	1,042		4,176	7,998
Nonoperating:					
Contributions	-	1,996	$ 3,193	5,189	4,536
Change in allowance for uncollectible promises (Note 2)	-	15	8	23	199
Net gains and income on endowment investments, net of distributions (Note 4)	5,682	12,183	627	18,492	27,073
Other adjustments and changes	4,297	(1,719)	1,659	4,237	4,404
Net assets released from restrictions	689	(689)	-	-	-
Increase in net assets from nonoperating activities	10,668	11,786	5,487	27,941	36,212
Increase in net assets	13,802	12,828	5,487	32,117	44,210
Net assets at beginning of the year	273,648	108,754	136,249	518,651	474,441
Net assets at end of the year	$ 287,450	$ 121,582	$ 141,736	$ 550,768	$ 518,651

The accompanying notes are an integral part of the consolidated financial statements

UNIVERSITY OF PUGET SOUND Consolidated Statements of Cash Flows

For the Year Ended June 30, 2018 (With Comparative Financial Information for the Year Ended June 30, 2017) (Dollars in Thousands)

	2018	2017
Cash flows from operating activities:		
Change in net assets	$ 32,117	$ 44,210
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	10,790	10,437
Contributions restricted for long-term investment	(4,381)	(8,388)
Gifts of investments, property, and outside trusts	(28)	(11)
(Gains) losses on endowment investments and split-interest agreements	(31,478)	(40,993)
Actuarial adjustments of liabilities under split-interest agreements	168	(166)
Loss on disposal of intangible	226	-
Amortization of tax-exempt bond premium, discount, and issuance costs	(145)	(145)
Accretion, settlement, and adjustments to asset retirement obligations	64	(280)
Unrealized (gain) loss on interest rate swap agreements	(2,552)	(4,102)
Changes in:		
Receivables, net	239	(580)
Contributions receivable, net	(801)	4,231
Inventories, prepaid expenses, and other assets	47	(264)
Accounts payable	72	580
Accrued payroll and other liabilities	579	(732)
Advance deposits from students	(106)	61
Net cash provided by operating activities	4,811	3,858
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	61,754	95,425
Purchases of investments	(54,643)	(88,671)
Net (purchases) sales of short-term investments	3,160	(13,975)
Receipt (purchases) of assets restricted for investment in campus facilities	(589)	(1,503)
Purchases of campus facilities and intangibles	(8,733)	(9,168)
Disbursements of loans to students	(2,315)	(1,600)
Repayments of Perkins loans from students	1,958	2,087
Net cash provided (used) for investing activities	592	(17,405)
Cash flows from financing activities:		
Contributions restricted for long-term investment	4,381	8,388
Investment income subject to split-interest agreements	216	271
New liabilities under split-interest agreements	44	46
Payments to split-interest agreement beneficiaries	(378)	(346)
Repayments of long-term debt	(1,165)	(1,085)
Changes in government advances for student loans	(52)	79
Net cash provided by financing activities	3,046	7,353
Net increase (decrease) in cash and cash equivalents	8,449	(6,194)
Cash and cash equivalents at beginning of the year	19,114	25,308
Cash and cash equivalents at end of the year	$ 27,563	$ 19,114
Supplemental cash flow information:		
Interest paid (net of capitalized interest of $12 and $21 in 2018 and 2017, respectively)	$ 3,698	$ 3,871
Noncash investing and financing activities:		
Purchases of equipment and building construction on account	$ 1,201	$ 1,543
Student loan cancellations	$ 227	$ 252

The accompanying notes are an integral part of the consolidated financial statements

UNIVERSITY OF PUGET SOUND Consolidated Supplemental Schedule of Changes in Endowment Investments

For the Year Ended June 30, 2018 (With Comparative Financial Information for the Year Ended June 30, 2017) (Dollars in Thousands)

	2018	2017
Endowment investments, beginning of the year	$ 344,560	$ 310,361
Contributions	2,899	4,796
Transfers and other additions	3,087	2,330
Return on endowment investments	33,033	41,125
Amount distributed for operating activities	(14,541)	(14,052)
Net change in endowment investments	24,478	34,199
Endowment investments, end of the year	$ 369,038	$ 344,560
Total return on pooled endowment	9.58%	13.71%

See accompanying Report of Independent Auditors

NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The University of Puget Sound (the university, Puget Sound), established in 1888, is a nonprofit corporation organized under the laws of the state of Washington. The university is an independent predominantly residential undergraduate liberal arts college with selected graduate programs building effectively on a liberal arts foundation. The university, as a community of learning, maintains a strong commitment to teaching excellence, scholarly engagement, and fruitful student-faculty interaction.

The mission of the university is to develop in its students capacities for critical analysis, aesthetic appreciation, sound judgment, and apt expression that will sustain a lifetime of intellectual curiosity, active inquiry, and reasoned independence. A Puget Sound education, both academic and co-curricular, encourages a rich knowledge of self and others; an appreciation of commonality and difference; the full, open, and civil discussion of ideas; thoughtful moral discourse; and the integration of learning, preparing the university's graduates to meet the highest tests of democratic citizenship. Such an education seeks to liberate each person's fullest intellectual and human potential to assist in the unfolding of creative and useful lives.

Basis of Accounting and Presentation

The accompanying financial statements are the consolidated statements of the university and its wholly owned subsidiaries CVI GVF Holdings 13 Ltd. and Rainier Heights Holdings, LLC. All material transactions between the university and its consolidated subsidiaries have been eliminated.

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP). While the underlying accounts of the university are maintained in accordance with the principles of fund accounting to facilitate observance of specific restrictions placed on the resources available to the university, the consolidated financial statements focus on the university as a whole.

The university's activities and net assets are classified in the consolidated financial statements as unrestricted, temporarily restricted, or permanently restricted based on the existence or absence of donor-imposed restrictions. These classifications are described below:

Unrestricted net assets - resources not subject to donor-imposed restrictions.

Temporarily restricted net assets - resources that can be expended subject to donor-imposed restrictions as to use or passage of time.

Permanently restricted net assets - resources that a donor requires the university to retain in perpetuity. Generally, the donor permits the university to use all or a part of the income and appreciation earned on the contributed assets.

The Consolidated Statements of Activities presents expenses by functional classification in accordance with the overall educational mission of the university. Depreciation and amortization expense is allocated directly to functional classifications based on the nature of the underlying assets. Interest expense on long-term debt is allocated to the functional areas that have benefited from the proceeds. The cost of operating and maintaining campus facilities is allocated to the functional areas based on occupancy square footage. The cost of supporting information technology systems is allocated to the functional areas based on estimated utilization of system resources and support.

The university has defined nonoperating activities to include contributions added to endowment, contributions supporting major capital purchases, contributions and other activity related to split-interest agreements, and changes in the allowance for uncollectible promises. Also included are retirement plan actuarial adjustments, interest rate swap agreement changes in fair value, endowment income, gains, or losses, net of amounts distributed to support operations in accordance with the applicable spending policies. Certain other gains and losses that do not occur in the normal course of operations are also included in nonoperating activity.

The Consolidated Statements of Activities includes comparative summarized information for the year ended June 30, 2017. Such information does not include sufficient detail by net asset class to constitute a presentation in conformity with U.S. GAAP. Accordingly such information should be read in conjunction with the university's consolidated financial statements for the year ended June 30, 2017, from which the summarized information was derived. In addition, the notes to the consolidated financial statements exclude comparative information for certain disclosures. Certain reclassifcations of prior year amounts have been made to confirm to the 2018 classifications. Such reclassifications had no effect on previously reported net assets, change in net assets or net cash flows.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments with maturities of three months or less when purchased, except for those held for long-term investment. Cash equivalents totaled $11,633 and $14,787, respectively, at June 30, 2018 and 2017. The university's cash balances exceed federally insured limits at times. The university has not experienced any significant losses on its cash investments.

Contributions Receivable

Unconditional promises (contributions receivable) are recognized at the estimated present value of expected future cash flows, discounted using a risk adjusted rate. An allowance for uncollectible promises is provided based on management's judgment including but not limited to factors such as prior giving history, type of contribution, collection risk, and nature of fundraising activity. Conditional promises are recorded when donor stipulations are substantially met. Contributions received, including unconditional promises to give, are recognized as revenues in the period received.

NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, *CONTINUED*

Inventories
Inventories are carried at cost using average cost, first-in first-out, and retail valuation methods. The cost of inventories is not in excess of net realizable value.

Student Loans Receivable
The university participates in the Federal Perkins revolving loan program. The availability of funds for loans under the program has historically been dependent on reimbursements to the pool from repayments on outstanding loans. The Federal Perkins loan program expired on September 30, 2017, so no new loans will be disbursed after the close of the 2018 award year. The outstanding loan balance was $12,950 and $12,819 at June 30, 2018 and 2017, respectively. Funds contributed to the program by the Federal government must ultimately be returned to the government so they are classified as liabilities under "Government advances for student loans" in the Consolidated Statements of Financial Position. Outstanding loans cancelled under the program result in a decrease in the liability to the government. The Distribution of Assets from the Perkins Loan Revolving Fund process replaces the existing Excess Liquid Capital process as part of the wind-down of the Federal Perkins Loan Program. The U.S. Department of Education has determined that asset distributions from the Perkins fund, which include the return of federal contributions to the Department, will begin after October 1, 2018.

Investments
Investments include short-term investments, endowment investments, investments included in prepaid expenses and other assets, and assets held in split-interest agreements trusteed by the university. Investments are stated at fair value (see Note 3) reported in the context of market conditions as of the valuation date. The university employs procedures to ensure appropriate oversight of its investments. Procedures include ongoing monitoring and review of valuations and assumptions provided by investment managers. Based on the results of these procedures, the university believes that the carrying amounts of these financial instruments are reasonable estimates of the fair value. Perpetual trusts and some charitable remainder trusts are managed by outside trustees and are not subject to the university's investment policies.

For real estate or hard-to-value assets held for investment directly or in trust by the university or its subsidiaries, reported fair value is based on a representative appraisal performed at intervals appropriate to establish current market values, with consideration given to the cost/benefit of the appraisal. Investment transactions are recorded on a trade-date basis and the cost of securities sold is based on their weighted average cost. Interest is accrued as earned, and dividends are recorded on the ex-dividend date.

Risk and Investment Performance
Cash, cash equivalents, and investments are exposed to various risks, which can include interest rate, market, and credit risks. To minimize these risks, the university has a diversified portfolio with a number of investment managers in a variety of asset classes. The university regularly evaluates its investments including their performance. Due to inherent risks and potential volatility in investment valuations, the amounts reported in the Consolidated Statements of Financial Position and Consolidated Statements of Activities can vary substantially from year to year.

Beneficial Interest in Outside Trusts
Funds held in trust by others represent resources neither in the possession nor under the control of the university. These trusts are administered by outside trustees, with the university deriving income and/or a residual interest from the assets. When an irrevocable trust is established and the university is notified of its existence and can establish the fair value of the assets of the trust, the university recognizes its beneficial interest in the outside trust as a contribution at fair value. The fair value is measured as the present value of the estimated expected future benefits to be received when the trust assets are distributed. The contribution revenue recognized is classified as an increase in either temporarily or permanently restricted net assets based on the time or use restrictions placed by the donor upon the university's beneficial interest in the assets. Periodic adjustments to the beneficial interest to reflect changes in the fair value, life expectancy, and discount rate are recognized as actuarial gains or losses. The discount rates used at June 30, 2018 and June 30, 2017, were 3.40% and 2.40%, respectively.

Amounts held as Trustee or Agent Under Split-Interest Agreements
The university has legal title, either in the university's name or as trustee, to charitable remainder and lead trusts. No significant financial benefit can be realized until the contractual obligations are released. The university also receives contributions for charitable gift annuity contracts. Actuarial methods are used to record these annuities and trusts using discount rates ranging from 1.20% to 9.40%. For charitable gift annuities and charitable remainder trusts, when a gift is received, the present value of future expected payments to the beneficiaries is recorded as a liability based upon life expectancy tables and current discount rate assumptions and the remainder is recorded as a contribution. For charitable lead trusts, when a gift is received, the present value of future expected payments to the university, as lead beneficiary, is recorded as a contribution and the remainder is recorded as a liability to the remainder beneficiaries. Contribution revenue recognized from charitable gift annuities and charitable remainder and lead trusts is classified as an increase in unrestricted, temporarily restricted, or permanently restricted net assets based on the existence or absence of time or use restrictions placed by the donor upon the university's interest in the assets. Annuity and trust assets are reported at fair value. Investment income and gains are credited, and beneficiary payments, direct costs of funds management, and investment losses are charged to the liability accounts, with periodic adjustments made between the liability and the net assets to record actuarial gains or losses resulting from changes in fair value and life expectancy.

The university maintains separate reserve funds adequate to meet future payments under its charitable gift annuity contracts as required by governing states' laws. The total amount held in separate reserve funds was $931 as of June 30, 2018, and $904 as of June 30, 2017.

Intangible Assets and Campus Facilities
Intangible assets, including software and software related contracts, electronic library resources, and website development costs, are recorded at cost. Purchased intangible assets with a cost of $5 (five thousand) or more and developed intangible assets with a cost of $100 (one hundred

NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, *CONTINUED*

thousand) or more are capitalized. Intangible library resources do not have a capitalization threshold. These assets have finite useful lives and are amortized on a straight-line basis over their estimated useful lives, ranging from four to 20 years.

Campus facilities, including land and improvements, buildings and improvements, equipment, and library resources, are recorded at cost or, if received as a gift, at fair value on the date of donation. Land improvements, buildings, and building improvements with a cost of $25 (twenty five thousand) or more and equipment with a cost of $5 (five thousand) or more, are capitalized. Library resources and collections do not have capitalization thresholds. The university's natural history and other collections are capitalized but not depreciated. Maintenance and repairs are charged to operations when they occur. Expenditures that significantly increase the value, performance, capacity, or service potential or extend the useful lives of campus facilities are capitalized and depreciated. Depreciation is computed on a straight-line basis over estimated useful lives of 15 to 50 years for land improvements, 25 to 75 years for buildings, 20 to 40 years for building improvements, four to ten years for equipment, and 15 years for library resources.

The costs and accumulated depreciation and amortization of assets sold or retired are removed from the accounts, and the related gains and losses are included in the Consolidated Statements of Activities. In the absence of donor-imposed restrictions on the use of assets, gifts of long-lived assets are reported as unrestricted contributions.

Asset Retirement Obligations

Asset retirement obligations include legal 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 each obligation is measured based on the present value of estimated future retirement costs. Asset retirement costs are depreciated on a straight-line basis over the useful life of the associated asset. 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. The liability is removed when the related obligation is settled.

Advance Deposits from Students

Payments from students received by the end of the current fiscal year that are for a term in the subsequent fiscal year have been deferred for inclusion in unrestricted operating revenues in that subsequent year.

Fundraising Expenses

Fundraising expenses of $3,191 and $3,378 are included in Institutional support in the Consolidated Statements of Activities for the years ended June 30, 2018 and 2017, respectively, and include direct expenses associated with fundraising activities and allocations for depreciation expense, interest on long-term debt, operation and maintenance of campus facilities, and information technology support.

Federal Income Taxes

The university has been recognized by the Internal Revenue Service as exempt from federal income taxes under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3) except to the extent of unrelated business taxable income. Donations to the university are generally tax deductible. The university's wholly-owned subsidiaries CVI GVF Holdings 13 Ltd. and Rainier Heights Holdings, LLC are subject to federal income tax as applicable. The university had no unrecognized tax benefits that would have required an adjustment to its net assets, and no unrecognized tax benefits at June 30, 2018 or 2017.

June 30, 2018 (Dollars in Thousands)

NOTE 2 – PROMISES TO GIVE

Included in "Contributions receivable" are the following unconditional promises to give:

	June 30, 2018	June 30, 2017
Endowment	$ 1,831	$ 1,480
Construction and improvement of campus facilities	1,660	1,168
Student financial aid	94	174
Other programs and activities, including unrestricted promises for future periods	201	70
	3,786	2,892
Discount to present value	(277)	(161)
Allowance for uncollectable promises	(88)	(111)
	$ 3,421	$ 2,620
Unconditional promises expected to be collected in:		
Less than one year	$ 1,221	
One to five years	2,536	
More than five years	29	
	$ 3,786	

Discount rates ranged from 1.14% to 3.23% and from 1.14% to 2.63% for June 30, 2018 and June 30, 2017, respectively.

Conditional promises to give totaled $1,617 at June 30, 2018. Conditions include meeting a fundraising goal and submissions of research grants. These promises will be recognized when conditions are substantially met.

NOTE 3 – FAIR VALUE MEASUREMENTS

Fair value measurements are determined based on the assumptions that market participants, in the context of an orderly market, would use in pricing an asset or liability. U.S. GAAP establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in an active market for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 – inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. This includes quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that are derived principally from or corroborated by observable market data.

Level 3 – inputs that are unobservable, supported by little or no market activity and that are significant to the fair value of the assets and liabilities. Unobservable inputs reflect an entity's own determination about the assumptions that market participants would use in pricing the asset or liability.

An asset or liability's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In accordance with Subtopic 820-10, certain investments that are measured at fair value using the net asset value per share (or the equivalent) practical expedient have not been classified in the fair value hierarchy leveling. The fair value amounts presented in the table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the Consolidated Statements of Financial Position.

June 30, 2018 (Dollars in Thousands)

NOTE 3 – FAIR VALUE MEASUREMENTS, *CONTINUED*

For assets and liabilities reported at fair value, the following table presents the fair value measurements used as of June 30, 2018:

	Totals	Level 1	Level 2	Level 3
Endowment investments:				
Global equity:				
US	$ 23,140	$ 23,140	$ -	$ -
International	26,454	26,454	-	-
Global equity measured at net asset value	95,309	-	-	-
Global fixed income/credit:				
Mutual funds	27,708	27,708	-	-
Balanced fund	839	839	-	-
Global fixed income/credit measured at net asset value	14,640	-	-	-
Absolute return hedge funds:				
Absolute return hedge funds measured at net asset value	63,606	-	-	-
Real assets:				
Real assets measured at net asset value	55,834	-	-	-
Private capital:				
Private capital measured at net asset value	55,740	-	-	-
Cash and other assets:				
Cash and short-term investments	3,194	3,194	-	-
Perpetual trusts	2,188	-	-	2,188
Restricted cash measured at net asset value	386	-	-	-
Total endowment investments	369,038	81,335	-	2,188
Other investments:				
Marketable securities	6,825	6,825	-	-
Municipal/government agency obligations	25,571	-	25,571	-
Real estate	2,674	-	-	2,674
Beneficial interest in outside trusts	1,199	-	-	1,199
Assets held under split interest agreements	5,711	4,240	1,471	-
Total assets	$ 411,018	$ 92,400	$ 27,042	$ 6,061
Liabilities:				
Interest rate swap agreements	$ 7,515	$ -	$ 7,515	$ -
Total liabilities	$ 7,515	$ -	$ 7,515	$ -

	Fair Value	Redemption Restrictions	Redemption Notice	Unfunded Commitments
Investments measured at net asset value:				
Global equity:				
Commingled global equity	$ 81,482	25% quarterly or 100% annually	90 days	$ -
Commingled global equity	13,066	Illiquid		-
Commingled global equity impact	761	25% quarterly or 100% annually		-
	$ 95,309			$ -
Global fixed income/credit:				
Commingled global fixed income	$ 12,617	25% quarterly or 100% annually	90 days	$ -
Commingled global fixed income	2,023	Illiquid		-
	$ 14,640			$ -
Absolute return hedge funds:				
Absolute return hedge funds in liquidation	$ 81	In Liquidation		$ -
Commingled absolute return hedge funds	54,746	25% quarterly or 100% annually	90 days	-
Commingled absolute return hedge funds	8,779	Illiquid		-
	$ 63,606			$ -
Real assets:				
Private energy	$ 39,964	Illiquid		$ 1,818
Timber	3,562	Illiquid		10
Real estate	10,192	Illiquid		1,366
Sustainable real assets	-			2,500
Commingled real assets	159	25% quarterly or 100% annually		-
Commingled real assets	1,957	Illiquid		-
	$ 55,834			$ 5,694
Private capital:				
Private capital	$ 31,780	Illiquid		$ 6,659
Commingled private capital	23,960	Illiquid		-
	$ 55,740			$ 6,659
Cash:				
Restricted cash redemptive	$ 333	25% quarterly or 100% annually	90 days	$ -
Restricted cash non-redemptive	53	Illiquid		-
	$ 386			$ -

June 30, 2018 (Dollars in Thousands)

NOTE 3 – FAIR VALUE MEASUREMENTS, *CONTINUED*

For assets and liabilities reported at fair value, the following table presents the fair value measurements used as of June 30, 2017:

	Totals	Level 1	Level 2	Level 3
Endowment investments:				
Global equity:				
US	$ 27,409	$ 27,409	$ -	$ -
International	35,350	35,350	-	-
Global equity measured at net asset value	80,374	-	-	-
Global fixed income/credit:				
Mutual funds	30,521	30,521	-	-
Balanced fund	836	836	-	-
Global fixed income/credit measured at net asset value	6,385	-	-	-
Absolute return hedge funds:				
Absolute return hedge funds measured at net asset value	53,576	-	-	-
Real assets:				
Real assets measured at net asset value	52,768	-	-	-
Private capital:				
Private capital measured at net asset value	48,661	-	-	-
Cash and other assets:				
Cash and short-term investments	6,354	6,354	-	-
Perpetual trusts	2,162	-	-	2,162
Restricted cash measured at net asset value	164	-	-	-
Total endowment investments	344,560	100,470	-	2,162
Other investments:				
Marketable securities	6,795	6,795	-	-
Municipal/government agency obligations	28,139	-	28,139	-
Real estate	2,289	-	-	2,289
Beneficial interest in outside trusts	1,607	-	-	1,607
Assets held under split interest agreements	5,275	3,633	1,642	-
Total assets	$ 388,665	$ 110,898	$ 29,781	$ 6,058
Liabilities:				
Interest rate swap agreements	$ 10,066	$ -	$ 10,066	$ -
Total liabilities	$ 10,066	$ -	$ 10,066	$ -

	Fair Value	Redemption Restrictions	Redemption Notice	Unfunded Commitments
Investments measured at net asset value:				
Global equity:				
Commingled global equity	$ 63,851	25% quarterly or 100% annually	90 days	$ -
Commingled global equity	15,728	Illiquid		-
Commingled global equity impact	795	25% quarterly or 100% annually		-
	$ 80,374			$ -
Global fixed income/credit:				
Commingled global fixed income	$ 5,123	25% quarterly or 100% annually	90 days	$ -
Commingled global fixed income	1,262	Illiquid		-
	$ 6,385			$ -
Absolute return hedge funds:				
Absolute return hedge funds in liquidation	$ 141	In Liquidation		$ -
Commingled absolute return hedge funds	42,874	25% quarterly or 100% annually	90 days	-
Commingled absolute return hedge funds	10,561	Illiquid		-
	$ 53,576			$ -
Real assets:				
Private energy	$ 36,248	Illiquid		$ 3,256
Timber	7,001	Illiquid		10
Real estate	8,829			1,367
Commingled private real assets	690	Illiquid		-
	$ 52,768			$ 4,633
Private capital:				
Private capital	$ 29,486	Illiquid		$ 10,152
Commingled private capital	19,175	Illiquid		-
	$ 48,661			$ 10,152
Cash:				
Restricted cash redemptive	$ 132	25% quarterly or 100% annually	90 days	$ -
Restricted cash non-redemptive	32	Illiquid		-
	$ 164			$ -

June 30, 2018 (Dollars in Thousands)

NOTE 3 – FAIR VALUE MEASUREMENTS, *CONTINUED*

Although the university uses its best judgment in determining the fair value of assets and liabilities, there are inherent limitations in any methodology. Therefore, the values presented herein are not necessarily indicative of the amount the university could realize in a current transaction. Future confirming events could affect the estimates of fair value and could be material to the consolidated financial statements. These events could also affect the amount realized upon liquidation of the investments. Carrying amounts for cash and cash equivalents approximate fair value because of the short maturity of these instruments.

Redemption terms and restrictions and unfunded commitments are presented for investments when manager-reported net asset value (NAV) is used as a practical expedient to estimate fair value. Valuations of underlying assets which comprise the NAV are provided by fund managers and consider observable market-based inputs, observable market data, valuation models, comparable sales, recent known financing transactions, and income streams discounted for risk levels, among other valuation methodologies.

Global equities include marketable US and international securities held in exchange traded funds and commingled multi-manager pools. The investments consist of primarily equity-oriented securities from developed and emerging markets globally. The exchange traded funds are passive strategies designed to closely track specified equity benchmarks. The commingled pools include exposure to passive strategies to closely track specified equity benchmarks and active strategies that attempt to deliver above-market performance. Directional hedged equities generally utilize both long and short positions in corporate securities and derivatives to provide favorable risk-adjusted returns.

Global fixed income investments provide diversification to reduce the overall volatility and generate predictable cash flows that can be used in support of annual spending requirements. Fixed income is diversified across various sub-classes by investment style and strategy.

Absolute return hedge funds utilize strategies designed to generate long-term capital appreciation with low volatility and little correlation with equity and bond markets. Some absolute return funds may invest a small portion of assets in private capital funds or other illiquid vehicles.

Real assets include private investments in real estate, timber, oil, natural gas, and agriculture. The primary purpose of these investments is to provide a potential hedge against inflationary pressures and to achieve overall portfolio diversification. Real asset investments may have low correlations to the traditional equity and fixed income markets and offer attractive long-term risk-adjusted returns.

Private capital funds are not generally available for liquidation by the university and depend on fund managers' decisions about exit timing to provide distributions. In addition, the university has minimal ability to influence the operating decisions affecting these investments. The fair values of private capital funds have been estimated using the most current information available and as applicable, adjusting for cash flows since the valuation date.

Unfunded commitments may be called at any time during the fund investment periods, which currently range from one to 12 years.

The following table presents changes for assets measured at fair value using significant unobservable inputs (Level 3):

	June 30, 2018	June 30, 2017
Balance, beginning of the year	$ 6,058	$ 7,468
Total realized and unrealized gains (losses)	532	(1,267)
Purchases	-	334
Issues	-	-
Sales	(183)	(477)
Net transfers	(346)	-
Balance, end of the year	$ 6,061	$ 6,058
Unrealized gains (losses) related to Level 3 assets held at the end of the year included in "Net gains (losses) and income on endowment investments, net of distributions" in the Consolidated Statements of Activities	$ 532	$ 448

NOTE 4 – ENDOWMENT INVESTMENTS AND NET ASSETS

At June 30, 2018, the university's endowment consisted of approximately 625 individual funds established for a variety of purposes. The endowment includes both donor-restricted endowments and funds designated by the board of trustees to function as endowments (quasi-endowments). Quasi-endowment funds may be expended at the discretion of the university's board of trustees. As required by U.S. GAAP, net assets associated with endowment funds, including quasi-endowment funds, are classified and reported based on the existence or absence of donor-imposed restrictions.

Endowment Investment and Spending Policies

To enable broad diversification and economies of scale, the university's policy is to pool endowment assets for investment purposes to the fullest extent possible as permitted by gift agreements and applicable government regulations. On January 1, 2017, the university implemented its Board of Trustees' Statement on Divestment, a portion of which creates a new fossil fuel free portfolio within the pooled endowment. This option provides donors a way to make gifts to a pool that avoids investment in companies deemed to contribute to climate change. In the rare cases when a donor has prohibited a gift from being pooled for investment purposes, such endowments (referred to as non-pooled endowments) are separately invested and managed.

June 30, 2018 (Dollars in Thousands)

NOTE 4 – ENDOWMENT INVESTMENTS AND NET ASSETS, *CONTINUED*

The university's pooled endowment provides ongoing financial support for operations that will remain stable (or grow) in real or inflation-adjusted terms, as adjusted for new additions to the pooled endowment. The primary investment objective of the pooled endowment is to provide a sustainable maximum level of return consistent with prudent risk levels. The specific investment objectives of the general and fossil fuel free pooled endowments are to attain annual total real return of at least 5% and 3.5%, respectively, over the long-term. Policy dictates that adherence to a sound long-term investment program, which balances short-term spending needs with the preservation of the real (inflation-adjusted) value of assets, is crucial to the endowment's long-term success. Investments are diversified across a wide range of asset classes, including those providing return premiums for illiquidity, so as to provide a balance that will enhance total return under a range of economic scenarios, while avoiding undue risk concentrations in any single asset class or investment category. Sufficient liquidity in the endowment portfolio to meet the spending policy and operational needs, preserve the university's desired credit ratings, and maintain compliance with any debt agreements is also considered when making investment decisions regarding asset allocation.

In accordance with the Washington State Uniform Prudent Management of Institutional Funds Act (UPMIFA), the university considers the following factors, among others, in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the university and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation or deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the university; and (7) the investment policies of the university.

Pooled endowment spending is determined using the total return concept. The board of trustees approved a spending rate for the general pooled endowment based on 5% of a trailing 36-month average market value and for the fossil fuel free portfolio based on 3.5% of the inception to date average market value for the years ended June 30, 2018 and 2017. For a few donor-restricted endowment funds, the university honors and adheres to donor-stipulated spending limitations.

At June 30, 2018, nearly 99% of the university's endowment investments were pooled.

Funds with Deficiencies

As of June 30, 2018 and 2017, there were $4 and $0, respectively, in endowment funds with values less than the total original and all subsequent contributions. Deficiencies of this nature are reported in unrestricted net assets.

Interpretation of Relevant Law

Consistent with its understanding of donor intent, the board of trustees of the university has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. The university classifies as permanently restricted net assets: (a) the original value of gifts to donor-restricted endowments and (b) any other amounts added to donor-restricted endowments that donors have stipulated are not expendable. The remaining portion of the donor-restricted endowment fund that is not classified as 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. Temporarily restricted board-designated quasi-endowment funds were established with expendable restricted bequests and gifts.

Net asset balances and changes to the net asset balances for the year ended June 30, 2018 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, June 30, 2017	$ 115,604	$ 96,617	$ 133,663	$ 345,884
Contributions, net	-	73	3,137	3,210
Transfers and other additions (deductions)	1,297	(2)	1,792	3,087
Net assets released from restrictions	624	(624)	-	-
Return on investments:				
Investment income (loss)	571	1,181	(21)	1,731
Net appreciation (depreciation) of investments	9,817	20,837	648	31,302
Total return on investments	10,388	22,018	627	33,033
Amount distributed for operating activities	(4,706)	(9,835)	-	(14,541)
Endowment net assets, June 30, 2018	$ 123,207	$ 108,247	$ 139,219	$ 370,673
Endowment net assets consisted of the following at June 30, 2018:				
Donor-restricted endowments	$ (4)	$ 106,653	$ 137,602	$ 244,251
Board-designated quasi-endowments	123,211	1,576	-	124,787
	123,207	108,229	137,602	369,038
Unconditional promises to endowment	-	18	1,617	1,635
Total endowment net assets	$ 123,207	$ 108,247	$ 139,219	$ 370,673

June 30, 2018 (Dollars in Thousands)

NOTE 4 – ENDOWMENT INVESTMENTS AND NET ASSETS, *CONTINUED*

Net asset balances and changes to the net asset balances for the year ended June 30, 2017 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, June 30, 2016	$ 103,430	$ 78,437	$ 131,786	$ 313,653
Contributions, net	-	219	2,609	2,828
Transfers and other additions (deductions)	2,259	(2)	73	2,330
Net assets released from restrictions	963	(963)	-	-
Return on investments:				
Investment income (loss)	673	1,448	(1,731)	390
Net appreciation (depreciation) of investments	12,691	27,118	926	40,735
Total return on investments	13,364	28,566	(805)	41,125
Amount distributed for operating activities	(4,412)	(9,640)	-	(14,052)
Endowment net assets, June 30, 2017	$ 115,604	$ 96,617	$ 133,663	$ 345,884
Endowment net assets consisted of the following at June 30, 2017:				
Donor-restricted endowments	$ -	$ 95,015	$ 132,392	$ 227,407
Board-designated quasi-endowments	115,604	1,549	-	117,153
	115,604	96,564	132,392	344,560
Unconditional promises to endowment	-	53	1,271	1,324
Total endowment net assets	$ 115,604	$ 96,617	$ 133,663	$ 345,884

NOTE 5 – INTANGIBLE ASSETS AND CAMPUS FACILITIES

Intangible Assets

Intangible assets include software and software related contracts, electronic library resources, and website development costs. The weighted average amortization period for assets acquired in the current period is 15 years.

	June 30, 2018	June 30, 2017
Intangible assets:		
Gross carrying amount	$ 14,158	$ 13,811
Accumulated amortization	(5,072)	(4,420)
Net carrying amount	$ 9,086	$ 9,391
Aggregate amortization expense:		
2018	$ 988	
Estimated amortization expense for each of the next five years and thereafter is as follows:		
2019	$ 982	
2020	709	
2021	684	
2022	677	
2023	675	
Thereafter	5,359	
Total	$ 9,086	

Campus Facilities

Campus facilities consisted of the following:

	June 30, 2018	June 30, 2017
Land and improvements	$ 40,062	$ 35,808
Building and improvements	271,892	268,856
Equipment	13,572	14,124
Library resources	2,346	2,193
Collections	940	935
Construction in progress	1,904	2,719
	330,716	324,635
Accumulated depreciation	(130,336)	(122,226)
Campus facilities, net	$ 200,380	$ 202,409

June 30, 2018 (Dollars in Thousands)

NOTE 5 – INTANGIBLE ASSETS AND CAMPUS FACILITIES, *CONTINUED*

Asset Retirement Obligations

Under U.S. GAAP, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the liability can be reasonably estimated. For the university, these obligations are primarily for the disposal of asbestos and certain other regulated materials generally found in pre-1980 campus facilities. Though these materials do not currently pose a health hazard in any of these facilities, appropriate remediation procedures are required to remove these materials upon renovation or demolition.

The following schedule summarizes the university's asset retirement obligation activity:

	June 30, 2018	June 30, 2017
Asset retirement obligation, beginning of the year	$ 1,615	$ 1,895
Obligations settled	(11)	(14)
Accretion expense	69	67
Revisions in estimated cash flows	6	(333)
Asset retirement obligation, end of the year	$ 1,679	$ 1,615

NOTE 6 – LONG-TERM DEBT

Long-term debt consisted of the following:

	Final Maturity	June 30, 2018	June 30, 2017
WHEFA Revenue Bonds, 2012A	2042	$ 37,086	$ 37,246
WHEFA Revenue Bonds, 2012B	2036	25,579	26,266
WHEFA Revenue Bonds, 2001	2031	9,389	9,812
Capital lease obligations	2032	261	271
Total		$ 72,315	$ 73,595

Principal due within the next five fiscal years and thereafter is as follows:

2019	$ 1,623
2020	1,689
2021	1,762
2022	1,844
2023	1,931
Thereafter	61,422
	70,271
Unamortized premium	2,620
Unamortized issuance costs	(576)
Total	$ 72,315

The Washington Higher Education Facilities Authority (WHEFA) is a financing conduit provided by the State of Washington for private higher education facility acquisition and construction in the state. The university's unrestricted revenues are pledged as collateral on the WHEFA tax-exempt bond obligations. The tax-exempt bonds are obligations solely of the university and are not guaranteed by the state. The WHEFA bond agreements contain covenants relating to maintenance of facilities, insurance, and other general items. In addition, the WHEFA 2001 and WHEFA 2012B bond agreements contain covenants that the university will comply with certain liquidity requirements. The university's underlying long-term rating is "A1" by Moody's Investors Service, Inc., and "A+" by Standard & Poor's Global Ratings.

In October 2012 the university entered into loan agreements whereby WHEFA issued tax-exempt Revenue and Refunding Revenue Bonds in the amount of $34,805 at a net premium of $3,577 (Series 2012A) and Refunding Revenue Bonds in the amount of $29,195 (Series 2012B). The bonds are general obligations of the university. The proceeds from the Series 2012A bonds were used to finance the construction of a 135-bed residence hall, and to refund outstanding WHEFA 2006A bonds. The proceeds from Series 2012B were used to refund outstanding WHEFA 2006B bonds. The 2012A bonds bear interest at fixed rates ranging from 3.0% to 5.0%. The 2012B bonds were sold through a direct purchase transaction with a bank, who will hold the bonds for an initial seven year term, after which the university will remarket the bonds. The bonds bear interest at 70% of the one-month London Interbank Offer Rate (LIBOR) plus a credit spread, which equated to an average interest rate of 1.98% for fiscal year 2018. The university is subject to certain financial covenants.

During 2001 the university entered into a loan agreement with WHEFA whereby WHEFA issued $10,620 of tax-exempt Variable Rate Demand Revenue Bonds, Series 2001. The proceeds were used to finance the construction of a new student residence hall. Pursuant to the loan agreement, the bonds bear interest at a rate that is determined weekly through the remarketing process, with the maximum annual rate capped at 12%. The average interest rate for fiscal year 2018 was 1.29%, which included 10 basis points for remarketing.

June 30, 2018 (Dollars in Thousands)

NOTE 6 – LONG-TERM DEBT, *CONTINUED*

For the year ended June 30, 2018, the university incurred total interest costs related to long-term debt of $3,534 of which $12 was capitalized. Interest costs include debt interest payments, swap agreement interest, remarketing, amortization of bond premium, discount and costs of issuance.

The university has a $5,000 unsecured line of credit in the form of a demand note with a bank. The agreement provides for interest at the bank's prime rate with no additional fees. As of June 30, 2018, the bank's prime rate was 5%. This line of credit, which may be renewed annually, has not been drawn on but is available for operating expenses or to provide liquidity for the Series 2001 bonds should the need arise. The current agreement matures February 28, 2019.

Interest Rate Swap Agreements

During 2005 and 2006, in an effort to manage the fluctuations in cash flows resulting from variable interest rates and to lower its overall borrowing costs, the university entered into three separate interest rate swap agreements to convert its variable rate bonds to a substantially fixed rate through maturity. Under the terms of the swap agreements, the university pays the swap counterparties fixed amounts of interest over the term of the contracts and receives variable interest payments based on 67% of the one-month LIBOR. Additional key terms of the agreements are as follows:

Swap Counterparty	Outstanding Notional	Trade Date	Effective Date	Swap Fixed Rate	Final Maturity Date
The Bank of New York Mellon	$ 14,985	5/25/06	4/1/08	3.875%	10/1/2030
The Bank of New York Mellon	$ 25,550	5/25/06	6/30/06	3.855%	10/1/2036
Societe Generale, New York Branch	$ 9,475	8/9/05	9/1/05	3.426%	10/1/2031

The university accounts for its interest rate swap agreements in accordance with U.S. GAAP. The fair value of the interest rate swap agreements is the estimated amount that the university would receive or pay to transfer the agreements as of the reporting date, net of credit valuation adjustments, and is recognized as either an unrealized gain or loss, as appropriate. Amounts reported in the Consolidated Statements of Financial Position as of June 30, 2018 and 2017, for "Interest rate swap agreements" of $7,515 and $10,066, respectively, are also known as the mark-to-market value. The net changes in the fair value of the interest rate swap agreements for the years ended June 30, 2018 and 2017, were net unrealized gains of $2,552 and $4,102, respectively, recognized within "Other adjustments and changes" in the Consolidated Statements of Activities. Providing the university holds the swaps to maturity, the fair value of the derivatives will be zero. The university retains the option to terminate, cancel, and cash settle the interest rate swap agreements at any time.

The university utilizes its interest rate swap agreements solely as a cash flow hedge and does not use derivative instruments for trading or speculative purposes. The university seeks to diversify counterparty risk and executes credit-sensitive derivative transactions only with counterparties with strong credit ratings. The university is not required to post collateral for its swaps unless its credit rating drops below Baa2 by Moody's Investors Service, Inc or BBB by Standard & Poor's Rating Services on the Societe Generale Swap and Baa3 by Moody's Investors Service, Inc or BBB- by Standard & Poor's Rating Services on the Bank of New York Mellon swaps. The amount of the collateral would be the mark-to-market loss exposure at the time the credit rating dropped below the required level.

NOTE 7 – RESTRICTIONS ON NET ASSETS

Restrictions on net assets consisted of the following:

	June 30, 2018	June 30, 2017
Temporarily restricted:		
Time restrictions:		
Unappropriated earnings from donor-restricted endowments	$ 106,122	$ 94,510
Term endowment	531	505
Total donor-restricted endowments	106,653	95,015
Unconditional promises to give	1,804	1,349
Split-interest agreements	1,449	1,531
Cash surrender value of life insurance policies	25	21
Total time restrictions	109,931	97,916
Purpose restrictions:		
Construction of campus facilities	5,418	4,554
Educational programs and activities	6,233	6,284
Total purpose restrictions	11,651	10,838
Total temporarily restricted	$ 121,582	$ 108,754
Permanently restricted:		
Endowment funds	$ 139,219	$ 133,663
Split-interest agreements	2,512	2,581
Loan funds	5	5
Total permanently restricted	$ 141,736	$ 136,249

June 30, 2018 (Dollars in Thousands)

NOTE 8 – RETIREMENT PLANS

Defined Contribution Plan

The university contributes to a defined contribution retirement plan for the benefit of eligible faculty and staff (participants), with funding vehicles available through Teachers Insurance Annuity Association of America (TIAA) and College Retirement Equities Fund (CREF), (together TIAA-CREF). University contributions for participants begin after one year of service to the university or one year of service at an eligible employer during the twelve months immediately prior to their employment at the university. Contributions are 10% or 12% of salaries, depending upon position classifications and are fully vested. The university's contributions totaled $5,308 and $5,169 for the years ended June 30, 2018 and 2017, respectively.

Defined Benefit Plans

The university has in place an unfunded early retirement and career change plan for eligible members of the faculty. The university also accrues post-retirement medical benefits available to certain active faculty under the faculty early retirement and career change policy (pre-65 benefits) and certain retired faculty and staff under a discontinued medical benefits plan for retirees (post-65 benefits). Plan expenses and liabilities are valued based on actuarial methods and are reflected in the consolidated financial statements. U.S. GAAP requires employers to recognize the overfunded or underfunded status of a defined benefit post-retirement plan as an asset or liability in their statement of financial position and to recognize changes in that funded status in the year in which the changes occur. As a not-for-profit organization, the university recognizes such changes through changes in unrestricted net assets.

Amounts recognized in "Accrued payroll and other liabilities" in the Consolidated Statements of Financial Position as of June 30, 2018 and 2017, and in "Other adjustments and changes" in the Consolidated Statements of Activities for the years then ended are as follows:

	Faculty Early Retirement and Career Change Plan		Post-Retirement Medical Plan	
	2018	2017	2018	2017
Projected and accumulated post-retirement benefit obligations:				
Beginning of the year	$ 7,996	$ 6,892	$ 3,443	$ 3,405
Benefits paid	(253)	-	(117)	(154)
Amounts recognized in the Consolidated Statements of Activities:				
Components of net benefit expense recognized as operating expense:				
Service cost	490	467	169	171
Interest cost	286	229	124	115
Amortization of actuarial loss	225	219	72	85
Total net benefit expense	1,001	915	365	371
(Gain) loss recognized within other adjustments and changes	(1,298)	189	(390)	(179)
End of the year	$ 7,446	$ 7,996	$ 3,301	$ 3,443
Post-retirement benefit liability recognized within accrued payroll and other liabilities in the Consolidated Statements of Financial Position:				
Current portion	$ 469	$ 429	$ 198	$ 206
Noncurrent portion	6,977	7,567	3,103	3,237
Total	$ 7,446	$ 7,996	$ 3,301	$ 3,443
Plan funded (unfunded) status	$ (7,446)	$ (7,996)	$ (3,301)	$ (3,443)

The weighted-average assumptions used to determine plan benefit obligations as of June 30, 2018 and 2017, and the net benefit expense for the years then ended, included:

	Faculty Early Retirement and Career Change Plan		Post-Retirement Medical Plan	
	2018	2017	2018	2017
Benefit obligation (post-retirement benefit liability):				
Discount rate	4.18%	3.68%	4.21%	3.70%
Rate of compensation increase	5.00%	5.00%	N/A	N/A
Net benefit expense:				
Discount rate	3.68%	3.42%	3.70%	3.46%
Rate of compensation increase	5.00 %	5.00%	N/A	N/A

Amounts recognized as changes in unrestricted net assets that are expected to be recognized as amortization components of net benefit expense in the next fiscal year include a net loss of $225 for the faculty early retirement and career change plan and a net loss of $72 for the post-retirement medical plan.

June 30, 2018 (Dollars in Thousands)

NOTE 8 – RETIREMENT PLANS, *CONTINUED*

Benefits were estimated based upon the same assumptions used to measure the benefit obligation. Benefits expected to be paid in each of the next five years, and in the aggregate for the five years thereafter, are as follows:

	Faculty Early Retirement and Career Change Plan	Post-Retirement Medical Plan
2019	$ 469	$ 205
2020	$ 429	$ 222
2021	$ 411	$ 211
2022	$ 339	$ 223
2023	$ 368	$ 208
2024–2028	$ 2,951	$ 1,252

NOTE 9 – WASHINGTON STATE STATUTORY REQUIREMENTS

Washington State statutory requirements related to charitable gift annuities require the following disclosure of unconsolidated financial information for the university as of June 30, 2018:

	University of Puget Sound (unconsolidated)	Wholly Owned Subsidiaries	Eliminating Entries	University of Puget Sound (consolidated)
Assets:				
Cash and cash equivalents	$ 27,563	$ -	$ -	$ 27,563
Due from subsidiaries	2,893	-	(2,893)	-
Short-term investments	28,892	-	-	28,892
Receivables, net	1,882	-	-	1,882
Contributions receivable, net	3,421	-	-	3,421
Inventories	535	-	-	535
Prepaid expenses and other assets	1,520	2,674	-	4,194
Student loans receivable, net	12,950	-	-	12,950
Beneficial interest in outside trusts	1,199	-	-	1,199
Assets held under split-interest agreements	5,711	-	-	5,711
Endowment investments	367,895	1,143	-	369,038
Intangibles, net	9,086	-	-	9,086
Assets restricted for investment in campus facilities	3,504	-	-	3,504
Campus facilities, net	200,380	-	-	200,380
Total assets	$ 667,431	$ 3,817	$ (2,893)	$ 668,355
Liabilities:				
Accounts payable	$ 2,793	$ -	$ -	$ 2,793
Due to university	-	2,893	(2,893)	-
Accrued payroll and other liabilities	16,733	-	-	16,733
Advance deposits from students	2,222	-	-	2,222
Liabilities under split-interest agreements	2,937	-	-	2,937
Government advances for student loans	11,393	-	-	11,393
Asset retirement obligation	1,679	-	-	1,679
Interest rate swap agreements	7,515	-	-	7,515
Long-term debt, net	72,315	-	-	72,315
Total liabilities	$ 117,587	$ 2,893	$ (2,893)	$ 117,587
Net Assets:				
Unrestricted	$ 287,450	$ -	$ -	$ 287,450
Temporarily restricted	120,658	924	-	121,582
Permanently restricted	141,736	-	-	141,436
Total net assets	549,844	924	-	550,768
Total liabilities and net assets	$ 667,431	$ 3,817	$ (2,893)	$ 668,355

The amount included to meet future payments under gift annuity contracts in liabilities under split-interest agreements was $562 as of June 30, 2018, and $577 as of June 30, 2017.

NOTE 10 – COMMITMENTS AND CONTINGENCIES

The university has allocated a portion of its pooled endowment to investments in natural resources, private real estate and equity and fixed income asset classes. At June 30, 2018, an outstanding commitment of $12,353 remains to be invested in these asset classes.

As of June 30, 2018, the university had outstanding commitments in the amount of $2,318 related to the construction, renovation and improvement of campus facilities.

In the normal course of activities, the university from time to time is the subject of various claims and also has claims against others. In the opinion of management, the results of these matters will not have a significant impact on the consolidated financial statements.

Federally funded programs, including financial aid, research and development, and other programs, are routinely subject to special audit. The reports on examinations, which are conducted pursuant to specific regulatory requirements by the auditors for the university, are required to be submitted to both the university and the Federal Audit Clearinghouse. Federal oversight agencies have the authority to determine liabilities as well as to limit, suspend, or terminate federally funded programs. In the university's opinion, no material instances of noncompliance have occurred during the year ended June 30, 2018, related to the university's federally funded student financial aid, research and development, and other programs.

NOTE 11 – SUBSEQUENT EVENTS

The university evaluated subsequent events through November 9, 2018, the date these consolidated financial statements were issued, and concluded there were no events requiring recording or disclosure.

UNIVERSITY OF PUGET SOUND Board of Trustees and Officers (Unaudited)

As of November 9, 2018

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