

# SANFORD BURNHAM PREBYS MEDICAL DISCOVERY INSTITUTE

## NOTES TO FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

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### 1. SIGNIFICANT ACCOUNTING POLICIES

**General**—Sanford Burnham Prebys Medical Discovery Institute (the “Institute”), formerly Sanford Burnham Medical Research Institute, conducts basic biomedical research and is funded primarily by grants from agencies of the U.S. government. The Institute is a California not-for-profit public benefit corporation, exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

**Funding**—Grant applications are submitted to various federal and nonfederal agencies. Those applications that are funded are typically awarded for a four-year period, with the amount awarded negotiated in advance. Grant revenue is recognized as unrestricted revenue when the research costs are incurred. Unspent grant funds received in advance of the related expenditure are reported as deferred revenue.

The Institute established an operating division in Orlando, Florida, Sanford Burnham Prebys Medical Discovery Institute at Lake Nona, in 2007. Funding is provided by a \$155 million grant, plus interest, from the State of Florida to be disbursed in varying amounts ranging from \$4.4 million to \$45.4 million per year over a 10-year period commencing in March 2007, conditioned on compliance with certain covenants and conditions. This grant is accounted for as a contribution under accounting principles generally accepted in the United States of America (GAAP). Grant funds from the State of Florida are reported as temporarily restricted revenue with a corresponding release from restriction when expended. Unspent grant funds from the State of Florida are reflected as temporarily restricted net assets until spent.

Certain local governments and private entities (the “Funding Parties”) agreed to provide temporary space, land, and up to \$81 million in funding for the development of the Institute’s temporary and permanent facilities, including future improvements, located in the Lake Nona area of the city of Orlando. During fiscal year 2009, \$76.8 million was recognized as temporarily restricted revenue related to the permanent facilities and is being recognized as unrestricted revenue ratably over the life of the 25-year land lease, with 16 years remaining as of June 30, 2016.

The grant for the use of the land for the Lake Nona permanent site was reflected as use of long-lived assets and deferred revenue (until resolution of uncertainties about the project were resolved), which are amortized, ratably, over the life of the 25-year lease and reflected as unrestricted expense and revenue. The Funding Parties hold a joint leasehold mortgage in the permanent site, ground lease, and permanent facility. During fiscal year 2009, with the occupancy of the building, deferred revenue of \$3,874,000 was recognized as temporarily restricted revenue and is being recognized as unrestricted revenue ratably over the remaining life of the lease. As of June 30, 2016 and 2015, \$2,649,000 and \$2,818,000, respectively, remained in temporarily restricted net assets.

The Institute received a contribution to fund joint scientific faculty and research and equipment at Lake Nona totaling \$27 million. During fiscal year 2009, the agreement was amended to revise the payment terms and allow the Institute greater flexibility related to

use of the funds. The payment of the remaining funds will continue through fiscal year 2022 with \$1.75 million being paid each year except for the last year when \$1.25 million will be paid. Receipts under this revised agreement are recorded as unrestricted revenue as conditions are met and funds become receivable. In fiscal years 2016 and 2015, certain conditions were met and \$1.75 million was received and recognized as revenue in each year.

**Contributions**—Contributions are recorded as revenue at their present value when unconditionally pledged or when received, whichever is earlier. The discounted values of recorded pledges are accreted to their full values, using a risk-free interest rate, during the period beginning when the pledge is made until the time it is expected to be paid.

Contributions subject to donor-imposed restrictions for use in a future period or for a specific purpose are reported as either temporarily or permanently restricted, depending on the nature of the donor's restriction. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions. Donor-restricted contributions, whose restrictions are met in the same reporting period, are reported as temporarily restricted contributions with a corresponding release from restrictions.

When an expense is incurred for which both restricted and unrestricted net assets are available, it is the Institute's policy to first exhaust restricted resources and then apply unrestricted resources.

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

**Cash and Cash Equivalents**—Cash and cash equivalents represent the Institute's working capital and include cash on hand and other highly liquid investments having an original maturity of less than three months. Cash and cash equivalents may include cash in bank accounts and investments in money market funds. Cash and cash equivalents related to the Institute's investment strategies are included in short-term investments on the statements of financial position.

**Restricted Cash and Cash Equivalents**—Restricted cash and cash equivalents represent a required bank deposit of half of the annual principal payment on the 2006 debt issuance.

**Prepaid and Other Assets and Receivables**—Included in prepaid and other assets and receivables is \$2,668,000 and \$3,214,000 as of June 30, 2016 and 2015, respectively, for loans to employees for housing relocation. These loans are secured by deeds of trust and incur interest at rates ranging from 0% to 2%. For each loan with a below-market interest rate, the Institute uses an imputed interest rate and records employee benefit expense and interest revenue over the life of the loan.

**Use of Long-Lived Assets**—Use of long-lived assets relates to the fair value of land provided to the Institute for its permanent facility to use to conduct research at its operating division in Florida. Use of the land is amortized over the term of the agreement of 25 years.

**Pledges Receivable**—The Institute records pledges receivable, net of allowances for uncollectible amounts, when there is sufficient evidence in the form of verifiable documentation that an unconditional promise was made. The Institute discounts pledges that are expected to be collected after one year, using the risk-free rate of return at the time of the pledge. The discount is recognized as contribution revenue in future years, as the discount is amortized using an effective yield over the duration of the pledges. The provision for uncollectible amounts, if any, is calculated based on specific identification of potentially uncollectible pledges.

**Investments**—Investments are carried at fair value, which is generally determined by management based on quoted market prices provided by independent outside valuation services.

Investments for which readily determinable market values do not exist are recorded at estimated fair value as determined by the Institute, with the assistance of fund managers, the general partners, or third-party service providers, using methods and assumptions the Institute considers appropriate based on its understanding of the underlying characteristics of the investments.

Long-term investments include securities related to permanently restricted net assets, funds designated by the Institute’s Board of Trustees (the “Board”) to function as endowments, and unrestricted investments held long term. All other investments are reported as short term.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of volatility associated with certain investment securities, it is probable that changes in the values of investment securities will occur from time to time and such changes could materially affect the amounts reported in the accompanying statements of financial position.

**Property and Depreciation**—Purchased property is recorded at cost. Donated property is recorded at fair value at the date of donation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets as follows:

	<b>Years</b>
Buildings and improvements	7–50
Furniture and equipment	3–5

**Deferred Rent**—The Institute has various lease agreements in place, which have resulted in a deferred rent balance related to a free rent period of \$1,630,000 and \$1,725,000 as of June 30, 2016 and 2015, respectively. Deferred rent is included in accounts payable, accrued expenses, and other liabilities.

**Deferred Revenue**—The Institute records advance payments on conditional pledges, grants, and contracts to be spent in future years as deferred revenue. See Note 6.

**Spending-Rate Policy**—The Institute utilizes a spending-rate policy and formula under which the Board designates a predetermined portion of the Institute’s long-term investment return for support of current operations; the remainder is retained to support operations of future years and to offset potential market declines. Under the Institute’s spending policy, 5% of the average of the market value as of December 31 of the previous three years is appropriated. Accordingly, the Institute has presented its investment return

separated between the amount designated for current operations and the amount in excess of (or less than) the amount designated for current operations. Management believes that this presentation better presents the Institute's change in net assets and results of operations, as permitted by Accounting Standards Codification (ASC) 958-320, *Not-for-Profit Entities—Investments*, and emphasizes the Institute's use of a prudent approach to determining the portion of cumulative investment returns that can be used to support operations.

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

**Recent Accounting Pronouncements**—In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 outlines a single comprehensive model for entities to use in accounting for revenue from contracts with customers. This standard supersedes most other revenue recognition guidance, including industry-specific guidance. ASU 2014-09 is effective for accounting periods beginning after December 15, 2017. Management of the Institute is in the process of evaluating the impact that the adoption of ASU 2014-09 will have on the financial statements. ASU 2015-14 deferred the effective date of this statement to accounting periods beginning after December 15, 2018.

In April 2015, the FASB issued ASU 2015-03, *Imputation of Interest—Simplifying the Presentation of Debt Issuance Costs*. This update changes the presentation of debt issuance costs in the financial statements. Under the ASU, an entity presents such costs in the balance sheet as a direct deduction from the recognized debt liability rather than as an asset. Amortization of the costs is reported as interest expense. ASU 2015-03 is effective for fiscal years beginning after December 15, 2015. The new guidance will be applied on a retrospective basis, whereby the statements of financial position for each period presented will be adjusted to reflect the respective period specific effects. Management elected to early adopt the provisions of this new standard and the adoption has been reflected in Note 7 to the financial statements.

In May 2015, the FASB issued ASU 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. The ASU removes the requirement to categorize within the fair value hierarchy investments for which fair values are estimated using the net asset value per share as a practical expedient provided by FASB ASC 820, *Fair Value Measurement*. Disclosures about investments in certain entities that calculate net asset value per share are limited under this ASU to investments for which the entity has elected to estimate the fair value using the net asset value practical expedient. The guidance requires retrospective application and is effective for public business entities for fiscal years, and interim periods within those years, beginning after December 15, 2015. For all other entities, the guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Management of the Institute is in the process of evaluating the impact that the adoption of ASU 2015-07 will have on the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. The ASU requires lessees to recognize assets and liabilities arising from leases on the balance sheet. Under the ASU, a lessee should recognize in the statements of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the

underlying asset for the lease term. ASU 2016-02 is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. Management of the Institute is in the process of evaluating the impact that the adoption of ASU 2016-02 will have on the financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities—Presentation of Financial Statements for Not-for-Profit Entities*. The ASU makes several improvements to current reporting requirements to provide more useful information to donors, grantors, creditors, and other users of the financial statements. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017. Early adoption is permitted. Management of the Institute is in the process of evaluating the impact that the adoption of ASU 2016-14 will have on the financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows—Classification of Certain Cash Receipts and Cash Payments*. The ASU addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice of how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. Management of the Institute is in the process of evaluating the impact that the adoption of ASU 2016-15 will have on the financial statements.

**Subsequent Events**—In accordance with ASC 855, *Subsequent Events*, the Institute evaluated subsequent events through October 24, 2016, the date of the release of these financial statements.

## 2. FAIR VALUE OF FINANCIAL INSTRUMENTS

ASC 820, *Fair Value Measurements and Disclosures*, defines “fair value” 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 (exit price). ASC 820 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

**Level 1**—Quoted prices in active markets for identical assets or liabilities as of the reporting date.

**Level 2**—Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data as of the reporting date.

**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. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

The Institute’s assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

The following is a general description of the valuation methodologies used for financial assets and liabilities measured at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy:

*Marketable Securities* — Include cash and cash equivalents, U.S Treasury notes, listed equity and bond market mutual funds and exchange-traded equity securities held in professionally managed separate accounts, with valuation based upon quoted prices in active markets. Each of the mutual and managed funds are invested in a diverse portfolio of underlying investments, including U.S. securities, global securities, commercial paper, U.S. treasuries, and U.S. government securities. The valuation methodologies used for financial assets measured at fair value for fixed-income and equity securities (including both mutual and managed funds) are based on Level 1 inputs determined by quoted prices in active markets.

In addition, marketable securities include corporate bond funds. Fair value for these funds is primarily determined by over-the-counter secondary market broker quotes, which are observable market inputs. These securities are classified as Level 2.

*Nonmarketable Securities* — Include directional fund-of-fund hedge funds. The underlying investments in such funds consist of equity futures contracts, asset backed securities, and exchange traded funds with varying redemption terms and conditions and are valued using the net asset value per share. These have an initial lockup period of 1 year, and offer a quarterly redemption frequency with a 60 day notice period.

These investments are classified as Level 3.

Certain of the Institute's assets and liabilities are reported at fair value in the accompanying statements of financial position. Fair value measurement information for assets accounted for at fair value on a recurring basis as of June 30, 2016, is as follows:

	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<i>Marketable Securities:</i>				
Cash and cash equivalents	\$ 46,499,000	\$ -	\$ -	\$ 46,499,000
U.S. government obligations	98,776,000			98,776,000
Corporate bond funds		5,708,000		5,708,000
Fixed income securities—				
Mutual and managed funds	35,764,000			35,764,000
Equity securities—				
Mutual and managed funds	65,650,000			65,650,000
Commodities funds	9,913,000			9,913,000
Real estate funds	1,627,000			1,627,000
<i>Non-marketable Securities:</i>				
Alternative investments—				
Directional hedge funds			11,800,000	11,800,000
Total investments	<u>\$ 258,229,000</u>	<u>\$ 5,708,000</u>	<u>\$ 11,800,000</u>	<u>\$ 275,737,000</u>

Fair value measurement information for assets (liabilities) accounted for at fair value on a recurring basis as of June 30, 2015, is as follows:

	<b>Fair Value Measurements Using</b>			<b>Total</b>
	<b>Quoted Prices in Active Markets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	
Investments—				
Short-term funds	\$ 23,824,000	\$ -	\$ -	\$ 23,824,000
Fixed income securities—				
Mutual and managed funds	16,589,000			16,589,000
Equity securities—				
Mutual and managed funds	<u>126,507,000</u>			<u>126,507,000</u>
Total investments	<u>\$ 166,920,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 166,920,000</u>
Financial liabilities—interest rate swap	<u>\$ -</u>	<u>\$ (2,532,000)</u>	<u>\$ -</u>	<u>\$ (2,532,000)</u>

The changes in Level 3 instruments measured on a recurring basis for the year ended June 30, 2016 are as follows:

Balance—June 30, 2015	\$ -
Net realized and unrealized gains	
Purchases	11,800,000
Settlements	
Balance—June 30, 2016	<u>\$ 11,800,000</u>

There were no transfers in or out of Levels 1, 2, or 3 during the years ended June 30, 2016 and 2015.

The method and inputs used to determine the fair value of the secured loan receivable are discussed in Note 3. The method and inputs used to determine the fair value of the interest rate swap are discussed in Note 7.

The estimated fair values of cash and cash equivalents, receivables, accounts payable, accrued expenses, and other liabilities approximate their individual carrying amounts due to the short-term nature of these instruments.

### **3. INVESTMENTS AND SECURED LOAN RECEIVABLE**

The Institute's investment portfolio is managed by independent professional investment managers subject to oversight by a committee of the Board. Certain of these managers are authorized to invest a limited portion of the Institute's portfolio in alternative investments to increase portfolio diversification and return and to reduce volatility.

Investments as of June 30, 2016 and 2015, are summarized as follows:

	<b>2016</b>	<b>2015</b>
Cash and cash equivalents	\$ 46,499,000	\$ 23,824,000
U.S. government obligations	98,776,000	
Corporate bond funds	5,708,000	
Fixed income securities—		
Mutual and managed funds	35,764,000	16,589,000
Equity securities—		
Mutual and managed funds	65,650,000	126,507,000
Commodities funds	9,913,000	
Real estate funds	1,627,000	
Alternative investments:		
Directional hedge funds	<u>11,800,000</u>	<u>                    </u>
 Total investments	 <u>\$ 275,737,000</u>	 <u>\$ 166,920,000</u>

Investments above include long-term investments of \$8,709,000 and \$9,096,000 as of June 30, 2016 and 2015, respectively that the Board of the Institute designated as quasi-endowment.

In August 2010, the Institute entered into a tri-party repurchase agreement, in which the Institute loaned cash from the 2006 COP reserve fund of \$3,958,000 to a financial institution. The loan is secured by collateral in specified financial assets, which are held by a third-party custodian. This transaction did not meet the criteria to be accounted for as a sale under ASC 860, *Transfers and Servicing*, and, therefore, it was recorded as a secured loan. The loan was paid in full through the refinancing of the COPs in October 2015 (see Note 7). As of June 30, 2016 and 2015, the balance of the secured loan was \$0 and \$3,958,000, respectively. The fair value of the loan, calculated using market observable interest rates (Level 2 inputs) as of June 30, 2015, was \$3,907,000.

State law allows the Board to appropriate so much of the net appreciation as is prudent considering the Institute's long-term and short-term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions. Under the Institute's endowment spending policy, effective fiscal year 2010, 5% of the average of the fair value at December 31 of the previous three years is appropriated to support current operations. The following schedule summarizes the investment return and its classification in the statements of activities.

Investment return for the years ended June 30, 2016 and 2015, is composed of the following:

	<b>2016</b>		
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Total</b>
Interest and dividends	\$ 2,462,000	\$ 324,000	\$ 2,786,000
Net realized and unrealized losses	(2,709,000)	(156,000)	(2,865,000)
Management fees	<u>(1,000)</u>	<u>(18,000)</u>	<u>(19,000)</u>
Total investment return	(248,000)	150,000	(98,000)
Investment returns designated for current operations	<u>(2,161,000)</u>	<u>(583,000)</u>	<u>(2,744,000)</u>
Investment return reduced by the portion of cumulative net appreciation designated for current operations	<u>\$ (2,409,000)</u>	<u>\$ (433,000)</u>	<u>\$ (2,842,000)</u>
	<b>2015</b>		
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Total</b>
Interest and dividends	\$ 1,306,000	\$ 364,000	\$ 1,670,000
Net realized and unrealized losses	(1,699,000)	(457,000)	(2,156,000)
Management fees	<u>(1,000)</u>	<u>(18,000)</u>	<u>(19,000)</u>
Total investment return	(394,000)	(111,000)	(505,000)
Investment returns designated for current operations	<u>1,240,000</u>	<u>477,000</u>	<u>1,717,000</u>
Investment return reduced by the portion of cumulative net appreciation designated for current operations	<u>\$ (1,634,000)</u>	<u>\$ (588,000)</u>	<u>\$ (2,222,000)</u>

#### 4. PLEDGES RECEIVABLE

Pledges receivable as of June 30, 2016 and 2015, are as follows:

	2016	2015
Gross amounts due in:		
Less than one year	\$ 27,230,000	\$ 51,413,000
One to five years	27,896,000	7,078,000
More than five years	<u>2,000</u>	<u>2,000</u>
 Gross pledges receivable	 55,128,000	 58,493,000
 Less present value discount	 (761,000)	 (675,000)
Less allowance for uncollectible pledges	<u>                    </u>	<u>(3,422,000)</u>
 Total	 <u>\$ 54,367,000</u>	 <u>\$ 54,396,000</u>

Discount rates ranged from .75% to 2% for both 2016 and 2015.

Pledges receivable, net of present value discount, include permanently restricted pledges of \$1,014,000 and \$1,482,000 as of June 30, 2016 and 2015, respectively.

The Institute received contributions from trustees of \$3,529,400 and \$2,271,000 for the years ended June 30, 2016 and 2015, respectively.

During the year ended June 30, 2014, the Institute received a conditional pledge of \$275,000,000, payable over a period of 10 years, from a donor. The pledge was amended in December 2015 to eliminate certain conditions that both the Institute and donor agreed would not occur, which resulted in a \$75,000,000 reduction of the original conditional pledge. The amendment also included prepayment terms for the outstanding amount of the pledge. The Institute received prepayment in full satisfaction of the terms of the pledge in January 2016; \$113,523,000 of the prepayment was recorded as deferred revenue relating to future annual milestones. All related investment earnings on the deferred balance is recorded as deferred revenue. As of June 30, 2016, the deferred revenue balance related to the 2014 pledge was \$114,475,000, inclusive of investment earnings.

This conditional pledge is restricted for various uses and is contingent upon the Institute meeting certain periodic milestones and taking certain actions throughout the term of the pledge, some of which may or may not occur. Due to the conditional nature of this pledge, revenue is only recorded to the extent such milestones are met or actions are taken and approved by the donor. During the years ended June 30, 2016 and 2015, \$28,911,000 and \$24,916,000, respectively, was recorded as temporarily restricted revenue because the required milestones were met.

For the years ended June 30, 2016 and 2015, \$27,939,000 and \$16,514,000, respectively, of the temporarily restricted revenue was released from restriction because it was used for the purposes intended by the donor.

As of June 30, 2016 and 2015, \$17,258,000 and \$17,286,000, respectively, remained in temporarily restricted net assets.

The Institute is named as the beneficiary in various revocable trusts and wills. The contribution revenue will be recognized when the agreements become irrevocable or when the assets are distributed to the Institute for its unconditional use, whichever occurs first.

## 5. PROPERTY

The carrying value and related accumulated depreciation of property as of June 30, 2016 and 2015, are as follows:

	<b>2016</b>	<b>2015</b>
Land	\$ 25,793,000	\$ 25,793,000
Buildings and building improvements	165,328,000	164,581,000
Furniture and equipment	110,505,000	106,434,000
Construction in progress	<u>745,000</u>	<u>37,000</u>
Total	302,371,000	296,845,000
Less accumulated depreciation	<u>163,207,000</u>	<u>157,392,000</u>
Property—net	<u>\$ 139,164,000</u>	<u>\$ 139,453,000</u>

Depreciation expense was \$12,711,000 and \$14,812,000 for the years ended June 30, 2016 and 2015, respectively.

## 6. DEFERRED REVENUE

Deferred revenue as of June 30, 2016 and 2015, consisted of the following:

	<b>2016</b>	<b>2015</b>
Conditional contribution	\$ 114,475,000	\$ -
Deferred grant revenue	8,471,000	4,881,000
Other	<u>1,846,000</u>	<u>2,172,000</u>
Total	<u>\$ 124,792,000</u>	<u>\$ 7,053,000</u>

## 7. DEBT

In 2009, the Institute entered into an asset acquisition transaction with another not-for-profit organization. The Institute acquired certain property and equipment out of the other organization's bankruptcy and assumed the other organization's Variable Rate Demand Revenue Certificates of Participation (the "Certificates") issued through the County of San Diego in the aggregate outstanding principal amount of \$21,360,000 at the date of the transaction.

In November 2012, the Institute borrowed \$18,885,000 through the issuance of a direct purchase tax-exempt loan (the "2012 Loan"). Proceeds from the issuance of the Loan were used to refinance the outstanding balance of the Certificates of \$18,885,000. The Loan matures in 2017, includes an option to renew for a three-year period, and accrues interest at a rate equal to the British Bankers' Association London Inter Bank Offered Rate (LIBOR),

plus 0.95%. The interest rate paid by the Institute on the Loan for fiscal years 2016 and 2015 averaged 3.43%. The fair value of the Loan approximates its carrying amount due to the variable interest rate feature of the Loan.

During the year ended June 30, 2006, the Institute borrowed \$59,405,000 through the issuance of tax-exempt serial and term COPs sponsored by the County of San Diego. Proceeds from the issuance of the COPs were used to defease the 1999 COPs sponsored by the County of San Diego and to finance certain new capital improvements and equipment purchases. The COPs are collateralized by a pledge of the Institute's revenues and include certain covenants, including restrictions on the issuance of parity debt. Principal is due in varying annual installments through 2034. Interest is payable on a semiannual basis at 5%. The COPs were sold at a premium of \$1,168,000, which was being amortized over the life of the COPs. As of June 30, 2016 and 2015, the unamortized premium was \$0 and \$609,000, respectively.

In accordance with ASU 2015-03, Deferred Financing Costs have been reclassified from an asset to offset the associated debt for the period ended June 30, 2015. Deferred Issuance Costs of \$488,000 and \$1,912,000 are included in Debt on the statements of financial position as of June 30, 2016 and 2015, respectively.

In October 2015, the Institute borrowed \$55,585,000 through the issuance of tax-exempt Limited Revenue Obligations Series 2015A (the "2015A Obligations") and a \$3,475,000 taxable Revenue Obligations Series 2015B (the "2015B Obligations") sponsored by the County of San Diego. The 2015A Obligations proceeds together with the debt service reserve fund were used to refinance the \$47,500,000 outstanding aggregate principal amount of the 2006 COP and the \$16,705,000 outstanding principal amount of the 2012 Loan. The 2015B Obligations were used to fund the early termination amount of the swap agreement, as described below. The 2015A Obligations mature in 2031 with principal due in varying annual installments; interest is payable on a semiannual basis at rates ranging from 2% to 5%. The 2015B taxable Obligations mature in 2020 with principal due in varying annual installments; interest is payable on a semiannual basis at rates ranging from 1% to 2.625%. The 2015A Obligations were sold at a premium of \$6,378,000 which is being amortized over the life of the 2015A Obligations. As of June 30, 2016 the unamortized premium was \$6,130,000.

The 2015A and 2015B Obligations are collateralized by a pledge of the Institute's revenues and are subject to compliance with certain debt covenants, including restrictions on the issuance of parity debt.

The estimated fair value of the Institute's debt, calculated using market observable interest rates (Level 2 inputs) as of June 30, 2016 and 2015, is \$68,995,000 and \$50,161,000, respectively.

Total interest expense incurred for the years ended June 30, 2016 and 2015, was \$4,815,000 and \$3,330,000, respectively.

Scheduled principal repayments on debt as of June 30, 2016, are as follows:

<b>Years Ending June 30</b>	
2017	\$ 2,915,000
2018	3,005,000
2019	3,125,000
2020	3,260,000
2021	3,370,000
Thereafter	<u>43,385,000</u>
Total	<u>\$ 59,060,000</u>

**Interest Rate Swap Agreement**—In connection with the assumption of the Certificates, the Institute assumed an interest rate swap agreement covering the outstanding principal amount of the Certificates through November 2030. Under this agreement, the Institute receives payments from the counterparty based on LIBOR and the Institute pays the counterparty a fixed rate of interest of 3.43%. Under the 2012 Loan agreement entered into in November 2012, the interest rate swap remained in place. Interest expense on the Loan is recorded in general and administrative expenses in the accompanying statements of activities based on the fixed interest rate paid by the Institute under the swap agreement, plus the Loan variable interest rate of LIBOR, plus 0.95%, less the variable rate received by the Institute under the swap agreement.

The taxable proceeds from the 2015B Obligations funded the early termination of the swap agreement for \$2,894,000 in October 2015 and represents the net present value of the difference between the obligation under the contracted rate of interest and that of the then-current rate for a similar contract.

In accordance with ASC 815, *Derivatives and Hedging*, the Institute's interest rate swap agreement is reported at fair value in the statements of financial position. The fair value of the swap agreement will fluctuate generally based on changes in market rates of interest. Any unrealized gains or losses resulting from changes in fair value are reported in the statements of activities. The Institute's interest rate swap agreement was in a liability position, based on market prices of similar financial instruments, of approximately \$2,532,000 as of June 30, 2015, resulting primarily from a decrease in market interest rates subsequent to the assumption of the swap agreement, which is reported in accounts payable, accrued expenses, and other liabilities. The fair value of the interest rate swap agreement decreased by \$27,000 during the year ended June 30, 2015. The unrealized and realized loss on the fair value of the interest rate swap agreement is included in general and administrative expenses in the accompanying statements of activities.

## 8. NET ASSETS

Temporarily restricted net assets as of June 30, 2016 and 2015, include net assets restricted for use in future periods, campus-specific use, or for designated research purposes as follows:

	2016	2015
Restricted for future periods	\$ 53,295,000	\$ 52,798,000
Restricted for Sanford Burnham Prebys Medical Discovery Institute at Lake Nona	75,557,000	96,496,000
Restricted for research purposes	<u>27,329,000</u>	<u>30,198,000</u>
Total	<u>\$ 156,181,000</u>	<u>\$ 179,492,000</u>

Permanently restricted net assets of \$14,027,000 and \$14,015,000 as of June 30, 2016 and 2015, respectively, represent investments to be held in perpetuity either as a result of explicit donor stipulation or by the State Prudent Management of Institutional Funds Act (SPMIFA). The income from the investments is expendable to support research or the Institute's operations in accordance with the donors' wishes.

**Endowment**—The Institute's endowment consists of 13 individual funds established for various purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Institute has interpreted SPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Institute classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) 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. 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 organization in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, the organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the organization and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the organization
- The investment policies of the organization

The endowment net assets composition by type of fund as of June 30, 2016 and 2015, is as follows:

<b>2016</b>	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-restricted endowment funds	\$ 3,235,000	\$1,030,000	\$13,013,000	\$17,278,000
Board-designated endowment funds	<u>8,709,000</u>	<u>                    </u>	<u>                    </u>	<u>8,709,000</u>
Total funds	<u>\$11,944,000</u>	<u>\$1,030,000</u>	<u>\$13,013,000</u>	<u>\$25,987,000</u>
<b>2015</b>	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-restricted endowment funds	\$ 3,638,000	\$1,457,000	\$12,503,000	\$17,598,000
Board-designated endowment funds	<u>9,096,000</u>	<u>                    </u>	<u>                    </u>	<u>9,096,000</u>
Total funds	<u>\$12,734,000</u>	<u>\$1,457,000</u>	<u>\$12,503,000</u>	<u>\$26,694,000</u>

Unrestricted endowment funds of \$3,235,000 and \$3,638,000 as of June 30, 2016 and 2015, respectively, relate to earnings on donor-restricted endowments in excess of the Institute's spending-rate policy.

The changes in endowment net assets for the years ended June 30, 2016 and 2015, are as follows:

	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Endowment net assets—July 1, 2014	<u>\$ 12,973,000</u>	<u>\$ 1,867,000</u>	<u>\$ 12,033,000</u>	<u>\$ 26,873,000</u>
Investment return:				
Investment income	349,000	194,000		543,000
Unrealized loss	(299,000)	(210,000)		(509,000)
Realized gain	—	—	—	—
Total investment return	<u>50,000</u>	<u>(16,000)</u>	<u>-</u>	<u>34,000</u>
Contributions	<u>450,000</u>	<u>—</u>	<u>470,000</u>	<u>920,000</u>
Appropriation of endowment assets for expenditure	<u>(739,000)</u>	<u>(394,000)</u>	<u>—</u>	<u>(1,133,000)</u>
Endowment net assets—June 30, 2015	<u>12,734,000</u>	<u>1,457,000</u>	<u>12,503,000</u>	<u>26,694,000</u>
Investment return:				
Investment income	347,000	202,000		549,000
Unrealized loss	(2,337,000)	(1,196,000)		(3,533,000)
Realized gain	<u>1,989,000</u>	<u>992,000</u>	<u>—</u>	<u>2,981,000</u>
Total investment return	<u>(1,000)</u>	<u>(2,000)</u>	<u>-</u>	<u>(3,000)</u>
Contributions	<u>—</u>	<u>—</u>	<u>510,000</u>	<u>510,000</u>
Appropriation of endowment assets for expenditure	<u>(789,000)</u>	<u>(425,000)</u>	<u>—</u>	<u>(1,214,000)</u>
Endowment net assets—June 30, 2016	<u>\$ 11,944,000</u>	<u>\$ 1,030,000</u>	<u>\$ 13,013,000</u>	<u>\$ 25,987,000</u>

See Note 4 for permanently restricted pledges receivable as of June 30, 2016. These pledges receivable are not included in the above schedule of endowment net assets.

The description of the amounts classified as permanently restricted net assets as of June 30, 2016 and 2015, is as follows:

	<b>2016</b>	<b>2015</b>
Permanently restricted net assets—the portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by SPMIFA	<u>\$ 13,013,000</u>	<u>\$ 12,503,000</u>
Total endowment funds classified as permanently restricted net assets	<u>\$ 13,013,000</u>	<u>\$ 12,503,000</u>
Temporarily restricted net assets—the portion of perpetual endowment funds subject to a time restriction under SPMIFA—with purpose restrictions	<u>\$ 1,030,000</u>	<u>\$ 1,457,000</u>
Total endowment funds classified as temporarily restricted net assets	<u>\$ 1,030,000</u>	<u>\$ 1,457,000</u>

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 SPMIFA requires the Institute to retain as a fund of perpetual duration. These deficiencies may result from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions or continued appropriation for certain programs that were deemed prudent by the Board. In accordance with GAAP, deficiencies of this nature, if any, are reported in unrestricted net assets. There were no such deficiencies as of June 30, 2016 or 2015.

The Institute 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 organization must hold in perpetuity or for donor-specified periods. Under this policy, as approved by the Board, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of certain appropriate indices while assuming commensurate risk. Based upon its investment approach and asset allocation strategy, the Institute expects its endowment funds, over time, to generate returns that will support a spending rate of 5% annually. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate of return objectives, the Institute relies on a total return and preservation of capital strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Institute targets a diversified asset allocation to achieve its long-term rate-of-return objectives within prudent risk constraints. The Finance Committee of the Institute's Board of Trustees maintains the Institute's asset allocation.

## 9. COMMITMENTS

**Operating Leases**—The Institute has entered into operating leases for equipment and facilities space. The lease agreements expire on various dates through December 2022. Future minimum payments due under the noncancelable operating leases with remaining terms in excess of one year as of June 30, 2016, are as follows:

<b>Years Ending June 30</b>	
2017	\$ 4,711,000
2018	4,785,000
2019	4,865,000
2020	4,400,000
2021	2,894,000
Thereafter	<u>329,000</u>
Total	<u>\$ 21,984,000</u>

Rent expense totaled \$4,696,000 and \$4,691,000 for the years ended June 30, 2016 and 2015, respectively.

**Pension Plan**—The Institute has a defined contribution pension plan. For eligible employees, the Institute matches an employee’s contribution after one year of continuous service to a maximum of 10% of the employee’s annual salary if the employee’s contributions are at least 5% of annual salary. The Institute’s contributions expense related to this plan for fiscal year 2016 and 2015 was \$3,942,000 and \$4,085,000, respectively.

**Deferred Compensation Plan**—The Institute has a deferred compensation plan under which eligible employees may elect salary deferrals to be made to the plan up to the maximum amount permitted by law. The Institute may make elective contributions and/or matching contributions at the sole discretion of the Board. No elective contributions were made in fiscal years 2016 and 2015. Plan assets and the related liabilities to participants are included in prepaid and other assets and receivables, and in accounts payable, accrued expenses, and other liabilities, respectively, in the accompanying statements of financial position and totaled \$2,803,000 and \$2,471,000 as of June 30, 2016 and 2015, respectively.

Additionally, the Institute has an unfunded, nonqualified deferred compensation plan for certain employees. The amount of the employer contribution, if any, is determined by the Board. The Institute’s contributions expense related to this plan was \$521,000 and \$462,000 for fiscal year 2016 and 2015, respectively.

**Legal**—The Institute is, from time to time, a party to certain legal actions arising in the ordinary course of business. In the opinion of management, liabilities, if any, under these actions will not result in material charges against net assets.

**Guarantees and Indemnities**—From time to time, the Institute enters into certain types of contracts that contingently require the Institute to indemnify parties against third-party claims. These contracts primarily relate to (i) certain technology transfer/license agreements, under which the Institute may be required to indemnify licensees; (ii) certain real estate leases, under which the Institute may be required to indemnify property owners for environmental or other liabilities and other claims arising from the Institute’s use of the premises; and (iii) certain agreements with the Institute’s officers, directors, and employees, under which the Institute may be required to indemnify such persons for liabilities arising out of their employment relationship.

The terms of such obligations vary by contract and, in most instances, a specific or maximum dollar amount is not explicitly stated therein. Generally, amounts under these contracts cannot be reasonably estimated until a specific claim is asserted. Consequently, no liabilities have been recorded for these obligations in the Institute’s statements of financial position for any of the periods presented.

**Future Operations** — As part of the Institute’s overall objective to focus its effort and resources on the mission of the Institute, the Board is exploring strategic alternatives with respect to its operating division in Florida. The Institute did not meet the relevant criteria for reporting the division pursuant to FASB Topic 205-20, *Presentation of Financial Statements - Discontinued Operations*, and FASB Topic 360, *Property, Plant, and Equipment* as of June 30, 2016. The Institute will continue to evaluate the reporting criteria, as the Board continues to explore alternatives.

## **10. INCOME TAXES**

The Institute has no material deferred tax assets or deferred tax liabilities recorded as of June 30, 2016 and 2015.

The Institute did not recognize a change in liability for unrecognized tax benefits (the difference between a tax position taken, or expected to be taken, in a tax return and the benefit recognized and measured in the financial statements). There were no liabilities for unrecognized tax benefits at June 30, 2016 and 2015.

## **11. OTHER RELATED-PARTY DISCLOSURES**

For the years ended June 30, 2016 and 2015, the Institute made payments of \$1,896,000 and \$1,669,000, respectively, to vendors of goods, services, and equipment at which officers or trustees of the Institute served as directors.

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