

**OHIO WESLEYAN UNIVERSITY
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL REPORT

JUNE 30, 2017 and 2016

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

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Independent Auditors' Report

Board of Trustees
Ohio Wesleyan University
Delaware, Ohio

We have audited the accompanying consolidated financial statements of Ohio Wesleyan University and subsidiaries, which comprise the consolidated statements of financial position as of June 30, 2017 and 2016, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the June 30, 2017 and 2016 financial statements of OWU Fund, LP, described in Note 1.A. OWU Fund, LP represents 38% and 36% of consolidated total assets as of June 30, 2017 and 2016, respectively, and 77% and (93)% of the consolidated net investment income (loss) for the years ended June 30, 2017 and 2016, respectively. This entity was audited by other auditors whose reports have been furnished to us and our opinion, insofar as it relates to the amounts included for this entity, is based solely on the reports of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of 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 auditors' 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 auditors consider 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, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ohio Wesleyan University and subsidiaries as of June 30, 2017 and 2016, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Meloney + Novotny LLC

Cleveland, Ohio
November 14, 2017

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Assets		
Cash and cash equivalents	\$ 11,363,776	\$ 10,622,225
Accounts receivable:		
Students, net	629,540	822,237
Grants	506,456	352,064
Other	<u>611,690</u>	<u>380,180</u>
Total accounts receivable	1,747,686	1,554,481
Pledges receivable, net	7,731,580	7,760,248
Student loans receivable, net	4,480,893	4,450,121
Inventories and prepaid expenses	1,012,323	952,590
Investments	233,570,556	212,701,727
Interests in trusts	2,855,010	2,781,516
Land, buildings and equipment, net	130,945,529	131,286,414
Construction in progress	3,263,037	2,159,579
	<hr/>	<hr/>
Total assets	<u>\$396,970,390</u>	<u>\$374,268,901</u>

The accompanying notes are an integral part of these financial statements.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 3,060,541	\$ 2,902,717
Accrued compensation	4,056,810	3,436,437
Deferred income and deposits	3,856,262	3,936,153
Other accrued liabilities	1,875,765	1,743,158
Deferred tax liability	226,000	325,000
Notes payable	122,742	256,675
Bonds payable, net	24,718,076	27,239,201
Postretirement benefits other than pensions	7,719,000	10,336,000
Accrued pension liability	786,539	1,167,501
Annuities and unitrusts payable	3,589,224	3,142,492
Advances from federal government for student loans	<u>3,952,707</u>	<u>3,894,263</u>
Total liabilities	53,963,666	58,379,597
Net assets:		
Unrestricted	82,312,395	82,975,916
Temporarily restricted	77,924,982	58,936,322
Permanently restricted	<u>176,489,177</u>	<u>167,653,943</u>
Total net assets - University	336,726,554	309,566,181
Noncontrolling interest	<u>6,280,170</u>	<u>6,323,123</u>
Total net assets	<u>343,006,724</u>	<u>315,889,304</u>
Total liabilities and net assets	<u>\$396,970,390</u>	<u>\$374,268,901</u>

The accompanying notes are an integral part of these financial statements

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF ACTIVITIES

Year Ended June 30, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenue, gains and other support:				
Tuition and fees	\$ 69,707,169			\$ 69,707,169
Less: University funded financial aid	(37,701,440)			(37,701,440)
Financial aid from outside sources	(6,438,917)			(6,438,917)
Net tuition and fees	25,566,812			25,566,812
Gifts, pledges and bequests	6,728,327	\$ 3,566,887	\$ 8,752,965	19,048,179
Other investment income	256,423	27	233	256,683
Investment return designated for current operations	4,038,953	10,361,047		14,400,000
Grants	967,993	734,890		1,702,883
Other income	1,681,003	271,284	54,777	2,007,064
Sales and services of auxiliary enterprises	17,882,046			17,882,046
Net assets released from restrictions	12,238,289	(12,238,289)		-
Total operating revenue, gains and other support	69,359,846	2,695,846	8,807,975	80,863,667
Operating expenses:				
Instruction	25,921,922			25,921,922
Student services	12,130,673			12,130,673
Academic support, including library	6,740,753			6,740,753
Auxiliary enterprises	13,057,912			13,057,912
Management and general	7,357,144			7,357,144
Fundraising	4,266,055			4,266,055
Public services	290,771			290,771
Research	240,597			240,597
Total operating expenses	70,005,827			70,005,827
Net (decrease) increase in net assets from operations	(645,981)	2,695,846	8,807,975	10,857,840
Nonoperating revenues and expenses:				
(Losses) gains on investments in excess of amount designated for current operations	(2,781,184)	16,242,066	4,513	13,465,395
Postretirement obligation adjustment	2,617,000			2,617,000
Pension-related charges other than net periodic pension cost	355,786			355,786
Deferred tax benefit	99,000			99,000
Actuarial adjustment of split-interest agreements		50,748	22,746	73,494
Change in net assets	(355,379)	18,988,660	8,835,234	27,468,515
Net assets, beginning of year	89,299,039	58,936,322	167,653,943	315,889,304
Net capital distribution - noncontrolling interest	(351,095)			(351,095)
Net assets, end of year	<u>\$ 88,592,565</u>	<u>\$ 77,924,982</u>	<u>\$176,489,177</u>	<u>\$343,006,724</u>

The accompanying notes are an integral part of these financial statements.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF ACTIVITIES

Year Ended June 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenue, gains and other support:				
Tuition and fees	\$ 70,526,786			\$ 70,526,786
Less: University funded financial aid	(36,610,561)			(36,610,561)
Financial aid from outside sources	(6,576,481)			(6,576,481)
Net tuition and fees	27,339,744			27,339,744
Gifts, pledges and bequests	5,807,995	\$ 2,051,711	\$ 5,697,765	13,557,471
Other investment income	324,863	80	(148)	324,795
Investment return designated for current operations	515,575	9,942,737		10,458,312
Grants	884,489	636,855		1,521,344
Other income	1,818,359	197,346	139,202	2,154,907
Sales and services of auxiliary enterprises	18,251,652			18,251,652
Net assets released from restrictions	13,193,254	(13,193,254)		-
Total operating revenue, gains and other support	68,135,931	(364,525)	5,836,819	73,608,225
Operating expenses:				
Instruction	24,599,695			24,599,695
Student services	11,554,840			11,554,840
Academic support, including library	6,775,718			6,775,718
Auxiliary enterprises	13,060,457			13,060,457
Management and general	6,992,408			6,992,408
Fundraising	4,313,960			4,313,960
Public services	184,962			184,962
Research	171,867			171,867
Total operating expenses	67,653,907			67,653,907
Net increase (decrease) in net assets from operations	482,024	(364,525)	5,836,819	5,954,318
Nonoperating revenues and expenses:				
(Losses) gains on investments in excess of amount designated for current operations	(1,087,876)	(21,565,685)	594	(22,652,967)
Postretirement obligation adjustment	12,453,000			12,453,000
Pension-related charges other than net periodic pension cost	(454,190)			(454,190)
Deferred tax benefit	60,000			60,000
Actuarial adjustment of split-interest agreements		(49,617)	(88,885)	(138,502)
Change in net assets	11,452,958	(21,979,827)	5,748,528	(4,778,341)
Net assets, beginning of year	78,031,059	80,916,149	161,905,415	320,852,623
Net capital distribution - noncontrolling interest	(184,978)			(184,978)
Net assets, end of year	<u>\$ 89,299,039</u>	<u>\$ 58,936,322</u>	<u>\$167,653,943</u>	<u>\$315,889,304</u>

The accompanying notes are an integral part of these financial statements.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ 27,468,515	\$ (4,778,341)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	5,140,595	4,714,724
Amortization of bond issuance costs	33,524	33,524
Loss on disposal of asset	185,406	-
Realized and unrealized (gains) losses on investments	(27,865,395)	12,402,032
Contributions, net of pledges, for permanently restricted purposes	(8,752,965)	(8,169,178)
Income restricted for long-term investment	(55,010)	(139,054)
Change in deferred tax liability	(99,000)	(60,000)
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(193,205)	601,366
Decrease in pledges receivable	28,668	5,564,708
(Increase) decrease in student loans receivable	(30,772)	345,951
Increase in inventories and prepaid expenses	(59,733)	(371,806)
(Increase) decrease in interests in trusts	(73,494)	138,502
Increase (decrease) in accounts payable	157,824	(1,852,633)
Increase (decrease) in accrued compensation	620,373	(135,350)
(Decrease) increase in deferred income and deposits	(79,891)	133,901
Increase (decrease) in other accrued liabilities	132,607	(94,212)
Decrease in postretirement benefits other than pensions	(2,617,000)	(12,453,000)
(Decrease) increase in accrued pension liability	(380,962)	439,247
Increase in annuities and unitrusts payable	446,732	232,823
Increase in advances from federal government for student loans	58,444	73,058
Net cash used in operating activities	<u>(5,934,739)</u>	<u>(3,373,738)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of land, buildings and equipment	(6,088,574)	(7,238,193)
Sales of securities, net	6,996,566	568,698
Net cash provided by (used in) investing activities	<u>907,992</u>	<u>(6,669,495)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on bonds payable	(2,554,649)	(2,494,319)
Payments on notes payable	(133,933)	(133,917)
Capital distributions to noncontrolling investors	(351,095)	(184,978)
Contributions, net of pledges, for permanently restricted purposes	8,752,965	8,169,178
Income restricted for long-term investment	55,010	139,054
Net cash provided by financing activities	<u>5,768,298</u>	<u>5,495,018</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	741,551	(4,548,215)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>10,622,225</u>	<u>15,170,440</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 11,363,776</u>	<u>\$ 10,622,225</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	<u>\$ 634,095</u>	<u>\$ 624,066</u>

The accompanying notes are an integral part of these financial statements.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Nature of Organization and Significant Accounting Policies

- A. Organization – Ohio Wesleyan University (the University) is an independent, liberal arts institution of higher education offering various bachelor degree academic programs. The University derives its income from student tuition, gifts and grants, investment income, operation of residence halls and various related activities. The accounting policies of the University reflect practices common to colleges and universities and conform to accounting principles generally accepted in the United States of America for such institutions.

OWU Fund, LP is a limited partnership which commenced operations January 1, 2012, in which the University is the sole limited partner and is intended to serve as a single investor fund for the administrative convenience of the investor. The partnership acts as an investment vehicle for a significant portion of the University's endowment. OWU Fund, LP was audited by other auditors as of and for the years ended June 30, 2017 and 2016.

O.W.U. Properties, Inc. is a wholly-owned for-profit subsidiary of the University (Note 6) and is consolidated for financial statement purposes with the University.

Stuyvesant Hall Holdings, Inc. is a wholly-owned subsidiary of the University and has a 60.00% ownership interest in Stuyvesant Hall, LLC and a 0.01% ownership interest in Stuyvesant Hall Master Tenant, LLC.

Stuyvesant Hall, LLC holds title to the Stuyvesant Hall building and the land on which it is built.

Stuyvesant Hall Master Tenant, LLC ownership is divided among three members which includes Stuyvesant Hall Holdings, Inc., who is the LLC managing member. Stuyvesant Hall Master Tenant, LLC has a 40% ownership interest in Stuyvesant Hall, LLC and leases space from Stuyvesant Hall, LLC.

The three Stuyvesant Hall entities were formed by the University to facilitate the rehabilitation of the Stuyvesant Hall building, a 245-bed historic building located in Delaware, Ohio on the campus of the University.

The Stuyvesant Hall building is listed on the National Register of Historic Places, making it eligible for tax credits under federal and state tax laws (Federal Historic Tax Credits and State of Ohio Historic Tax Credits) for qualified expenditures incurred in a substantial renovation of the building. Stuyvesant Hall, LLC filed and received approval from the National Parks Service on Parts 1 and 2 of its application for Federal Historic Tax Credits on qualified rehabilitation expenditures. The rehabilitation project was completed in September 2012.

In September 2012, Stuyvesant Hall Master Tenant, LLC entered into a master lease agreement with Stuyvesant Hall, LLC for leasing 100% of the building for a term of 32 years ending in 2044.

Stuyvesant Hall Master Tenant, LLC subleases the residential space to student residents on an annual basis and leases approximately 11,500 square feet of commercial space to the University under a six year lease.

- B. Basis of Consolidation – These consolidated financial statements include the accounts of the University, OWU Fund, LP (OWU Fund), O.W.U. Properties, Inc. (OWU Properties), Stuyvesant Hall Holdings, Inc. (Holdings), Stuyvesant Hall, LLC (Stuyvesant Hall) and Stuyvesant Hall Master Tenant, LLC (Master Tenant). All significant intercompany activity was eliminated in consolidation.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

- C. Basis of Presentation – The consolidated financial statements of the University have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Assets and liabilities presented in the consolidated statements of financial position are recorded in order of liquidity or nearness to conversion to cash. The University has reported information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted and permanently restricted based upon the existence or absence of donor-imposed restrictions as follows:

Unrestricted – Net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

Temporarily Restricted – Net assets whose use by the University is subject to donor-imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.

Permanently Restricted – Net assets subject to donor-imposed stipulations that they be maintained permanently by the University. Generally, donors of these assets permit the University to use all or part of the income earned on these assets. Such assets primarily include the University's permanent endowment funds.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Expiration of donor-imposed stipulations that simultaneously increase one class of net assets and decrease another is reported as reclassifications between the applicable classes of net assets. Changes in designations of net assets represent donor reclassifications of gifts received in prior years and, therefore, do not represent operating activity in the consolidated statements of activities.

The expiration of a donor-imposed restriction on a contribution or on endowment income is recognized in the period in which the restriction expires and at the time the related resources are reclassified to unrestricted net assets. A restriction expires when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled or both.

The University follows the policy of reporting donor-imposed restricted contributions and endowment income whose restrictions are met in the same period as received as temporarily restricted support.

Contributions of land, buildings and equipment without donor stipulations concerning the use of such long-lived assets are reported as revenues of the unrestricted net asset class. Contributions of cash or other assets that the donor stipulates are to be used to acquire land, building and equipment are reported as revenues of the temporarily restricted net asset class. The restrictions are considered to be released at the time of acquisition of such long-lived assets.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

C. Basis of Presentation (Continued)

The University has evaluated all subsequent events through November 14, 2017, which is the date the consolidated financial statements were available to be issued.

D. Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. Concentrations of Credit Risk – Financial instruments which potentially subject the University to concentrations of credit risk consist principally of cash and cash equivalents, investments and student accounts and notes receivable. The University places its temporary cash investments with various financial institutions. Concentration of credit risk for investments is limited by the University's policy of asset allocation among different investment types. Concentration of credit risk for student accounts and notes receivable is limited due to the large base of accounts and geographic diversification.

F. Cash and Cash Equivalents – Cash and cash equivalents include amounts on deposit with various financial institutions, including interest-bearing demand deposit accounts, which, at times, may exceed federally insured amounts. Cash equivalents also include all U.S. Government obligations, commercial paper and corporate notes with original maturities of three months or less, except those held for long-term investment, which are classified with investments.

G. Student Accounts Receivable – The University has provided an allowance for uncollectible accounts receivable. Management estimates the allowance based on its review of delinquent accounts and an assessment of the University's historical evidence of collections. The allowance was \$760,000 at June 30, 2017 and 2016.

H. Student Loans Receivable – The University participates with the U.S. Department of Education in the Federal Perkins Loan Program for the purpose of granting low interest loans (5% at June 30, 2017 and 2016) to students demonstrating financial need. After a student's graduation or withdrawal, Perkins loans are to be repaid over a maximum of ten years. The allowance for uncollectible student loans was \$475,000 at June 30, 2017 and 2016.

Perkins funds are ultimately refundable to the U.S. Government to the extent funds are available from the program. Consequently, these funds are shown as a liability in the consolidated statements of financial position. The interest rates charged on substantially all Federal Perkins loans receivable are fixed by the U.S. Department of Education. The interest rates charged on University loans receivable are fixed by the University and do not fluctuate with market conditions.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

- I. Inventories – The carrying value of inventories approximates cost, under the first-in, first-out method, not in excess of market.
- J. Fair Value of Financial Instruments – The University has disclosed fair value information about financial instruments for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using discounted cash flows or other evaluation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument.

Due to their short-term nature, the carrying values of cash and cash equivalents, receivables, accounts payable and other accrued expenses reported in the accompanying consolidated statements of financial position approximate their fair value. The carrying value of the University's long-term debt is based on the University's current incremental borrowing rates for similar types of borrowing arrangements, which approximate fair value.

The carrying value of the University's investments approximates their fair value in accordance with the Fair Value Measurements standards, as defined by accounting principles generally accepted in the United States of America. These standards establish a three level hierarchy for disclosure to show the extent and the level of judgment used to estimate fair value measurements:

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

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

Level 3 – Unobservable inputs in which little or no market data exists.

The asset's or liability's fair value measurement level is based on the lowest level of any input that is significant to the fair value measurement.

The following tables set forth by level the University's assets and liabilities that are accounted for at a fair value on a recurring basis as of June 30, 2017 and 2016:

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

J. Fair Value of Financial Instruments (Continued)

	2017			Fair Value Total
	Level 1	Level 2	Level 3	
Assets:				
Investments				
Fixed income	\$ 4,317,044	\$ 2,500,000	\$ -	\$ 6,817,044
Other	609,152	-	11,097	620,249
U.S. Government securities	94,373	-	-	94,373
Common stocks	52,032,368	-	-	52,032,368
Exchange-traded funds				
Global equity	18,654,260	-	-	18,654,260
Real assets	3,129,991	-	-	3,129,991
U.S. equity	10,747,038	-	-	10,747,038
Fixed income	4,201,603	-	-	4,201,603
Mutual funds				
Global equity	10,401,321	-	-	10,401,321
Fixed income	19,088,559	-	-	19,088,559
Real assets	6,578,111	-	-	6,578,111
Commingled funds				
Real assets	-	2,166,789	-	2,166,789
Global equity	-	10,418,297	-	10,418,297
Derivative investment				
Warrant	203,160	-	-	203,160
Hedge fund class				
Global equity	-	-	5,111,960	5,111,960
Absolute return/credit	-	11,856	331,584	343,440
Private equity fund class				
Global venture capital/ private	-	-	1,294,594	1,294,594
Hybrid fund of funds	-	-	505,065	505,065
Real assets	-	-	2,628,467	2,628,467
U.S. private equity	-	-	3,103,065	3,103,065
U.S. venture capital	-	-	5,523,637	5,523,637
Money market mutual funds	986,475	-	-	986,475
Multi-asset class	-	-	66,865,287	66,865,287
Cash and cash equivalents	2,055,403	-	-	2,055,403
	<u>133,098,858</u>	<u>15,096,942</u>	<u>85,374,756</u>	<u>233,570,556</u>
Interests in trusts	-	-	2,855,010	2,855,010

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

J. Fair Value of Financial Instruments (Continued)

	2016			Fair Value Total
	Level 1	Level 2	Level 3	
Assets:				
Investments				
Fixed income	\$ 3,646,667	\$ 2,500,000	\$ 417,718	\$ 6,564,385
Other	555,093	-	11,097	566,190
U.S. Government securities	792,192	-	-	792,192
Common stocks	37,985,762	-	-	37,985,762
Depository receipts	1,729,477	-	-	1,729,477
Equity units	59,465	-	-	59,465
Exchange-traded funds				
Global equity	6,694,582	-	-	6,694,582
Fixed income	3,833,063	-	-	3,833,063
Mutual funds				
Global equity	14,679,081	-	-	14,679,081
Fixed income	13,907,820	-	-	13,907,820
Real assets	8,537,550	-	-	8,537,550
Commingled funds				
Real assets	-	2,861,318	-	2,861,318
Global equity	-	8,097,182	-	8,097,182
Derivative investment				
Warrant	119,329	-	-	119,329
Hedge fund class				
Global equity	-	2,958,326	3,801,685	6,760,011
Absolute return/credit	-	11,473,731	2,804,102	14,277,833
Private equity fund class				
Global venture capital/ private	-	-	1,840,871	1,840,871
Hybrid fund of funds	-	-	910,146	910,146
Private natural resources	-	-	929,944	929,944
U.S. private equity	-	-	2,253,138	2,253,138
U.S. venture capital	-	-	5,930,529	5,930,529
Money market mutual funds	442,985	-	-	442,985
Multi-asset class	-	-	63,618,673	63,618,673
Cash and cash equivalents	9,310,201	-	-	9,310,201
	<u>102,293,267</u>	<u>27,890,557</u>	<u>82,517,903</u>	<u>212,701,727</u>
Interests in trusts	-	-	2,781,516	2,781,516

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

J. Fair Value of Financial Instruments (Continued)

Investments – Since January 1, 2012, the University has invested in securities primarily through the OWU Fund and Makena Capital Management (Makena). The University, through the OWU Fund, invests in cash and cash equivalents, common stocks, mutual funds, fixed income and other securities with quoted prices in active markets that are considered to be Level 1 inputs. Any investments with underlying holdings classified as Level 1 but legally structured with limited redemption rights (most limited partnerships and master trusts) have been designated as Level 2 assets. In addition, the University has a percentage of its investments in alternative investments that are valued at Level 2 and Level 3. Level 2 alternative investment inputs include quoted prices for similar assets in active markets and inputs that are derived principally from or corroborated by observable market data. A portion of the University's investments is valued at Level 3 because of unobservable inputs, use of significant management judgment and redemption terms of some investment vehicles. This includes multi-asset class funds, private equities and real assets structured within limited partnerships and/or off-shore funds, which are based on valuations provided by external investment managers and the managers' third party administrators.

The University's investment with Makena is a Multi-Asset Class portfolio and is reported as a Level 3 investment due to liquidity restrictions. Makena's portfolio is comprised of alternative investment funds (93% and 88%), marketable securities (7% and 8%) and cash equivalents (0% and 4%) as of June 30, 2017 and 2016, respectively.

Interests in trusts – Interests in trusts include contributions receivable from lead and remainder trusts and are recorded at the present value of the projected net future cash flows to be received, based on current market interest rates. This type of asset has no readily determinable exit price due to legal constraints and, therefore, is considered to be a Level 3 input.

Assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3 inputs) are as follows:

	2017				
	Beginning Balance	Additions/ Purchases	Distributions	Realized and Unrealized Gains (Losses)	Ending Balance
Fixed income	\$ 417,718	\$ -	\$ (418,348)	\$ 630	\$ -
Hedge/absolute return funds	6,605,787	3,345,650	(5,185,578)	677,685	5,443,544
Other	11,097	-	-	-	11,097
Private equity fund class:					
Global venture capital/private	1,840,871	45,000	(792,478)	201,201	1,294,594
Hybrid fund of funds	910,146	-	(397,705)	(7,376)	505,065
Private natural resources	929,944	-	(929,944)	-	-
Real assets	-	3,812,922	(1,677,098)	492,643	2,628,467
U.S. private equity	2,253,138	1,066,826	(562,553)	345,654	3,103,065
U.S. venture capital	5,930,529	112,500	(833,802)	314,410	5,523,637
Multi-asset class	63,618,673	-	(3,770,117)	7,016,731	66,865,287
Interests in trusts	2,781,516	-	-	73,494	2,855,010

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

J. Fair Value of Financial Instruments (Continued)

	2016				
	Beginning Balance	Additions/ Purchases	Distributions	Realized and Unrealized Gains (Losses)	Ending Balance
Fixed income	\$ 417,718	\$ -	\$ -	\$ -	\$ 417,718
Hedge/absolute return funds	17,457,384	-	(9,295,488)	(1,556,109)	6,605,787
Other	11,097	-	-	-	11,097
Private equity fund class:					
Global venture capital/private	2,370,583	47,500	(865,782)	288,570	1,840,871
Hybrid fund of funds	1,206,134	-	(210,708)	(85,280)	910,146
Private natural resources	1,190,783	25,000	(76,771)	(209,068)	929,944
U.S. private equity	1,937,173	623,761	(418,066)	110,270	2,253,138
U.S. venture capital	6,285,683	127,500	(583,607)	100,953	5,930,529
Multi-asset class	67,421,051	-	(3,699,809)	(102,569)	63,618,673
Interests in trusts	2,920,018	-	-	(138,502)	2,781,516

K. Investments – Investments are carried at fair market value. Investments in equity securities with readily determinable fair values and all debt securities are recorded at fair value based on quoted market prices. Alternative investments are recorded based on estimated fair values. Methods for determining estimated fair values include discounted cash flows and estimates provided by fund trustees and general partners. The estimated fair value of certain of these investments is based on valuations provided by external investment managers, adjusted for cash receipts, disbursements and significant known changes in market values of publicly held securities held in the portfolio. The University considers the carrying values of these investments to be a reasonable estimate of fair value. Because these investments are not readily marketable and may be subject to withdrawal restrictions, their estimated value is subject to uncertainty and, therefore, may differ from the values that would have been used had a ready market for such investments existed.

Alternative investments include certain interests in international equities, hedge/absolute return, venture capital funds and real estate investment trusts. The University invests in limited partnerships and co-mingled vehicles, some of which employ traditional strategies (long only) in readily marketable securities (liquid equities or bonds traded on exchanges) and others of which employ less traditional strategies (long and short equity or fixed income and other hedging strategies) that may include the use of options, futures and other derivative instruments.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

K. Investments (Continued)

Realized gains and losses represent the difference between the proceeds on sale of investments and their cost when acquired or fair value when donated. Investment return includes interest, dividends and both realized and unrealized gains and losses. In those cases where a donor has placed restrictions on the use of net appreciation, such appreciation is reported as part of either temporarily restricted or permanently restricted net assets based on donor restrictions.

The University's endowment funds consist of assets which are invested on the basis of a total return policy to provide income and to realize appreciation in investment values. Realized investment gains accumulated by these funds may be used to support operations unless temporarily or permanently restricted by the donor or by law.

The University holds investment securities which are exposed to various risks including interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the University's investment account balances and the amounts reported in the consolidated statements of financial position.

- L. Land, Buildings, Equipment and Depreciation – The carrying value of land, buildings, equipment and other properties is stated at cost or appraised value at date of receipt as gifts. The University capitalizes additions and major replacements of plant and equipment while repairs are expensed. The University provides for depreciation on the straight-line method over the estimated useful lives summarized in the following table:

Land improvements	15 years
Buildings and building improvements	10-100 years
Equipment	5-10 years
Vehicles and office equipment	3-10 years

- M. Bond Issue Costs – Bond issue costs are amortized on a straight-line basis over the life of the bonds. Unamortized bond issuance costs are a direct reduction from bonds payable in the consolidated statements of financial position.
- N. Annuities and Unitrusts – The University's split interest agreements with donors consist of irrevocable charitable lead and remainder trusts, charitable gift annuities and life income contracts for which the University is either the remainder beneficiary or one of several remainder beneficiaries. Payments are made to donors and/or other beneficiaries in accordance with the respective agreements. Contribution revenues for split-interest agreements are recognized at the dates the agreements are established. Revenues are recorded at fair value, net of the present value of the estimated future payments to be made to the beneficiaries. The present value of payments to beneficiaries under split interest agreements has been calculated using actuarial estimates of life expectancies and discount rates ranging from 1.2% to 9.2% at June 30, 2017 and 2016.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

N. Annuities and Unitrusts (Continued)

Assets neither in the possession nor under the control of the University and to which the University has no ultimate claim on the corpus have not been included in the consolidated financial statements. However, pursuant to donors' wishes, income derived from these resources has been included as additions to temporarily restricted net assets in the consolidated statements of activities, as it is received.

O. Deferred Income and Deposits – Deferred income and deposits represent cash received from students for the following fiscal year but not earned, unearned grant revenue and other deposits.

P. Self Insurance – The University has elected to act as a self-insurer for certain costs related to employee health benefit programs. Costs resulting from non-insured losses are charged to expense when incurred, and the University has an established reserve for claims incurred but not yet paid. The University has insurance coverage which limits its exposure for individual claims and which limits the aggregate exposure to approximately \$465,000 per month.

Q. Art Collections – The University maintains a collection of artwork in its Humphreys Art Hall. Due to the difficulty in establishing a value for collection pieces donated to the University, these assets are not recorded in the consolidated financial statements. Collection purchases are expensed as purchased. The University provides a clean, secure and stable environment for its permanent collections. The artwork is given reasonable care towards its preservation.

R. Federal Income Tax – The University is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code, except on net income derived from unrelated business activities. The University recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. Examples of tax positions include the tax-exempt status of the University, the continued tax-exempt status of bonds issued by the University and various positions related to potential sources of unrelated taxable income. The University believes that it has appropriate support for any tax positions taken and, as such, does not have any uncertain tax positions that are material to the consolidated financial statements.

Stuyvesant Hall and Master Tenant are organized as limited liability companies and are taxed as partnerships for federal income tax purposes. Accordingly, all profits and losses of the companies are recognized by each member on their respective tax returns. Holdings was organized as a C Corporation pursuant to the provisions of the Internal Revenue Code.

A current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the year. Deferred tax liabilities or assets are recognized for the estimated future tax effects of temporary differences between financial reporting and tax accounting and operating loss and tax credit carry forwards. The primary components of temporary differences which give rise to the net deferred tax liability relate to depreciation and the timing of recognition of certain income items. A benefit for deferred federal income taxes of \$99,000 and \$60,000 was necessary for the years ended June 30, 2017 and 2016, respectively.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 1. Nature of Organization and Significant Accounting Policies (Continued)

R. Federal Income Tax (Continued)

As of June 30, 2017, the University's income tax years from 2013 and thereafter remain subject to examination by the Internal Revenue Service, as well as various state and local taxing authorities.

S. Conditional Asset Retirement Obligations – The University is required to recognize a liability for a conditional asset retirement obligation. Management has considered its legal obligations to perform an asset retirement analysis on its existing properties. Management believes that there is an indeterminate settlement date for the asset retirement obligations because the range of time over which the University may settle the obligations is unknown and cannot be estimated. As a result, management cannot reasonably estimate the liability related to these asset retirement activities as of June 30, 2017 and 2016.

T. Reclassifications – Certain reclassifications of 2016 amounts have been made to conform to the 2017 presentation.

Note 2. Investments

The University pools certain assets of permanent endowment, quasi-endowment, annuity and life income funds on a market value basis. Each individual fund subscribes to or disposes of units on the basis of the market value per unit at the beginning of the calendar quarter within which the transaction takes place, except for assets which are separately invested due to specific donor restrictions.

During the year ended June 30, 2012, the University transitioned a significant portion of its investments to the OWU Fund and Makena. The University continues to set investment policy, allows asset allocation ranges and monitors performance. The University has delegated the authority for investment decisions of the OWU Fund to Cambridge and Associates which includes asset allocation and manager selection. In addition, the University has made an investment in Makena, a multi-asset class manager with a 2-year lock up. The University has redeemed holdings from other managers and placed those funds and transferred other investments into these investment vehicles.

The composition of investments is set forth in the following table:

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 2. Investments (Continued)

	June 30	
	<u>2017</u>	<u>2016</u>
Fixed income	\$ 6,817,044	\$ 6,564,385
Other	620,249	566,190
U.S. Government securities	94,373	792,192
Common stocks	52,032,368	37,985,762
Depository receipts	-	1,729,477
Equity units	-	59,465
Exchange-traded funds		
Global equity	18,654,260	6,694,582
Real assets	3,129,991	-
U.S. equity	10,747,038	-
Fixed income	4,201,603	3,833,063
Mutual funds		
Global equity	10,401,321	14,679,081
Fixed income	19,088,559	13,907,820
Real assets	6,578,111	8,537,550
Commingled funds		
Real assets	2,166,789	2,861,318
Global equity	10,418,297	8,097,182
Derivative investment		
Warrant	203,160	119,329
Hedge fund class		
Global equity	5,111,960	6,760,011
Absolute return/credit	343,440	14,277,833
Private equity fund class		
Global venture capital/private	1,294,594	1,840,871
Hybrid fund of funds	505,065	910,146
Private natural resources	-	929,944
Real assets	2,628,467	-
U.S. private equity	3,103,065	2,253,138
U.S. venture capital	5,523,637	5,930,529
Money market mutual funds	986,475	442,985
Multi-asset class	66,865,287	63,618,673
Cash and cash equivalents	2,055,403	9,310,201
	<u>\$233,570,556</u>	<u>\$212,701,727</u>
Total investments		

At June 30, 2017, the University has committed to invest additional funds in limited partnership investments in the amount of approximately \$6,818,000, at the direction of the general partners. Investment expenses were \$1,398,000 and \$1,282,000 for the years ended June 30, 2017 and 2016, respectively, and included in investment income.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 2. Investments (Continued)

The composition of investment return is as follows:

	Years Ended June 30	
	2017	2016
Investment income (interest and dividends)	\$ 256,683	\$ 532,172
Realized and unrealized gains (losses) on investments	27,865,395	(12,402,032)
Total investment return	28,122,078	(11,869,860)
Other investment income	(256,683)	(324,795)
Investment return designated for current operations	(14,400,000)	(10,458,312)
Non-operating investment return	\$ 13,465,395	\$(22,652,967)

Note 3. Pledges Receivable

As of June 30, 2017 and 2016, the University had received unconditional promises totaling \$8,490,385 and \$8,593,466, respectively, on which management has recorded an allowance for uncollectible promises of \$295,362 and \$286,620, respectively. The amounts are recorded at the present value of future cash flows based on a discount rate of 3% for June 30, 2017 and 2016. The discount is \$463,443 and \$546,598 at June 30, 2017 and 2016, respectively. The pledges receivable are due as follows:

June 30, 2017				
	Temporarily Restricted Plant	Temporarily Restricted Other	Permanently Restricted	Total
Less than one year	\$ 1,112,306	\$ 141,125	\$ 302,571	\$ 1,556,002
One to five years	865,937	1,105,464	3,925,847	5,897,248
More than five years	157,608	-	120,722	278,330
	\$ 2,135,851	\$ 1,246,589	\$ 4,349,140	\$ 7,731,580

June 30, 2016				
	Temporarily Restricted Plant	Temporarily Restricted Other	Permanently Restricted	Total
Less than one year	\$ 1,307,980	\$ 53,540	\$ 329,499	\$ 1,691,019
One to five years	1,809,491	1,045,614	2,874,425	5,729,530
More than five years	162,692	-	177,007	339,699
	\$ 3,280,163	\$ 1,099,154	\$ 3,380,931	\$ 7,760,248

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 3. Pledges Receivable (Continued)

At June 30, 2017 and 2016, the University had also been notified of revocable pledges, bequests and other indications of intentions to give. These potential contributions have not been substantiated by written promises to the University. The University's policy is not to record these intentions to give as revenue until they are reduced to writing or are collected.

Note 4. Land, Buildings and Equipment

Land, buildings and equipment at June 30, 2017 and 2016 consist of the following:

	June 30	
	<u>2017</u>	<u>2016</u>
Grounds and land improvements	\$ 11,907,264	\$ 11,470,364
Buildings and building improvements	166,620,014	163,130,575
Equipment	17,247,170	16,966,898
Vehicles and office equipment	9,372,388	8,863,606
Less accumulated depreciation	(74,201,307)	(69,145,029)
	<u>\$130,945,529</u>	<u>\$131,286,414</u>

Depreciation expense totaled \$5,140,595 and \$4,714,724 for the years ended June 30, 2017 and 2016, respectively.

Note 5. Pension Plans and Other Postretirement Benefit Plans

The University maintains a defined contribution pension plan, administered by TIAA-CREF, which covers the majority of its faculty and administrative personnel. All costs of this plan, \$2,750,467 and \$2,712,043 for the years ended June 30, 2017 and 2016, respectively, are funded and reflected as expenditures in the year earned, and no past service costs exist.

The University also maintains a non-contributory defined benefit pension plan, which covered the majority of the University's hourly and certain administrative personnel, through June 30, 1998. This defined benefit plan provides pension benefits that are based upon the employee's length of service with the University. The University's funding policy is to contribute annually the minimum amount required by applicable regulations.

Effective July 1, 1998, the University froze all benefits in the defined benefit pension plan and transferred coverage for all employees to the defined contribution pension plan.

In addition to the University's defined contribution and defined benefit retirement plans, the University has a defined benefit postretirement plan. The plan provides certain health care and life insurance benefits for retired employees who began employment with the University prior to September 1, 1999. The health care plan is contributory. Prior to January 1, 2016, the University made contributions to this plan equal to benefits paid. Effective January 1, 2016, the plan was changed whereby the University contributes a monthly stipend of \$100 for all covered participants which resulted in a decrease of the benefit obligation of \$14,052,860.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 5. Pension Plans and Other Postretirement Benefit Plans (Continued)

The various components of these plans, which are included in the University's consolidated financial statements, are as follows:

	Pension Plan		Postretirement Benefit Plan	
	June 30		June 30	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Net Periodic Benefit Cost				
Service cost	\$ -	\$ -	\$ 57,868	\$ 130,609
Interest cost	100,001	121,139	277,581	703,017
Return on plan assets	(123,282)	(137,607)	-	-
Prior service cost	-	-	(2,951,087)	(1,664,124)
Amortization of loss	<u>187,899</u>	<u>130,894</u>	<u>812,263</u>	<u>776,992</u>
Net periodic benefit cost	<u>\$ 164,618</u>	<u>\$ 114,426</u>	<u>\$ (1,803,375)</u>	<u>\$ (53,506)</u>

The pension plan has \$778,077 of unrecognized actuarial loss at June 30, 2017. The estimated amortization of actuarial loss is \$133,391 in 2018.

The postretirement benefit plan has amounts unrecognized in net periodic benefit cost for prior service credit of \$10,997,984 and a net actuarial loss of \$3,457,891 at June 30, 2017. The estimated amortization of prior service cost and actuarial loss is \$2,941,180 and \$569,063, respectively, in 2018.

	Pension Plan		Postretirement Benefit Plan	
	June 30		June 30	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Change in Benefit Obligation				
Benefit obligation at beginning of year	\$ 3,290,263	\$ 3,088,586	\$ 10,336,000	\$ 22,789,000
Service cost	-	-	57,868	130,609
Interest cost	100,001	121,139	277,581	703,017
Actual distributions	(147,922)	(202,250)	-	-
Actuarial (gain) loss	(263,635)	282,788	(2,509,311)	1,751,600
Net contributions (employer)	-	-	(443,138)	(985,366)
Change in plan provisions	<u>-</u>	<u>-</u>	<u>-</u>	<u>(14,052,860)</u>
Benefit obligation at end of year	2,978,707	3,290,263	7,719,000	10,336,000
Plan assets	<u>2,192,168</u>	<u>2,122,762</u>	<u>-</u>	<u>-</u>
Funded status	<u>\$ (786,539)</u>	<u>\$ (1,167,501)</u>	<u>\$ (7,719,000)</u>	<u>\$ (10,336,000)</u>

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 5. Pension Plans and Other Postretirement Benefit Plans (Continued)

	Pension Plan		Postretirement Benefit Plan	
	June 30		June 30	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Actuarial Assumptions				
Weighted average discount rate:				
Expense	3.25%	4.00%	3.35%	4.67%
Benefit obligation (at year end)	3.50%	3.25%	3.65%	3.35%
Expected rate of return on assets	6.00%	6.00%	N/A	N/A
Medical trend:				
For next year (pre 65/post 65)	N/A	N/A	9.0%/N/A	7.10%/NA
Ultimate trend rate	N/A	N/A	4.50%	5.50%
Year reached	N/A	N/A	2026	2023

Under the postretirement benefit plan, if the medical trend rates were to increase by 1% for each year, the benefit obligation as of June 30, 2017 would also increase by \$176,918 and the sum of the service and interest cost components of the Net Periodic Postretirement Benefit Cost for the fiscal year ended June 30, 2017 would increase by \$11,100. If the medical trend rates were to decrease by 1% for each year, the benefit obligation as of June 30, 2017 would also decrease by \$163,400 and the sum of the service and interest cost components of the Net Periodic Postretirement Benefit Cost for the fiscal year ended June 30, 2017 would decrease by \$10,082.

Pension Plan Assets

The University's weighted average asset allocations at the measurement date and the target asset allocations by category are as follows:

Asset Category	2017	2016	Target
	<u>Actual</u>	<u>Actual</u>	
Equity securities	54.7 %	55.6 %	50-70 %
Debt securities	43.5	43.5	30-50
Cash equivalents	<u>1.8</u>	<u>0.9</u>	<u>0-15</u>
Total	<u>100.0</u> %	<u>100.0</u> %	<u>100.0</u> %

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 5. Pension Plans and Other Postretirement Benefit Plans (Continued)

Pension Plan Assets (Continued)

The pension plan's investment policy reflects the long-term nature of the plan's funding obligations. The assets are invested to provide the opportunity for both income and growth of principal. This objective is pursued as a long-term goal designed to provide required benefits for participants without undue risk. It is expected that this objective can be achieved through a well-diversified asset portfolio. All equity investments are made within the guidelines of quality, marketability and diversification mandated by the Employee Retirement Income Security Act and other relevant statutes. Investment managers are directed to maintain equity portfolios at a risk level approximately equivalent to that of the specific benchmark established for that portfolio. Assets invested in fixed income securities and pooled fixed income portfolios are managed actively to pursue opportunities presented by changes in interest rates, credit ratings or maturity premiums. The expected long-term rate of return on pension plan assets was developed by the University, in conjunction with the plan actuary, and is based on the past return of the plan investments.

Pension Plan Contributions

There are no expected contributions to the pension plan for the year ended June 30, 2018.

Estimated Future Benefit Payments

Future benefit payments, which reflect expected future service, as appropriate, during the next five fiscal years, and in the aggregate for the five fiscal years thereafter, are:

<u>Fiscal Year Ended June 30</u>	<u>Pension Benefits</u>	<u>Other Benefits</u>
2018	\$ 147,284	\$ 615,000
2019	153,236	676,000
2020	170,347	689,000
2021	175,446	703,000
2022	174,060	645,000
2023 - 2027	887,117	2,699,000

The University's pension plan assets at June 30, 2017 and 2016 are all Level 1 assets. The fair value, by asset category, is as follows:

	<u>2017</u>	<u>2016</u>
Equity securities	\$1,199,189	\$1,179,355
Debt securities	954,075	923,752
Cash equivalents	<u>38,904</u>	<u>19,655</u>
	<u>\$2,192,168</u>	<u>\$2,122,762</u>

In addition to the retirement plans described above, the University maintains an unfunded defined benefit pension plan for former employees that remain eligible for benefits earned prior to 1952 (the termination date of the plan). The future unfunded costs related to this plan are expected to approximate \$36,000 next year, with declining unfunded costs thereafter.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 6. Investment in OWU Properties

The University currently owns all the stock in its taxable subsidiary, OWU Properties. OWU Properties is the general partner in the Austin Manor Limited Partnership (Austin Manor) and owns 1% of the partnership units of Austin Manor. The University also owns a 2% interest in Austin Manor, directly. Certain limited partners of Austin Manor are also trustees of the University. Austin Manor was formed to finance the renovation of a University owned residence hall into an apartment complex. As part of the renovation, the University transferred ownership of the residence hall and the related land to OWU Properties.

The University has consolidated the assets and operations of OWU Properties into its financial statements. The assets and operations of OWU Properties were immaterial to the University for the years ended June 30, 2017 and 2016.

Under terms of the Austin Manor financing agreement, the University has guaranteed 42.415% of a \$2,392,787 first mortgage loan (\$216,499 and \$389,698 outstanding at June 30, 2017 and 2016, respectively).

The University has also loaned approximately \$5,006,000 to Austin Manor. The first loan of \$650,000 was borrowed from the University's endowment funds and is secured by a third mortgage. The second loan of approximately \$4,356,000 was borrowed from the University's current funds and is unsecured. These loans bear interest at the rate of 8%. Interest payments are limited to 50% of Austin Manor's cash flows after all other debt service and operating expenses are paid. At June 30, 2017, the unaudited accumulated partnership deficit of Austin Manor, including depreciation and amortization costs of \$3,008,133, approximated \$7,693,120. For the year ended June 30, 2017, Austin Manor generated net income, determined by the cash basis of accounting, of approximately \$164,617. No interest was paid in 2017 and 2016.

The University has also loaned OWU Properties \$140,000 to fund a required special distribution to the partners of Austin Manor. The unsecured loan bears interest at a rate of 8%.

Prior to 2005, the University determined that the loans to Austin Manor and OWU Properties were impaired loans and they remain uncollectible as of June 30, 2017. Interest income is recognized on the loans and is fully reserved. The recorded allowance for doubtful accounts associated with the Austin Manor and OWU Properties loans and related accrued interest is \$7,577,366 at June 30, 2017, bringing the net carrying value to \$-0-.

Note 7. Notes Payable

Under an unsecured line of credit arrangement with a bank, the University may borrow up to \$6,000,000 at the London Interbank Offered Rate (LIBOR) interest rate (1.23% at June 30, 2017) plus 1.5% to fund cyclical working capital requirements. The line of credit arrangement expires in March 2018. As of June 30, 2017, there was \$-0- outstanding on this line of credit (\$-0- outstanding as of June 30, 2016). This line of credit agreement requires the maintenance of certain financial ratios and restricts the University's ability to pledge or sell certain assets and consolidate with or acquire assets of other entities. Interest expense for the line of credit for the years ended June 30, 2017 and 2016 was \$-0-.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 7. Notes Payable (Continued)

In May 2015, the University entered into a promissory note agreement of \$426,100 at the monthly LIBOR interest rate (1.23% at June 30, 2017) plus 1.5%. In June 2015, the note term was changed to 34 months with monthly principal payments of \$11,160 through May 2018. The note proceeds were used to pay the interest rate swap contract associated with the 2009 bonds which were refinanced with the 2015 bond issue. Interest expense for the promissory note for the years ended June 30, 2017 and 2016 was \$4,213 and \$5,997, respectively.

Note 8. Bonds Payable

Bonds payable at June 30, 2017 and 2016 consisted of the following:

	<u>2017</u>	<u>2016</u>
Fixed-rate bonds issued in 2015, maturing through 2025 (2015 Bonds)	\$14,272,084	\$15,760,581
Variable-rate bonds issued in 2011, maturing through 2021 (2011 Bonds)	10,344,777	10,825,929
2.0% to 4.0% bonds issued in 2004 and maturing through 2018 (2004 Bonds)	<u>250,000</u>	<u>835,000</u>
	24,866,861	27,421,510
Unamortized discount, premium and bond issuance costs	<u>(148,785)</u>	<u>(182,309)</u>
Total bonds payable	<u>\$24,718,076</u>	<u>\$27,239,201</u>

On May 6, 2015, the University, in conjunction with the Ohio Higher Educational Facility Commission (the Commission), issued \$17,339,202 of State of Ohio Higher Educational Facility bonds (the 2015 Bonds) at a 2.48% fixed rate. While the bonds were issued through the Commission, they were placed as a private placement with the Delaware County Bank and BMO Harris Bank. The bond proceeds were used to retire a 2009 Bond issue.

The 2015 Bonds are subject to the 2015 bond base lease terms (the Lease) with the Commission in conjunction with the 2009 Project. The University is required to make rental payments under the Lease in amounts sufficient to pay the principal and interest on the 2015 Bonds. The 2015 Bonds are special obligations of the State of Ohio and the debt service on the 2015 Bonds is payable solely from the revenues to be derived by the Commission from its ownership of the 2009 Project. The 2015 Bonds are collateralized by a security interest in the 2009 Project. The University has agreed to purchase the 2009 Project from the Commission after all of the debt service on the 2015 Bonds has been paid.

On December 16, 2011, the University entered into a loan in the form of a draw term loan agreement with PNC Bank for up to \$15,000,000 (the 2011 Bonds). The terms of the loan call for a 2-year interest-only repayment period during the draw period, then an additional 96 months to maturity based on a 25-year amortization of the balance with a balloon payment due for any outstanding balance on the bonds' maturity date of December 16, 2021. The loan is based on the daily LIBOR rate (1.17% at June 30, 2017) plus 1.10%. The proceeds were for the renovation of Stuyvesant Hall.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 8. Bonds Payable (Continued)

In 2004, the University, in conjunction with the Commission, issued \$6,000,000 in Higher Educational Facility Revenue Bonds (the 2004 Bonds) to refund outstanding 1994 Revenue Bonds. Proceeds from the 2004 Bonds, as well as the existing Bond and Bond Reserve Funds, were used to refinance the outstanding 1994 Bonds, pay costs of issuance and establish a new Bond Reserve Fund.

The 2004 Project is leased to the University by the Commission pursuant to a lease agreement. The University is required to make rental payments under the Lease in amounts sufficient to pay the principal and interest on the 2004 Bonds. The University has agreed to purchase the 2004 Project from the Commission after the principal of the Bonds has been paid. The 2004 Bonds are special obligations of the State of Ohio and the debt service on the 2004 Bonds is payable solely from the revenues to be derived by the Commission from its ownership of the 2004 Project. The University has also unconditionally guaranteed the payment of the 2004 Bonds and agreed to maintain a certain level of funding in a Bond Reserve Fund (\$285,905 at June 30, 2017 included in investments). In addition, the 2004 Bonds are insured by municipal bond insurance, so long as the Bonds remain outstanding.

Effective January 1, 2016, the University changed its method of presentation relating to debt issuance costs in accordance with FASB ASU 2015-03 (*Simplifying the Presentation of Debt Issuance Costs*). Prior to 2017, the University's policy was to present these debt issuance costs in assets in the consolidated statements of financial position, net of accumulated amortization. During fiscal 2017, the University has presented these debt issuance costs as a direct reduction of the related capital lease obligations. The effect of the retrospective adoption on the 2016 consolidated financial statements was to reclassify \$182,309 from other assets to bonds payable.

Principal payments for all bonds, for the years ending June 30, are as follows:

2018	\$ 2,259,610
2019	2,046,622
2020	2,085,890
2021	2,126,142
2022	10,106,420
Thereafter	<u>6,242,178</u>
	<u>\$24,866,862</u>

Interest expense for all bonds payable for the years ended June 30, 2017 and 2016 was \$597,545 and \$622,282, respectively.

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 9. Net Assets

Net assets of the University and subsidiaries, and the nature of any restrictions consisted of the following:

	June 30	
	<u>2017</u>	<u>2016</u>
Temporarily restricted net assets		
Scholarships, prizes and awards	\$ 27,952,052	\$ 20,338,371
Faculty support and academic programs	7,378,404	4,368,707
General university operations	22,706,076	15,251,529
Library acquisitions	1,233,985	1,064,315
Annuity, pooled income and unitrust funds	(1,676,868)	(1,508,173)
Interest in trusts	991,607	940,859
Endowment income designated for restricted purposes	11,097,525	10,708,105
Unexpended gifts and grants	3,650,171	2,718,350
Pledges receivable	3,382,440	4,379,317
Other purposes	1,209,590	674,942
	<u>\$ 77,924,982</u>	<u>\$ 58,936,322</u>
Permanently restricted net assets		
Scholarships, prizes and awards	\$ 75,841,525	\$ 72,822,762
Faculty support and academic programs	30,989,456	29,712,938
General university operations	46,079,016	44,472,314
Library acquisitions	1,309,182	1,288,382
Annuity, pooled income and unitrust funds	6,143,524	4,764,785
Interest in trusts	1,863,403	1,840,657
Student loan funds	2,282,685	2,217,375
Pledges receivable	4,349,140	3,380,931
Other purposes	7,631,246	7,153,799
	<u>\$176,489,177</u>	<u>\$167,653,943</u>

Net assets released from restrictions relate to the following:

	June 30	
	<u>2017</u>	<u>2016</u>
Academic support, including library	\$ 806,373	\$ 753,362
Financial aid from outside sources	5,523,368	5,683,682
Plant	2,968,858	3,147,222
Instruction	1,797,970	1,880,914
Management and general	32,526	677,637
Student services	754,114	869,096
Research	236,252	161,458
Other	118,828	19,883
	<u>\$ 12,238,289</u>	<u>\$ 13,193,254</u>

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 10. Endowment Funds

The Board of Trustees of the University has approved an investment policy detailing the long-term goals, asset allocation, measurable objectives, on-going communication, review and oversight. The basic philosophy of the investment policy is that administration and management of the endowment are to be implemented through diversified investment options designed to recognize income needs for ongoing operations, as well as committed spending and capital-growth needs to meet expansion goals and costs increased by future inflation.

Permanently restricted endowment funds represent funds which are restricted as to use in perpetuity. The University records permanent endowment gifts at historic dollar value. Distributions from endowment funds are spent in compliance with the donor's restrictions applicable to the funds being distributed. The current spending rule provides an annual cash flow to the operating budget equal to the fixed amount of spending calculated at June 30, 1998 plus 4% of new endowment gifts each year through the current year.

Distributions for operations during the years ended June 30, 2017 and 2016 were \$14,400,000 and \$10,458,312, respectively. Following the University's spending policy, only \$10,944,573 would have been distributed during the year ended June 30, 2017; however, a Board resolution was passed for the distribution to include a supplemental endowment draw to support Board-approved investments in strategic initiatives.

From time to time the fair value of assets associated with the individual donor restricted endowment funds may fall below the level that the donor requires the University to retain as a perpetual fund balance. These deficiencies result from unfavorable market fluctuations that occur shortly after the investment of new permanently restricted contributions or as a result of continued expenditure for programs that the Board deems prudent. The fair value of assets associated with certain individual donor-restricted endowment funds was below the carrying value by \$3,394,371 and \$4,103,000 at June 30, 2017 and 2016, respectively.

The endowment pool, which includes true endowment and quasi-endowment, was as follows as of June 30, 2017 and 2016:

	2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment assets, beginning of year	\$ 9,424,160	\$ 36,674,089	\$155,511,886	\$201,610,135
Investment return:				
Investment income	17,553	367,354	4,513	389,420
Net appreciation (realized and unrealized)	1,240,216	26,004,416	-	27,244,632
Total investment return	1,257,769	26,371,770	4,513	27,634,052
Cash contributions and transfers	-	-	6,457,904	6,457,904
Appropriation of endowment assets for expenditure	(4,038,953)	(10,361,047)	-	(14,400,000)
Endowment assets, end of year	<u>\$ 6,642,976</u>	<u>\$ 52,684,812</u>	<u>\$161,974,303</u>	<u>\$221,302,091</u>

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 10. Endowment Funds (Continued)

	2016			
	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment assets, beginning of year	\$ 10,512,036	\$ 57,855,804	\$ 147,694,907	\$ 216,062,747
Investment return:				
Investment income	8,550	198,232	594	207,376
Net depreciation (realized and unrealized)	(580,851)	(11,437,210)	-	(12,018,061)
Total investment return	(572,301)	(11,238,978)	594	(11,810,685)
Cash contributions and transfers	-	-	7,816,385	7,816,385
Appropriation of endowment assets for expenditure	(515,575)	(9,942,737)	-	(10,458,312)
Endowment assets, end of year	<u>\$ 9,424,160</u>	<u>\$ 36,674,089</u>	<u>\$ 155,511,886</u>	<u>\$ 201,610,135</u>

Note 11. Noncontrolling Interest

The following is a reconciliation of net assets relating to the University and to the noncontrolling interests of the OWU Fund, Stuyvesant Hall and Master Tenant:

	<u>University</u>	<u>Noncontrolling Interest</u>	<u>Total</u>
Net assets balance at June 30, 2015	\$ 314,622,747	\$ 6,229,876	\$ 320,852,623
Capital distribution	-	(184,978)	(184,978)
Change in net assets attributable to:			
University	(5,056,566)	-	(5,056,566)
Noncontrolling interests	-	278,225	278,225
Net assets balance at June 30, 2016	309,566,181	6,323,123	315,889,304
Capital distribution	-	(351,095)	(351,095)
Change in net assets attributable to:			
University	27,160,373	-	27,160,373
Noncontrolling interests	-	308,142	308,142
Net assets balance at June 30, 2017	<u>\$ 336,726,554</u>	<u>\$ 6,280,170</u>	<u>\$ 343,006,724</u>

OHIO WESLEYAN UNIVERSITY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Note 12. Commitments and Contingencies

At June 30, 2017, the University has outstanding commitments on various construction projects totaling approximately \$2,343,000 most of which is related to building renovations.

The University is involved in litigation and is subject to certain claims that arise in the normal course of operations. In the opinion of management, the ultimate disposition of the litigation and claims will not have a material adverse effect on the University's operations or financial position.

The University rents commercial space in the Stuyvesant Hall building from Master Tenant, under a 6-year sublease agreement. The sublease expires in August 2018. Future minimum lease payments are \$16,100 per month. These amounts are eliminated in consolidation.

Stuyvesant Hall receives rental income from Master Tenant under a 32-year master lease that expires in 2044. Future minimum lease payments are \$72,458 per month. These amounts are eliminated in consolidation.