

SEATTLE ART MUSEUM

Consolidated Financial Statements

For the Years Ended June 30, 2018 and 2017

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Independent Auditor's Report

**To the Audit Committee of the Board of Trustees
Seattle Art Museum
Seattle, Washington**

We have audited the accompanying consolidated financial statements of Seattle Art Museum and subsidiaries (collectively, the Museum), which comprise the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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



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Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Museum as of June 30, 2018 and 2017, and the consolidated changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 18, the 2017 financial statements have been restated to capitalize costs related to the renovation and expansion of the Seattle Asian Art Museum that had been expensed in previous years. Our opinion is not modified with respect to this matter.

Clark Nuber P.S.

Certified Public Accountants
December 4, 2018

SEATTLE ART MUSEUM AND SUBSIDIARIES

Consolidated Balance Sheets
June 30, 2018 and 2017

	2018	2017
Assets		
Cash and cash equivalents	\$ 19,807,118	\$ 14,858,711
Pledges receivable, current portion	720,716	1,416,995
Accounts receivable	220,319	346,521
Prepaid expenses and inventories	1,585,362	1,526,129
Total Current Assets	22,333,515	18,148,356
Pledges receivable, net of current portion	18,823,185	28,200,896
Government grant receivable	8,777,825	-
Incentive to lessee	5,075,891	5,469,541
Deferred rental receivable	9,281,805	9,223,387
Prepaid lease	623,000	627,666
Property and equipment, net	125,452,343	117,535,021
Investments restricted for long-term purposes	140,636,091	121,990,894
Funds held in trust by others	10,789,303	10,509,546
Total Assets	\$ 341,792,958	\$ 311,705,307
Liabilities and Net Assets		
Accounts payable and accrued expenses	\$ 997,179	\$ 1,786,396
Construction costs payable and retainage	3,262,264	-
Line of credit	-	973,592
Notes payable, current portion	221,357	203,241
Deferred revenue	3,150,367	1,228,591
Total Current Liabilities	7,631,167	4,191,820
Notes payable, net of current portion	4,557,873	4,779,228
Minimum pension liability	1,882,153	2,818,199
Total Liabilities	14,071,193	11,789,247
Net Assets:		
Unrestricted-		
SAM and controlling interest in consolidated subsidiaries	31,461,949	28,907,749
Noncontrolling interest in consolidated subsidiaries	1,948,356	-
Total unrestricted	33,410,305	28,907,749
Temporarily restricted	137,980,364	123,566,095
Permanently restricted	156,331,096	147,442,216
Total Net Assets	327,721,765	299,916,060
Total Liabilities and Net Assets	\$ 341,792,958	\$ 311,705,307

See accompanying notes.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Consolidated Statements of Activities
For the Years Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Unrestricted Net Assets, Operating Activities		
Support and Revenues:		
Contributions and grants	\$ 8,153,843	\$ 7,364,811
Store and café	3,424,438	2,995,097
Admissions	4,315,600	3,173,676
Other income	1,669,958	2,133,278
Investment return	32,127	19,451
Contributions and endowment earnings released from restriction	10,232,480	11,091,605
Transfers from nonoperating activities	-	85,890
	<u>27,828,446</u>	<u>26,863,808</u>
Expenses:		
Program-		
Exhibition and collection care	5,948,747	6,964,694
Facility and security	6,192,725	6,127,608
Marketing	2,218,186	1,927,506
Store and café	2,191,525	2,017,897
Education	1,641,843	1,559,312
	<u>18,193,026</u>	<u>18,597,017</u>
Total program expenses		
	18,193,026	18,597,017
Support expenses-		
Administration	4,770,584	4,610,646
Fundraising	1,582,650	1,829,800
Membership	1,176,405	1,130,175
Depreciation	623,846	549,750
	<u>8,153,485</u>	<u>8,120,371</u>
Total support expenses		
	8,153,485	8,120,371
Total Expenses	<u>26,346,511</u>	<u>26,717,388</u>
Net Operating Activities	1,481,935	146,420

See accompanying notes.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Consolidated Statements of Activities (Continued)
For the Years Ended June 30, 2018 and 2017

	2018	2017
Nonoperating Activities:		
Rental income	7,074,946	6,914,228
Rental expense	(6,109,792)	(5,926,251)
Contributions designated as nonoperating	-	2,059,080
Uncollectible pledges	(458)	(266,862)
Capital contribution from noncontrolling interest	1,948,820	-
Capital projects depreciation	(6,191,879)	(6,395,184)
Accession of art objects	(939,706)	(298,803)
Financing expense	(185,244)	(157,916)
Minimum pension adjustment	1,035,991	1,660,414
Underwater endowment activity	520,547	3,342,799
Contributions and endowment earnings released from restriction	5,867,396	6,586,893
Transfers to operating activities	-	(85,890)
Net Nonoperating Activities	3,020,621	7,432,508
Change in Unrestricted Net Assets	4,502,556	7,578,928
Temporarily Restricted Net Assets:		
Contributions and grants	21,736,381	9,945,706
Art deaccessions	113,771	103,040
Investment return	8,672,590	13,436,427
Distribution received from funds held in trust by others	511,950	486,305
Underwater endowment activity	(520,547)	(3,342,799)
Change in donor restriction	-	1,000,000
Contributions and endowment earnings released from restriction	(16,099,876)	(17,678,498)
Change in Temporarily Restricted Net Assets	14,414,269	3,950,181
Permanently Restricted Net Assets:		
Contributions and grants	8,609,123	3,044,738
Change in donor restriction	-	(1,000,000)
Investment return from funds held in trust by others	279,757	406,842
Change in Permanently Restricted Net Assets	8,888,880	2,451,580
Change in Net Assets	27,805,705	13,980,689
Net assets, beginning of year	299,916,060	285,935,371
Net Assets, End of Year	\$ 327,721,765	\$ 299,916,060

See accompanying notes.

SEATTLE ART MUSEUM AND SUBSIDIARIES

**Consolidated Statements of Cash Flows
For the Years Ended June 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
Cash Flows From Operating Activities:		
Change in net assets	\$ 27,805,705	\$ 13,980,689
Adjustments to reconcile change in net assets to cash flows used by operating activities-		
Depreciation and amortization	6,815,725	6,944,934
Contributions and grants restricted for endowment	(8,609,123)	(3,044,738)
Contributions and grants restricted for capital campaign	(18,654,023)	(6,563,708)
Realized and unrealized gains on investments	(7,549,362)	(12,601,654)
Change in value of funds held in trust by others	(279,757)	(406,842)
Change in minimum pension liability	(936,046)	(1,416,213)
Capital contribution from noncontrolling interest	(1,948,820)	-
Accession of art objects, net	825,935	195,763
Changes in operating assets and liabilities:		
Pledges and accounts receivable	669,527	1,584,153
Other assets	(112,985)	614,647
Incentive to lessee	393,650	393,651
Accounts payable and accrued expenses	(789,217)	(129,006)
Deferred revenue	(573,224)	(429,832)
Net Cash Used by Operating Activities	(2,942,015)	(878,156)
Cash Flows From Investing Activities:		
Proceeds from sales of investments	14,881,718	27,123,054
Purchases of investments	(24,171,955)	(30,178,764)
Net change in cash equivalents included in investments	(1,805,598)	(538,550)
Purchases of property and equipment	(11,470,783)	(8,790,485)
Accession of art objects, net	(825,935)	(195,763)
Net Cash Used by Investing Activities	(23,392,553)	(12,580,508)
Cash Flows From Financing Activities:		
Proceeds from contributions and grants restricted for endowment	16,104,816	9,002,572
Proceeds from contributions and grants restricted for capital campaign	14,406,170	4,197,685
Capital contribution from noncontrolling interest	1,948,820	-
Net repayment of line of credit	(973,592)	(700,000)
Principal payments on notes payable	(203,239)	(186,235)
Net Cash Provided by Financing Activities	31,282,975	12,314,022
Net Change in Cash and Cash Equivalents	4,948,407	(1,144,642)
Cash and cash equivalents, beginning of year	14,858,711	16,003,353
Cash and Cash Equivalents, End of Year	\$ 19,807,118	\$ 14,858,711
Supplementary Information:		
Property and equipment purchases in accounts payable	\$ 3,262,264	\$ -
Cash paid for interest	\$ 181,987	\$ 254,119

See accompanying notes.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 1 - Organization and Summary of Significant Accounting Policies

Nature of the Organization - The Seattle Art Museum (SAM) is a not-for-profit organization formed for the purpose of promoting and cultivating the fine arts. The accompanying consolidated financial statements include the activity of SAM and SAM's controlled subsidiaries (collectively referred to as the Museum). The Museum's activities include acquiring, exhibiting and caring for paintings, sculptures and other works of art, providing lectures and art education, and generally fostering art in all of its locations.

The Museum started as The Seattle Fine Arts Society in 1917 and has three locations. The main location of the Museum opened in December 1991 and is located in downtown Seattle (the City) at 1300 First Avenue. An expansion of the downtown facility opened in 2007, approximately doubling its square footage to provide more gallery space to exhibit the Museum's collections and an expanded retail store.

The Museum's original home in the City's Volunteer Park was built in 1933 by the Museum on the City property. The Volunteer Park facility underwent renovations and was reinstalled with displays of the Museum's Asian art collection, reopening in August 1994 as the Seattle Asian Art Museum (SAAM). The SAAM is currently undergoing another renovation and expansion as further described in Note 2.

The 8.5 acre Olympic Sculpture Park (OSP or the Park) in downtown Seattle opened in 2007. In 1999, the Museum purchased the site, which was enhanced by the acquisition of adjacent property. As a free community gathering space, it includes permanent and temporary sculptures, pedestrian paths, amphitheater, and a pavilion with a café and a parking garage.

Principles of Consolidation - The accompanying financial statements include the activity of SAM and SAM's controlled subsidiaries, SAM-SAAM Renovation, LLC, SAAM Building Landlord, LLC, and SAAM Building Master Tenant, LLC. Inter-organization balances and transactions have been eliminated in consolidation.

SAM's controlled subsidiaries (collectively referred to as the LLCs) were formed under the laws of the State of Washington effective December 2017. The LLCs were formed for the purpose of receiving historic tax credit funding as a part of the SAAM renovation and expansion project further described in Note 2. SAM-SAAM Renovation, LLC is wholly-owned by SAM. The owners of SAAM Building Master Tenant, LLC are SAM-SAAM Renovation, LLC with a 1% managing member interest and a historic tax credit investor with a 99% investor member interest. SAAM Building Landlord LLC is owned 80% by SAM-SAAM Renovation LLC and 20% by SAAM Building Master Tenant, LLC.

Noncontrolling interest presented in the consolidated financial statements is comprised of the direct ownership interest of the historic tax investor in SAAM Building Master Tenant, LLC and the indirect ownership interest in SAAM Building Landlord, LLC.

Basis of Accounting - The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 1 - Continued

Basis of Presentation - The Museum reports its financial position and activities according to three classes of net assets, depending on the existence and nature of donor restrictions: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted Net Assets - Contains support received and revenue earned that are not subject to donor-imposed restrictions and over which the Board of Trustees has discretionary control.

Temporarily Restricted Net Assets - Contains donor-imposed restrictions that require the Museum to use or expend the assets as specified. The restrictions are satisfied either by the passage of time and/or by action of the Museum.

Permanently Restricted Net Assets - Contains support in the form of endowment or sustaining funds. In accordance with purposes established by donors, the Museum is permitted to expend part or all of the investment return derived for either specified or unspecified purposes. Such income (loss) is recognized as a change in unrestricted or temporarily restricted net assets based on donor stipulations.

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. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Expirations of temporary restrictions on net assets (i.e., the donor stipulated purpose has been fulfilled or the stipulated time period has lapsed) are reported as reclassifications between the applicable classes of net assets. Contributions received to acquire long-lived assets are reported as temporarily restricted contributions and released from restriction ratably over the life of the asset.

Cash and Cash Equivalents - The Museum considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash balances include operating reserves maintained for the lease described at Note 13. Cash balances at June 30, 2018, include \$1.78 million that is held by SAM's controlled subsidiaries and limited to use for the SAAM capital project described in Note 2.

Receivables - Receivables primarily consist of unconditional promises to give (pledges receivable), which are recognized as revenues or gains in the period in which the promise is given, government grants receivable, and trade receivables. Conditional promises to give are recognized only when the conditions on which they depend are substantially met and the promises become unconditional. Accounts are charged to a reserve as they are deemed uncollectible based on a periodic review of the accounts. Receivable balances are unsecured.

Inventories - Inventories are stated at the lower of cost or market on a first in first out basis. Inventories primarily represent gift shop articles, books and supplies held for sale.

Incentive to Lessee and Deferred Rental Receivable - Incentives paid to a lessee have been capitalized on the consolidated balance sheet as an asset and amortized over the term of the lease under the straight-line method. Deferred rental receivable represents the cumulative difference of recognizing lease revenue on a straight-line basis and the actual cash rental payments.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 1 - Continued

Investments - Investments consist primarily of marketable debt and equity securities as well as other nonmarketable securities. Investments in debt and equity securities are carried at fair value based on quoted market prices. Realized and unrealized gains and losses on investments are included in investment return in the consolidated statements of activities. Investments restricted for long-term purposes consist of contributions received that are restricted by the donor for long-term purposes such as for an endowment.

Investments in nonmarketable securities are carried at estimated fair value as provided by investment managers. The Museum reviews and evaluates the values provided by the investment managers and agrees with the valuation methods and assumptions used in determining the fair value of these investments. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these investments existed.

Property and Equipment - All expenditures for repairs, maintenance, renewals and betterments that substantially prolong the useful lives of assets are capitalized. All acquisitions of property and equipment in excess of \$2,500 that have an estimated useful life exceeding one year are capitalized. Property and equipment are carried at cost or, if donated, at the approximate fair value at the date of donation.

Depreciation is computed using the straight-line method over the following useful lives:

Buildings	40 years
Tenant improvements	Shorter of 40 years or life of lease
Park hardscaping	20 years
Furnishings and non-computer equipment	5 - 15 years
Computer equipment	3 years

From time to time, the Museum engages in large construction projects to remodel or expand existing locations. The Museum capitalizes certain administrative costs associated with these construction projects as the Museum believes this treatment more accurately reflects the costs incurred for these projects.

Deferred Revenues - Income from nonoperating rental activities and other revenues are deferred and recognized over the periods to which the activities relate.

Contributions - Donor-restricted contributions are recognized in the period the contribution is received. Unconditional promises to give are recorded in the period the promise is received. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risk involved. An allowance for uncollectible contributions receivable is provided based upon management's judgment including such factors as prior collection history, type of contribution and nature of fundraising activity. Amortization of the discount is reported as contribution revenue. Donated marketable securities and other noncash donations are recorded as contributions at their estimated fair values at the date of donation.

Art Collections - Art objects are expensed when purchased and therefore, are not shown as assets on the consolidated balance sheets. Art objects pledged or donated to the Museum are not recorded for financial accounting purposes and, accordingly, are not included as contributed revenue in the consolidated statements of activities or as receivables on the consolidated balance sheets. Proceeds from deaccessions or insurance recoveries are reflected in the consolidated statements of activities based on the existence and nature of donor-imposed restrictions.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 1 - Continued

Donated Services and Use of Facilities - The Museum recognizes contributed services as revenue and expense if the services create or enhance nonfinancial assets or require specialized skills and would otherwise need to be purchased by the Museum. A substantial number of unpaid volunteers have made significant contributions of their time in furtherance of the Museum's programs. The value of this contributed time is not included in the accompanying consolidated financial statements as it does not meet the criteria for recognition.

Costs incurred by the Museum to operate and maintain the Volunteer Park facility are partially funded by the City of Seattle. Such funding and the related costs are included as support and expenses in the accompanying consolidated financial statements.

Operating and Nonoperating Activity - Operating activities represent support and revenues and expenses solely related to the annual exhibition and education programs for the Museum. Nonoperating activities are the support and revenues and expenses related to leasing of the expanded downtown facility and land at the Olympic Sculpture Park, contributions for nonoperating activities, capital projects administration and other expenses, debt financing, adjustments for uncollectible pledges, minimum pension adjustments and the impacts of underwater endowments on unrestricted net assets. Nonoperating activities also include accession purchases related to the art collections. Art accession and deaccession are considered outside the scope of ongoing museum programs and operations due to the variable nature of this activity from one year to the next. Transfers reported on the consolidated statement of activities from nonoperating to operating activities represent prior nonoperating funding received utilized for operating activities in the current fiscal year.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 1 - Continued

Allocation of Functional Expenses - The costs of providing various programs and other operating activities have been summarized on a functional basis in the consolidated statements of activities, with the exception of depreciation and amortization expense, which has not been allocated. To evaluate the comparability of the Museum's management and general overhead with other nonprofit organizations, all expenses, including depreciation, amortization, and nonoperating expenses, must be allocated on a functional basis. Total expenses on a functional basis as defined by U.S. GAAP for the years ended June 30 are as follows:

	<u>2018</u>	<u>2017</u>
Operating Expenses:		
Program-		
Exhibition and collection care	\$ 6,006,864	\$ 7,050,293
Facility and security	6,413,778	6,215,268
Marketing	2,218,761	1,928,081
Store and café	2,191,564	2,017,935
Education	<u>1,649,518</u>	<u>1,564,094</u>
	18,480,485	18,775,671
Supporting-		
Administration	5,106,971	4,981,742
Fundraising	1,582,650	1,829,800
Membership	<u>1,176,405</u>	<u>1,130,175</u>
	<u>7,866,026</u>	<u>7,941,717</u>
Total Operating Expenses	26,346,511	26,717,388
Nonoperating Expenses:		
Program-		
Rental expense	6,109,792	5,926,251
Accession of art objects	939,706	298,803
Financing expense	<u>185,244</u>	<u>157,916</u>
	7,234,742	6,382,970
Supporting-		
Capital projects depreciation	<u>6,191,879</u>	<u>6,395,184</u>
Total Nonoperating Expenses	13,426,621	12,778,154
Total Expenses	<u>\$ 39,773,132</u>	<u>\$ 39,495,542</u>

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 1 - Continued

Income Taxes - SAM has been notified by the Internal Revenue Service that it is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code) with the exception of income from any activities that are not related to SAM's tax-exempt purpose. SAM is further classified as an organization that is not a private foundation under Section 509(a)(1) of the Code. The LLCs have no provision for or benefit from income taxes included in these consolidated financial statements as taxable income or loss passes through to, and is reportable by, each member individually.

Use of Estimates - The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent 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.

Subsequent Events - The Museum's management has evaluated subsequent events through December 4, 2018, the date on which the financial statements were issued.

Note 2 - SAAM Renovation and Expansion Project

In September 2017, the Museum committed to a major renovation and modest expansion of the SAAM. The City owns the SAAM building, and the building is listed on the National Register of Historic Places and landmarked by the City. The building has not been substantially renovated or restored since its original construction in 1933. The renovation includes new climate and humidity control for optimum art preservation, updated plumbing and electrical systems, seismic upgrades to safeguard visitors and collections, an updated loading dock and receiving area for safer art transport, as well as improvements to accessibility. The renovation also restores the existing building and its facades and finishes to National Historic Rehabilitation Standards.

The SAAM building renovation qualifies for federal tax credits under the Historic Rehabilitation Tax Credit (HRTC) federal tax statutes. In order to take advantage of federal tax credits, which are only available to private business entities, the leasing structure was modified to create the LLCs. These LLCs are controlled by SAM and are included in the Museum's consolidated financial statements.

The expansion is new construction on the southeast side of the building, extending the building footprint by approximately 3,200 square feet. The addition will add approximately 12,000 useable square feet on three floors. This additional space provides for a new art gallery, new space for expanded mechanical and electrical systems, a new dedicated education space for school and other groups, new art storage, conservation space, and offices.

The total project budget is approximately \$54,000,000, which includes construction, design and engineering, entitlements, art moving, storage and reinstallation, and will be funded through a combination of city and state funding, a capital campaign and historical rehabilitation tax credits. The City has committed to providing funding of \$19,000,000 to the project. As of June 30, 2018, the Museum had billed the City approximately \$14,000,000, of which \$8,777,825 is reported as a receivable on the consolidated balance sheet at June 30, 2018. The receivable balance is expected to be collected during the year ended June 30, 2019, however, it is reported as a noncurrent asset on the consolidated balance sheet because it is restricted to spending on the SAAM capital project.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 3 - Pledges Receivable

Pledges receivable consisted of the following at June 30:

	2018				2017
	Endowment	SAAM Campaign	Other	Total	Total
Pledges due in-					
Less than one year	\$ 6,295,000	\$ 1,215,677	\$ 720,716	\$ 8,231,393	\$ 11,215,617
Two to five years	6,979,307	2,440,639	567,725	9,987,671	17,444,088
More than five years	-	-	1,664,970	1,664,970	1,597,158
Less discount to present value (1.00% to 2.75%)	(126,741)	(69,123)	(16,038)	(211,902)	(365,050)
Less allowance for doubtful accounts	-	(109,689)	(18,542)	(128,231)	(273,922)
Total Pledges Receivable, Net	\$ 13,147,566	\$ 3,477,504	\$ 2,918,831	\$ 19,543,901	\$ 29,617,891

Endowment and SAAM Campaign pledges that are due in less than one year are reported as noncurrent pledges receivable on the consolidated balance sheets because the proceeds are restricted by donors for long-term investment.

Note 4 - Funds Held in Trust by Others

The Museum is a beneficiary of a trust held for the benefit of local nonprofit organizations. The trust, which is held in perpetuity, is administered by a financial institution and provides for quarterly earnings distributions to the Museum. The earnings are available for general operating purposes. The Museum's interest in the trust agreement, which is approximately 16%, is included in funds held in trust by others and permanently restricted net assets. The Museum received \$511,950 and \$486,305 in distributions from the trust during the years ended June 30, 2018 and 2017, respectively. The Museum's interest in gains and losses in the trust value are recognized in the consolidated statements of activities as permanently restricted. The balance related to the Museum's interest in this trust is reported at fair value and totaled \$10,789,303 and \$10,509,546 as of June 30, 2018 and 2017, respectively.

Note 5 - Investments

Investments are held for the endowment funds described in Note 12 and consisted of the following categories at June 30:

	2018	2017
Cash and cash equivalents	\$ 6,130,583	\$ 4,076,189
Debt securities	20,276,400	17,560,392
Equity securities	49,881,013	40,471,706
Alternative investments	64,348,095	59,882,607
Total Investments	\$ 140,636,091	\$ 121,990,894

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 5 - Continued

The following summarizes the return on investments by net asset classification for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Unrestricted (operating and nonoperating)- Dividends and interest	\$ 32,127	\$ 19,451
Temporarily restricted-		
Dividends and interest	1,571,527	1,223,815
Realized and unrealized gains	7,549,362	12,601,654
Investment fees	<u>(448,299)</u>	<u>(389,042)</u>
	<u>8,672,590</u>	<u>13,436,427</u>
Total Investment Return	<u>\$ 8,704,717</u>	<u>\$ 13,455,878</u>

Note 6 - Fair Value Measurements

U.S. GAAP defines fair value, establishes a framework for measuring fair value, and requires disclosure about fair value measurements. To increase consistency and comparability in fair value measurements, U.S. GAAP uses a fair value hierarchy that prioritizes the inputs to valuation approaches into three broad levels. The hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3).

Valuation Techniques - Financial assets and liabilities valued using Level 1 inputs are based on unadjusted quoted market prices within active markets. Financial assets and liabilities valued using Level 2 inputs are based primarily on quoted prices for similar assets or liabilities in active or inactive markets. Financial assets and liabilities using Level 3 inputs are primarily valued using management's assumptions about the assumptions market participants would utilize in pricing the asset or liability. Valuation techniques utilized to determine fair value are consistently applied.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2018 and 2017.

Mutual Funds - Valued at quoted market prices in active markets.

Equity Securities - Valued at the closing price reported on the active market on which the securities are traded.

Debt Securities - Valued using bid valuations from similar instruments in actively traded markets.

Alternative Investments - Value at net asset value (NAV) per share, or its equivalent, as a practical expedient, as reported by the investment manager unless specific evidence indicates the NAV should be adjusted.

Funds Held in Trust by Others - Valued based on the quoted market prices of underlying investments of the trust and the Museum's proportional beneficial interest in the trust.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 6 - Continued

The valuation methodologies used by the Museum may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Museum's management believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Fair Values Measured on a Recurring Basis - Fair values of assets measured on a recurring basis at June 30, 2018 and 2017, were as follows:

	Fair Value Measurements at June 30, 2018			
	Level 1	Level 2	Level 3	Total
Funds Held in Trust by Others	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,789,303</u>	<u>\$ 10,789,303</u>
Investments:				
Marketable securities-				
Equity securities/mutual funds:				
Large blend	\$ 14,040,040	\$ -	\$ -	\$ 14,040,040
Foreign large growth	13,304,378	-	-	13,304,378
Natural resources	3,977,802	-	-	3,977,802
Foreign large blend	4,978,180	-	-	4,978,180
Global bond funds	3,906,630	-	-	3,906,630
Emerging markets fund	9,673,983	-	-	9,673,983
Debt securities/mutual funds:				
Aggregate bonds	4,490,773	-	-	4,490,773
Inflation protection	4,057,421	-	-	4,057,421
U.S. government	-	11,728,206	-	11,728,206
Total Investments in the Fair Value Hierarchy	<u>\$ 58,429,207</u>	<u>\$ 11,728,206</u>	<u>\$ -</u>	70,157,413
Investments measured at NAV ^(a)				64,348,095
Interest-bearing cash ^(b)				<u>6,130,583</u>
Total Investments				<u>\$ 140,636,091</u>

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 6 - Continued

	Fair Value Measurements at June 30, 2017			
	Level 1	Level 2	Level 3	Total
Funds Held in Trust by Others	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,509,546</u>	<u>\$ 10,509,546</u>
Investments:				
Marketable securities-				
Equity securities/mutual funds:				
Large blend	\$ 10,946,890	\$ -	\$ -	\$ 10,946,890
Foreign large growth	12,058,760	-	-	12,058,760
Natural resources	2,575,977	-	-	2,575,977
Foreign large blend	4,488,226	-	-	4,488,226
Global bond funds	2,477,555	-	-	2,477,555
Emerging markets fund	7,924,298	-	-	7,924,298
Debt securities/mutual funds:				
Intermediate-term bonds	4,253,336	-	-	4,253,336
Inflation protection	3,505,054	-	-	3,505,054
U.S. government	-	9,802,002	-	9,802,002
Total Investments in the Fair Value Hierarchy	<u>\$ 48,230,096</u>	<u>\$ 9,802,002</u>	<u>\$ -</u>	58,032,098
Investments measured at NAV ^(a)				59,882,607
Interest-bearing cash ^(b)				<u>4,076,189</u>
Total Investments				<u>\$ 121,990,894</u>

(a) In accordance with the Accounting Standards Codification (ASC) Subtopic 820-10, certain investments that were measured at fair value using the NAV per share (or its equivalent) practical expedient, which is industry standard, have not been classified in the fair value hierarchy. The fair value amounts presented in these tables are intended to permit reconciliation of the fair value hierarchy to the investment line item presented in the consolidated balance sheets.

(b) Interest-bearing cash is reported at cost plus accrued interest. The balance presented in these tables are intended to permit reconciliation of the fair value hierarchy to the investment line item presented in the consolidated balance sheets.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 6 - Continued

A reconciliation of the beginning and ending balances, by each major category of assets and liabilities, for fair value measurements made using significant unobservable inputs (Level 3) follows:

	Funds Held in Trust by Others
Balance, June 30, 2016	\$ 10,102,704
Total unrealized gain	<u>406,842</u>
Balance, June 30, 2017	10,509,546
Total unrealized gain	<u>279,757</u>
Balance, June 30, 2018	<u><u>\$ 10,789,303</u></u>

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 6 - Continued

The table below summarizes significant terms of the agreements with investment companies that value investments at NAV. There are no significant redemption restrictions or unfunded commitments on other types of investments.

<u>Asset Class</u>	<u>Fair Value</u>	<u>Remaining Life</u>	<u>Unfunded Commitments</u>	<u>Redemption Terms</u>	<u>Redemption Restrictions</u>
Limited Partnerships:					
Global venture capital/ private equity	\$ 359,326	Through 2022	\$ 548,249	None	None
US private equity	659,722	Through 2022	2,477,933	None	None
US venture capital	2,134,655	Through 2022	8,649,248	None	None
Emerging markets	3,049,692	None	None	Quarterly with 60 days notice.	None
Other	2,932,211	Through 2027	None	None	None
Multi-strategy	4,148,996	None	None	Quarterly with 90 days notice.	None
Real assets	1,207,019	None	None	Monthly with 16 days notice.	None
Limited Liability Corporation:					
Real assets	3,068,646	Through 2020	1,729,939	None	None
Other	2,645,542	None	None	Monthly with 10 days notice.	None
Global equity	5,263,295	None	None	Weekly with 3 business days notice.	None
Direct Investment:					
Long/short equity	2,316,602	None	None	Varies from annual or 18 months with 45 days' notice to annual or every two years with 60 days' notice.	No redemption gate - 20% fund level gate; one-third and one- quarter investor level gates.
Opportunistic	9,456,216	None	None	Varies from annual to every two years with 90 days notice.	No redemption gate- 10% fund level gate.
US Private equity	12,928,523	None	None	Monthly with 31 days notice.	No redemption gate.
International Equity Fund:					
Emerging markets	3,693,942	None	None	Monthly with 60 days notice.	None
Global equity	10,483,708	None	None	Monthly with 10 business days notice.	None
	<u>\$ 64,348,095</u>		<u>\$ 13,405,369</u>		

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 7 - Property and Equipment

Property and equipment is summarized as follows at June 30:

	<u>2018</u>	<u>2017</u>
Furnishings and equipment	\$ 21,194,343	\$ 20,517,381
Buildings	70,704,275	70,801,502
Tenant improvements	22,849,230	22,849,230
Remediation and hardscaping	38,874,173	38,866,861
Land	17,797,741	17,797,741
Work in progress	<u>21,907,309</u>	<u>7,758,135</u>
	193,327,071	178,590,850
Less accumulated depreciation	<u>(67,874,728)</u>	<u>(61,055,829)</u>
	<u>\$ 125,452,343</u>	<u>\$ 117,535,021</u>

Work in progress at June 30, 2018 and 2017, consisted primarily of the SAAM capital project described in Note 2.

Note 8 - Benefit Plans

The Museum maintains a defined contribution retirement plan (the DC Plan) qualified under Section 403(b) of the Internal Revenue Code. The DC Plan covers all permanent employees who have completed at least 1,000 hours of service and have attained the age of 21 years. Employer contributions are vested over a six year period. For the years ended June 30, 2018 and 2017, the Museum contributed \$554,872 and \$228,414, respectively.

The Museum also maintains a defined benefit pension plan (the DB Plan) covering a portion of its employees. Participant benefits are primarily related to years of credited service and annual earnings. As of September 1, 2006, the DB Plan was frozen to new participants. During the year ended June 30, 2013, the DB Plan was amended to freeze the accrual of benefits for all participants as of June 30, 2013. Benefits accrued through June 30, 2013, will not be reduced and participants will continue to earn vesting credit if not fully vested. The Museum's funding policy is to contribute amounts to the DB Plan sufficient to comply with the minimum regulatory funding requirements. For the years ended June 30, 2018 and 2017, the Museum recognized \$99,945 and \$244,201, respectively, of net periodic pension cost.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 8 - Continued

The following is the DB Plan's funded status and amounts recognized in the Museum's financial statements as of and for the years ended June 30:

	<u>2018</u>	<u>2017</u>
Change in projected benefit obligation (PBO)-		
Projected benefit obligation at beginning of year	\$ 12,114,373	\$ 12,870,103
Interest cost	432,582	420,612
Assumptions change	(94,596)	(214,199)
Benefits paid	(531,108)	(424,815)
Actuarial gain	<u>(586,779)</u>	<u>(537,328)</u>
Projected benefit obligation at end of year	11,334,472	12,114,373
Change in plan assets-		
Fair value of plan assets at beginning of year	9,296,174	8,635,691
Actual gain return on plan assets	687,253	1,085,298
Benefits paid	<u>(531,108)</u>	<u>(424,815)</u>
Fair value of plan assets at end of year	<u>9,452,319</u>	<u>9,296,174</u>
Funded Status at Year End (Minimum Pension Liability)	<u>\$ (1,882,153)</u>	<u>\$ (2,818,199)</u>
Accumulated Benefit Obligation	<u>\$ 11,334,472</u>	<u>\$ 12,114,373</u>

Assumptions used to determine the benefit obligations for the DB Plan were as follows as of June 30:

	<u>2018</u>	<u>2017</u>
Weighted-average assumptions used to determine net periodic pension cost-		
Assumed discount rate	3.67%	3.35%
Expected long-term rate of return on DB Plan assets	6.00%	6.00%
Rate of compensation increase	N/A	N/A
Weighted-average assumptions used to determine benefit obligations-		
Assumed discount rate	3.67%	3.67%
Rate of compensation increase	N/A	N/A

The expected long-term rate of return on assets reflects anticipated future experience. This basis is consistent with the prior period.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 8 - Continued

Investment goals and risk management practices:

- The total portfolio will be managed on a balanced basis with considerations for diversification, quality and marketability, in accordance with the investment policy statement.
- The portfolio strategy employed seeks total return over a long-term basis. Consistency of returns on an annual basis is emphasized over individual year results.

The inputs and valuation techniques used to measure the fair value of the assets are consistently applied and described in Note 5. All assets are valued using Level 1 inputs and consisted of the following at June 30:

	<u>2018</u>	<u>2017</u>
Money market funds	\$ 434	\$ 184,182
Debt mutual funds-		
Intermediate-term	2,945,024	2,798,756
International bond	673,278	651,200
Equity mutual funds-		
International	1,391,969	1,395,613
Large blend	1,068,844	1,019,436
Small blend	778,391	736,862
Large value	1,150,548	1,113,974
Large growth	1,126,159	1,118,371
Real estate mutual funds	<u>317,672</u>	<u>277,780</u>
Total Plan Assets	<u>\$ 9,452,319</u>	<u>\$ 9,296,174</u>

Pension benefit payments, which reflect expected future service, are expected to be paid in future years. Expected future benefit payments for each of the next five fiscal years and in the aggregate for the next five years are:

For the Fiscal Year Ending June 30,

2019	\$ 594,178
2020	608,227
2021	687,172
2022	744,186
2023	745,177
2024 through 2028	<u>3,564,038</u>
	<u>\$ 6,942,978</u>

As of the report date, the Museum is currently determining the optimal contribution amount to be made during the fiscal year ending June 30, 2019 for the plan year ended June 30, 2018.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 9 - Notes Payable

Notes payable consisted of the following at June 30:

	<u>2018</u>	<u>2017</u>
Note payable to FSP-RIC, LLC in the original amount of \$2,507,400; bears interest at 7% per annum; monthly payment of principal and interest beginning on February 2012; matures in May 2031.	\$ 2,172,334	\$ 2,272,410
Note payable to U.S. Bank in the original amount of \$2,802,964; bears interest at a subsidized rate of 1.27% per annum; monthly payment of principal and interest beginning on May 2017; matures in May 2031; secured with all equipment, property and improvements acquired with proceeds of the loan.	2,606,896	2,710,059
Note payable to U.S. Bank that allows for borrowings up to \$2 million through a draw period that ends April 25, 2020; bears interest at a rate of LIBOR plus 1.32%; interest is payable monthly and monthly payments of principal begin May 2020; secured by the purchased asset; no borrowings as of June 30, 2018.	<u>-</u>	<u>-</u>
Gross notes payable	4,779,230	4,982,469
Less current portion	<u>(221,357)</u>	<u>(203,241)</u>
Long-Term Portion of Notes Payable	<u>\$ 4,557,873</u>	<u>\$ 4,779,228</u>

Interest expense for the years ended June 30, 2018 and 2017 was \$181,987 and \$254,119, respectively.

Aggregate principal maturities on the notes payable are as follows:

For the Year Ending June 30,

2019	\$ 221,357
2020	240,652
2021	261,197
2022	283,067
2023	306,342
Thereafter	<u>3,466,615</u>
	<u>\$ 4,779,230</u>

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 10 - Lines of Credit

The Museum has a \$7,000,000 line of credit with U.S. Bank. The line of credit is due on demand and collateralized with general endowment assets. Amounts borrowed under this agreement bear interest at 0.9% per annum plus the one-month LIBOR rate quoted by U.S. Bank (2% at June 30, 2018). All outstanding principal is due April 30, 2019. There was an outstanding balance of \$973,592 at June 30, 2017, and no balance due at June 30, 2018. The Museum is subjected to certain loan covenants as stipulated in the debt agreements, which include a liquidity coverage ratio, fixed charge coverage ratio and collateral coverage ratio among others. As of June 30, 2018, the Museum was in compliance with loan covenants.

The Museum entered into a \$15,000,000 revolving loan agreement with U.S. Bank during the year ended June 30, 2018 to use as a bridge loan for the SAAM capital project described in Note 2. Amounts borrowed under this agreement bear interest at 1.06% per annum plus the one-month LIBOR rate quoted by U.S. Bank (2% at June 30, 2018). All outstanding principal is due April 25, 2023. The loan is collateralized with the SAAM campaign pledges receivable. There was no outstanding balance at June 30, 2018.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 11 - Net Assets

Net assets consisted of the following at June 30:

	<u>2018</u>	<u>2017</u>
Unrestricted:		
SAM and controlling interest in consolidated subsidiaries	\$ 31,461,949	\$ 28,907,749
Noncontrolling interest in consolidated subsidiaries	<u>1,948,356</u>	<u>-</u>
Total Unrestricted Net Assets	33,410,305	28,907,749
Temporarily Restricted:		
Art acquisition	2,348,888	2,755,331
Capital projects	119,273,760	106,976,316
Conservation Center	478,635	-
Education	1,568,163	806,848
Exhibition and collection care	2,468,752	2,370,223
General operations	4,968,652	3,857,992
Sculpture park operations	21,728	3,665,814
Library	2,693,163	21,965
Technology	25,419	13,326
Time restricted pledges	<u>4,133,204</u>	<u>3,098,280</u>
Total Temporarily Restricted Net Assets	137,980,364	123,566,095
Permanently Restricted:		
Endowment funds for the following purposes-		
Art acquisition	5,778,450	5,778,775
Conservation Center	507,500	-
Education	22,435,546	22,245,033
Exhibition and collection care	27,377,915	26,410,677
General operations	68,501,760	61,557,563
Sculpture park operations	20,614,268	20,614,268
Technology	162,000	164,354
Library	164,354	162,000
Funds held in trust by others	<u>10,789,303</u>	<u>10,509,546</u>
Total Permanently Restricted Net Assets	156,331,096	147,442,216
Total Net Assets	<u>\$ 327,721,765</u>	<u>\$ 299,916,060</u>

Temporarily Restricted-Capital Projects - Contributions received to acquire long-lived assets are reported as temporarily restricted contributions and released from restriction ratably over the life of the asset. There are some minor funds available to support art acquisitions, curatorial research, education programs or other specific purposes, as well as unreleased endowment earnings that carry donor purposed restrictions.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 11 - Continued

The following is a schedule of changes in the consolidated unrestricted net assets of the Museum attributable to SAM and to the noncontrolling interest in the consolidated subsidiaries for the years ended June 30:

	SAM	Noncontrolling Interest	Total
Balances, June 30, 2016	\$ 21,328,821	\$ -	\$ 21,328,821
Change in unrestricted net assets	<u>7,578,928</u>	<u>-</u>	<u>7,578,928</u>
Balances, June 30, 2017	28,907,749	-	28,907,749
Capital contribution from noncontrolling interest	-	1,948,820	1,948,820
Other changes in unrestricted net assets	<u>2,554,200</u>	<u>(464)</u>	<u>2,553,736</u>
Total change in unrestricted net assets	<u>2,554,200</u>	<u>1,948,356</u>	<u>4,502,556</u>
Balances, June 30, 2018	<u>\$ 31,461,949</u>	<u>\$ 1,948,356</u>	<u>\$ 33,410,305</u>

Note 12 - Endowments

The Museum's endowments consist of over 100 funds established for a variety of purposes. As required by U.S. GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law - The Board of Trustees of the Museum has adopted the Washington State Prudent Management of Institutional Funds Act (PMIFA). The Board of Trustees has reviewed PMIFA and, having considered its rights and obligations thereunder, has determined that it is desirable to preserve, on a long-term basis, 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 determination, the Museum 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.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 12 - Continued

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 Museum in a manner consistent with the standard of prudence prescribed by PMIFA. In accordance with PMIFA, the Museum 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 Museum 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 Museum; or
- The investment policies of the Museum.

As of June 30, endowment net assets, excluding endowment pledges receivable and beneficial interest held in trust, consisted of the following:

	<u>2018</u>	<u>2017</u>
Donor restricted endowment funds-		
Unrestricted	\$ (3,839,638)	\$ (4,360,185)
Temporarily restricted	9,586,502	7,430,692
Permanently restricted	<u>132,394,227</u>	<u>118,920,387</u>
Total Endowment Net Assets	<u>\$ 138,141,091</u>	<u>\$ 121,990,894</u>

Reconciliation to endowment investments at June 30:

	<u>2018</u>	<u>2017</u>
Endowment net assets	\$ 138,141,091	\$ 121,990,894
Conditional contribution deposited with endowment investments	<u>2,495,000</u>	<u>-</u>
Total Endowment Investments	<u>\$ 140,636,091</u>	<u>\$ 121,990,894</u>

During the year ended June 30, 2018, the Museum received a \$2,495,000 conditional endowment contribution. To be entitled to retain the contribution the Museum is required to raise a matching amount of contributions for the endowed purpose. At June 30, 2018, the funds received were deposited with the endowment investments and a corresponding liability was recorded and included in deferred revenues on the consolidated balance sheets. The liability will be relieved in future years, and contribution revenue will be recognized, when the Museum receives the qualifying matching contributions from other donors.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 12 - Continued

Reconciliation to permanently restricted net assets at June 30:

	<u>2018</u>	<u>2017</u>
Permanently restricted endowment net assets	\$ 132,394,227	\$ 118,920,387
Permanently restricted endowment pledges receivable	13,147,566	18,012,283
Funds held in trust by others	<u>10,789,303</u>	<u>10,509,546</u>
Total Permanently Restricted Net Assets	<u>\$ 156,331,096</u>	<u>\$ 147,442,216</u>

Changes to endowment net assets, excluding endowment pledges receivable and beneficial interest held in trust, for the years ended June 30, 2018 and 2017, were as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balances, June 30, 2016	\$ (7,702,984)	\$ 3,354,054	\$ 110,143,911	\$ 105,794,981
Endowment investment return-				
Interest and dividends	-	1,243,266	-	1,243,266
Realized and unrealized gains	<u>-</u>	<u>12,193,161</u>	<u>-</u>	<u>12,193,161</u>
Total endowment investment return	-	13,436,427	-	13,436,427
Underwater endowment activity	3,342,799	(3,342,799)	-	-
Contributions and pledge payments	-	-	9,776,476	9,776,476
Appropriation of endowment for expenditure	-	(6,016,990)	-	(6,016,990)
Change in donor restriction	<u>-</u>	<u>-</u>	<u>(1,000,000)</u>	<u>(1,000,000)</u>
Balances, June 30, 2017	(4,360,185)	7,430,692	118,920,387	121,990,894
Endowment investment return-				
Interest and dividends	-	1,571,527	-	1,571,527
Realized and unrealized gains	<u>-</u>	<u>7,101,063</u>	<u>-</u>	<u>7,101,063</u>
Total endowment investment return	-	8,672,590	-	8,672,590
Underwater endowment activity	520,547	(520,547)	-	-
Contributions and pledge payments	-	-	13,473,840	13,473,840
Other activity	-	(250)	-	(250)
Appropriation of endowment for expenditure	<u>-</u>	<u>(5,995,983)</u>	<u>-</u>	<u>(5,995,983)</u>
Balances, June 30, 2018	<u>\$ (3,839,638)</u>	<u>\$ 9,586,502</u>	<u>\$ 132,394,227</u>	<u>\$ 138,141,091</u>

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 12 - Continued

Funds With Deficiencies - From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or PMIFA requires the Museum to retain as a fund of perpetual duration. In accordance with U.S. GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$3,839,638 and \$4,360,185 as of June 30, 2018 and 2017, respectively. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. Subsequent gains that restore the fair value of the assets of the endowment fund to the required level will be classified as an increase in unrestricted net assets. The deficiencies and subsequent gains associated with these endowment funds are referred to as underwater endowment activity in the consolidated statements of activities.

Return Objectives and Risk Parameters - The Museum has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Museum must hold in perpetuity or for donor-specified periods as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that match or exceed the rate of return of a custom benchmark designed to effectively and proportionately represent the mix of asset classes within the Museum's portfolio while assuming a moderate level of investment risk. The primary investment objective of the endowment fund is to earn an average annual inflation-adjusted (real) return of at least 5% net of all investment management fees over the long term.

Strategies Employed for Achieving Objectives - To satisfy its long-term rate-of-return objectives, the Museum relies on a total return strategy in which investment returns are achieved through both capital appreciation, realized and unrealized gains and losses, and current yield, such as interest and dividends. The Museum targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy and How the Investment Objectives Relate to Spending Policy - For the year ended June 30, 2018, the Museum employed a blended distribution rate of 5.7% based on the endowment's average fair value over the three-year period ending December 31, 2016. For the year ended June 30, 2017, the Museum employed a blended distribution rate of 5.7% based on the endowment's average fair value over the three-year period ending December 31, 2015. Under the current investment policy the distribution rate is to be maintained within the 5.0% to 6.0% range. In establishing this policy, the Museum considered the long-term expected return on its endowment. The Museum's objective is to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

Note 13 - Lease Agreements as Lessee

Museum Development Authority - The Museum Development Authority (the MDA) is a public corporation chartered by the City of Seattle (the City) pursuant to the Enabling Act. The public purpose of the MDA pursuant to its charter is to undertake, assist with and otherwise facilitate the development and operation of public art facilities in conjunction with the Museum, including, but not limited to, a downtown art museum and a public sculpture park on the Seattle waterfront. In accordance with the MDA charter, the Museum appoints three of the nine members of the MDA governing council. The MDA owns a portion of the existing downtown Museum facility, which is leased to the Museum. The activities, assets and liabilities of the MDA are not included in these financial statements.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 13 - Continued

The Museum is leasing land from MDA for use of its parcel at the Olympic Sculpture Park. Total lease payments of \$623,000 for this land are included in prepaid leases on the consolidated balance sheets and amortized over the life of the lease. The initial lease period expires in January 2152. The advanced lease payments are being amortized over the 150-year life of the lease. Contribution for the in-kind donation has not been recorded as the leased land is not readily susceptible to objective measurement or valuation given the unique required use of the land.

The Museum also leases units owned by MDA for expanded exhibition space in the addition adjacent to the Museum's downtown Seattle facility. The lease expires in December 2031, with required minimum lease payments through 2031. In addition to the minimum lease payments, the Museum is also obligated to bear the operating expenses of the MDA, and comply with certain public benefit provisions.

Future minimum payments under the terms of the lease approximate the following:

For the Fiscal Year Ending June 30,

2019	\$ 3,939,000
2020	3,937,000
2021	3,941,000
2022	3,941,000
2023	3,940,000
Thereafter	<u>30,535,000</u>
	<u><u>\$ 50,233,000</u></u>

The Museum is obligated to pay additional amounts under certain conditions specified in its lease agreements. Lease expense for the years ended June 30, 2018 and 2017, approximated \$3,993,000 and \$3,961,000, respectively.

SAAM Building - The Museum leases the Seattle Asian Art Museum (SAAM) building from the City of Seattle (the City). During the year ended June 30, 2018, the Museum and the City signed a new agreement for the SAAM building in conjunction with the start of the SAAM capital project described in Note 2. The lease commenced in December 2017 and terminates in December 2072. The lease agreement requires no cash rent payments from the Museum to the City. Instead, the lease requires the Museum to undertake the SAAM capital project described in Note 2, maintain and operate the SAAM building as a museum open to the public, and maintain the historic features of the SAAM building. The lease also requires the Museum to provide certain public benefits and to perform property operation activities. To help defray the Museum's costs of operating and maintaining the SAAM building, the City will provide annual operating support payments to the Museum beginning in the year the SAAM capital project is completed. The operating support payments start at \$250,000 per year and increase every five years during the term of the lease.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 14 - Lease Agreement as Lessor

The Museum has an agreement with Nordstrom, Inc. to lease a portion of a condominium (Nordstrom Lease). Approximately 70% of the leased space is owned by the Museum. The remaining approximately 30% of the leased space is owned by FSP-RIC, LLC, which the Museum leases solely in order to sublet the space to Nordstrom, Inc. as part of the Nordstrom lease. The Nordstrom Lease term is 21 years, ending on May 31, 2031. In addition to base rent, Nordstrom is also responsible for operating expenses, in accordance with the lease agreement. The FSP-RIC Lease obligation is performed by Nordstrom, and the lease has the same commencement and expiration dates as the Nordstrom Lease.

During the year ended June 30, 2018 and 2017, the Museum received approximately \$5,358,000 in lease payments. The following is a schedule of the approximate minimum future rent receivable:

For the Fiscal Year Ending June 30,

2019	\$ 5,299,188
2020	5,299,188
2021	5,299,188
2022	5,299,188
2023	5,299,188
Thereafter	<u>50,663,408</u>
	<u><u>\$ 77,159,348</u></u>

As a lease incentive, the Museum has assumed two real estate leases (the Existing Leases) on space from which Nordstrom has vacated to occupy the Museum's condominium. The cost of the lease assumption is \$849,756 and is amortized against leasing income over the term of the Museum's lease with Nordstrom. For both of the years ended June 30, 2018 and 2017, amortization of the lease assumption approximated \$62,000.

The Museum also provided a cash allowance for tenant improvements totaling approximately \$7,007,230. Cash allowance for tenant improvements is capitalized and amortized against leasing income over the term of the lease. Of the cash allowance, \$2,507,400 was financed by a note payable from FSP-RIC, LLC. Principal payments during the years ending June 30, 2018 and 2017 totaled \$100,076 and \$93,330, respectively. For the years ended June 30, 2018 and 2017, amortization of the cash allowance approximated \$318,000.

Note 15 - Concentration of Credit Risk

Financial instruments that potentially subject the Museum to concentrations of credit risk consist principally of cash and cash equivalents, investments and receivables. Investment managers engaged by the Museum make investment purchases, and the investments are monitored for the Museum by an investment advisor. Though the market value of investments is subject to fluctuations on a year-to-year basis, management believes the investment policy is prudent for the long-term welfare of the Museum and its beneficiaries. Balances in cash and cash equivalents and investments exceed federally insured limits.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements For the Years Ended June 30, 2018 and 2017

Note 15 - Continued

Concentrations of credit risk with respect to pledges receivable are generally diversified due to the large number of individuals composing the Museum's programs and donor base. The Museum performs ongoing credit evaluations and writes off uncollectible amounts as they become known. The Museum has had no experience with significant losses due to concentrations of credit risk.

Note 16 - Related Party Transactions

The Museum receives contributions from members of the Board of Trustees and through foundations and corporations associated with members of the Board of Trustees. For the years ended June 30, 2018 and 2017, trustee contributions approximated \$16,062,000 and \$13,326,000, respectively. Outstanding amounts associated with the trustee pledges receivable approximated \$13,984,000 and \$18,731,000 as of June 30, 2018 and 2017, respectively.

The Museum leases real property from MDA, a related party, as further described in Note 13.

Note 17 - Exhibit and Other Commitments

The Museum has entered into agreements to host several major exhibits. These exhibits will open in upcoming fiscal years. Under these agreements, the Museum is obligated to pay fees for use of the exhibits and exhibit related expenses. At June 30, 2018 and 2017, estimated fees for other exhibition commitments totaled approximately \$404,000 and \$876,000, respectively.

On occasion the Museum will enter into employment agreements with employees. When this occurs, the agreements are generally for multiple years and include provisions for salary and other employee benefits.

Note 18 - Restatement of 2017 Financial Statements

During the year ended June 30, 2018, the Museum committed to the major capital project of the renovation and expansion of the SAAM described in Note 2. Upon commitment to the project in fiscal year 2018 management determined there were costs that were incurred and expenses in fiscal years 2017 and 2016 that should now be capitalized as part of the capital project. The fiscal year 2017 financial statements have been restated to capitalize these costs and to make corresponding changes to the accounting for donor-restricted contributions now that the related expenditures are capitalized instead of expensed.

SEATTLE ART MUSEUM AND SUBSIDIARIES

Notes to Consolidated Financial Statements
For the Years Ended June 30, 2018 and 2017

Note 18 - Continued

The restatements made to the fiscal year 2017 financial statements are summarized in the following table.

	As of and for the Year Ended June 30, 2017		
	Previously Reported	Adjustments	As Restated
Consolidated Balance Sheet:			
Property and equipment, net	\$ 109,820,379	\$ 7,714,642	\$ 117,535,021
Unrestricted net assets	27,573,137	1,334,612	28,907,749
Temporarily restricted net assets	117,186,065	6,380,030	123,566,095
Total net assets	292,201,418	7,714,642	299,916,060
Consolidated Statement of Activities:			
Nonoperating activities-			
Capital projects expense	(4,935,430)	4,935,430	-
Contributions and endowment earnings released from restriction	11,776,627	(5,189,734)	6,586,893
Change in unrestricted net assets	7,833,232	(254,304)	7,578,928
Temporarily restricted net assets -			
Contributions and grants	9,274,269	671,437	9,945,706
Contribution and endowment earnings released from restriction	(22,868,232)	5,189,734	(17,678,498)
Change in temporarily restricted net assets	(1,910,990)	5,861,171	3,950,181
Total change in net assets	8,373,822	5,606,867	13,980,689
Net assets, beginning of year	283,827,596	2,107,775	285,935,371
Net assets, end of year	292,201,418	7,714,642	299,916,060
Consolidated Statement of Cash Flows:			
Net cash from operating activities	(2,287,338)	1,409,182	(878,156)
Net cash from investing activities	(6,973,641)	(5,606,867)	(12,580,508)
Net cash from financing activities	8,116,337	4,197,685	12,314,022