KPMG

# UNIVERSITY OF WASHINGTON
# INTERNAL LENDING PROGRAM

Financial Statements

June 30, 2017 and 2016

(With Independent Auditors' Report Thereon)

**UNIVERSITY OF WASHINGTON**
**INTERNAL LENDING PROGRAM**

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KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

## Independent Auditors' Report

The Board of Regents
University of Washington:

We have audited the accompanying financial statements of the University of Washington Internal Lending Program (Program or ILP), a department of the University of Washington, as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, as listed in the table of contents.

### Management's Responsibility for the Financial Statements

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

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

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

### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Washington Internal Lending Program as of June 30, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

**Emphasis of Matter**

As discussed in note 1, the financial statements present only the University of Washington Internal Lending Program and do not purport to, and do not, present fairly the financial position of the University of Washington, as of June 30, 2017 and 2016, the changes in its financial position, or its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

**Other Matter**

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Seattle, Washington
November 14, 2017

### Discussion and Analysis Prepared by Management

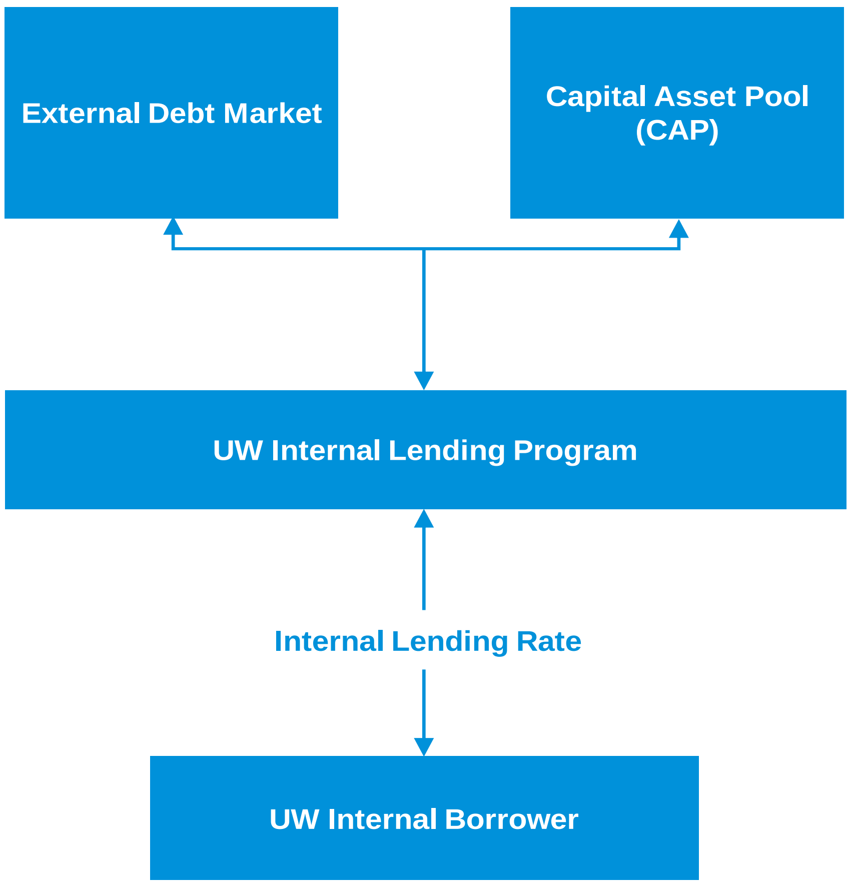
The following discussion and analysis provides an overview of the financial position and activities of the University of Washington Internal Lending Program (Program or ILP) for the years ended June 30, 2017 and 2016. This discussion has been prepared by management and should be read in conjunction with the financial statements and accompanying notes, which follow this section. The ILP commenced operations on July 1, 2008 based upon the direction and authority of the University of Washington Board of Regents (Board of Regents). It operates as a program of the University of Washington (University).

The ILP makes loans to internal borrowers at a uniform lending rate. These internal loans are funded through the issuance of University General Revenue debt obligations or through the Capital Asset Pool (CAP). The CAP uses University funds to finance capital projects with maturities up to 30 years.

The internal loan portfolio consists of loans to internal units, while the external debt portfolio is comprised of short-term and long-term debt obligations of the institution. The external debt portfolio is actively managed to reduce the institution's cost of capital and to achieve stability and predictability in the internal lending rate. Active management of the external debt portfolio entails the possible use of risk-evaluated debt structures and debt management techniques to achieve the lowest risk-adjusted cost of capital consistent with market conditions and institutional credit considerations.

The management of the ILP and the external debt portfolio is performed in accordance with policies set forth in the University's Debt Management Policy as approved by the Board of Regents.

The diagram below outlines the relationship between the University's internal borrowers, the ILP, and the external debt market:




**Using the Financial Statements**

The ILP's financial statements include the Statements of Net Position, Statements of Revenues, Expenses, and Changes in Net Position, Statements of Cash Flows, and notes to financial statements. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) principles, which establish standards for external financial reporting for state and local governments, including public colleges and universities. Information about the financial condition of the ILP is provided in the summaries and explanations that follow.

### Statements of Net Position Summary

The Statements of Net Position reflect the financial condition of the ILP at the end of the year and report the various categories of all assets, deferred outflows of resources, liabilities, and net position. The following summary statements of net position show the ILP's total assets, deferred outflows of resources, total liabilities, and net position as of June 30, 2017, 2016, and 2015:

**Summary Statements of Net Position**

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Current assets | $ 299,946,454 | 237,303,790 | 211,236,876 |
| Noncurrent assets | 1,819,380,073 | 1,710,655,881 | 1,661,376,606 |
| Total assets | 2,119,326,527 | 1,947,959,671 | 1,872,613,482 |
| Deferred outflows of resources | 23,949,688 | 22,531,220 | 24,756,071 |
| Total assets and deferred outflows of resources | $ 2,143,276,215 | 1,970,490,891 | 1,897,369,553 |
| Current liabilities | $ 161,532,163 | 160,898,688 | 109,267,388 |
| Noncurrent liabilities | 1,891,136,606 | 1,738,823,511 | 1,731,814,666 |
| Total liabilities | 2,052,668,769 | 1,899,722,199 | 1,841,082,054 |
| Unrestricted net position | 90,607,446 | 70,768,692 | 56,287,499 |
| Total liabilities and net position | $ 2,143,276,215 | 1,970,490,891 | 1,897,369,553 |

The following are comments about the summary statements of net position:

- As of June 30, 2017, current assets of the ILP include $177.1 million in cash and cash equivalents in the University of Washington Invested Funds Pool, $52.6 million in restricted investments of undistributed bond proceeds, and $62.7 million in internal loan receivables. As of June 30, 2016, current assets of the ILP include $117.0 million in Due from the University of Washington Invested Funds Pool, $49.4 million in restricted investments of undistributed bond proceeds, and $63.8 million in internal loan receivables. In fiscal year 2017, current assets increased by $62.6 million primarily due to an increase in cash and cash equivalents in the University of Washington Invested Funds Pool from operations and as a result of an increase in undistributed bond proceeds. In fiscal year 2016, current assets increased by $26.1 million due to an increase in cash and cash equivalents from operations and current portion of ILP receivables.
- Noncurrent assets consist entirely of internal loan receivables from participating departments within the University of Washington. Noncurrent assets were $108.7 million more at the end of fiscal year 2017 than at the end of fiscal year 2016, and $49.3 million more at the end of fiscal year 2016 than at the end of fiscal year 2015, as a result of increased long-term internal lending made to various University departments.

- Deferred outflows of resources consist entirely of deferred losses on refundings. Deferred outflows of resources increased $1.4 million in fiscal year 2017 as a result of debt refunding during the year. Deferred outflows of resources decreased $2.2 million in fiscal year 2016 as a portion of the balance was amortized during the year.
- As of June 30, 2017, current liabilities include $66.3 million in bonds payable, $42.4 million in Due to University of Washington, $25.0 million in outstanding commercial paper, and $24.5M in interest payable. As of June 30, 2016, current liabilities include $63.1 million in bonds payable, $46.2 million in Due to University of Washington, $25.0 million in outstanding commercial paper, and $24.4 million in interest payable. In fiscal year 2017 current liabilities increased by $0.6 million primarily due to an increase in the current portion of bonds payable, which was offset by a decrease in Due to University of Washington, which resulted from fewer capital project expenditures made close to year-end which were reimbursed in July 2017. In fiscal year 2016 current liabilities increased by $51.6 million primarily due to an increase in the current portion of bonds payable and an increase in Due to University of Washington, which resulted from additional capital project expenditures made close to year-end which were reimbursed in July 2016.
- Noncurrent liabilities as of June 30, 2017, include $1,754.6 million in bonds payable and $136.5 million in CAP payable to Invested Funds. Noncurrent liabilities as of June 30, 2016, include $1,618.4 million in bonds payable and $120.4 million in CAP payable to Invested Funds. This resulted in an increase of $152.3 million or 9% due to an increase in long-term portion of bonds payable as a result of additional external borrowing. The fiscal year 2016 noncurrent liability ending balance is $7.0 million or 0.4% higher than the fiscal year 2015 ending balance due to an increase in long-term portion of bonds payable.

**ILP's Net Position**

The categories of net position listed in the table above are defined as follows:

"Unrestricted net position" are all funds available to the ILP for any purpose associated with the University's mission. Unrestricted net position is primarily designated for future internal loans. Net position increased by $19.8 million or 28% during fiscal year 2017 and by $14.5 million or 26% during fiscal year 2016 as the ILP collected more money on internal loans than was paid externally for interest expense. The change in net position of $19.8 million in fiscal year 2017 was an increase of $5.3 million over the change in net position in fiscal year 2016 of $14.5 million, which is primarily the result of increased investment revenue due to both higher Invested Funds balance and higher rate of return. The change in net position of $14.5 million in fiscal year 2016 was a decrease of $6.8 million over the change in net position in fiscal year 2015 of $21.3 million, which is primarily the result of decreased interest revenue due to a lower internal interest rate.

### Statements of Revenues, Expenses, and Changes in Net Position

The statements of revenues, expenses, and changes in net position presents the ILP's operations and nonoperating revenues and changes in net position. The following summary shows the revenues, expenses, and changes in net position for the years ended June 30, 2017, 2016, and 2015:

**Summary Statements of Revenues, Expenses, and Changes in Net Position**

| | | 2017 | 2016 | 2015 |
|---|---|---|---|---|
| Operating revenues | $ | 82,649,236 | 76,525,013 | 74,390,759 |
| Operating expenses | | 73,330,475 | 65,179,201 | 60,791,588 |
| Operating income | | 9,318,761 | 11,345,812 | 13,599,171 |
| Nonoperating revenues | | 10,519,993 | 3,135,381 | 7,664,649 |
| Change in net position | | 19,838,754 | 14,481,193 | 21,263,820 |
| Net position, beginning of year | | 70,768,692 | 56,287,499 | 35,023,679 |
| Net position, end of year | $ | 90,607,446 | 70,768,692 | 56,287,499 |

The following are comments about the revenues and expenses highlighted in the summary:

- Fiscal year 2017 operating revenues consists of interest collected and accrued on internal loans, an increase of $6.1 million or 8% from the prior year. The revenue increase is due to an increase in the amount of internal loans in fiscal year 2017 of $107.6 million. Fiscal year 2016 operating revenues consists of interest collected and accrued on internal loans, an increase of $2.1 million or 3% from the prior year. The revenue increase is due to an increase in the amount of internal loans in fiscal year 2016 of $53.0 million.
- Nonoperating revenue includes $6.8 million in investment income earned and $3.7 million in Build America Bonds (BABs) grant revenue recognized. Nonoperating revenue increased by $7.4 million or 335% in fiscal year 2017 primarily due to an increase in investment income. This increase was primarily due to two factors: increased balance of the Invested Funds Pool and increased rate of return. The ILP received an annual Invested Funds (IF) income allocation, net of expenses, of $6.8 million and $0.2 million in fiscal years 2017 and 2016, respectively, which was driven by the factors noted above. Returns for the Invested Funds Pool are paid on a quarter lag and for fiscal years March 31, 2017 and 2016 were 4% and 0%, respectively.
- Operating expenses include $69.3 million in interest paid and accrued on outstanding bonds and commercial paper in fiscal year 2017 compared to $62.6 million in fiscal year 2016. Interest expense increased by $6.6 million in fiscal year 2017 due to increased debt service as a result of additional borrowings. Expenses to administer the ILP program totaled $4.0 million and $2.5 million for the fiscal years ended 2017 and 2016, respectively. These administrative expenses include fees paid for legal counsel, financial advisory services, rating agencies, staff salaries and benefits, and Provost credit support fee. Recurring administrative expenses saw a decrease of $0.6 million in fiscal year 2017, which was offset by a $2.2 million increase due to the new Provost credit support fee.

**Debt Administration**

Moody's and Standard & Poor's have both recognized the financial strength of the University: Aaa from Moody's (their highest rating) and AA+ (stable outlook) from Standard & Poor's. At the beginning of each fiscal year, the Board of Regents approves an annual bond resolution that contains the maximum amount of new General Revenue Bonds that the University can issue in the upcoming year. The annual bond resolution allows the University to manage its external debt portfolio by issuing debt during favorable market conditions. During fiscal years 2017 and 2016, the ILP issued $205.2 million and $180.5 million, respectively, in General Revenue Bonds, as disclosed in note 7.

Moody's and Standard & Poor's have assigned a short-term rating of P-1/A-1+, respectively, for the University's commercial paper program. These are the highest short-term ratings each agency assigns. The University has a $250.0 million commercial paper program, and may issue commercial paper throughout the year for various purposes. In fiscal years 2017 and 2016, the ILP issued $45.0 million and $0 million and paid down $45.0 million and $111.5 million, respectively, in commercial paper.

The ILP provides regular updates on internal loans and external debt as part of its ongoing reporting to the Board of Regents.

**UNIVERSITY OF WASHINGTON**
**INTERNAL LENDING PROGRAM**

Statements of Net Position

June 30, 2017 and 2016

| Assets | | 2017 | 2016 |
|---|---|---|---|
| Current assets: | | | |
| Cash in the University of Washington Invested Funds Pool | $ | 177,091,420 | 117,001,906 |
| Restricted investments, current | | 52,607,508 | 49,433,441 |
| Interest receivable | | 6,938,537 | 6,806,703 |
| Other receivable | | 573,859 | 228,274 |
| Internal Lending Program receivable, current portion | | 62,735,130 | 63,833,466 |
| Total current assets | | 299,946,454 | 237,303,790 |
| Noncurrent assets: | | | |
| Internal Lending Program receivable, net of current portion | | 1,819,380,073 | 1,710,655,881 |
| Total noncurrent assets | | 1,819,380,073 | 1,710,655,881 |
| Total assets | | 2,119,326,527 | 1,947,959,671 |
| Deferred outflows of resources: | | | |
| Loss on refunding | | 23,949,688 | 22,531,220 |
| Total assets and deferred outflows of resources | $ | 2,143,276,215 | 1,970,490,891 |
| **Liabilities and Net Position** | | | |
| Liabilities: | | | |
| Accounts payable | $ | — | 1,500 |
| Accrued salaries and vacation payable | | 107,051 | 86,118 |
| Interest payable | | 24,461,383 | 24,375,911 |
| Unearned revenue – Build America Bonds | | 748,738 | — |
| Due to University of Washington | | 42,449,765 | 46,213,832 |
| Commercial paper, current portion | | 25,000,000 | 25,000,000 |
| CAP payable to IF | | 2,513,764 | 2,101,192 |
| Bonds payable, current portion | | 66,251,462 | 63,120,135 |
| Total current liabilities | | 161,532,163 | 160,898,688 |
| CAP payable to IF, net of current portion | | 136,521,583 | 120,417,171 |
| Bonds payable, net of current portion | | 1,754,615,023 | 1,618,406,340 |
| Total noncurrent liabilities | | 1,891,136,606 | 1,738,823,511 |
| Total liabilities | | 2,052,668,769 | 1,899,722,199 |
| Net position: | | | |
| Unrestricted net position | | 90,607,446 | 70,768,692 |
| Total liabilities and net position | $ | 2,143,276,215 | 1,970,490,891 |

See accompanying notes to financial statements.

**UNIVERSITY OF WASHINGTON**
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Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2017 and 2016

| | | 2017 | 2016 |
|---|---|---|---|
| Operating revenues: | | | |
| Interest revenue | $ | 82,649,236 | 76,525,013 |
| Total operating revenues | | 82,649,236 | 76,525,013 |
| Operating expenses: | | | |
| Interest expense | | 69,283,709 | 62,645,912 |
| Administration expenses | | 4,046,766 | 2,533,289 |
| Total operating expenses | | 73,330,475 | 65,179,201 |
| Operating income | | 9,318,761 | 11,345,812 |
| Nonoperating revenues: | | | |
| Grant revenue subsidies | | 3,675,841 | 2,895,917 |
| Investment revenue, net of expenses | | 6,844,152 | 239,464 |
| Total nonoperating revenues | | 10,519,993 | 3,135,381 |
| Change in net position | | 19,838,754 | 14,481,193 |
| Net position at beginning of year | | 70,768,692 | 56,287,499 |
| Net position at end of year | $ | 90,607,446 | 70,768,692 |

See accompanying notes to financial statements.

**UNIVERSITY OF WASHINGTON**
**INTERNAL LENDING PROGRAM**

Statements of Cash Flows

Years ended June 30, 2017 and 2016

| | | 2017 | 2016 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Interest received from internal borrowers | $ | 82,517,402 | 75,464,118 |
| Loans made to internal borrowers | | (173,281,659) | (116,678,111) |
| Principal received from internal borrowers | | 65,655,803 | 63,676,244 |
| Payments for administration expenses | | (4,027,333) | (2,566,748) |
| Net cash (used in) provided by operating activities | | (29,135,787) | 19,895,503 |
| Cash flows from noncapital financing activities: | | | |
| Proceeds from issuance of bonds | | 233,589,264 | 212,167,145 |
| Proceeds from the issuance of commercial paper | | 45,000,000 | — |
| Proceeds from the Invested Funds Pool (CAP Program) | | 18,867,925 | — |
| Advances from the University for capital projects | | — | 45,943,442 |
| Build America Bonds grant received | | 4,078,994 | 1,922,122 |
| Payments to the University | | (3,764,067) | — |
| Principal paid on debt | | (100,600,941) | (87,373,222) |
| Principal paid on commercial paper | | (45,000,000) | (111,545,000) |
| Interest paid on debt | | (66,615,958) | (60,194,301) |
| Net cash provided by noncapital financing activities | | 85,555,217 | 920,186 |
| Cash flows from investing activities: | | | |
| Purchases of investments | | (245,358,958) | (209,423,722) |
| Proceeds from sales of investments | | 242,219,708 | 212,999,404 |
| Investment income | | 6,809,335 | 228,672 |
| Net cash provided by investing activities | | 3,670,085 | 3,804,354 |
| Net increase in cash and cash equivalents | | 60,089,515 | 24,620,043 |
| Cash and cash equivalents at beginning of year | | 117,001,906 | 92,381,863 |
| Cash and cash equivalents at end of year | $ | 177,091,421 | 117,001,906 |
| Reconciliation of operating income to net cash (used in) provided by operating activities: | | | |
| Operating income | $ | 9,318,761 | 11,345,812 |
| Adjustments to reconcile operating income to net cash used by operating activities: | | | |
| Interest expense | | 69,283,709 | 62,645,912 |
| Changes in operating assets and liabilities: | | | |
| Decrease in interest receivable | | (131,834) | (1,060,895) |
| Increase in Internal Lending Program receivable | | (107,625,856) | (53,001,867) |
| Increase (decrease) in accounts payable and accrued liabilities | | 19,433 | (33,459) |
| Net cash (used in) provided by operating activities | $ | (29,135,787) | 19,895,503 |

See accompanying notes to financial statements.

## (1) Organization and Summary of Significant Accounting Policies

### *(a) Organization*

The University of Washington's Internal Lending Program (Program or ILP) is a program of the University of Washington. The purpose of the ILP is to lower the University of Washington's (the University) overall cost of capital and provide internal borrowing units with a stable and predictable borrowing rate. The Board of Regents approved the ILP on May 15, 2008, with ILP operations commencing on July 1, 2008.

Debt of $576,386,287 incurred by the University or its units before July 1, 2008 and restricted investments of $4,937,799 were transferred into the ILP at the remaining book value and related receivables from internal borrowers of $571,448,488 were established between the internal borrowers and the ILP as of July 1, 2008. The internal borrowers pay the same interest rate at which the transferred debt was issued in the external market. Debt noted below was not transferred or transferred at the same interest rate:

- Debt repaid from state-appropriated University funds was not transferred
- Debt issued by an external entity other than the state of Washington on behalf of the University was not transferred
- Personal property capital leases and personal property Certificates of Participation (COP's) were not transferred
- Lines of credit were not transferred
- University of Washington General Revenue Bonds, Series 2007 were transferred at the ILP rate

The ILP makes new loans to internal borrowers at a uniform internal lending rate. These loans are funded through the issuance of University General Revenue Bonds, state of Washington General Obligation Bonds, short-term notes such as commercial paper, or through the Capital Asset Pool (CAP). The CAP uses University funds to finance capital projects with maturities up to 30 years. The debt issued to fund loans is an obligation of the University; the Program manages the debt on behalf of the University. The ILP program policies include a provision for a rate stabilization reserve and a provision for rate adjustments if necessary.

### *(b) Basis of Presentation*

The financial statements of the ILP have been prepared in accordance with accounting standards established by the Governmental Accounting Standards Board (GASB). The ILP is reporting as a special-purpose government engaged in business-type activities (BTA). In accordance with BTA reporting, the ILP presents a Management's Discussion and Analysis, Statements of Net Position, Statements of Revenues, Expenses, and Changes in Net Position, Statements of Cash Flows, and notes to financial statements. The financial statements present only the University of Washington's Internal Lending Program and do not purport to, and do not, present fairly the financial position of the University, as of June 30, 2017 and 2016, the changes in its financial position, or its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles. The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

***(c) Cash in the University of Washington Invested Funds Pool***

The Internal Lending Program's cash is managed by the University through the Treasurer of the Board of Regents. During 2017 and 2016, the Program's funds on deposit with the University were invested in the University's Invested Funds Pool (IFP).

***(d) Restricted Investments***

Restricted investments represent unspent bond proceeds invested at State Street Bank and invested bond proceeds held by trustees to serve as debt service funds in accordance with the terms of the bond indenture and are stated at amortized cost.

***(e) Internal Lending Program Receivable***

Internal Lending Program Receivable represents the amounts owed by participating units in the University to the Program. Any internal loans authorized after the inception of the ILP require a signed financing agreement before funds are released. The agreement is signed by a borrowing unit representative, a representative from the Provost's Office, the Associate Vice President for Treasury, and the Executive Vice President for Finance and Administration. Loans transferred at the Program's inception do not have a financing agreement. All receivables are from within the University.

***(f) Due to University of Washington***

Due to University of Washington represents cash paid by the University on behalf of the ILP due to the timing of capital expenditures and will be reimbursed by the ILP at a later date.

***(g) Unearned Revenue – Build America Bonds***

The American Recovery and Reinvestment Act of 2009 created the Build America Bond (BAB) program, which authorized state and local governments to issue BABs as taxable bonds in 2009 and 2010 to finance any capital expenditures for which they otherwise could issue tax-exempt bonds. The issuers receive a direct federal subsidy payment for a portion of their borrowing cost on BABs equal to 28% to 35% of the total coupon interest paid to investors. The direct federal subsidy once earned, is considered a nonexchange transaction separate from the interest payments made by the Program and is recorded in nonoperating revenue when the Program makes its interest payment and all eligibility requirements are met.

***(h) Operating Revenues and Expenses***

The Program's statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenue and expenses. Operating revenues result from exchange transactions associated with providing loans to internal borrowers – the Program's primary business. Operating expenses are all expenses incurred to provide loans to internal borrowers. Nonoperating revenues consists of investment revenue generated by the short-term investments the Program holds during the year and BAB federal subsidies.

### *(i) Federal Income Taxes*

As a part of the University, the ILP is exempt from federal income taxes, except to the extent of unrelated business income. ILP did not incur unrelated business income tax during 2017 and 2016, and accordingly, the financial statements do not include a provision for federal income taxes.

### *(j) Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

## (2) Cash in the University of Washington Invested Funds Pool

Pooled investments held on behalf of the ILP by the University of Washington are recorded at the ILP's share of the carrying value of the University of Washington Invested Funds Pool. These funds are available on demand without prior notice or penalty. The Invested Funds Pool was invested as follows at June 30:

| | 2017 | 2016 |
|---|---|---|
| Cash and cash equivalents | 6.2 % | 6.4 % |
| Treasuries and agencies | 69.0 | 73.0 |
| Mortgage-related securities | 8.6 | 8.6 |
| Asset-backed debt securities | 6.7 | 7.0 |
| Corporate and other fixed income | 9.5 | 5.0 |
| Total | 100.0 % | 100.0 % |

## (3) Concentrations

Financial instruments that subject the ILP to concentrations of credit risk consist of pooled investments held on behalf of the ILP at the University of Washington.

## (4) Restricted Investments

Current restricted investments of $52.6 million represent unspent bond proceeds. Such amounts are invested at State Street Bank and consist of money market funds, which hold U.S. government securities with remaining maturities of one year or less at the time of purchase. Any interest earnings in excess of the arbitrage rate may be subject to rebate to the Internal Revenue Service (IRS). During fiscal years 2017 and 2016, there were no rebatable arbitrage earning due to the IRS. Restricted investments are classified as current assets based upon the Program's intention to spend down on capital projects during the next fiscal year.

The Internal Lending Program's restricted investments are managed by the University through the Treasurer of the Board of Regents.


(Continued)

## (5) Internal Lending Program Receivable

Internal Lending Program receivables include receivables that were transferred and new receivables made since inception of the Program. The transferred receivables had fixed rates that ranged from 3.0% to 6.4%. The new receivables had a uniform rate of 5.50%; effective April 1, 2015, the ILP interest rate was reduced to 4.75%, and further was reduced to 4.50% effective July 1, 2016.

Estimated repayment schedules related to the internal lending receivable balances from participating units for the year ended June 30, 2017 are summarized as follows:

**Internal Lending Program Receivable**

(Dollars in thousands)

| | Central | | School of medicine | | University of Washington Medical Center | | Student life | |
|---|---|---|---|---|---|---|---|---|
| | **Principal** | **Interest** | **Principal** | **Interest** | **Principal** | **Interest** | **Principal** | **Interest** |
| 2018 | $ 20,202 | 21,351 | 5,149 | 1,982 | 14,803 | 18,055 | 4,290 | 6,527 |
| 2019 | 18,309 | 20,478 | 3,281 | 1,728 | 15,461 | 17,306 | 4,494 | 6,323 |
| 2020 | 18,954 | 19,702 | 3,237 | 1,564 | 16,166 | 16,524 | 4,708 | 6,109 |
| 2021 | 19,865 | 18,895 | 3,397 | 1,398 | 16,850 | 15,706 | 4,932 | 5,884 |
| 2022 | 20,185 | 18,061 | 3,569 | 1,223 | 17,613 | 14,853 | 5,167 | 5,649 |
| 2023–2027 | 95,480 | 78,242 | 15,205 | 3,651 | 85,029 | 60,723 | 29,764 | 24,307 |
| 2028–2032 | 102,536 | 58,494 | 7,451 | 625 | 85,716 | 40,295 | 30,064 | 16,743 |
| 2033–2037 | 99,980 | 35,938 | — | — | 72,193 | 21,458 | 25,674 | 10,581 |
| 2038–2042 | 59,729 | 16,603 | — | — | 30,859 | 10,453 | 31,805 | 4,121 |
| 2043–2047 | 43,196 | 4,452 | — | — | 30,194 | 2,855 | 1,690 | 13 |
| Premium (discount) and other | 8 | — | — | — | — | — | — | — |
| Total | $ 498,444 | 292,216 | 41,289 | 12,171 | 384,884 | 218,228 | 142,588 | 86,257 |

| | Commuter services | | Intercollegiate athletics | | Housing and dining | | Total | |
|---|---|---|---|---|---|---|---|---|
| | **Principal** | **Interest** | **Principal** | **Interest** | **Principal** | **Interest** | **Principal** | **Interest** |
| 2018 | $ 518 | 368 | 4,055 | 11,099 | 13,718 | 25,004 | 62,735 | 84,386 |
| 2019 | 541 | 344 | 4,321 | 10,913 | 14,336 | 24,313 | 60,743 | 81,405 |
| 2020 | 566 | 318 | 4,520 | 10,714 | 14,995 | 23,581 | 63,146 | 78,512 |
| 2021 | 592 | 294 | 4,727 | 10,507 | 15,698 | 22,804 | 66,061 | 75,488 |
| 2022 | 619 | 266 | 4,944 | 10,289 | 16,392 | 21,999 | 68,489 | 72,340 |
| 2023–2027 | 3,551 | 877 | 32,710 | 47,450 | 75,310 | 98,504 | 337,049 | 313,754 |
| 2028–2032 | 2,024 | 116 | 42,166 | 38,993 | 90,883 | 77,048 | 360,840 | 232,314 |
| 2033–2037 | — | — | 52,783 | 28,376 | 96,486 | 52,695 | 347,116 | 149,048 |
| 2038–2042 | — | — | 66,074 | 15,084 | 116,608 | 24,461 | 305,075 | 70,722 |
| 2043–2047 | — | — | 32,222 | 1,594 | 34,669 | 1,548 | 141,971 | 10,462 |
| Premium (discount) and other | | | — | — | — | — | 8 | — |
| Total | $ 8,411 | 2,583 | 248,522 | 185,019 | 489,095 | 371,957 | 1,813,233 | 1,168,431 |

The debt service payments shown above do not include receivables for projects under construction totaling $68.9 million. The ILP does not finalize loan payments until construction is complete.

## (6) Commercial Paper

Commercial paper payable outstanding as of June 30, 2017 totaled $25.0 million. This short-term borrowing program is primarily used to manage cash flows for capital projects that are funded with long-term debt. The use of commercial paper will typically increase prior to the issuance of long-term debt and be paid down with the proceeds of the long-term debt. During 2017, the University issued $45.0 million in commercial paper and paid off $45.0 million in commercial paper.

**Short-Term Debt Payable**

(Dollars in thousands)

| | Balance at June 30, 2016 | Additions | Reductions | Balance at June 30, 2017 |
|---|---|---|---|---|
| Commercial paper | $ 25,000 | 45,000 | (45,000) | 25,000 |
| Total | $ 25,000 | 45,000 | (45,000) | 25,000 |

**Short-Term Debt Payable**

(Dollars in thousands)

| | Balance at June 30, 2015 | Additions | Reductions | Balance at June 30, 2016 |
|---|---|---|---|---|
| Commercial paper | $ 136,545 | — | (111,545) | 25,000 |
| Total | $ 136,545 | — | (111,545) | 25,000 |

The Board of Regents has approved the University’s $250.0 million commercial paper program in an ongoing resolution. The University may issue commercial paper at any time within the limits of the resolution.

## (7) Long-Term Liabilities

Long-term liabilities for the years ended June 30, 2017 and 2016 include State of Washington General Obligation Bonds, University General Revenue Bonds, Revenue Bonds payable from specific revenue streams relating to participating departments, State of Washington COP’s, and funds borrowed through the Capital Asset Pool that are payable back to the Invested Funds Pool at the University. These obligations have fixed interest rates ranging from 0.9% to 6.1%.



(Continued)

Debt service requirements related to bonds payable and certificates of participation payable at June 30, 2017 were as follows:

**Bonds Payable and Certificates of Participation Payable**

(Dollars in thousands)

| | State of Washington General Obligation Bonds | | University of Washington Revenue Bonds | | State of Washington Certificates of Participation | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Principal | Interest | Principal | Interest | Principal | Interest | Principal | Interest |
| 2018 | $ 12,177 | 4,119 | 37,810 | 72,642 | 1,625 | 397 | 51,612 | 77,158 |
| 2019 | 12,115 | 3,483 | 39,780 | 71,064 | 1,700 | 325 | 53,595 | 74,872 |
| 2020 | 8,373 | 2,925 | 41,250 | 69,394 | 1,780 | 250 | 51,403 | 72,569 |
| 2021 | 8,764 | 2,501 | 44,005 | 67,579 | 1,870 | 170 | 54,639 | 70,250 |
| 2022 | 9,127 | 2,049 | 46,070 | 65,536 | 1,440 | 87 | 56,637 | 67,672 |
| 2023–2027 | 33,134 | 3,904 | 244,590 | 295,291 | 440 | 27 | 278,164 | 299,222 |
| 2028–2032 | 3,343 | 132 | 287,550 | 231,255 | — | — | 290,893 | 231,387 |
| 2033–2037 | — | — | 262,176 | 166,933 | — | — | 262,176 | 166,933 |
| 2038–2042 | — | — | 371,955 | 89,953 | — | — | 371,955 | 89,953 |
| 2043–2047 | — | — | 216,505 | 13,162 | — | — | 216,505 | 13,162 |
| Premium | 6,870 | — | 125,576 | — | 841 | — | 133,287 | — |
| Total | $ 93,903 | 19,113 | 1,717,267 | 1,142,809 | 9,696 | 1,256 | 1,820,866 | 1,163,178 |

Long-term liability activity for the years ended June 30, 2017 and 2016 is summarized as follows:

**Long-Term Liabilities**

(Dollars in thousands)

| | Balance at June 30, 2016 | Additions | Reductions | Balance at June 30, 2017 | Current portion 2017 |
|---|---|---|---|---|---|
| General obligation bonds payable | $ 103,258 | 9,130 | 25,355 | 87,033 | 12,177 |
| General revenue bonds payable | 1,457,881 | 205,160 | 71,350 | 1,591,691 | 37,810 |
| Certificates of participation payable | 10,400 | — | 1,545 | 8,855 | 1,625 |
| Unamortized premium on bonds | 109,987 | 37,313 | 14,012 | 133,288 | 14,639 |
| CAP payable to IFP | 122,518 | 18,868 | 2,351 | 139,035 | 2,514 |
| Total long-term liabilities | $ 1,804,044 | 270,471 | 114,613 | 1,959,902 | 68,765 |

**Long-Term Liabilities**

(Dollars in thousands)

| | Balance at June 30, 2015 | Additions | Reductions | Balance at June 30, 2016 | Current portion 2016 |
|---|---|---|---|---|---|
| General obligation bonds payable | $ 124,215 | 30,145 | 51,102 | 103,258 | 15,600 |
| General revenue bonds payable | 1,307,281 | 180,475 | 29,875 | 1,457,881 | 33,130 |
| Certificates of participation payable | 11,880 | — | 1,480 | 10,400 | 1,545 |
| Unamortized premium on bonds | 107,989 | 17,032 | 15,034 | 109,987 | 12,845 |
| CAP payable to IFP | 127,434 | — | 4,916 | 122,518 | 2,101 |
| Total long-term liabilities | $ 1,678,799 | 227,652 | 102,407 | 1,804,044 | 65,221 |

### *(a) Issuance Activity*

On July 14, 2016, the State of Washington refunded General Obligation Bonds totaling $9.8 million (UW portion) with new bond issuances totaling $9.1 million and premium of $1.7 million. The refunded bonds had an average interest rate and coupon rate of 5.00%; the new bonds have an average coupon rate of 4.90%. The refunding decreased the total debt service payments to be made over the next 8 years by $1.1 million and resulted in a total economic gain of $958 thousand.

On November 9, 2016, the University issued $205.2 million in General Revenue & Refunding Bonds, 2016 A&B, at a premium of $35.6 million. Part of the proceeds were used to refund existing debt. The amount of refunded bonds was $38.2 million; the amount of refunding bonds was $35.0 million (plus premium of $5.0 million). The refunded bonds had coupon rates ranging from 4.00% to 5.00% with an average coupon of 4.68%; the new bonds have an average coupon of 4.39%. The refunding decreased the total debt service payments to be made over the next 21 years by $6.2 million and resulted in a total economic gain of $5.0 million. The remainder of the proceeds will be used to fund a variety of projects. The average life of the 2016 A&B General Revenue Bonds is 17.2 years with final maturity on December 1, 2046. The average coupon of these bonds is 4.80%.

On September 9, 2015, the University issued $180.5 million in General Revenue Bonds, 2015 C&D, at a premium of $12.2 million. The proceeds were used to fund various projects such as construction of Animal Research and Care Facilities, West Campus Utility Plant, and other projects. In addition, proceeds were used to pay off $111.5 million in commercial paper. The 2015 C&D bonds have coupon rates ranging from 1.40% to 5.00% with an average coupon rate of 4.03%. The average life of the 2015 C&D General Revenue bonds is 15.60 years with final maturity on December 1, 2045.

### *(b) Prior-Year Defeasance of Debt*

In prior years, the University defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the ILP's financial statements. As of June 30, 2017 and 2016, $38.7 million and $139.0 million, respectively, of bonds outstanding are considered defeased.

## (8) Related-Party Transactions

The University provides support to the Program by providing the following items:

- Use of the University's buildings and equipment
- Administrative and accounting support
- Serving as the purchasing and disbursing agent
- Various other operational and support services

These costs are not billed but are contributed to the ILP.

All Program receivables are due from borrowers within the University. All due from the University balances are invested in the University IFP. All investments are managed by the University Treasury Office.

## (9) Pension Plan

The University offers the University of Washington Retirement Plan (UWRP), a defined contribution plan with supplemental payment to beneficiaries, when required. The ILP participates in this plan and is allocated a cost for the participation of this plan. The cost is included in the benefits load rate set by the University in calculating its fringe benefit expense and is applied on a per employee basis and is not a significant dollar amount.

*University of Washington Retirement Plan (403(b))*

Faculty, librarians and professional staff are eligible to participate in the University of Washington Retirement Plan, a 403(b) defined-contribution plan administered by the University.

403(b) Plan Description – Contributions to the plan are invested by participants in annuity contracts or mutual fund accounts offered by one or more fund sponsors. Employees have at all times a 100% vested interest in their accumulations. Benefits from the plan are available upon separation or retirement at the member's option. RCW 28B.10.400 et. seq. assigns the authority to the University of Washington Board of Regents to establish and amend benefit provisions.

403(b) Plan Funding Policy – Employee contribution rates, based on age, are 5%, 7.5% or 10% of salary. The University matches the contributions of employees. Within parameters established by the legislature, contribution requirements may be established or amended by the University of Washington Board of Regents.

### (10) Commitments and Contingencies

The Program is subject to claims and lawsuits that are covered by the University's self-insurance fund.

### (11) Subsequent Events

On August 31, 2017, the University issued $45.0 million in commercial paper. The proceeds will be used to fund the Life Sciences Building and Phase 4a of the Housing Master Plan.