



# Berklee Consolidated Financial Statements

May 31, 2018 and 2017



Berklee

## Letter from the Senior Vice President of Administration and Finance and Chief Financial Officer—Fiscal Year 2018

It is my pleasure to present the audited financial statements for Berklee for the fiscal year ending May 31, 2018. In an era of increasing challenges for higher education, Berklee's 2018 financial results reflect our continuing focus on: 1. Ensuring Berklee is as affordable as possible for students; 2. Investing in support of the institution's vision, mission, and strategic priorities; and 3. Maintaining our financial strength.

From an operating perspective, Berklee ended the year with total operating revenues of \$283 million and an operating margin of \$8.7 million or 3.1 percent of operating revenues, consistent with our 2-4 percent target range. Two years after the merger of Berklee College of Music and The Boston Conservatory, our 2018 operating results reflect continuing growth in Conservatory programs and financial results. Berklee Online turned in another strong year due primarily to growth in online degree enrollment. Berklee's campus in Valencia, Spain, which offers undergraduate study abroad as well as graduate programs and is now operating at full capacity, produced its best financial results to date. Our core operations on the Boston campus continue to perform well, reflecting continuing demand for Berklee's quality programs. During the year, Berklee invested in the institution's highest strategic priorities, including the development of a new technology platform and new online master's degree programs, which launched in September 2018. With generous support from a musician/philanthropist and the City of New York, Berklee opened a center in New York at the iconic Power Station Studios. Located just steps from Broadway, Power Station at BerkleeNYC will offer exciting opportunities for our music, dance, and theater students. Affordability was a top priority in 2018 as scholarship support reached new highs, while tuition increases were limited.

Fundraising continued its positive momentum in 2018. Support for the college enabled Berklee to exceed the cumulative \$100 million goal for our Soundbreaking capital campaign by almost 20 percent with over a year to go until the campaign is complete. Scholarship support has been a key designation.

Berklee's endowment increased to over \$365 million in assets in 2018, generating new highs in support for the institution's operating budget. The endowment is now the largest asset on Berklee's balance sheet.

Berklee's balance sheet continued to strengthen in 2018, with increasing liquidity and growing net assets. Total assets have grown to just under \$765 million, with over \$450 million in the endowment, short-term investments, and cash. Total liabilities have declined by \$16 million to \$375 million, reflecting scheduled principal payments on the institution's debt as well as a decline in accrued pension liabilities, consistent with the closure of the defined benefit plan to new employees in 2012. Net assets increased by 10 percent in 2018 to \$389 million.

During the fiscal year, both S&P Global Ratings (A stable) and Moody's Investors Service (A2 stable) affirmed their current ratings of Berklee, noting the strength of Berklee's enterprise profile and reputation. In their reports, both noted the strength of Berklee's market positioning in music, dance, and theater, as well as Berklee's consistent operating performance.

As higher education continues to face challenges and uncertainties in the years ahead, our balanced approach—affordability, strategic investment, and financial sustainability—will help us to navigate such an environment in the best interests of our students and the entire Berklee community.



Richard M. Hisey

Senior Vice President of Administration and Finance and Chief Financial Officer



**BERKLEE COLLEGE OF MUSIC, INC.**

Consolidated Financial Statements

May 31, 2018 and 2017

(With Independent Auditors' Report Thereon)





KPMG LLP  
Two Financial Center  
60 South Street  
Boston, MA 02111

## **Independent Auditors' Report**

The Board of Trustees  
Berklee College of Music, Inc.:

We have audited the accompanying consolidated financial statements of Berklee College of Music, Inc. which comprise the consolidated statements of financial position as of May 31, 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 consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

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

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

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

### **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Berklee College of Music, Inc. as of May 31, 2018 and 2017, and the changes in their net assets and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

**KPMG LLP**

September 27, 2018

**BERKLEE COLLEGE OF MUSIC, INC.**

Consolidated Statements of Financial Position

May 31, 2018 and 2017

<b>Assets</b>	<b>2018</b>	<b>2017</b>
Cash and cash equivalents	\$ 45,748,671	47,507,876
Short-term investments (note 3)	40,359,132	15,255,270
Accounts receivable, net (note 7)	451,136	417,789
Contributions receivable, net (note 8)	10,510,548	12,922,625
Other assets	12,026,382	9,678,225
Loans receivable, net (note 7)	2,725,387	3,883,849
Deposits with bond trustees (note 6)	4,659	3,765
Long-term investments (notes 3 and 4)	365,075,720	358,716,518
Property, improvements, and equipment, net (note 5)	287,997,285	295,877,848
Total assets	<u>\$ 764,898,920</u>	<u>744,263,765</u>
<b>Liabilities and Net Assets</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 27,541,029	24,986,685
Student deposits and deferred liabilities	32,623,923	31,926,313
Accrued pension liabilities (note 9)	39,310,728	54,161,014
Bonds and notes payable (note 6)	272,802,212	277,453,048
Refundable advances – U.S. government grants	3,418,464	3,277,685
Total liabilities	<u>375,696,356</u>	<u>391,804,745</u>
Net assets:		
Unrestricted	290,020,594	262,646,526
Temporarily restricted (note 11)	43,419,263	40,508,165
Permanently restricted (note 11)	55,762,707	49,304,329
Total net assets	<u>389,202,564</u>	<u>352,459,020</u>
Total liabilities and net assets	<u>\$ 764,898,920</u>	<u>744,263,765</u>

See accompanying notes to consolidated financial statements.

**BERKLEE COLLEGE OF MUSIC, INC.**

Consolidated Statement of Activities

Year ended May 31, 2018

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>2018 Total</u>
Operating:				
Revenues:				
Student tuition and fees	\$ 251,309,258	—	—	251,309,258
Less internally funded scholarship aid	(59,289,429)	—	—	(59,289,429)
Less externally funded scholarship aid	(6,143,209)	—	—	(6,143,209)
Net tuition and fees	185,876,620	—	—	185,876,620
Contributions	1,271,128	14,789,941	—	16,061,069
Grants and contracts	1,476,136	—	—	1,476,136
Investment return for operations (note 4)	13,119,448	2,893,501	—	16,012,949
Other income	4,203,009	—	—	4,203,009
Sales and service of auxiliary enterprises	64,500,673	—	—	64,500,673
Net assets released from restrictions	12,479,519	(12,479,519)	—	—
Total operating revenues	282,926,533	5,203,923	—	288,130,456
Expenses:				
Instruction	103,356,958	—	—	103,356,958
Academic support	18,086,850	—	—	18,086,850
Student and enrollment services	21,830,840	—	—	21,830,840
Institutional support and advancement	47,828,338	—	—	47,828,338
Auxiliary enterprises	34,954,234	—	—	34,954,234
Operation and maintenance of physical plant:				
Depreciation and amortization	15,576,029	—	—	15,576,029
Interest	11,890,720	—	—	11,890,720
Maintenance	20,737,988	—	—	20,737,988
Total operating expenses	274,261,957	—	—	274,261,957
Change in net assets from operating activities	8,664,576	5,203,923	—	13,868,499
Nonoperating:				
Investment return (note 3)	13,998,212	3,587,579	—	17,585,791
Investment return for operations (note 4)	(13,119,448)	(2,893,501)	—	(16,012,949)
Contributions for long-term items	47,973	—	4,066,699	4,114,672
Net assets released from capital restriction	595,224	(595,224)	—	—
Change in donor intent	—	(2,391,679)	2,391,679	—
Gain on sale of fixed assets	2,558,276	—	—	2,558,276
Pension obligation changes other than net periodic costs (note 9)	14,629,255	—	—	14,629,255
Change in net assets from nonoperating activities	18,709,492	(2,292,825)	6,458,378	22,875,045
Change in net assets	27,374,068	2,911,098	6,458,378	36,743,544
Net assets at beginning of year	262,646,526	40,508,165	49,304,329	352,459,020
Net assets at end of year	\$ 290,020,594	43,419,263	55,762,707	389,202,564

See accompanying notes to consolidated financial statements.

**BERKLEE COLLEGE OF MUSIC, INC.**

Consolidated Statement of Activities

Year ended May 31, 2017

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>2017 Total</u>
Operating:				
Revenues:				
Student tuition and fees	\$ 243,925,322	—	—	243,925,322
Less internally funded scholarship aid	(56,328,851)	—	—	(56,328,851)
Less externally funded scholarship aid	(5,386,202)	—	—	(5,386,202)
Net tuition and fees	182,210,269	—	—	182,210,269
Contributions	1,167,992	10,184,222	—	11,352,214
Grants and contracts	927,516	76,230	—	1,003,746
Investment return for operations (note 4)	13,474,704	2,475,318	—	15,950,022
Other income	4,291,164	—	—	4,291,164
Sales and service of auxiliary enterprises	61,229,540	—	—	61,229,540
Net assets released from restrictions	8,162,200	(8,162,200)	—	—
Total operating revenues	271,463,385	4,573,570	—	276,036,955
Expenses:				
Instruction	97,975,850	—	—	97,975,850
Academic support	17,431,249	—	—	17,431,249
Student and enrollment services	19,014,289	—	—	19,014,289
Institutional support and advancement	47,194,444	—	—	47,194,444
Auxiliary enterprises	31,983,218	—	—	31,983,218
Operation and maintenance of physical plant:				
Depreciation and amortization	15,195,991	—	—	15,195,991
Interest	10,724,757	—	—	10,724,757
Maintenance	20,460,015	—	—	20,460,015
Total operating expenses	259,979,813	—	—	259,979,813
Change in net assets from operating activities	11,483,572	4,573,570	—	16,057,142
Nonoperating:				
Effects of acquisition (note 14)	52,672,394	6,450,332	1,321,433	60,444,159
Investment return (note 3)	30,183,238	7,038,636	—	37,221,874
Investment return for operations (note 4)	(13,474,704)	(2,475,318)	—	(15,950,022)
Contributions for long-term items	65,400	298,198	5,584,758	5,948,356
Loss on extinguishment of debt (note 6)	(8,220,966)	—	—	(8,220,966)
Net assets released from capital restriction	1,108,987	(1,108,987)	—	—
Pension obligation changes other than net periodic costs (note 9)	12,404,826	—	—	12,404,826
Change in net assets from nonoperating activities	74,739,175	10,202,861	6,906,191	91,848,227
Change in net assets	86,222,747	14,776,431	6,906,191	107,905,369
Net assets at beginning of year	176,423,779	25,731,734	42,398,138	244,553,651
Net assets at end of year	\$ 262,646,526	40,508,165	49,304,329	352,459,020

See accompanying notes to consolidated financial statements.

**BERKLEE COLLEGE OF MUSIC, INC.**

Consolidated Statements of Cash Flows

Years ended May 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Change in net assets	\$ 36,743,544	107,905,369
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	15,576,029	15,195,991
Effects from acquisition	—	(60,444,159)
Realized and unrealized gains on investments	(17,386,162)	(37,221,874)
Pension obligation changes other than net periodic pension costs	(14,629,255)	(12,404,826)
Gain on sale of fixed assets	(2,558,276)	—
Loss on extinguishment of debt	—	8,220,966
Contributions for long-term investment	(5,528,177)	(6,799,632)
Change in operating assets	30,573	(2,160,248)
Change in operating liabilities	<u>3,030,924</u>	<u>4,073,164</u>
Net cash provided by operating activities	<u>15,279,200</u>	<u>16,364,751</u>
Cash flows from investing activities:		
Change in deposits with bond trustees	(894)	(3,765)
Purchase of property, plant, improvements, and equipment	(9,304,343)	(12,617,230)
Proceeds from sale of fixed assets	4,236,811	—
Boston Conservatory cash at time of affiliation	—	3,308,341
Disbursements and repayment of student loans	1,158,462	612,239
Proceeds from sale and maturity of investments	29,876,883	50,357,014
Purchase of investments	<u>(43,953,786)</u>	<u>(55,653,061)</u>
Net cash used in investing activities	<u>(17,986,867)</u>	<u>(13,996,462)</u>
Cash flows from financing activities:		
Payments on bonds and notes payable	(4,720,494)	(178,264,796)
Proceeds from debt refinancing	—	182,938,090
Debt issuance costs	—	(1,231,030)
Drawdown on line of credit	—	26,784,425
Repayment on line of credit	—	(26,784,425)
Contributions for long-term investment	5,528,177	6,799,632
Increase in refundable advances – U.S. government grants	<u>140,779</u>	<u>125,605</u>
Net cash provided by financing activities	<u>948,462</u>	<u>10,367,501</u>
Net change in cash and cash equivalents	<u>(1,759,205)</u>	<u>12,735,790</u>
Cash and cash equivalents, beginning of year	<u>47,507,876</u>	<u>34,772,086</u>
Cash and cash equivalents, end of year	\$ <u>45,748,671</u>	<u>47,507,876</u>
Supplemental data:		
Interest paid	\$ 11,918,427	12,391,019
Change in accounts payable attributable to capital acquisitions	551,212	(2,082,084)

See accompanying notes to consolidated financial statements.



## **BERKLEE COLLEGE OF MUSIC, INC.**

### **Notes to Consolidated Financial Statements**

May 31, 2018 and 2017

#### **(1) Background**

Berklee College of Music, Inc. (the College) is a nonprofit co-educational institution of higher learning offering a bachelors and master degrees as well as a four-year program leading to a professional diploma. Since its founding in 1945, the College has become an international center for performing arts education geared to career musicians, dancers, composers, arrangers, music educators, and other professionals. The College offers not-for-credit courses, for-credit courses and degrees online through its Berklee Online Program and master's degrees through its operations located in Valencia, Spain. The Boston Conservatory (the Conservatory), a nationally accredited performing arts conservatory offering Bachelor of Fine Arts, Bachelor of Music and Master of Music degrees operates as a division of the College known as The Boston Conservatory at Berklee.

#### **(2) Summary of Significant Accounting Policies**

##### ***(a) Basis of Statement Presentation***

The accompanying consolidated financial statements are prepared in accordance with United States generally accepted accounting principles (GAAP). The consolidated financial statements, presented on the accrual basis of accounting, focus on the College as a whole and all intercompany amounts have been eliminated. Balances and transactions are presented based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes to net assets are classified as follows:

*Permanently restricted net assets* – Net assets subject to donor-imposed stipulations are maintained permanently by the College. Generally, the donors permit the College to use, for general or specific purposes, all or part of any income earned and any capital gains on related investments.

*Temporarily restricted net assets* – Net assets subject to donor-imposed stipulations to be met by actions of the College and/or the passage of time. Investment returns on donor-restricted endowment funds are classified as changes in temporarily restricted net assets and are generally available for appropriation to support operational needs in accordance with the College's endowment spending policy and any restrictions on use imposed by donors.

*Unrestricted net assets* – Net assets not subject to donor-imposed stipulations.

Unless limited by donor restrictions or law, revenues and expenses, gains or losses on investments, and changes in other assets or liabilities are reported on the consolidated statements of activities as increases and decreases in unrestricted net assets. Net assets released from restrictions, for which the donor purpose has been met or the stipulated time period has elapsed, are reported as reclassifications between applicable net asset classes.

Contributions and unconditional promises to give are recognized as revenue in the period received. Promises to give that are expected to be collected after the consolidated statement of financial position date are reported as contribution revenue in temporarily restricted net assets. Promises to give that require the corpus to be maintained permanently are reported as contributions for long-term items in permanently restricted net assets. Contributions of land, buildings, or equipment are reported as unrestricted nonoperating support unless the donor places restrictions on their use.

Contributions of assets other than cash are recorded at their estimated fair value at the date of the gift.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(b) Operations**

The consolidated statements of activities report the change in net assets from operating and nonoperating activities. Operating revenues and expenses are attributable to the College's academic programs and auxiliary enterprises. Tuition revenue is reported net of a discount awarded to students from various sources including college financial aid, scholarships from endowment funds, and/or state and federal grants. Nonoperating activities are attributable to effects of merger, the return on investments, contributions of capital assets, contributions to the endowment, loss on extinguishment of debt, and pension obligations.

Expenses associated with the operation and maintenance of plant assets, including depreciation and interest expense, are disclosed separately on the consolidated statement of activities. Note 12 presents the impact had these expenses been allocated, based on actual square footage utilized, to operating expenses for instruction, academic support, student and enrollment services, institutional support and advancement, and auxiliary enterprises. Expenses associated with fundraising activities were \$4,109,087 and \$4,430,373 in 2018 and 2017, respectively, and are included in institutional support and advancement on the statements of activities.

**(c) Cash and Cash Equivalents**

Cash equivalents represent money market funds and short-term instruments with maturities at date of purchase of three months or less.

**(d) Short-term Investments**

Short-term investments consist of operating funds deposited in cash management accounts with maturities at the time of purchase less than one year, and are carried at fair value.

**(e) Contributions Receivable**

Unconditional promises to give are recorded at fair value when initially pledged. Initial recording for pledges expected to be collected in one year or more is arrived at by considering actual expected payments and by discounting the pledge to its present value by a risk adjusted rate to account for the inherent risk associated with the expected future cash flows. Unconditional promises to give are periodically reviewed to estimate an allowance for doubtful collections. Management estimates the allowance by a review of historical experience and a specific review of collection trends that differ from plans on individual accounts. Conditional promises to give are not included as support until the conditions are substantially met.

**(f) Long-Term Investments**

Investments are reported at market value or estimated fair value. Accordingly, the gains and losses that result from market fluctuations are recognized in the statement of activities in the period in which the fluctuations occur.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(g) Fair Value Measurements**

GAAP defines fair value and establishes a framework for measuring and disclosing fair value measurements. Fair value represents the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants as of the measurement date. GAAP establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three levels:

- Level 1 – quoted prices in active markets accessible at the measurement date for assets or liabilities
- Level 2 – observable prices based on inputs not quoted in active markets but corroborated by market data.
- Level 3 – unobservable inputs are used when little or no market data is available.

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. The College utilizes valuation techniques that maximizes the use of observable inputs and minimizes the use of unobservable inputs to the extent possible. Transfers between categories occur when there is an event that changes the inputs used to measure the fair value of an asset or liability. Transfers between fair value categories are recognized at the end of the reporting period.

The College holds shares or units in nonmarketable securities including alternative investments such as private equity, venture capital, hedge funds, and real asset strategies. Such alternative investment funds may hold securities or other financial instruments for which a readily determinable fair value exists and are priced accordingly. For investments that do not have a readily determinable fair value, the fair value of those investments is estimated based upon the net asset value (NAV) per share or its equivalent as a practical expedient.

Investments are generally redeemable or may be liquidated at NAV under the original terms of the subscription agreements and operations of the underlying funds. However, it is possible that these redemption rights may be restricted or eliminated by the funds in the future in accordance with the fund agreements. Due to the nature of the investments held by these funds, changes in market conditions, the economic environment, or liquidity provisions may significantly impact the NAV of the funds and, consequently, the fair value of the College's interests in the funds. Although certain investments may be sold in secondary market transactions, subject to meeting certain requirements of the governing documents of the funds, the secondary market is not active and individual transactions are not necessarily observable. It is, therefore, reasonably possible that if the College were to sell its interest in a fund in the secondary market, the sale could occur at an amount materially different from the reported value.

**(h) Property, Improvements, and Equipment**

Property, improvements, and equipment are stated at cost. Depreciation, including amortization of leasehold improvements and library books, is computed using the straight-line method over the related assets' estimated useful economic lives. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized. The cost of maintenance and repairs is charged to expense as incurred.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

If the College determines a conditional asset retirement obligation exists, it assesses whether or not the amount of the obligation can be reasonably estimated. If the obligation can be reasonably estimated, the College records the present value of the obligation, the corresponding cost is capitalized, and the liability is accreted to fair value each reporting period until settled. Depreciation of the cost is recognized over the life of the related asset.

**(i) *Impairment of Long-Lived Assets***

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated discounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. No impairments were recognized for the years ended May 31, 2018 and 2017.

**(j) *Student Deposits and Deferred Revenue***

Student deposits along with advance payments for tuition, room and board, and fees related to the summer and fall semesters have been deferred and will be reported as unrestricted revenue in the year in which the revenue is earned.

**(k) *Bond Issuance Costs***

Bond issuance costs are amortized using the effective interest method over the life of the associated bond issue. The debt issuance costs related to a recognized debt liability are presented on the consolidated statement of financial position as a direct deduction from the debt liability, similar to the presentation of debt premiums and discounts.

**(l) *Tax Status***

The College is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code (the Code), and is generally exempt from taxes pursuant to Section 501(a) of the Code. Accordingly, it is generally not subject to income taxes except to the extent it has taxable income from activities that are not related to its exempt purpose. The College has generated unrelated business income for the year ended May 31, 2018 but it is not significant to the consolidated financial statements. The College believes it has taken no significant uncertain tax positions.

On December 22, 2017, the President signed into law H.R. 1, originally known as the Tax Cuts and Jobs Acts. The new law (Public Law No. 115-97) includes substantial changes to the taxation of individuals, businesses, multinational enterprises and others. In addition to many generally applicable provisions, the law contains several specific provisions that result in changes to the tax treatment of tax-exempt organizations and their donors. The College has reviewed these provisions and the potential impact and concluded the enactment of H. R. 1 will not have a material effect on the operations of the organization.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(m) Foreign Currency Translation**

The College's accounting records, for Valencia, Spain, are maintained in the functional currency of U.S. dollars. The cumulative adjustment from foreign currency translation at May 31, 2018 and 2017 included in Institutional Support was a net (loss)/gain of (\$136,698) and \$15,911, respectively.

The foreign currency equivalents used to translate Euros into U.S. dollars are as follows:

	<b>U.S. dollar to one euro</b>	
	<b>2018</b>	<b>2017</b>
Revenues and expenses at the monthly average rate:		
The annual average rate for the fiscal year ended May 31	1.19:1	1.09:1
Assets, liabilities, and net assets at the current rate		
as of May 31	1.18:1	1.12:1

**(n) Self-Funded Insurance**

The College has a self-funding medical insurance program, open to most employees and certain of their family members, in order to manage rising health insurance costs over the long-term. A stop loss policy is in effect, which limits the College's annual loss per claimant to \$150,000 and 125% of expected claims, as calculated by the program's actuary on an aggregate basis. The College's expense under the self-insured medical plan amounted to \$9,592,386 and \$7,761,187 for the years ended May 31, 2018 and 2017, respectively. The estimated unpaid claims liability, included in accrued expenses at May 31, 2018 and 2017, amounted to \$1,020,000 and \$1,274,500, respectively.

**(o) Use of Estimates**

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

**(p) Reclassifications**

Certain items in 2017 have been reclassified to conform to the current year presentation.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(3) Investments**

The College's investments at fair value are summarized as follows at May 31:

	<u>2018</u>	<u>2017</u>
Money market funds	\$ 63,994,225	45,013,340
U.S. equity funds	8,105,053	7,583,836
International equity funds	115,296,271	108,146,671
Alternative investments	<u>218,039,303</u>	<u>213,227,941</u>
Total	\$ <u>405,434,852</u>	<u>373,971,788</u>

Total return on long-term investments consisted of the following for the years ended May 31:

	<u>2018</u>	<u>2017</u>
Investment return:		
Interest and Dividends	\$ 199,629	28,368
Unrealized gain	13,228,479	20,178,161
Realized gain	<u>4,157,683</u>	<u>17,015,345</u>
Total return on investments	\$ <u>17,585,791</u>	<u>37,221,874</u>



**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

The following tables summarize the College's investments by major category in the fair value hierarchy as of May 31, 2018 and 2017, as well as related strategy, liquidity, and funding commitments:

	<b>May 31, 2018</b>		<b>Redemption or liquidation</b>	<b>Days' notice</b>	<b>Related unfunded commitment</b>
	<b>Level 1</b>	<b>Total</b>			
Short-term investment strategies:					
Cash and cash equivalents	\$ 20,000	20,000			
Mutual funds	40,339,132	40,339,132			
Long-term investment strategies:					
Investments at fair value:					
Cash and cash equivalents	23,635,093	23,635,093			
Traditional equity index funds	8,105,053	8,105,053			
Global (excluding U.S.) equities	52,765,362	52,765,362			
Investments at net asset value:					
Global (excluding U.S.) equities:					
Developed markets	—	49,116,829	Quarterly	30	None
Emerging markets	—	13,414,080	Quarterly	90	None
Hedged equity funds of funds:					
Multiple strategies	—	20,989,014	Various (1)	45–60	None
Private equity and venture capital funds	—	18,879,511	Illiquid (2)	N/A	6,083,760
Real assets:					
Private real estate	—	20,335,415	Illiquid (3)	N/A	5,002,370
Direct hedge equity/multiple strategies	—	90,573,954	Various (4)	90	None
Direct absolute return/multiple strategies	—	67,261,409	Various (5)	45–180	None
Total	\$ 124,864,640	405,434,852			

(1) Funds with quarterly redemption = \$13,806,680, annually = \$7,182,334

(2) These funds are expected to liquidate within 1–8 years

(3) Variety of benchmarks and limitations on withdrawals.

(4) Funds with semi-annual redemption = \$17,313,335, annual redemption \$45,563,078, illiquid \$10,741,441, rolling 3 year 90 days notice \$16,956,100

(5) Funds with annual redemption \$67,240,312, illiquid \$21,097

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

	<u>May 31, 2017</u>		<u>Redemption or liquidation</u>	<u>Days' notice</u>	<u>Related unfunded commitment</u>
	<u>Level 1</u>	<u>Total</u>			
Short-term investment strategies:					
Cash and cash equivalents	\$ 20,060	20,060			
Mutual funds	15,235,210	15,235,210			
Long-term investment strategies:					
Investments at fair value:					
Cash and cash equivalents	29,758,070	29,758,070			
Traditional equity index funds	7,583,836	7,583,836			
Global (excluding U.S.) equities	50,958,204	50,958,204			
Investments at net asset value:					
Global (excluding U.S.) equities:					
Developed markets	—	43,731,206	Quarterly	30	None
Emerging markets	—	13,457,261	Quarterly	90	None
Hedged equity funds of funds:					
Multiple strategies	—	19,467,819	Various (1)	45–60	None
Private equity and venture capital funds	—	22,822,428	Illiquid (2)	N/A	4,255,588
Real assets:					
Commodities oil and energy	—	1,274,252	Illiquid	N/A	907,787
Private real estate	—	15,139,081	Illiquid (3)	N/A	4,405,981
Direct hedge equity/multiple strategies	—	87,922,632	Various (4)	90	None
Direct absolute return/multiple strategies	—	66,601,729	Various (5)	45–180	None
Total	<u>\$ 103,555,380</u>	<u>373,971,788</u>			

(1) Funds with monthly redemption = \$12,667,348, illiquid = \$6,800,471

(2) These funds are expected to liquidate within 1–8 years

(3) Variety of benchmarks and limitations on withdrawals.

(4) Funds with semi-annual redemption = \$16,442,406, annual redemption \$44,708,654, illiquid \$10,591,930, rolling 3 year 90 days notice \$16,179,642

(5) Funds with annual redemption \$66,580,128, illiquid \$21,601

No investments at fair value are considered to be Level 2 or Level 3 investments in the fair value hierarchy at May 31, 2018 or 2017, respectively.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

Alternative investments are redeemable at NAV under the original terms of the partnership agreement and/or subscription agreements and operations of underlying funds. All alternative investment redemptions require written notice prior to the redemption period. The long-term investments' fair values as of May 31, 2018 are classified below by redemption period:

	<u>Investment fair values</u>
Investments redemption period:	
Daily	\$ 72,098,278
Monthly	52,765,362
Quarterly	93,293,689
Semi-annually	17,313,335
Annually	119,985,724
Locked up or illiquid	<u>49,978,464</u>
Total as of May 31, 2018	<u>\$ 405,434,852</u>

The investments categorized as locked up are those funds that are locked up based on subscription agreements until liquidation, such as private equity and real asset funds.

**(4) Endowment**

The College's endowment consists of approximately 230 individual funds established for a variety of purposes including both donor-restricted endowment funds and funds designated by the Board of Trustees (the Board) to function as endowments. Net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

**(a) Interpretation of Relevant Law**

The College is subject to the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as adopted by the Commonwealth of Massachusetts. Under UPMIFA, the Board has discretion to determine appropriate expenditures of a donor-restricted endowment fund in accordance with a robust set of guidelines about what constitutes prudent spending. UPMIFA permits the College to appropriate for expenditure or accumulate so much of an endowment fund as the College determines to be prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. Seven criteria are to be used to guide the College in its yearly expenditure decisions: 1) duration and preservation of the endowment fund; 2) the purposes of the College and the endowment fund; 3) general economic conditions; 4) effect of inflation or deflation; 5) the expected total return from income and the appreciation of investments; 6) other resources of the College; and 7) the investment policy of the College.

## **BERKLEE COLLEGE OF MUSIC, INC.**

### **Notes to Consolidated Financial Statements**

**May 31, 2018 and 2017**

Although UPMIFA offers short-term spending flexibility, the explicit consideration of the preservation of funds among factors for prudent spending suggests that a donor-restricted endowment fund is still perpetual in nature. Under UPMIFA, the Board is permitted to determine and continue a prudent payout amount, even if the market value of the fund is below historic dollar value. There is an expectation that, over time, the permanently restricted amount will remain intact. This perspective is aligned with the accounting standards definition that permanently restricted funds are those that must be held in perpetuity even though the historic dollar value may be dipped into on a temporary basis.

The College classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets, until appropriated for spending by the Board.

#### ***(b) Return Objectives and Risk Parameters***

The College has adopted investment and spending policies for endowment assets that are intended to ensure a total return (yield plus capital appreciation) necessary to at least preserve, but expected to enhance (in real dollar terms) endowment assets, while providing a dependable source of income for current operations and scholarships. Endowment assets include those assets of donor-restricted funds that the College must hold in perpetuity or for a donor-specified period as well as board-designated funds.

To satisfy its long-term rate-of-return objectives, the College relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The College targets a diversified asset allocation that places emphasis on investments in equities, fixed income and alternative investments to achieve its long-term return objectives within prudent risk constraints.

#### ***(c) Spending Policy and How the Investment Objectives Relate to Spending Policy***

State law permits the spending of gains on endowment funds over a stipulated period of time. State law allows the Board to appropriate all of the income and a specified percentage of the net appreciation as is prudent considering the College's long and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions. Under the College's current endowment spending policy, which is within the guidelines specified under state law, 5% of the average of the fair value of qualifying endowment investments at the end of the previous three years is authorized for appropriation. The authorized appropriation amounted to \$16,012,949 in 2018 and \$15,950,022 in 2017. In establishing this policy, the College considered the expected return on its endowment. Accordingly, the College expects the current spending policy to allow its endowment to maintain its purchasing power by growing at a rate equal to planned payouts. Additional real growth will be provided through new gifts and any excess investment return.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(d) Funds with Deficiencies**

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below their original contributed value. These deficiencies result from unfavorable market fluctuations that occurred after the investment of new permanently restricted contributions. 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. Deficiencies of this nature that are reported as reductions in unrestricted net assets totaled \$7,608 and \$21,206 as of May 31, 2018 and 2017, respectively.

Endowment funds consisted of the following at May 31, 2018:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (7,608)	16,334,794	51,189,690	67,516,876
Board-designated endowment funds	<u>297,558,844</u>	<u>—</u>	<u>—</u>	<u>297,558,844</u>
Total endowed funds	<u>\$ 297,551,236</u>	<u>16,334,794</u>	<u>51,189,690</u>	<u>365,075,720</u>

Endowment funds consisted of the following at May 31, 2017:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (21,206)	17,690,942	43,269,829	60,939,565
Board-designated endowment funds	<u>297,776,953</u>	<u>—</u>	<u>—</u>	<u>297,776,953</u>
Total endowed funds	<u>\$ 297,755,747</u>	<u>17,690,942</u>	<u>43,269,829</u>	<u>358,716,518</u>

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

Changes in endowment funds for the year ended May 31, 2018 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment funds, June 1, 2017	\$ 297,755,747	17,690,942	43,269,829	358,716,518
Investment return:				
Net appreciation	13,998,212	3,587,579	—	17,585,791
Total investment return	13,998,212	3,587,579	—	17,585,791
Contributions	—	—	5,528,182	5,528,182
Appropriation of endowment assets for expenditure	(13,119,448)	(2,893,501)	—	(16,012,949)
Transfers from operations	(1,083,275)	341,453	—	(741,822)
Change in donor intent	—	(2,391,679)	2,391,679	—
Endowment funds, May 31, 2018	\$ <u>297,551,236</u>	<u>16,334,794</u>	<u>51,189,690</u>	<u>365,075,720</u>

Changes in endowment funds for the year ended May 31, 2017 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment funds, June 1, 2016	\$ 272,189,394	9,079,378	35,141,797	316,410,569
Additions as a result of acquisition	8,360,313	4,055,464	1,321,182	13,736,959
Investment return:				
Net appreciation	30,183,238	7,038,636	—	37,221,874
Total investment return	30,183,238	7,038,636	—	37,221,874
Contributions	—	(7,218)	6,806,850	6,799,632
Appropriation of endowment assets for expenditure	(13,474,704)	(2,475,318)	—	(15,950,022)
Transfers from operations	497,506	—	—	497,506
Endowment funds, May 31, 2017	\$ <u>297,755,747</u>	<u>17,690,942</u>	<u>43,269,829</u>	<u>358,716,518</u>



**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(5) Property, Improvements, and Equipment**

Property, improvements, and equipment consisted of the following at May 31:

	<u>2018</u>	<u>2017</u>	<u>Estimated useful life</u>
Land	\$ 52,661,439	53,293,375	—
Buildings	184,841,091	186,041,567	40 years
Improvements	159,098,898	155,750,195	15–20 years
Furniture and equipment	54,873,141	50,256,401	3–10 years
Library books	3,265,501	3,265,501	10 years
Construction in progress	1,351,184	61,478	—
	456,091,254	448,668,517	
Less accumulated depreciation	(168,093,969)	(152,790,669)	
	<u>\$ 287,997,285</u>	<u>295,877,848</u>	

Total depreciation expense was \$15,576,029 and \$15,195,991 in 2018 and 2017, respectively.

**(6) Bonds and Notes Payable**

Bonds and notes payable consisted of the following at May 31:

	<u>2018</u>	<u>2017</u>
(a) MDFA Revenue Bonds, Berklee College of Music Series 2011, dated September 22, 2011 (including unamortized premium of \$4,225,899 and \$4,407,161 in 2018 and 2017, respectively)	\$ 84,970,899	86,857,161
(b) MHEFA Revenue Bonds, Berklee College of Music Series 2007A, dated August 8, 2007 (including unamortized premium of \$270,016 and \$284,811 in 2018 and 2017, respectively)	10,095,015	10,389,811
(c) MHEFA Revenue Bonds, Berklee College of Music Series 2016, dated August 1, 2016 (including unamortized premium of \$31,482,826 in 2018)	179,562,826	182,102,262
Total bonds payable	274,628,740	279,349,234
Deferred issuance cost on bonds	(1,826,528)	(1,896,186)
Bonds payable	<u>\$ 272,802,212</u>	<u>277,453,048</u>

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(a) MDFA Revenue Bonds, Berklee College of Music Issue, Series 2011**

On September 22, 2011, the College issued \$90,000,000 Revenue Bonds, Series 2011 (the Series 2011 bonds) from the Massachusetts Development Finance Agency (MDFA). The College used some of the proceeds from the Series 2011 bonds to finance and refinance the acquisition, design, and construction of several real estate projects located primarily on Massachusetts Avenue. The Series 2011 bonds bear interest at rates ranging from 2.00% to 5.00% and are due in varying installments of \$141,900 to \$4,358,725 until October 1, 2041.

**(b) MHEFA Revenue Bonds, Berklee College of Music Issue, Series 2007A**

On August 8, 2007, the College issued \$173,510,000 Revenue Bonds, Series 2007A (the Series 2007A bonds) from the Massachusetts Health and Education Facilities Authority (MHEFA). The Series 2007A bonds bear interest at rates ranging from 3.88% to 5.00% and are due in varying installments of \$271,000 to \$8,393,493 until October 1, 2037.

**(c) MDFA Revenue Bonds, Berklee College of Music Issue, Series 2016**

On August 1, 2016 the College issued \$149,505,000 Revenue Bonds, Series 2016 (the Series 2016 bonds) from the Massachusetts Development Finance Agency. The Series 2016 bonds bear interest ranging from 4.0% to 5.0% and have principal payments which began October 1, 2016 and terminate on October 1, 2046. The bonds were used to defease and/or refund all or portions of the previously issued Series 2007A bonds, Series 2013 bonds and the debt acquired as a result of the College's merger with the Conservatory, as well as to finance the cost of issuance. As a result of refinancing, the College recorded a loss on extinguishment of debt of \$7,587,762.

**(d) Revolving Credit Facility**

The College established a three-year revolving line of credit facility with JP Morgan Chase in the amount of \$30,000,000 on June 3, 2013. Advances on this facility can be made as a Base Rate loan, a money market loan, or a LIBOR loan and interest will apply based on the commercial base rate, the money market rate in effect for the first day, and the adjusted LIBOR for the period, respectively. A nonusage facility fee of 0.10% per annum will apply.

On April 24, 2018 the College signed the third amendment to this credit facility in the amount of \$25,000,000 and extending the termination date to April 26, 2019. All other terms and conditions remained the same. There were no outstanding borrowings under this facility at May 31, 2018 or 2017.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

Scheduled long-term maturities of existing indebtedness at May 31, 2018 in each of the next five years and in the aggregate thereafter are as follows:

	<u><b>Amount</b></u>
Year ending May 31:	
2019	\$ 3,545,000
2020	3,690,000
2021	3,845,000
2022	6,300,000
2023	6,625,000
Thereafter	<u>214,644,999</u>
	238,649,999
Plus unamortized bond premium	<u>35,978,741</u>
	<u><u>\$ 274,628,740</u></u>

**(e) Interest Expense and Amortization Costs**

Interest expense on bonds and notes payable was \$11,890,720 and \$10,724,757 in 2018 and 2017, respectively. Amortization of bond issue costs was not significant in either 2018 or 2017.

The College is required to maintain certain financial ratios associated with its bond agreements and is in compliance with these requirements at May 31, 2018 and 2017.

**(7) Allowances for Uncollectible Accounts and Loans Receivable**

Accounts receivable, arising from student tuition and fees, are presented net of an allowance for uncollectible accounts of \$1,869,831 and \$1,382,834 at May 31, 2018 and 2017, respectively.

Loans receivable, primarily from the federal Perkins loan program, are net of an allowance for uncollectible accounts of \$1,164,144 and \$978,743, at May 31, 2018 and 2017, respectively.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(8) Contributions Receivable, net**

Contributions receivable consist of the following at May 31:

	<u>2018</u>	<u>2017</u>
Unconditional promises expected to be collected in:		
Less than one year	\$ 7,257,629	7,500,367
One year to five years	<u>5,748,553</u>	<u>7,568,433</u>
	13,006,182	15,068,800
Less allowance for uncollectible pledges	<u>(1,300,618)</u>	<u>(1,506,880)</u>
	11,705,564	13,561,920
Less present value discount	<u>(1,195,016)</u>	<u>(639,295)</u>
	<u>\$ 10,510,548</u>	<u>12,922,625</u>

The present value of estimated future cash flows is measured utilizing a discount rate equivalent to U.S. Treasury yields of similar maturity (3-year, 5-year, and 10-year rates) based on the anticipated pledge fulfillment date. The rates utilized to calculate the discount ranged from 0.52% and 3.05% in 2018 and 2017.

**(9) Retirement Plans**

The College offers a defined contribution plan to substantially all employees. This plan provides for investments through the Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF), as well as Transamerica Retirement Services. The College matches all savings in a pay period up to 3% of pay for full-time employees hired before January 1, 2012, up to 6% of pay for full-time employees hired January 1, 2012 or later, and up to 50% of 10% of pay for eligible part-time employees who are eligible for medical benefits under the College's healthcare program. All eligible, full-time employees hired after January 1, 2012 also receive an additional 3% of pay. The College contributed \$5,313,885 and \$3,956,901, respectively, for the years ended May 31, 2018 and 2017.

The College also sponsors a noncontributory, defined benefit pension plan (the Pension Plan) that covers substantially all those full-time employees that were hired prior to January 1, 2012. The Pension Plan calls for benefits to be paid to eligible employees at retirement based primarily upon years of service with the College and their compensation rates near retirement. Guidance under GAAP requires the Pension Plan's funding deficit or surplus to be recognized in the sponsoring employer's statement of financial position and plan assets and benefit obligations to be measured as of the date of the College's fiscal year-end. The College froze the Pension Plan to new membership as of January 1, 2012.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

Pension expense for the years ended May 31 includes the following components:

	<u>2018</u>	<u>2017</u>
Service cost of the current period	\$ 4,840,189	5,666,644
Interest cost on the projected benefit obligation	4,214,037	3,861,967
Expected return on assets held in the plan	(6,892,661)	(6,343,882)
Recognition of net actuarial loss	<u>3,493,863</u>	<u>4,465,291</u>
Pension expense	<u>\$ 5,655,428</u>	<u>7,650,020</u>

The following sets forth the change in benefit obligation, change in plan assets, and funded status of the Pension Plan and the amounts shown in the accompanying consolidated statements of net assets at May 31:

	<u>2018</u>	<u>2017</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 155,476,985	159,003,869
Service cost	4,840,189	5,666,644
Interest cost	4,214,037	3,861,967
Actuarial loss	(10,996,369)	(3,986,898)
Benefits paid	<u>(8,026,806)</u>	<u>(9,068,597)</u>
Benefit obligation at end of year	<u>145,508,036</u>	<u>155,476,985</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	103,461,780	94,922,173
Actual return on plan assets	7,031,684	10,296,519
Employer contributions	5,739,331	7,311,685
Benefits paid	<u>(8,026,806)</u>	<u>(9,068,597)</u>
Fair value of assets held in the plan	<u>108,205,989</u>	<u>103,461,780</u>
Pension liability at end of year	<u>\$ 37,302,047</u>	<u>52,015,205</u>

Pension expense was computed based on a weighted average discount rate of 3.89% for 2018 and 3.55% for 2017, expected long-term rate of return on assets of 7.00% for 2018 and 2017, and future personnel expense increases of 3.00% for 2018 and 2017. The discount rates that were used to measure service and interest cost during 2018 were 3.73% and 2.83%, respectively.

The discount rate used in determining the actuarial present value of the projected benefit obligation in 2018 and 2017 was 3.89% and 3.55%, respectively.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

The benefits expected to be paid after May 31, 2018 are as follows:

Years ending May 31:	
2019	\$ 11,326,452
2020	9,313,437
2021	9,440,270
2022	9,496,443
2023	9,292,114
2024–2027	47,077,445

The expected long-term rate of return on assets was determined by considering the current and expected asset allocations, as well as historical and expected returns on the categories of plan assets.

The College's asset allocations and investment policy guidelines as of the measurement date are as follows:

	Target allocation	Plan assets at May 31	
		2018	2017
Equity securities	55 %	27 %	35 %
Debt securities	15	3	10
Other	30	63	55

The investment strategy of the Pension Plan is designed to maximize total return (income plus capital change) while preserving the capital values of the funds, protecting the funds from inflation, and providing liquidity as needed for plan benefits. The objective is to provide a rate of return that meets or exceeds the expected long-term rate of return on plan assets.

Other changes in pension liability recognized in unrestricted net assets were as follows:

	Fiscal years ended May 31,	
	2018	2017
Net gain	\$ 14,629,255	12,404,826

The investment strategy of the noncontributory retirement plan is to allocate assets among investment classes that will provide for stability and growth of plan assets in varying market environments. To that end, the plan has adopted policies that require each asset class to be diversified and that multiple managers with differing styles of management are employed. On a quarterly basis, the plan reviews progress toward achieving its and individual managers' performance objectives.



**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

The value of the Pension Plan's assets by asset class are as follows at May 31, 2018:

	<b>May 31, 2018</b>		<b>Redemption or liquidation</b>	<b>Days' notice</b>	<b>Related unfunded commitment</b>
	<b>Level 1</b>	<b>Total</b>			
Investments at fair value:					
Cash and fixed income	\$ 10,696,054	10,696,054			
International equities	19,254,653	19,254,653			
Domestic equities	7,933,469	7,933,469			
Investments at net asset value:					
Domestic equities	—	2,404,370	Quarterly/ annually	30–90 days	None
International equities	—	20,867,334	Quarterly/ annually	30–180 days	None
Hedge funds	—	41,132,270	Illiquid	N/A	3,232,731
Real assets	—	5,917,839	Illiquid	N/A	1,050,319
	<u>\$ 37,884,176</u>	<u>108,205,989</u>			

The value of the Pension Plan's assets by asset class are as follows at May 31, 2017:

	<b>May 31, 2017</b>		<b>Redemption or liquidation</b>	<b>Days' notice</b>	<b>Related unfunded commitment</b>
	<b>Level 1</b>	<b>Total</b>			
Investments at fair value:					
Cash and fixed income	\$ 9,646,513	9,646,513			
International equities	20,748,807	20,748,807			
Domestic equities	7,062,856	7,062,856			
Investments at net asset value:					
Domestic equities	—	2,974,611	Quarterly/ annually	30–90 days	None
International equities	—	19,237,981	Quarterly/ annually	30–180 days	None
Hedge funds	—	38,595,846	Illiquid	N/A	1,879,705
Real assets	—	5,195,166	Illiquid	N/A	2,705,991
	<u>\$ 37,458,176</u>	<u>103,461,780</u>			

No investments at fair value are considered to be Level 2 or Level 3 investments in the fair value hierarchy at May 31, 2018 and 2017, respectively.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(10) Lease Commitments**

The College leases space in various buildings for its operations. The following is a schedule of future minimum lease payments under operating leases as of May 31:

	<u>Amount</u>
Fiscal year:	
2019	\$ 5,413,071
2020	4,792,891
2021	4,811,995
2022	4,540,785
2023	4,365,332
Thereafter	17,889,492

Rental expense was \$6,571,373 in 2018 and \$5,925,370 in 2017.

The College owns several buildings in which there are commercial tenants. The following is a schedule of future minimum rental income under operating leases as of May 31:

	<u>Amount</u>
Fiscal year:	
2019	\$ 1,157,770
2020	1,001,446
2021	910,858
2022	765,591
2023	377,082
Thereafter	153,904

Rental income was \$1,660,445 in 2018 and \$1,679,530 in 2017.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(11) Restricted Net Assets**

Temporarily restricted net assets consist of the following at May 31:

	<u>2018</u>	<u>2017</u>
Unspent gifts:		
Instruction	\$ 4,233,137	2,881,407
Institutional support	3,680,832	1,167,962
Student aid	7,627,168	7,811,665
Facilities	618,681	724,058
Capital campaign programs	<u>5,086,141</u>	<u>3,488,092</u>
	21,245,959	16,073,184
Unappropriated gains from permanently restricted net assets	16,334,794	17,690,942
Outstanding pledges	<u>5,838,510</u>	<u>6,744,039</u>
	<u>\$ 43,419,263</u>	<u>40,508,165</u>

The College classifies unspent gains from permanently restricted funds as temporarily restricted until it appropriates and spends such sums in accordance with the terms of the underlying endowment funds, at which time, they will be reclassified to unrestricted revenues.

Permanently restricted net assets consist of the following at May 31:

	<u>2018</u>	<u>2017</u>
Student aid	\$ 36,824,137	30,226,011
Instruction	10,467,556	8,796,322
Institutional support	3,898,241	4,247,746
Outstanding pledges	<u>4,572,773</u>	<u>6,034,250</u>
	<u>\$ 55,762,707</u>	<u>49,304,329</u>

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

**(12) Functional Expenses**

The following summary presents the effect on functional expenses had the direct and indirect cost components been allocated to the functional expenses for the years ended May 31, 2018 and 2017:

<b>Fiscal year ended May 31, 2018</b>					
	<b>Direct costs</b>	<b>Indirect costs</b>			<b>Total expenses</b>
		<b>Maintenance</b>	<b>Depreciation and amortization</b>	<b>Interest expense</b>	
Expenses:					
Education and general:					
Instruction	\$ 103,356,958	10,305,231	7,740,123	6,072,721	127,475,033
Academic support	18,086,850	422,462	317,306	248,951	19,075,569
Student and enrollment services	21,830,840	270,183	202,931	159,215	22,463,169
Institutional support and advancement	47,828,338	3,758,627	2,823,055	2,214,904	56,624,924
Auxiliary enterprises	34,954,234	5,981,485	4,492,614	3,194,929	48,623,262
Total operating expenses	<u>\$ 226,057,220</u>	<u>20,737,988</u>	<u>15,576,029</u>	<u>11,890,720</u>	<u>274,261,957</u>
<b>Fiscal year ended May 31, 2017</b>					
	<b>Direct costs</b>	<b>Indirect costs</b>			<b>Total expenses</b>
		<b>Maintenance</b>	<b>Depreciation and amortization</b>	<b>Interest expense</b>	
Expenses:					
Education and general:					
Instruction	\$ 97,975,850	10,167,099	7,551,273	5,258,469	120,952,691
Academic support	17,431,249	416,800	309,564	215,571	18,373,184
Student and enrollment services	19,014,289	266,561	197,979	137,867	19,616,696
Institutional support and advancement	47,194,444	3,708,246	2,754,176	1,917,921	55,574,787
Auxiliary enterprises	31,983,218	5,901,309	4,382,999	3,194,929	45,462,455
Total operating expenses	<u>\$ 213,599,050</u>	<u>20,460,015</u>	<u>15,195,991</u>	<u>10,724,757</u>	<u>259,979,813</u>

**(13) Berklee New York City**

As part of a commitment to develop and operate a music studio and educational center in New York City, the College has entered into a ten-year lease agreement for space at 441 West 53rd St, an iconic music industry property known as the "Power Station". The lease is for ten years commencing on September 1, 2017 at a base rent of approximately \$875,000 per year, fixed throughout the lease term.

**BERKLEE COLLEGE OF MUSIC, INC.**  
Notes to Consolidated Financial Statements  
May 31, 2018 and 2017

Funding for capital investment and operations support includes: up to \$6,000,000 of total grant monies from the City of New York and the New York City Economic Development Corporation (EDC); and up to \$18,000,000 from a donor advised fund established by a member of the College's Board of Trustees. For the year ended May 31, 2018, the College received \$3,005,100 of grants and contributions.

**(14) Merger with The Boston Conservatory**

The merger with The Boston Conservatory in fiscal year 2017 has been accounted for under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) guidance for not-for-profit entities regarding mergers and acquisitions, which defines a combination of one of more not-for-profit activities as either a merger or an acquisition.

The following table summarizes the value assigned to the Boston Conservatory net assets recognized as of the merger date, June 1, 2016.

Assets:	
Current assets	\$ 5,759,039
Long term investments	13,769,606
Property, plant and equipment	69,952,350
Other assets	<u>229,106</u>
Total assets	<u>89,710,101</u>
Liabilities:	
Current liabilities	3,114,721
Other liabilities	<u>26,151,221</u>
Total liabilities	<u>29,265,942</u>
Net assets recognized	<u>\$ 60,444,159</u>

**(15) Related Parties**

Members of the College's Board of Trustees and senior management may, from time to time, be associated, either directly or indirectly, with companies doing business with the College. The Board's conflict of interest policy requires, among other things, that no member of the Board of Trustees or its committees can participate in any decision by the College in which he or she (or an immediate family member) has a material financial interest. For members of the Board of Trustees and senior management, the College requires an annual disclosure of significant financial interest in, or employment or consulting relationships with, entities doing business with the College. When such relationships exist, measures are taken to address the actual or perceived conflict to protect the best interest of the College and ensure compliance with relevant conflict of interest laws or policy.

**(16) Subsequent Events**

For purposes of determining the effects of subsequent events on these consolidated financial statements, management has evaluated events subsequent to May 31, 2018 and through September 27, 2018 the date on which the consolidated financial statements were issued.