



LEHIGH UNIVERSITY

Consolidated Financial Statements

June 30, 2020

(with comparative financial information for June 30, 2019)

(With Independent Auditors' Report Thereon)

LEHIGH UNIVERSITY

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KPMG LLP
1601 Market Street
Philadelphia, PA 19103-2499

Independent Auditors' Report

The Board of Trustees
Lehigh University:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Lehigh University and its subsidiaries, which comprise the consolidated statement of financial position as of June 30, 2020, and the related consolidated statements of activities and cash flows for the year 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 audit. We conducted our audit 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 financial position of Lehigh University and its subsidiaries as of June 30, 2020, and the changes in their net assets and their cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.



Report on Summarized Comparative Information

We have previously audited the University's 2019 consolidated financial statements, and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated October 18, 2019. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2019 is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

KPMG LLP

Philadelphia, Pennsylvania
October 28, 2020

LEHIGH UNIVERSITY

Consolidated Statement of Financial Position

June 30, 2020

(with comparative financial information for June 30, 2019)

(In thousands)

Assets	2020	2019
Cash and cash equivalents (note 1(c))	\$ 70,603	50,690
Accounts receivable, net (note 6)	13,035	13,517
Prepaid expenses and other assets	6,120	9,883
Contributions receivable, net (note 9)	41,126	41,574
Notes receivable, net (note 7)	9,708	9,410
Investments (notes 3 and 5)	1,841,856	1,955,620
Funds held in trust by others	4,846	4,908
Property, plant, and equipment, net (note 8)	<u>606,937</u>	<u>537,294</u>
Total assets	<u>\$ 2,594,231</u>	<u>2,622,896</u>
Liabilities and Net Assets		
Accounts payable and accrued expenses	\$ 47,440	49,709
Deferred revenues	16,910	18,592
Annuity payment obligations	17,634	18,118
Other liabilities (notes 11, 12, and 14)	130,984	102,422
Deposits held for others	1,088	1,179
Refundable federal student loan funds	822	1,359
Bonds, loans, and notes payable (note 11)	<u>362,491</u>	<u>368,731</u>
Total liabilities	<u>577,369</u>	<u>560,110</u>
Commitments and contingencies (notes 5, 11 and 17)		
Net assets (notes 4 and 10):		
Without donor restrictions	992,596	1,026,825
With donor restrictions	<u>1,024,266</u>	<u>1,035,961</u>
Total net assets	<u>2,016,862</u>	<u>2,062,786</u>
Total liabilities and net assets	<u>\$ 2,594,231</u>	<u>2,622,896</u>

See accompanying notes to consolidated financial statements.

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Consolidated Statement of Activities

Year ended June 30, 2020

(with summarized comparative financial information for the year ended June 30, 2019)

(In thousands)

	2020		Total	2019
	Without donor restrictions	With donor restrictions		
Support and revenues:				
Tuition and fees, net (note 1(h))	\$ 207,775	—	207,775	196,477
Federal grants and contracts (note 1(e))	32,192	—	32,192	28,643
State and local grants and contracts (note 1(e))	7,333	—	7,333	7,526
Private grants and contracts	4,400	—	4,400	5,222
Contributions (note 1(e))	11,923	—	11,923	14,326
Investment return, net (note 3)	89,462	—	89,462	90,948
Auxiliary enterprises, net (note 1(i))	35,299	—	35,299	44,491
Independent operations (note 1(a))	8,442	—	8,442	11,441
Other sources	9,010	—	9,010	9,827
Net assets released from restrictions	2,921	(2,921)	—	—
Total support and revenues	<u>408,757</u>	<u>(2,921)</u>	<u>405,836</u>	<u>408,901</u>
Expenses:				
Salaries and wages	182,140	—	182,140	180,186
Employee benefits	58,250	—	58,250	57,535
Purchased services	32,591	—	32,591	35,753
Occupancy	32,204	—	32,204	34,274
Depreciation	31,731	—	31,731	29,997
Interest	11,088	—	11,088	13,636
Independent operations	10,650	—	10,650	10,397
Other business expenses	47,493	—	47,493	51,626
Total expenses (note 13)	<u>406,147</u>	<u>—</u>	<u>406,147</u>	<u>413,404</u>
Operating income (loss)	<u>2,610</u>	<u>(2,921)</u>	<u>(311)</u>	<u>(4,503)</u>
Nonoperating activity:				
Investment (loss) return, net (note 3):				
University	(17,407)	(36,522)	(53,929)	71,614
Independent operations	2,517	—	2,517	(262)
Gifts and trusts	3,906	25,367	29,273	54,022
Net assets released from restrictions and changes in donor intent	(151)	151	—	—
Change in fair value of interest rate swaps (note 12)	(15,101)	—	(15,101)	(9,262)
Changes in postretirement health benefits obligation other than net periodic benefit cost (note 14):				
University	(4,378)	—	(4,378)	(3,405)
Independent operations	(132)	—	(132)	(93)
Net periodic benefit costs other than service costs (note 14):				
University	(1,952)	—	(1,952)	(1,973)
Independent operations	(61)	—	(61)	(61)
Other	(4,080)	2,230	(1,850)	(2,882)
Nonoperating income	<u>(36,839)</u>	<u>(8,774)</u>	<u>(45,613)</u>	<u>107,698</u>
Change in net assets	<u>(34,229)</u>	<u>(11,695)</u>	<u>(45,924)</u>	<u>103,195</u>
Net assets at beginning of year, as reported	1,026,825	1,035,961	2,062,786	1,955,901
Impact of change in accounting policy	—	—	—	3,690
Balance as of beginning of year	<u>1,026,825</u>	<u>1,035,961</u>	<u>2,062,786</u>	<u>1,959,591</u>
Net assets at end of year	<u>\$ 992,596</u>	<u>1,024,266</u>	<u>2,016,862</u>	<u>2,062,786</u>

See accompanying notes to consolidated financial statements.

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Consolidated Statement of Cash Flows

Year ended June 30, 2020

(with comparative financial information for the year ended June 30, 2019)

(In thousands)

	2020	2019
Cash flows from operating activities:		
Change in net assets	\$ (45,924)	103,195
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Gifts and trusts restricted for long-term investment	(26,726)	(41,258)
Noncash contributions	(2,561)	(1,690)
Investment earnings restricted for long-term investment	860	(727)
Net realized and unrealized gains on investments	(32,281)	(148,762)
Change in fair value of interest rate swap agreements	15,101	9,196
Payment of annuity obligations	1,369	1,337
Other nonoperating activity	2,750	1,791
Depreciation and amortization	33,067	31,057
Independent operations provision for uncollectible accounts	1,558	(86)
University provision for uncollectible accounts	177	186
Change in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(230)	1,255
Decrease (increase) in contributions receivable	448	(10,535)
Decrease in accounts payable and accrued expenses	(1,042)	(840)
Decrease in deferred revenues	(1,682)	(1,580)
(Decrease) increase in annuity payment obligations	(484)	18
Decrease in deposits held for others	(91)	(38)
Increase in accrued postretirement benefit cost	7,103	5,941
Decrease (increase) in prepaid expenses and other assets	3,763	(864)
(Decrease) increase in other liabilities	(324)	9
Net cash used in operating activities	(45,149)	(52,395)
Cash flows from investing activities:		
Proceeds from sale and maturity of investments	1,166,327	1,426,946
Purchases of investments	(1,024,898)	(1,332,547)
Student loans and other notes advanced	(1,243)	(1,464)
Independent operations loans advanced	(1,806)	(1,179)
Student loans and other notes collected	1,276	1,134
Independent operations loans collected	436	642
Purchase of land, buildings, and equipment, net of disposals	(94,012)	(80,822)
Decrease in accounts payable and accrued expenses for property, plant, and equipment	(1,227)	—
Net cash provided by investing activities	44,853	12,710
Cash flows from financing activities:		
Repayments of principal of indebtedness	(6,160)	(6,285)
Gifts and trusts restricted for long-term investment	26,726	41,258
Investment earnings restricted for long-term investment	(860)	727
Decrease in refundable loan funds	(537)	(75)
Payment of annuity obligations	(1,368)	(1,337)
Payment of employee retirement obligations	(2,511)	—
Net cash provided by financing activities	15,290	34,288
Net increase (decrease) in cash and cash equivalents	14,994	(5,397)
Cash, cash equivalents, and restricted cash at beginning of year, as reported	55,786	58,037
Impact of adoption of new accounting principle	—	3,146
Cash, cash equivalents, and restricted cash at end of year	\$ 70,780	55,786
Reconciliation of cash, cash equivalents, and restricted cash reported within the statement of financial position that sum to the total of the same such amounts shown above:		
Cash and cash equivalents	\$ 70,603	50,690
Cash restricted for long-term investment purposes	177	5,096
Total cash, cash equivalents, and restricted cash shown above	\$ 70,780	55,786
Supplemental data:		
Cash paid for interest	\$ 13,496	13,959
Increase in accounts payable and accrued expenses for property, plant, and equipment	—	3,432
Increase in other liabilities for property, plant, and equipment	6,166	32,763

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

June 30, 2020

(with comparative financial information for June 30, 2019)

(1) Summary of Significant Accounting Policies

(a) Organization

Lehigh University (the University), an independent, nondenominational, coeducational university, is incorporated in the Commonwealth of Pennsylvania as a nonprofit corporation and is a tax-exempt organization as described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended. The University is accredited by the Middle States Association of Colleges and Schools.

Founded in 1865, the University has approximately 5,200 undergraduates within its three major units – the College of Arts and Sciences, the College of Business, and the P.C. Rossin College of Engineering and Applied Science – and approximately 1,800 students enrolled in graduate programs offered through these colleges and in the College of Education.

The University's subsidiary organization, LU Properties, LLC (LU Properties), a Pennsylvania limited liability company, serves as Manager for limited liability companies that were established as a result of a real estate gift. The University is the sole member of all of the limited liability companies. As Manager, LU Properties is responsible for the strategic and operational aspects of the real estate investment. The results of their operations are shown as nonoperating investment return in the University's consolidated statement of activities.

LU Properties also serves as Manager for South River Investments LLC (South River) and So-Beth Funding LLC (So-Beth Funding). South River, a Pennsylvania limited liability company, was formed to own and develop certain real estate properties in the local community. The results of South River's operations appear in note 13, *Functional Allocation of Expenses*.

So-Beth Funding was formed to improve the condition of residential properties and quality of property management in the South Bethlehem community in order to create a more attractive and safe neighborhood for University students and the greater community. The results of So-Beth Funding's operations appear primarily as investment return in the University's consolidated statement of activities.

The Ben Franklin Technology Partners of Northeastern PA (BFTP) and Manufacturers Resource Center (MRC) are also wholly owned subsidiaries of the University. The results of their operations are shown as independent operations in the University's consolidated statement of activities.

BFTP is an entity that encourages public and private sector cooperation in stimulating economic growth. BFTP provides funds to its clients under the terms of its early stage loan programs and manufacturer grants. Considering the nature of the loans and collection history, BFTP has recorded an estimated allowance for doubtful collections.

MRC provides resources to help small and medium-sized regional manufacturing companies enhance their ability to compete successfully by providing consulting, education, and strategic partnering services.

The majority of the independent operations operating revenue reported in the University's consolidated statement of activities relates to BFTP and MRC revenue received in the form of federal and state grants, client fees for services, and investment return.

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The assets and liabilities of all subsidiary organizations appear in the appropriate line items of the consolidated statement of financial position.

(b) Basis of Presentation

The accompanying consolidated financial statements of the University include all subsidiary organizations and have been prepared on the accrual basis of accounting and in conformity with U.S. generally accepted accounting principles (GAAP). All significant interorganizational balances and transactions have been eliminated.

The University's consolidated financial statements are presented in accordance with the external financial reporting requirements for not-for-profit organizations, which include three basic financial statements and the classification of resources into two separate classes of net assets, as follows:

Without Donor Restrictions – Net assets that are free of donor-imposed restrictions. Net assets without donor restrictions may be designated for specific purposes by action of the Board of Trustees or senior management.

With Donor Restrictions – This category includes net assets subject to donor-imposed restrictions that may be met by actions of the University or by the passage of time. Also included in this category are net assets subject to donor-imposed restrictions to be maintained permanently by the University. Donors of these assets generally permit the University to use all or part of the investment return on related investments for general or specific purposes in accordance with a Board approved spending policy.

Note 10, *Net Assets*, provides additional information regarding the composition of net assets with and without donor restrictions.

Nonoperating activities reflect transactions of a long-term investment or capital nature, including contributions restricted for acquisitions of facilities and equipment, contributions restricted with donor-imposed stipulations, change in the fair value of interest rate swaps, gains and losses on investments, net of the University's spending policy, and certain postretirement benefits-related changes in net assets.

(c) Cash Equivalents

All highly liquid investments with an original maturity of three months or less, except those held for long-term investment purposes, are considered to be cash equivalents.

(d) Investments

Investments are stated at fair value or net asset value (NAV) as a practical expedient to fair value (notes 3 and 5).

Unrealized gains and losses on investments are included in nonoperating investment return in the consolidated statement of activities.

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The University's investments are exposed to various risks such as interest rate, market, and credit risks. Such risks, and the resulting investment security values, may be influenced by changes in economic conditions and market perceptions and expectations. Accordingly, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated statement of financial position.

(e) Contributions and Government Grants

Contributions received, including unconditional promises to give, are recognized as revenues when the donor's commitment is received. Unconditional promises to give are recognized at the estimated present value of the future cash flows, net of allowances. Allowances for uncollectible amounts are recorded based on management's estimate of realizability of the underlying promises to give.

Unconditional contributions, gifts, and grants with no purpose or time restrictions are reported as revenues without donor restrictions. Contributions made toward long-lived assets are held as donor restricted until the asset is completed and available for use. At such time, the contribution is considered to be released from restriction and reclassified to net assets without donor restrictions. Contributions that are released from restriction within the year received are classified as net assets without donor restrictions. Gifts of noncash assets are recorded at their fair value.

A contribution, gift, or grant is conditional if an agreement includes a barrier that must be overcome and either a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets. The presence of both a barrier and a right of return or right of release indicates that a recipient is not entitled to the contribution until it has overcome the barrier(s) in the agreement. Conditional promises to give are not recognized until they become unconditional, that is, when the barrier(s) in the agreement are overcome.

Contributions from federal and state government agencies are included as federal and state grants and contracts in the consolidated statement of activities.

(f) Split-Interest Agreements and Annuities Payable

The University's split-interest agreements with donors consist primarily of annuity, life income, and charitable trusts for which the University serves as trustee. A majority of the assets held in these trusts are included in investments. Contribution revenues are recognized at the date the trusts are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted during the term of the trusts for changes in the value of the assets and changes in the estimated present value of future cash outflows and other changes in the estimates of future benefits.

The annuities payable represent the net present value of future cash outflows over the annuitant's life expectancy, as required by the annuity agreements. The net present value is calculated using a discount rate range of 1.57% to 7.50%. The University is required by the laws of certain states to register and maintain reserves against charitable gift annuities. Such required reserves amounted to approximately \$11.5 million and \$11.3 million as of June 30, 2020 and 2019, respectively, and are reported within investments in the consolidated statement of financial position. Actual reserves meet or

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Notes to Consolidated Financial Statements

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(with comparative financial information for June 30, 2019)

exceed the requirements and are invested in accordance with the laws of the state in which the University offers gift annuities. These assets are managed internally in a conservative and disciplined manner.

(g) Property, Plant, and Equipment

Property, plant, and equipment are carried at cost or at the fair market value at the date of the gift, less accumulated depreciation. Depreciation is computed on a straight-line basis over the estimated useful lives of the related asset. Depreciation is not recorded on land or collections. Depreciable assets and lives generally are as follows:

Buildings	50 to 60 years
Equipment and books	5 to 10 years
Leasehold and other improvements	10 to 20 years

(h) Tuition and Fees

Tuition and fees are reported net of financial aid that effectively reduces the amount of tuition and fees collected from students. Net tuition and fees are recorded as revenue during the year that the related academic services are rendered. Financial aid amounts offset against gross tuition and fees for 2020 and 2019 were \$115.2 million and \$106.4 million, respectively. Generally, students who adjust their course load or withdraw completely prior to completion of 60% of the semester may receive a full or partial refund in accordance with the University's refund policy. Refunds issued reduce the amount of revenue recognized.

(i) Auxiliary Enterprises

Auxiliary enterprises revenue, primarily from room and board, is reported net of financial aid that effectively reduces the amount collected from students. Net room and board revenues are reported in the fiscal year in which the academic programs and services are delivered.

(j) Asset Retirement Liabilities

The University recognizes a liability for legal obligations associated with asset retirements in the period in which the obligation is incurred if a reasonable estimate of the fair value of the obligation can be made. When the liability is initially recorded, the University capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. The liability is accreted to its present value each period, and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the consolidated statement of activities.

(k) Deferred Revenues

Revenues received in exchange transactions for specific activities that have not yet taken place are recorded as deferred revenue. Significant components of deferred revenue include student tuition and educational fees received in advance of services to be rendered and unexpended advances of grant and contract revenues.

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(with comparative financial information for June 30, 2019)

(l) Use of Estimates

The preparation of the University's consolidated financial statements 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 dates of the consolidated statement of financial position and the reported amounts of revenue and expense included in the consolidated statement of activities. Actual results could differ from such estimates. Significant estimates include alternative investments that are measured at NAV per share as a practical expedient for fair value, the postretirement benefit liability, the allocation of functional expenses, anticipated endowment distributions, and contributions receivable that are recognized at the estimated present value of the future cash flows, net of allowances.

(m) Reclassifications

Certain 2019 amounts have been reclassified to conform to their presentation in the 2020 consolidated financial statements.

(n) Recent Accounting Pronouncements

(i) Leases

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02 (ASU 2016-02), *Leases (Topic 842)*. ASU 2016-02 is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new standard changes how organizations account for leases in which collectibility of the lease payments is uncertain. Due to the COVID-19 pandemic, the FASB allowed entities to push back the effective date for this update. As such, the University will adopt ASU 2016-02 for its fiscal year ending June 30, 2021. The University is currently evaluating the impact of this standard on its financial statements.

(ii) Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

In March 2017, the FASB issued ASU No. 2017-07 (ASU 2017-07), *Compensation—Retirement Benefits (Topic 715) Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. ASU 2017-07 requires that an employer report the service cost component of pension costs in the same line item as employee compensation costs within operating income. The other components of net benefit cost are required to be presented in the consolidated statement of activities separately from the service cost component and outside a subtotal of income from operations. The University adopted ASU 2017-07 for its fiscal year ended June 30, 2020 and applied the amendment in this ASU using a retrospective transition method. The effect of adoption results in approximately \$2.0 million moving from operating expenses to nonoperating in fiscal year 2019.

(iii) Restricted Cash

In November 2016, the FASB issued ASU No. 2016-18 (ASU 2016-18), *Statement of Cash Flows (Topic 230): Restricted Cash*. ASU 2016-18 requires that restricted cash and restricted cash equivalents be included as components of total cash and cash equivalents as presented on the

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June 30, 2020

(with comparative financial information for June 30, 2019)

statement of cash flows. The University adopted ASU 2016-18 for its fiscal year ended June 30, 2020. The University applied the amendments in this ASU using a retrospective transition method. Management has determined that this ASU did not significantly impact the University's consolidated financial statements.

(o) Prior Year Summarized Financial Information

The consolidated statement of activities includes certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such information should be read in conjunction with the University's consolidated financial statements for the year ended June 30, 2019, from which the summarized information was derived.

(p) Risks and Uncertainties

While the full impact of the COVID-19 pandemic on the University cannot be predicted at this time, the continued spread of the outbreak could have an adverse impact on the University's financial position. The extent of the impact will depend on future developments beyond the control of the University, including the duration and spread of the outbreak, any additional restrictions and advisories imposed by the federal and state governments, the continued effects of the pandemic on the financial markets, and higher education generally, and the continued effects of the pandemic on the economy overall, all of which are highly uncertain and cannot be predicted.

(2) Financial Assets and Liquidity Resources

Financial assets and liquidity resources available within one year for general expenditures, such as operating expenses, scheduled principal payments on debt, and capital construction costs not financed with debt, at June 30, 2020 and 2019 are as follows (in thousands):

	2020	2019
Financial assets:		
Cash and cash equivalents	\$ 62,410	28,693
Accounts receivable, net	12,435	12,917
Contributions without donor restrictions due in one year or less	6,724	6,673
Investments not subject to donor restrictions or board designations	191,506	255,708
	273,075	303,991
Liquidity resources:		
Commercial paper, \$75 million authorized, \$20 million outstanding on June 30, 2020 and 2019, respectively	55,000	55,000
Revolving line of credit from JPMorgan Chase Bank, \$50 million as of June 30, 2020, one year term	50,000	—
Total available within one year	\$ 378,075	358,991

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(with comparative financial information for June 30, 2019)

The University manages its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, the University invests cash in excess of daily requirements in short-term investments. The University has both operating reserves and physical plant renewal and replacement reserves set aside to be drawn upon to meet its operating and contractual obligations. The reserves are held in the cash and cash equivalents line on the statement of financial position. The University is subject to certain debt covenants. Note 11, *Bonds, Loans, and Notes Payable*, provides additional information about the University's obligations under such covenants.

In addition, the University's governing board and senior management have designated \$396.4 million as of June 30, 2020 to function as endowment and \$213.0 million as long term investments. Although the University does not intend to spend from its board-designated investments other than amounts appropriated for general expenditure as part of its annual budget approval and appropriation process, these funds could be made available, if necessary. However, both the donor restricted and board-designated endowments contain investments with provisions that limit or prevent liquidation that would reduce the total investments that could be made available (note 5).

Distributions from endowments with donor restrictions for the fiscal year ending June 30, 2021 are anticipated to be approximately \$42.1 million. Such distributions will be funded from fiscal year 2021 net investment return and from endowment investment return earned in prior years if income is less than the University's spending policy. Note 4, *Endowment Net Assets*, provides additional information about the University's endowment spending policy.

Student loans receivable are not considered to be available to meet general expenditures because principal and interest on these loans are used solely to make new loans.

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(with comparative financial information for June 30, 2019)

(3) Investments

Investments by major category at June 30, 2020 and 2019 are as follows (in thousands):

	<u>2020</u>	<u>2019</u>
Cash and short-term investments	\$ 81,132	100,496
Fixed income investments:		
U.S. government	174,553	188,595
Corporate	76,609	123,244
Other	2,976	3,099
Corporate stocks	17,919	15,556
Mutual and exchange-traded funds	126,454	168,505
Real estate	29,719	42,071
Alternative investments:		
Public equity	605,994	610,297
Absolute return	314,628	318,527
Private investments	408,059	381,257
Life insurance and other investments	3,813	3,973
Total investments	<u>\$ 1,841,856</u>	<u>1,955,620</u>

The University's investments are comprised of the assets of the University's endowment, real estate held for investment purposes, assets supporting certain split-interest agreements, and other investments for general operating purposes. Investments are reported at fair value or NAV as a practical expedient to fair value. Note 5, *Fair Value Measurements*, provides additional information about inputs used to determine fair value and about investments reported at NAV.

The majority of endowment and annuity fund investments are combined in investment pools with each individual account subscribing to or disposing of shares on the basis of the fair value per share. The investment objective is to maximize long-term total return through a combination of income and capital appreciation in a manner consistent with sound investment practices.

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The components of total investment return are reflected below (in thousands). Investment earnings for the years ended June 30, 2020 and 2019 are net of investment expenses.

	<u>2020</u>	<u>2019</u>
Investment earnings	\$ 6,033	15,656
Net realized and unrealized gains	<u>29,500</u>	<u>146,906</u>
	35,533	162,562
Independent operations	<u>3,115</u>	<u>2,255</u>
Total	<u>\$ 38,648</u>	<u>164,817</u>

Investment return, as reflected in the consolidated statement of activities, consists of the following components (in thousands):

	<u>2020</u>	<u>2019</u>
Operating:		
Endowment spending distribution	\$ 67,726	66,871
Spending distribution – other	11,759	11,736
Other investment earnings	<u>9,977</u>	<u>12,341</u>
	89,462	90,948
Independent operations	<u>598</u>	<u>2,517</u>
Total operating	<u>90,060</u>	<u>93,465</u>
Nonoperating:		
Endowment spending distribution	982	883
Other investment losses (net)	(1,842)	(155)
Net realized and unrealized (losses) gains, net of spending distribution	<u>(53,069)</u>	<u>70,886</u>
	(53,929)	71,614
Independent operations	<u>2,517</u>	<u>(262)</u>
Total nonoperating	<u>(51,412)</u>	<u>71,352</u>
Total investment return	<u>\$ 38,648</u>	<u>164,817</u>

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(4) Endowment Net Assets

The University's endowment consists of approximately 2,800 individual funds established for a variety of purposes. Its endowment includes both donor-restricted funds and funds designated by the Board of Trustees or senior management to function as endowments (board-designated). Net assets associated with endowment funds are classified and reported based upon the existence or absence of donor-imposed restrictions.

From time to time, the fair value of assets associated with donor restricted endowment funds may fall below the original gift amount. Deficiencies of this nature are reported in net assets with donor restrictions. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of the new donor restricted contributions.

Underwater donor restricted endowment funds at June 30, 2020 and 2019 are as follows (in thousands):

	<u>2020</u>	<u>2019</u>
Fair value of underwater endowment funds	\$ 157,199	91,662
Original endowment gift amounts	<u>167,689</u>	<u>95,813</u>
Underwater amounts	<u>\$ (10,490)</u>	<u>(4,151)</u>

Endowment funds include funds actively managed by the University as part of a single commingled investment pool as well as a limited number of individual funds that are separately invested or held in trust by others. The principal financial objective of the endowment pool is that the real purchasing power of the endowment principal should be preserved and, if possible, enhanced, to help ensure the University's financial future. The productivity of the endowment pool must strike a balance between the preservation of principal in real terms for perpetuity and supporting a spending policy that sustains the educational mission of the University.

The Prudent Investor Rule of the Commonwealth of Pennsylvania views investment prudence on the part of the fiduciary from the standpoint of the total portfolio. Therefore, any reasonable investment may be considered for endowment pool assets as long as the risk and return tradeoff of the entire portfolio is prudent. The University's investment policy includes a target asset allocation, well diversified among suitable asset classes that is expected to generate, on average, the level of expected return necessary to meet endowment objectives at a responsible level of volatility consistent with achieving that return. To monitor the effectiveness of the investment strategy of the endowment pool, performance goals are established to exceed the expected real rate of return, established benchmark indices, and the median return of comparable endowment funds.

Commonwealth of Pennsylvania law permits the University to allocate to operating income a minimum of 2% and a maximum of 7% of a three-year moving average of the market value of the endowed assets. Unless the terms of the gift instrument state otherwise, accumulated endowment gains may be spent over time by the University. Net gains in excess of less than the spending policy are reflected as nonoperating investment return activity.

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The University has an endowment spending policy based on 5% of a three-year moving average market value with a minimum increase of 0% per year and a maximum increase of 10% per year over the prior year's spending rate.

Any income earned in excess of the spending limit is reinvested while funds may be withdrawn from investment return earned in prior years if income is less than the spending policy provision. This is designed to insulate investment policy from budgetary pressures, and to insulate program spending from fluctuations in capital markets. Average annual spending rates per share were 5.0% and 5.1% for fiscal years 2020 and 2019, respectively.

Endowment net asset composition as of June 30, 2020 (in thousands):

	Without donor restrictions	With donor restrictions	Total
Donor-restricted endowment funds (corpus) \$	—	565,864	565,864
Board-designated endowment funds (corpus)	219,348	—	219,348
Accumulated gains on endowment funds	177,025	342,073	519,098
Total endowment net assets \$	396,373	907,937	1,304,310

Endowment net asset composition as of June 30, 2019 (in thousands):

	Without donor restrictions	With donor restrictions	Total
Donor-restricted endowment funds (corpus) \$	—	553,202	553,202
Board-designated endowment funds (corpus)	226,379	—	226,379
Accumulated gains on endowment funds	196,179	379,029	575,208
Total endowment net assets \$	422,558	932,231	1,354,789

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Changes in endowment net assets for the year ended June 30, 2020 (in thousands):

	Without donor restrictions	With donor restrictions	Total
Net assets, June 30, 2019	\$ 422,558	932,231	1,354,789
Investment return, net	8,802	4,273	13,075
Contributions and other additions, net	(437)	12,391	11,954
Endowment distributions	(27,750)	(40,958)	(68,708)
Other changes	(6,800)	—	(6,800)
Total change in endowment funds	<u>(26,185)</u>	<u>(24,294)</u>	<u>(50,479)</u>
Net assets, June 30, 2020	<u>\$ 396,373</u>	<u>907,937</u>	<u>1,304,310</u>

Changes in endowment net assets for the year ended June 30, 2019 (in thousands):

	Without donor restrictions	With donor restrictions	Total
Net assets, June 30, 2018	\$ 414,923	886,716	1,301,639
Investment return, net	41,519	63,336	104,855
Contributions and other additions, net	457	21,087	21,544
Endowment distributions	(28,848)	(38,906)	(67,754)
Other changes	(5,493)	(2)	(5,495)
Total change in endowment funds	<u>7,635</u>	<u>45,515</u>	<u>53,150</u>
Net assets, June 30, 2019	<u>\$ 422,558</u>	<u>932,231</u>	<u>1,354,789</u>

(5) Fair Value Measurements

The three levels of the fair value hierarchy are described below. The hierarchy gives the highest priority to unadjusted quoted or published prices in active markets for identical assets or liabilities (Level 1 measurements) and lowest priority to unobservable inputs (Level 3 measurements):

Level 1 – Unadjusted quoted prices or published NAVs in active markets that are accessible at the measurement date for identical assets or liabilities.

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Level 2 – Quoted prices for instruments that are identical or similar in markets that are not active and model-derived valuations for which all significant inputs are observable, either directly or indirectly in active markets

Level 3 – Prices or valuations that require inputs that are both significant to the fair value measurement and are unobservable

The hierarchy requires the use of observable market data when available. The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the measurement.

The following discussion describes the valuation methodologies used for assets and liabilities measured at fair value:

(a) Short-Term Assets and Liabilities

The carrying amount of student accounts receivable, accounts payable and accrued expenses, and the commercial paper component of the University's debt approximates fair value due to the short maturity of these financial instruments.

(b) Notes Receivable

Notes receivable are carried at face value less an allowance for doubtful accounts. A reasonable estimate of the fair value of loans receivable under student loan programs is not practical to determine because the federally sponsored loans are subject to significant government restrictions as to marketability, interest rates, and repayment terms. Because of the early stage nature of the companies to which program loans are provided by BFTP and the lack of a secondary market for such securities, it is not practical to determine their fair value.

(c) Contributions Receivable

The University values contributions receivable at fair value on the date the pledge is received using the present value of future cash flows. Contributions receivable are not measured at fair value subsequent to this initial measurement, because the discount rate selected for each contribution remains constant over time.

(d) Funds Held in Trust by Others

Funds held in trust by others are held and administered by outside trustees, with the University deriving income or a residual interest from the assets of such funds. Funds held in trust by others are recognized at the estimated fair value of the assets or the present value of the future cash flows when the irrevocable trust is established or the University is notified of its existence. As of June 30, 2020 and 2019, the inputs to fair value of these funds are classified as Level 2 or Level 3, depending on whether the assets will ultimately be distributed to the University.

(e) Split-Interest Agreements

Depending on the type of agreement, fair value measurements for split-interest agreements are performed either at inception or on a recurring basis. Fair value of the residual gift is generally based

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on the present value of expected future cash flows including payments to beneficiaries and investment return, and Level 3 inputs include the life expectancy of the donor and other beneficiaries as well as financial assumptions.

(f) Interest Rate Swaps

The fair value of the University's interest rate swap obligation is based on valuations provided NAV by an independent party, taking into account current interest rates and the current creditworthiness of the swap counterparties, which are considered Level 2 inputs to fair value.

(g) Investments

Fair value of equity securities has been determined from observable market or published quotations, when available. Fair value for fixed maturity securities is based upon prices provided by the University's investment managers and custodian banks. Both the investment managers and the custodian banks use a variety of pricing sources to determine fixed maturity market valuations.

Estimated fair value of alternative investments that are not readily marketable is recorded at the NAV as provided by external investment managers as a practical expedient for fair value. The University reviews and evaluates the values provided by external investment managers and agrees with the valuation methods and assumptions used in determining the NAV of those investments.

Certain investments that are measured at fair value using the NAV per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in the tables below are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

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The following table presents the University's fair value hierarchy for investments at June 30, 2020 (in thousands):

	Fair value measurements at reporting date using				Total
	Quoted or published prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Measured at NAV per share (or its equivalent)	
Short-term investments	\$ 81,132	—	—	—	81,132
Fixed income investments:					
U.S. government	145,896	28,657	—	—	174,553
Corporate	—	76,609	—	—	76,609
Other	—	2,976	—	—	2,976
Corporate stocks	17,919	—	—	—	17,919
Mutual and exchange-traded funds	126,454	—	—	—	126,454
Real estate	—	29,719	—	—	29,719
Alternative investments:					
Public equity	14,938	—	—	591,056	605,994
Absolute return	—	—	—	314,628	314,628
Private investments	—	—	—	408,059	408,059
Life insurance and other investments	3,803	10	—	—	3,813
Total investments	\$ <u>390,142</u>	<u>137,971</u>	<u>—</u>	<u>1,313,743</u>	<u>1,841,856</u>

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The following table presents the University's fair value hierarchy for investments at June 30, 2019 (in thousands):

	Fair value measurements at reporting date using				Total
	Quoted or published prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Measured at NAV per share (or its equivalent)	
Short-term investments	\$ 100,496	—	—	—	100,496
Fixed income investments:					
U.S. government	157,513	31,082	—	—	188,595
Corporate	—	123,244	—	—	123,244
Other	—	3,099	—	—	3,099
Corporate stocks	15,556	—	—	—	15,556
Mutual and exchange-traded funds	168,505	—	—	—	168,505
Real estate	—	42,071	—	—	42,071
Alternative investments:					
Public equity	15,142	—	—	595,155	610,297
Absolute return	—	—	—	318,527	318,527
Private investments	—	—	—	381,257	381,257
Life insurance and other investments	3,958	15	—	—	3,973
Total investments	\$ 461,170	199,511	—	1,294,939	1,955,620

The following redemption table clarifies the nature, risk, and liquidity of the University's investments in alternative investment vehicles that are reported at NAV per share (or its equivalent) at June 30, 2020 (in thousands):

	Fair value	Estimated remaining lives	Unfunded commitments (4)	Redemption terms	Redemption notice period
Public equity (1):	\$ 584,796	N/A	\$ —	Weekly – 2 years	0–120 Days
	6,260	up to 5 years	19,000	Generally not eligible	—
	591,056		19,000		
Absolute return (2):	256,827	N/A	—	Monthly – annually when eligible	45–90 Days
	57,801	up to 6 years	67,840	Generally not eligible	—
	314,628		67,840		
Private investments (3)	408,059	up to 12 years	252,469	Generally not eligible	—
Total	\$ 1,313,743		\$ 339,309		

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- (1) This category's primary objective is to capture the returns of publicly traded equities on a global market basis in order to provide long-term growth to the endowment.
- (2) The primary objective of this category is to capture the returns associated with skill-based active management by exploiting the inefficiencies associated with marketable securities, thus providing a diversifying return stream with low correlation to returns of stocks. These funds should also provide principal protection in equity sell-offs.
- (3) This category includes investments in private equity and real estate funds. The primary objective of private equity funds is to achieve long-term returns in excess of public equity investments in part by earning an illiquidity premium. The primary objective of real estate funds is to provide portfolio diversification, with long-term returns expected to be between that of stocks and bonds. These funds will also potentially offer some protection for the endowment in the event of inflation. Private investments typically have commitment periods up to 12 years.
- (4) The University is obligated under certain investment agreements to periodically advance additional funding up to contractual levels. The investment agreements do not specify exact funding dates, however, it is likely that funding will occur over the next several years. Funds to meet these commitments will be generated from rebalancing the investment pool asset allocation, as well as donor gifts and existing cash.

(6) Accounts Receivable, Net

Accounts receivable at June 30, 2020 and 2019 (net of allowances for doubtful accounts) are as follows (in thousands):

	2020	2019
Accounts receivable, net:		
Student accounts	\$ 2,426	533
Grants and contracts	7,141	7,201
Investment income	1,439	2,329
Other	2,029	3,454
	\$ 13,035	13,517

Allowances for doubtful accounts were \$3.0 million and \$2.4 million in 2020 and 2019, respectively.

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(7) Notes Receivable, Net

Notes receivable at June 30, 2020 and 2019 are as follows (in thousands):

	<u>2020</u>	<u>2019</u>
Notes receivable, net:		
University:		
Student loans	\$ 6,138	6,841
Other	1,750	1,102
Less allowance for doubtful loans	<u>(271)</u>	<u>(271)</u>
Total University	<u>7,617</u>	<u>7,672</u>
Independent operations:		
Program loans	11,726	11,115
Less allowance for doubtful accounts	<u>(9,635)</u>	<u>(9,377)</u>
Total independent operations	<u>2,091</u>	<u>1,738</u>
	<u>\$ 9,708</u>	<u>9,410</u>

Independent operations notes receivable primarily consist of loans provided by BFTP to early stage firms. The majority of these loans are fully reserved.

(8) Property, Plant, and Equipment, Net

Property, plant, and equipment are summarized as follows at June 30, 2020 and 2019 (in thousands):

	<u>2020</u>	<u>2019</u>
Land and improvements	\$ 72,400	70,868
Buildings and improvements	798,082	723,012
Furniture, equipment, books, and collections	226,735	220,397
Construction in progress	<u>119,199</u>	<u>100,974</u>
	1,216,416	1,115,251
Less accumulated depreciation	<u>(609,479)</u>	<u>(577,957)</u>
Total	<u>\$ 606,937</u>	<u>537,294</u>

Depreciation expense totaled \$33.4 million and \$31.6 million for the years ended June 30, 2020 and 2019, respectively. Interest expense that was capitalized totaled \$2.1 million and \$1.1 million for the years ended June 30, 2020 and 2019, respectively.

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(9) Contributions Receivable, Net

Unconditional promises to give are included in the consolidated financial statements as contributions receivable and revenue of the appropriate net asset category. Contributions arising from unconditional promises to give are recorded at fair value determined based on the present value of estimated future cash flows. Contributions receivable also include charitable remainder trusts where the University is not the trustee of the assets of the trust, but will receive a distribution upon its termination. The net present value of contributions receivable is calculated using a discount rate range of 1.76% to 4.40%. Unconditional promises are expected to be realized in the following periods (in thousands):

	2020	2019
In one year or less	\$ 16,711	16,087
Between one year and five years	22,920	23,177
More than five years	5,269	6,462
	44,900	45,726
Less:		
Unamortized discount	(1,481)	(1,839)
Allowance for uncollectible accounts	(2,293)	(2,313)
	\$ 41,126	41,574

Contributions receivable from federal and state government agencies are included in grants receivable (note 6). Outstanding amounts related to conditional federal grants as of June 30, 2020 were approximately \$44.7 million. Outstanding promises to give that were conditional amounted to \$8.4 million and \$11.4 million as of June 30, 2020 and 2019, respectively.

(10) Net Assets

Net assets without donor restrictions include the following at June 30, 2020 and 2019 (in thousands):

	2020	2019
Undesignated	\$ 310,706	242,150
Board designated endowment funds	396,373	422,558
Annuity and life income funds	3,158	3,301
Plant funds and capital project reserves	224,395	300,874
Independent operations	57,964	57,942
	\$ 992,596	1,026,825

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Net assets with donor restrictions include the following at June 30, 2020 and 2019 (in thousands):

	<u>2020</u>	<u>2019</u>
Contributions receivable	\$ 41,126	41,574
Loan funds	2,823	2,670
Annuity and life income funds	31,808	31,579
Endowment funds – corpus	565,864	553,202
Accumulated gains on endowment funds	342,073	379,029
Other – related to time and purpose restrictions	<u>40,572</u>	<u>27,907</u>
	<u>\$ 1,024,266</u>	<u>1,035,961</u>

Based upon spending restrictions in effect as of June 30, 2020, endowment funds and accumulated gains on donor-restricted endowment funds are restricted for the following future spending purposes.

	<u>With donor restrictions</u>	
	<u>Endowment funds</u>	<u>Accumulated gains on endowment funds</u>
Scholarships and fellowships	46 %	34 %
Professorships and chairs	12	13
Without donor purpose restrictions	19	40
Other	23	13

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(11) Bonds, Loans, and Notes Payable

Bonds, loans, and notes payable are reported net of any unamortized premiums, discounts, or issuance costs. Net unamortized premiums were \$2.7 million and \$2.9 million at June 30, 2020 and 2019, respectively. Net unamortized bond issuance costs were \$1.5 million and \$1.6 million at June 30, 2020 and 2019, respectively. The following table presents bonds, loans, and notes payable at June 30, 2020 and 2019 (in thousands):

	2020	2019
Taxable Commercial Paper Series A, up to \$75 million, weighted average interest rate of .20% and 2.35% on June 30, 2020 and 2019, respectively; average duration of 93 and 63 days for the years ended June 30, 2020 and 2019, respectively	\$ 20,000	20,000
Northampton County General Purpose Authority (NCGPA): Series 2000B bonds; tax-exempt variable rate revenue bonds, \$25,000 due serially from December 1, 2003 to December 1, 2030, variable rates of .10% and 1.55% on June 30, 2020 and 2019, respectively; bonds are supported with a standby bond purchase agreement, which expires on March 15, 2021 per the extension, effective August 7, 2020	13,826	14,752
Series 2001 bonds; tax-exempt variable rate revenue bonds, paid in full on October 15, 2019	—	1,944
Series 2004 bonds; tax-exempt index rate revenue bonds, \$50,000 due serially from May 15, 2025 to May 15, 2034, rates of .76% and 2.45% on June 30, 2020 and 2019, respectively	49,813	49,795
Series 2006A bonds; tax-exempt variable rate revenue bonds, \$16,820 due serially from November 15, 2007 to November 15, 2021, variable rates of .03% and 1.50% on June 30, 2020 and 2019, respectively	3,732	5,497
Series 2007 bonds; tax-exempt revenue bonds, \$24,615 variable rate CPI bonds due serially from November 15, 2019 to November 15, 2025, variable rates of 2.33% and 3.03% on June 30, 2020 and 2019, respectively	23,672	24,557

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	2020	2019
Series 2016A bonds; 4.00% to 5.00% tax-exempt fixed rate revenue bonds, \$26,715 due serially from November 15, 2026 to November 15, 2036	\$ 29,301	29,475
Series 2016B bonds; tax-exempt variable rate revenue bonds, \$74,950 due serially from November 15, 2017 to November 15, 2039, variable rate of .90% and 2.48% on June 30, 2020 and 2019, respectively	72,936	73,531
Series 2016 taxable bonds; \$150,000 due serially from November 15, 2044 to November 15, 2046, fixed rate 3.48%	149,211	149,180
	\$ 362,491	368,731

The proceeds of the series 2016 taxable bonds were used to finance current and future capital projects consistent with the University's capital plan, to pay the costs of issuance, and any other purpose duly authorized by the University.

Proceeds from all tax-exempt bonds, loans, and notes were used by the University to purchase land and buildings, construct or renovate facilities, upgrade computing and information service facilities, purchase equipment, and finance certain completed facilities.

The series 2016 taxable bonds are secured by a pledge of and security interest in the University's gross revenues.

Payment of all outstanding tax-exempt bonds is secured by separate loan agreements between the University and the Northampton County General Purpose Authority (NCGPA). Each loan agreement is a general obligation of the University for which it has pledged its full faith and credit. In addition, the University has granted NCGPA a security interest in the University's gross revenues as defined in each loan agreement. In accordance with the NCGPA loan agreements, the University established rates and charges sufficient to provide, in each fiscal year, for the payment of the University's operating expenses and debt service on its long-term indebtedness. The University may incur additional indebtedness under certain conditions described in the loan agreements and the bond indentures.

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At June 30, 2020, the aggregate annual maturities of bonds, loans, and notes payable for the next five years and, thereafter, are as follows (in thousands):

2021	\$	6,355
2022		6,595
2023		6,970
2024		7,240
2025		11,075
Thereafter		<u>302,970</u>
Total long-term bonds payable		341,205
Unamortized issuance costs		(1,457)
Unamortized bond premium		2,743
Commercial paper		<u>20,000</u>
	\$	<u><u>362,491</u></u>

The Series of 2000B and 2006A bonds bear interest at a weekly rate determined by the remarketing agent. Effective December 2, 2019, the Series 2004 bonds bear interest based upon a Federal Funds Rate set by the calculation agent on a monthly basis. The University may elect to convert to another variable rate mode or to a fixed mode as determined by the remarketing agent.

Bondholders have a right to tender variable rate bonds at interest rate reset dates.

The University entered into separate standby bond purchase agreements with banks to provide liquidity in case of tender of the 2000B bonds. These agreements expire prior to the maturity of the bonds and may be extended at the University's request. However, the banks have no obligation to agree to the extended purchase period.

The University serves as the liquidity facility for its 2006A bonds and the Commercial Paper program. As of June 30, 2020, the University estimates that \$62.5 million of liquid assets were available on a daily basis and an additional \$63.1 million was available within 7 days.

Included in other liabilities is a finance lease obligation of \$46.3 million related to the construction of a student housing residence facility on the University's land. The related construction costs are capitalized and included in property, plant, and equipment, net on the consolidated statement of financial position.

On April 21, 2020, the University obtained a \$50 million revolving line of credit from JPMorgan Chase Bank, N.A. ("JPM"). The JPM Line of Credit has a term of one-year. The JPM Line of Credit is a general obligation of the University secured by the gross revenues of the University on a parity with that granted under the University's covenants in its various existing financing documents executed in connection with the University's long-term debt.

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As a component of the tax-exempt debt portfolio, the University entered into interest rate swap agreements (note 12) that effectively convert certain variable rate revenue bond obligations to fixed rates or reduce the University's effective interest rate. Significant terms of each of the swap agreements are as follows (in thousands):

Series	Counterparty	Effective date	Current notional amount	University pays	University receives	Expiration date
2000B bonds	JPMorgan Chase Bank, N.A.	12/7/2000	\$ 13,880	4.530 %	67% of USD-1-month LIBOR-BBA	12/1/2030
2004 bonds	Wells Fargo Bank, N.A.	12/18/2008	50,000	1.953	67% of USD-Federal Funds	5/15/2034
2006A bonds	JPMorgan Chase Bank, N.A.	8/24/2006	3,735	3.392	67% of USD-1-month LIBOR-BBA	11/15/2021
2007 CPI bonds	JPMorgan Chase Bank, N.A.	2/1/2007	23,715	3.980 to 4.530	Variable rate based on CPI-U	various through 11/15/2025
2016B bonds	Wells Fargo Bank, N.A.	10/6/2016	73,160	1.148	70% of USD-Federal Funds	11/15/2039
			<u>\$ 164,490</u>			

(12) Derivative Instruments

The University employs derivatives, primarily interest rate swap agreements, to manage interest rate risk associated with outstanding debt. The net fair value of the University's swap agreements is included in other assets or other liabilities in the statement of financial position, and was recorded as a liability of \$19.6 million and \$4.5 million at June 30, 2020 and 2019, respectively. The change in fair value of the interest rate swaps is reflected in nonoperating activity on the statement of activities and was \$(15.1) million and \$(9.3) million for the years ended June 30, 2020 and 2019, respectively.

Certain of the University's interest rate swap agreements contain provisions that require the University's debt to maintain an investment grade credit rating from each of the major credit rating agencies. If the University's debt were to fall below investment grade, it would be a violation of these provisions, and the counterparties to the rate swap agreement could request next-day full collateralization on all rate swaps in net liability positions. To date, the University has not posted collateral for any rate swap agreements. If the credit-risk-related contingent features underlying these agreements were triggered on June 30, 2020, the University would be required to post an additional \$12.3 million of collateral to its counterparties.

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(13) Functional Allocation of Expenses

The following table includes operating expenses by type and function for the year ended June 30, 2020 (in thousands):

	Instruction	Research	Public service	Academic support	Student services	Institutional support	Auxiliary enterprises	Independent operations	Total
Salaries and wages	\$ 88,877	19,379	808	15,295	17,094	36,705	3,982	3,486	185,626
Employee benefits	29,308	4,020	225	5,600	5,306	12,609	1,182	1,059	59,309
Purchased services	2,271	5,080	169	1,810	1,753	10,318	11,190	1,500	34,091
Occupancy	9,216	1,983	211	2,135	2,261	4,601	11,797	675	32,879
Depreciation	9,844	5,017	215	3,487	3,283	5,561	4,324	1,657	33,388
Interest	5,379	1,207	51	920	1,031	2,207	293	—	11,088
Other expenses	11,916	7,228	941	8,463	8,128	3,617	7,200	2,273	49,766
Total	<u>\$ 156,811</u>	<u>43,914</u>	<u>2,620</u>	<u>37,710</u>	<u>38,856</u>	<u>75,618</u>	<u>39,968</u>	<u>10,650</u>	<u>406,147</u>

The following table includes operating expenses by type and function for the year ended June 30, 2019 (in thousands):

	Instruction	Research	Public service	Academic support	Student services	Institutional support	Auxiliary enterprises	Independent operations	Total
Salaries and wages	\$ 87,945	18,799	831	15,537	17,101	35,790	4,183	3,624	183,810
Employee benefits	29,399	3,733	208	5,495	5,294	12,206	1,200	966	58,501
Purchased services	2,501	4,957	198	2,335	2,321	10,394	13,047	1,769	37,522
Occupancy	10,506	2,273	241	2,470	2,516	4,739	11,529	635	34,909
Depreciation	9,386	5,033	185	3,376	3,052	5,353	3,612	1,611	31,608
Interest	6,658	1,450	62	1,167	1,289	2,689	321	—	13,636
Other expenses	13,075	7,675	1,290	8,754	8,601	5,542	6,689	1,792	53,418
Total	<u>\$ 159,470</u>	<u>43,920</u>	<u>3,015</u>	<u>39,134</u>	<u>40,174</u>	<u>76,713</u>	<u>40,581</u>	<u>10,397</u>	<u>413,404</u>

The consolidated financial statements report certain categories of expenses that are attributable to more than one function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include employee benefits, interest, and certain occupancy expenses, which are allocated on the basis of salary and wage expense.

Fund-raising costs were approximately \$11.7 million and \$14.4 million in 2020 and 2019, respectively, and are included in institutional support.

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(14) Postretirement and Postemployment Benefits Other than Pensions

The University pays for a portion of the cost of medical insurance for retired employees and their eligible dependents. During fiscal year 2020, the University reimbursed retirees a maximum of \$104.35 per month for premium expenses. The maximum monthly reimbursement amount will increase each year at the lesser of medical Consumer Price Index (CPI) or 8%. These postretirement medical benefits accrue from the later of date of hire or age 30. The University uses a July 1 measurement date for its plan. Summarized plan information is stated below (in thousands):

The following shows the reconciliation of the beginning and ending balances of the benefit obligation (in thousands):

	2020	2019
Benefit obligation at beginning of year	\$ 52,236	46,295
Operating:		
Service cost	1,893	1,602
Benefits paid	(1,313)	(1,193)
Total operating	580	409
Nonoperating:		
Interest cost	2,013	2,034
Actuarial gain	(661)	—
Assumption changes	5,171	3,498
Total nonoperating loss	6,523	5,532
Benefit obligation at end of year	\$ 59,339	52,236

The following table sets forth the status of the plan, which is unfunded, at June 30, 2020 and 2019:

	2020	2019
Accumulated postretirement benefit obligation:		
Retirees	\$ 21,689	17,300
Fully eligible active plan participants	15,910	16,521
Other active plan participants	21,740	18,415
Total	59,339	52,236
Plan assets at fair value	—	—
Accumulated postretirement benefit liability included in other liabilities on the consolidated statement of financial position	\$ 59,339	52,236

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Weighted average assumptions for the years ended June 30, 2020 and 2019 are as follows:

	<u>2020</u>	<u>2019</u>
Discount rate for net periodic postretirement benefit cost	3.90 %	4.45 %
Discount rate for accumulated postretirement benefit obligation	3.25	3.90
Maximum increase in reimbursement rate	lesser of medical CPI or 8%	lesser of medical CPI or 8%

Assumed healthcare cost trend rate at June 30, 2020 and 2019 is as follows:

	<u>2020</u>	<u>2019</u>
Healthcare cost trend rate assumed for next year	4.50 %	4.25 %
Rate to which the cost trend rate is assumed to decline (ultimate rate)	4.50	4.25
Year that ultimate rate is reached	N/A	N/A

Impact of 1% increase in assumed healthcare cost trend rate at June 30, 2020 and 2019 is as follows (in thousands):

	<u>2020</u>	<u>2019</u>
Increase in accumulated postretirement benefit obligation	\$ 12,762	10,117
Increase in net periodic postretirement benefit cost	1,044	948

Estimated future University contributions reflecting expected future service are as follows (in thousands):

Fiscal year(s) ending June 30:	
2021	\$ 1,366
2022	1,451
2023	1,546
2024	1,637
2025	1,735
2026 through 2030	10,471

(15) Retirement Plans

The University provides pensions to substantially all salaried faculty and staff through a defined-contribution plan administered by Teacher's Insurance and Annuity Association. The plan features base contributions from the University and voluntary employee contributions with a University match. Total expense for this plan was \$15.2 million and \$14.8 million in 2020 and 2019, respectively.

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(16) Grants and Contracts

The University receives grant and contract revenue from various government agencies and private sources for the support of research, training, and other sponsored programs. Revenues associated with the direct costs of these programs are recognized as the related costs are incurred. Indirect cost reimbursements from federal agencies are based on predetermined rates negotiated with the University's cognizant agency, the Office of Naval Research, and are in effect through fiscal year 2020. These rates are also used for other sponsored programs except where separately negotiated. Indirect cost reimbursements from all sources totaled \$9.2 million and \$9.1 million in 2020 and 2019, respectively.

(17) Commitments and Contingencies

(a) Litigation

The University is a party to various legal actions and claims arising in the ordinary course of operations. While it is not feasible to predict the ultimate outcome of such matters, management is of the opinion that the resolution of such matters will not have a material adverse effect on the University's consolidated financial position or changes in net assets.

(b) Other

Open commitments with general contractors, engineering firms, and other vendors related to the construction, renovation, and repair of certain facilities amounted to approximately \$25.0 million and \$22.1 million as of June 30, 2020 and 2019, respectively.

The University leases certain equipment and real property. These leases are classified as operating leases and have lease terms ranging from one to ten years. Total lease expenses were approximately \$2.8 million and \$2.9 million in 2020 and 2019, respectively.

(18) Income Taxes

The University has been recognized by the Internal Revenue Service (IRS) as exempt from federal income tax under Section 501(c)(3) of the U.S. Internal Revenue Code, except for taxes on income from activities unrelated to its exempt purpose. There was no provision for income taxes due on unrelated business income in the accompanying consolidated financial statements. Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the University and recognize a tax liability (or asset) if the University has taken an uncertain tax position that more likely than not would not be sustained upon examination by the IRS. Management has analyzed the tax positions taken by the University, and has concluded that as of June 30, 2020, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or an asset) or disclosure in the consolidated financial statements. The University is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

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(19) Subsequent Events

On August 19, 2020, the University issued \$170,000,000 aggregate principal amount of its Series 2020 taxable bonds (the Bonds). The Bonds are secured by a pledge of and security interest in the University's gross revenues. The proceeds of the Bonds will be used to finance current and future capital projects consistent with the University's capital plan and any other purpose duly authorized by the University. The University has evaluated subsequent events through October 28, 2020, the date the consolidated financial statements were issued, and concluded that there are no additional items requiring disclosure.