

# **Lili‘uokalani Trust**

Financial Statements and Supplemental Schedule  
December 31, 2017 and 2016  
Together with Independent Auditor’s Report



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A Hawaii Limited Liability Partnership

## **Independent Auditor's Report**

To the Trustees of  
Lili'uokalani Trust:

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Lili'uokalani Trust (the Trust), which comprise the statements of financial position as of December 31, 2017 and 2016, the related statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditor's Responsibility**

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

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

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

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lili'uokalani Trust as of December 31, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Matter**

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information, except as marked "unaudited," has been subjected to the auditing procedures applied in the audit of the 2017 financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information, except as marked "unaudited," is fairly stated in all material respects in relation to the financial statements as a whole. We do not express an opinion or provide any assurance on the information marked "unaudited," as it has not been subjected to the auditing procedures applied in the audit of the financial statements.

*KMH LLP*

KMH LLP

Honolulu, Hawaii  
August 20, 2018

# Lili'uokalani Trust

Statements of Financial Position  
December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b><u>Assets</u></b>		
Current Assets:		
Cash and cash equivalents	\$ 5,856,978	\$ 2,480,461
Accounts receivable, net	2,432,248	2,351,115
Investment receivable	66,435	1,223,157
Prepaid expenses and other assets	645,449	604,080
Total current assets	9,001,110	6,658,813
Property and Equipment, Net	43,845,124	36,201,663
Investments:		
Marketable securities	65,666,989	66,645,328
Other	170,127,587	156,807,264
Deferred Rent Receivable	21,738,995	21,098,938
Total assets	<u>\$ 310,379,805</u>	<u>\$ 287,412,006</u>
<b><u>Liabilities and Net Assets</u></b>		
Current Liabilities:		
Accounts payable and other accrued liabilities	\$ 1,722,832	\$ 1,786,145
Accrued vacation	1,103,451	936,006
Deferred revenue	609,000	637,000
Notes payable	338,851	327,637
Total current liabilities	3,774,134	3,686,788
Accrued Postretirement Benefits	1,402,017	1,258,915
Deferred Revenue, Less Current Portion	14,172,414	14,496,595
Notes Payable, Less Current Portion	11,154,957	11,493,819
Total liabilities	30,503,522	30,936,117
Commitments and Contingencies		
Net Assets - Unrestricted	279,876,283	256,475,889
Total net assets	279,876,283	256,475,889
Total liabilities and net assets	<u>\$ 310,379,805</u>	<u>\$ 287,412,006</u>

See accompanying notes to financial statements.

## Lili‘uokalani Trust

### Statements of Activities

For the Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Revenues, Gains, and Other Support:		
Rent	\$ 26,818,323	\$ 26,650,614
Real property and general excise tax reimbursements	7,395,092	7,002,960
Donations	6,525	10,585
Net realized gains on sales of real estate	13,750,676	-
Net realized and unrealized gains on investments	10,226,584	3,658,256
Income from investments	3,978,315	2,934,773
Other	17,581	39,440
	<u>62,193,096</u>	<u>40,296,628</u>
Total revenues, gains and other support		
Expenses:		
Program services	17,804,849	18,737,895
Program support services	5,011,728	4,642,580
Endowment management services	15,861,118	15,520,635
	<u>38,677,695</u>	<u>38,901,110</u>
Total expenses		
Total revenues, gains and other support over expenses	23,515,401	1,395,518
Pension-Related Changes Other Than Net Periodic Pension Costs	<u>(115,007)</u>	<u>186,747</u>
Increase in net assets	23,400,394	1,582,265
Net Assets - Unrestricted at Beginning of Year	<u>256,475,889</u>	<u>254,893,624</u>
Net Assets - Unrestricted at End of Year	<u>\$ 279,876,283</u>	<u>\$ 256,475,889</u>

See accompanying notes to financial statements.

## Lili'uokalani Trust

Statements of Functional Expenses  
For the Years Ended December 31, 2017 and 2016

	2017					2016				
	Program Services	Support Services			Total Expenses	Program Services	Support Services			Total Expenses
		Program Support	Endowment Management	Total			Program Support	Endowment Management	Total	
Salaries	\$ 7,826,561	\$ 2,068,049	\$ 1,563,580	\$ 3,631,629	\$ 11,458,190	\$ 8,711,652	\$ 2,050,475	\$ 1,398,469	\$ 3,448,944	\$ 12,160,596
Taxes	55,455	(4,666)	9,139,203	9,134,537	9,189,992	23,924	40,530	8,582,319	8,622,849	8,646,773
Employee Benefits and Payroll Taxes	1,910,226	529,067	315,842	844,909	2,755,135	2,002,229	456,526	311,360	767,886	2,770,115
Financial Assistance	2,594,237	-	-	-	2,594,237	3,244,389	184	38	222	3,244,611
Professional Services	356,201	797,936	1,196,165	1,994,101	2,350,302	312,826	811,072	958,233	1,769,305	2,082,131
Repairs and Maintenance	577,618	21,124	82,567	103,691	681,309	610,998	19,586	17,661	37,247	648,245
Occupancy Expense	223,435	165,936	283,107	449,043	672,478	192,447	185,302	202,256	387,558	580,005
Travel and Meals	425,918	101,050	128,690	229,740	655,658	323,202	195,399	138,845	334,244	657,446
Insurance	355,701	76,361	185,504	261,865	617,566	505,278	5,251	142,648	147,899	653,177
General Real Estate Expenses	3,832	104	586,274	586,378	590,210	-	14,058	663,186	677,244	677,244
Trustees' Fees	-	282,375	282,375	564,750	564,750	-	282,375	282,375	564,750	564,750
Utilities	425,576	12,579	12,804	25,383	450,959	447,924	18,821	14,367	33,188	481,112
Telephone	274,769	14,127	28,270	42,397	317,166	248,071	6,609	56,991	63,600	311,671
Equipment Rental	100,284	143,734	36,828	180,562	280,846	115,984	69,576	42,215	111,791	227,775
Supplies	118,527	61,902	53,060	114,962	233,489	175,520	57,687	107,430	165,117	340,637
Real Estate Management Fees	702	-	105,103	105,103	105,805	-	-	105,624	105,624	105,624
Education	10,172	68,383	7,007	75,390	85,562	56,089	65,134	16,014	81,148	137,237
Leasing Commission	-	-	57,767	57,767	57,767	-	-	45,440	45,440	45,440
Dues	5,362	27,312	16,087	43,399	48,761	20,426	12,672	25,409	38,081	58,507
Publications	7,450	8,258	6,934	15,192	22,642	6,113	5,238	10,105	15,343	21,456
Bad Debt Expense	-	-	11,045	11,045	11,045	-	-	44,425	44,425	44,425
Other Expenses	735,792	337,360	119,195	456,555	1,192,347	184,826	152,940	720,872	873,812	1,058,638
Total expenses before impairment, depreciation and amortization	16,007,818	4,710,991	14,217,407	18,928,398	34,936,216	17,181,898	4,449,435	13,886,282	18,335,717	35,517,615
Loss on Impairment of Property and Equipment	159,360	118,098	-	118,098	277,458	-	-	-	-	-
Depreciation and Amortization	1,637,671	182,639	1,643,711	1,826,350	3,464,021	1,555,997	193,145	1,634,353	1,827,498	3,383,495
Total	<u>\$ 17,804,849</u>	<u>\$ 5,011,728</u>	<u>\$ 15,861,118</u>	<u>\$ 20,872,846</u>	<u>\$ 38,677,695</u>	<u>\$ 18,737,895</u>	<u>\$ 4,642,580</u>	<u>\$ 15,520,635</u>	<u>\$ 20,163,215</u>	<u>\$ 38,901,110</u>

See accompanying notes to the financial statements.

## Lili'uokalani Trust

### Statements of Cash Flows

For the Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash Flows from Operating Activities:		
Cash received from customers	\$ 34,296,766	\$ 35,929,982
Cash paid to suppliers for goods and services	(23,272,161)	(22,938,483)
Cash paid to employees for services	(11,458,191)	(12,160,596)
Net investment income received	3,978,315	2,934,773
Other cash receipts	(90,900)	236,773
Net cash provided by operating activities	<u>3,453,829</u>	<u>4,002,449</u>
Cash Flows from Investing Activities:		
Proceeds from the sales or maturities of marketable securities and other	98,228,694	47,741,476
Purchase of marketable securities and other	(88,238,804)	(32,935,728)
Proceeds from the sales or maturities of limited partnership interests	14,325,947	16,772,110
Purchases of limited partnership interests	(24,685,634)	(26,373,748)
Proceeds from the sales of real estate	13,848,220	-
Purchases of real estate	(3,331,619)	(3,128,940)
Purchases of property and equipment	(9,896,468)	(6,178,624)
Net cash provided by (used in) investing activities	<u>250,336</u>	<u>(4,103,454)</u>
Cash Flows from Financing Activities --		
Repayment of Notes Payable	(327,648)	(320,157)
Net increase (decrease) in cash and cash equivalents	3,376,517	(421,162)
Cash and Cash Equivalents at Beginning of Year	<u>2,480,461</u>	<u>2,901,623</u>
Cash and Cash Equivalents at End of Year	<u>\$ 5,856,978</u>	<u>\$ 2,480,461</u>

See accompanying notes to financial statements.

## Lili'uokalani Trust

### Statements of Cash Flows

For the Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Reconciliation of Cash Flows from Operating Activities:		
Increase in net assets	\$ 23,400,394	\$ 1,582,265
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Net realized gains on sales of real estate	(13,750,676)	-
Loss on impairment of property and equipment	277,458	-
Net realized and unrealized gains on investments	(10,226,584)	(3,658,256)
Depreciation and amortization	3,464,021	3,383,495
Increase in accounts receivable	(81,133)	(624,356)
Decrease in investment receivable	1,156,722	2,880,850
(Increase) decrease in prepaid expenses and other assets	(41,369)	266,665
Increase in deferred rent receivable	(640,057)	(650,714)
(Decrease) increase in accounts payable and other accrued liabilities	(63,313)	314,971
Increase (decrease) in accrued vacation	167,445	(38,985)
(Decrease) increase in deferred revenue	(352,181)	670,629
Increase (decrease) in accrued postretirement benefits	143,102	(124,115)
Net cash provided by operating activities	<u>\$ 3,453,829</u>	<u>\$ 4,002,449</u>

See accompanying notes to financial statements.



# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 1. Summary of Operations and Significant Accounting Policies

### a. Operations

Lili'uokalani Trust (the Trust) was created in 1909 by the late Queen Lili'uokalani, Hawaii's last reigning monarch. The Trust is dedicated to providing support and services to orphan and destitute children within the State of Hawaii, with preference given to those of Hawaiian ancestry. Income of the Trust is derived principally from rental income received from long-term leases on owned real estate and income and gains earned from its investment portfolios. The Trust also engages in occasional sales of certain real property located in the state of Hawaii.

### b. Basis of Presentation

The Trust's net assets and activities are classified based on the existence or absence of donor-imposed restrictions as follows:

- **Unrestricted Net Assets** – Net assets not subject to donor-imposed stipulations. The portion of unrestricted net assets that the board of trustees has designated for a specific purpose is presented separately from the undesignated net assets in the accompanying statements of financial position. The board of trustees retains full control over such designated funds and may use them for any purpose.
- **Temporarily Restricted Net Assets** – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Trust and/or the passage of time. The Trust has no temporarily restricted net assets.
- **Permanently Restricted Net Assets** – Net assets subject to donor-imposed stipulations that must be maintained permanently by the Trust. The donors of these assets generally permit the use of the income earned on related investments for general or specific purposes. The Trust has no permanently restricted net assets.

### c. Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (US 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. Significant items subject to such estimates and assumptions include the carrying amount of receivables, investments, and accrued postretirement benefits. Actual results could differ from those estimates.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 1. Summary of Operations and Significant Accounting Policies (continued)

### d. Income Taxes

The Trust has been recognized by the Internal Revenue Service (IRS) as exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code (Code) and is classified as a private operating foundation under Section 4942. As an exempt private operating foundation, the Trust is not subject to the excise tax on net investment income for private foundations. To maintain its private operating foundation status, the Code requires the distribution, for charitable purposes, of at least 85 percent of the lesser of adjusted net income or the minimum investment return (i.e., five percent of the aggregate fair market value of investment assets less cash deemed to be held for charitable purposes). The distribution must not be less than 2/3 of minimum investment return.

In each of the years 2017 and 2016, the Trust has expended sufficient amounts for charitable purposes or utilized distribution carryovers from prior years to not incur a tax for failure to distribute income that is imposed by the aforementioned section of the Code.

### e. Cash and Cash Equivalents

The Trust primarily maintains its cash in bank deposit accounts and had approximately \$5,977,000 and \$2,673,000 in excess of federally insured limits at December 31, 2017 and 2016, respectively. The Trust has not experienced losses in these accounts and management believes there is no significant credit risk related to cash.

The Trust considers cash on hand, deposit accounts and financial instruments with original maturities of three months or less at the date of purchase to be cash and cash equivalents.

### f. Accounts Receivable

Accounts receivable consists of amounts due primarily from percentage rent due from lessees. Management determines the allowance for doubtful accounts by identifying troubled accounts and using historical experience applied to an aging of accounts. Accounts receivable are written off when deemed uncollectible and recoveries of previously written off receivables are recorded when received. For the years ended December 31, 2017 and 2016, management's estimated allowance was approximately \$166,000 and \$155,000, respectively.

### g. Investment Receivable

Investment receivable consists of amounts redeemed, but not yet received from investment managers on December 31.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 1. Summary of Operations and Significant Accounting Policies (continued)

### h. Prepaid Expenses and Other Assets

Prepaid expenses and other assets consist primarily of deferred leasing commissions and escrow deposits. Deferred leasing commissions are amortized on a straight-line basis over the term of the related leases.

### i. Property and Equipment

Property and equipment are recorded at cost, except that land acquired in the original deed of trust is recorded at the appraisal value at date of grant. The Trust owns both exempt and non-exempt property and equipment. Non-exempt property and equipment is used for endowment purposes. Exempt property and equipment is used for program services. Maintenance and repairs are expensed as incurred and expenditures for renewals or betterments are capitalized.

Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

Furniture, fixtures and equipment	3 to 7 years
Buildings and improvements	Shorter of lease term or 20-40 years
Land improvements	30-40 years

### j. Investments

Investments include marketable securities, non-controlling interests in for-profit limited partnerships, and real estate. Investments in marketable securities consist of mutual funds, equity securities and U.S. treasuries and are stated at fair value based on quoted market prices. Investments in real estate and for-profit limited partnerships are classified as other investments and are reported at the lower of cost or fair value.

### k. Deferred Rent Receivable

The Trust, as lessor, has lease agreements that provide for scheduled rent increases over the terms of the leases. Rental income is recognized on a straight-line basis over the term of the lease. The difference between rental income per the lease agreements and amounts recognized on a straight-line basis is recorded as deferred rent receivable on the accompanying statements of financial position.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 1. Summary of Operations and Significant Accounting Policies (continued)

### l. Deferred Revenue

Deferred revenue consists of rents received in advance of the due date and lease extension premiums. Lease extension premiums are amortized on a straight-line basis over the life of the related leases.

### m. Employee Benefit Plans

The Trust accounts for its postretirement benefit plan in accordance with Accounting Standards Codification (ASC) 715, *Employers Accounting for Pensions*. ASC 715 prescribes standards of financial accounting and reporting for an employer that offers pension benefits to its employees. ASC 715 requires employers to (a) recognize the overfunded or underfunded status of a single-employer defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in unrestricted net assets in the year in which the changes occur, and (b) measure the funded status of a plan as of the date of its year-end statement of financial position.

### n. Donations

The Trust reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

### o. Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

Long-lived assets (individual assets or asset groups) 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 future net cash flows expected to be generated by the asset. If future net cash flows are less than the carrying value of an asset, an impairment loss is recognized to the extent the asset's carrying value exceeds its fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 1. Summary of Operations and Significant Accounting Policies (continued)

### p. Recent Accounting Pronouncements

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. This ASU will be effective beginning after December 15, 2018. Management is currently assessing the impact of this ASU on its financial position and results of operations and has not yet determined if the adoption of this ASU will have a material effect on its financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*. This ASU replaces the existing lease guidance in U.S. GAAP with new guidance applicable to both lessees and lessors and requires lessees to recognize right-of-use assets and lease liabilities for all leases other than those that meet the definition of short-term leases at the commencement date of the lease. A right-of-use asset is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. A lease liability is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis. The standard also requires additional quantitative and qualitative disclosures regarding the amount, timing and uncertainty of cash flows arising from leases. This ASU will be effective beginning after December 15, 2019. Management is currently assessing the impact of this ASU on its financial position and results of operations and has not yet determined if the adoption of this ASU will have a material effect on its financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities*. This ASU changes presentation and disclosure requirements for not-for profit entities to provide more relevant information about their resources (and the changes in those resources) to donors, grantors, creditors, and other users. These include qualitative and quantitative requirements in net asset classes, investment return, expenses, liquidity and availability of resources and presentation of operating cash flow. This ASU will be effective beginning after December 15, 2018. Management is currently assessing the impact of this ASU on its financial position and results of operations and has not yet determined if the adoption of this ASU will have a material effect on its financial statements.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 1. Summary of Operations and Significant Accounting Policies (continued)

### p. Recent Accounting Pronouncements (continued)

In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improve the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This ASU requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. This ASU will be effective beginning after December 15, 2018. Management is currently assessing the impact of this ASU on its financial position and results of operations and has not yet determined if the adoption of this ASU will have a material effect on its financial statements.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This ASU clarifies and improves current guidance about whether a transfer of assets, or the reduction, settlement, or cancellation of liabilities, is a contribution or an exchange transaction. The ASU provides criteria for determining whether the resource provider is receiving commensurate value in return for the resources transferred which, depending on the outcome, determines whether the organization follows contribution guidance or exchange transaction guidance in the revenue recognition and other applicable standards. This ASU will be effective beginning after December 15, 2018. Management is currently assessing the impact of this ASU on its financial position and results of operations and has not yet determined if the adoption of this ASU will have a material effect on its financial statements.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 1. Summary of Operations and Significant Accounting Policies (continued)

### q. Reclassification

Certain reclassifications were made to prior year's financial statements to conform to the 2017 presentation. Such reclassification had no impact on the previously reported change in net assets.

### r. Subsequent Events

The Trust has evaluated subsequent events through August 20, 2018, the date the financial statements were available to be issued, and it was determined that all subsequent events had been properly accounted for.

In March 2018, the Trust entered into a \$768,000 mortgage loan agreement with a bank to fund the purchase of a condominium unit. The loan matures on March 2048, bears interest at 4.25 percent, and requires the Trust to make monthly principal and interest payments of \$3,779. The loan is secured by the condominium, furniture and fixtures, and present and future income derived from condominium rental agreements.

In May 2018, the Trust entered into a loan agreement (the Agreement) to lend \$13,000,000 to an unrelated third-party (the Borrower). The Agreement bears interest at 9.00 percent and requires monthly interest payments. The Agreement matures on the earlier of May 2028 or 120 days after an event, as specified in the Agreement. The Agreement is collateralized by the Borrower's shares in a privately held Company.

Subsequent to year end, the Trust purchased six properties amounting to \$14.6 million to be used for program services.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

### 2. Investments

#### a. Marketable Securities

Marketable securities stated at fair value at December 31, 2017 and 2016 were as follows:

	<u>Fair Value</u>	<u>Cost</u>	<u>Net Unrealized Gains/(Losses)</u>
2017:			
Mutual funds	\$ 44,144,669	\$ 37,050,818	\$ 7,093,851
Equity securities	11,231,675	6,358,495	4,873,180
U.S. treasuries	10,140,292	10,401,883	(261,591)
Other	150,353	150,353	-
	<u>\$ 65,666,989</u>	<u>\$ 53,961,549</u>	<u>\$ 11,705,440</u>
2016:			
Mutual funds	\$ 47,596,719	\$ 46,436,567	\$ 1,160,152
U.S. treasuries	10,031,998	10,243,219	(211,221)
Equity securities	8,929,658	6,371,236	2,558,422
Other	86,953	86,953	-
	<u>\$ 66,645,328</u>	<u>\$ 63,137,975</u>	<u>\$ 3,507,353</u>

#### b. Other Investments

The Trust's other investments consist of investments in for-profit limited partnerships and real estate held for use, sale and development. As allowed under ASC 958-325-35, the Trust accounts for its other investments at the lower of cost or fair value. Under this method, the same measurement attribute is used for all other investments and declines in the value of those investments are recognized if their aggregate market value is less than their carrying amount; recoveries of aggregate market value in subsequent periods are recorded in those periods subject only to the limitation that the carrying amount does not exceed the original cost.



## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

### 2. Investments (continued)

#### b. Other Investments (continued)

At December 31, 2017 and 2016, the cost and fair value of other investments were as follows:

	Cost	Fair Value (Unaudited)	Fair Value Over/(Under) Cost (Unaudited)
2017:			
Investment in real estate	\$ 44,395,307	\$ 563,174,430	\$ 518,779,123
Investment in for-profit limited partnerships	125,732,280	159,610,246	33,877,966
Total	<u>\$ 170,127,587</u>	<u>\$ 722,784,676</u>	<u>\$ 552,657,089</u>
2016:			
Investment in real estate	\$ 42,649,704	\$ 568,530,113	\$ 525,880,409
Investment in for-profit limited partnerships	114,157,560	129,658,406	15,500,846
Total	<u>\$ 156,807,264</u>	<u>\$ 698,188,519</u>	<u>\$ 541,381,255</u>

The Trust has formal commitments with various limited partnerships to acquire interests in the partnerships up to agreed upon amounts. The Trust, at the discretion of the limited partnerships, may be called upon to fully fund their commitments. At December 31, 2017 and 2016, the Trust had outstanding funding commitments of approximately \$16,447,000 and \$11,798,000, respectively.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

### 2. Investments (continued)

#### b. Other Investments (continued)

Investment in real estate at December 31, 2017 and 2016 consisted of the following:

	Use	Held for Sale	Development	Total
2017:				
Land	\$ 983,266	\$ 441,593	\$ 224,119	\$ 1,648,978
Building and improvements	<u>45,121,715</u>	<u>-</u>	<u>-</u>	<u>45,121,715</u>
	46,104,981	441,593	224,119	46,770,693
Accumulated depreciation and amortization	<u>(23,385,567)</u>	<u>-</u>	<u>-</u>	<u>(23,385,567)</u>
	22,719,414	441,593	224,119	23,385,126
Construction in progress (see Note 8)	<u>-</u>	<u>-</u>	<u>21,010,181</u>	<u>21,010,181</u>
Investment in real estate, net	<u>\$ 22,719,414</u>	<u>\$ 441,593</u>	<u>\$ 21,234,300</u>	<u>\$ 44,395,307</u>
2016:				
Land	\$ 1,001,525	\$ 532,720	\$ 224,120	\$ 1,758,365
Building and improvements	<u>45,121,334</u>	<u>-</u>	<u>-</u>	<u>45,121,334</u>
	46,122,859	532,720	224,120	46,879,699
Accumulated depreciation and amortization	<u>(21,904,247)</u>	<u>-</u>	<u>-</u>	<u>(21,904,247)</u>
	24,218,612	532,720	224,120	24,975,452
Construction in progress (see Note 8)	<u>-</u>	<u>-</u>	<u>17,674,252</u>	<u>17,674,252</u>
Investment in real estate, net	<u>\$ 24,218,612</u>	<u>\$ 532,720</u>	<u>\$ 17,898,372</u>	<u>\$ 42,649,704</u>

Real estate held for use primarily represents property that the Trust leases to third parties under long-term non-cancelable leases (see Note 7).

Real estate held for sale consists of the Trust's interest in the land under four condominium properties.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 2. Investments (continued)

### b. Other Investments (continued)

For the year ended December 31, 2017, the Trust received proceeds of approximately \$13,848,000 and recognized a gain of approximately \$13,751,000 related to the sale of its interest in the land under certain condominiums and properties. For the year ended December 31, 2016, the Trust did not sell any of its interests in the land under the condominiums.

Real estate held for development includes land acquisition costs, initial planning costs and capitalized interest related to various parcels of land in Kona. For the years ended December 31, 2017 and 2016, the Trust capitalized approximately \$343,000 and \$390,000 of interest costs, respectively.

## 3. Property and Equipment

Property and equipment at December 31, 2017 and 2016 consisted of the following:

	<u>2017</u>	<u>2016</u>
Land	\$ 15,512,589	\$ 8,693,589
Building and improvements	43,122,445	40,541,785
Furniture, fixtures and equipment	<u>6,570,481</u>	<u>6,086,848</u>
	65,205,515	55,322,222
Accumulated depreciation and amortization	<u>(23,534,299)</u>	<u>(21,581,966)</u>
	41,671,216	33,740,256
Construction in progress (see Note 8)	<u>2,173,908</u>	<u>2,461,407</u>
Property and equipment, net	<u><u>\$ 43,845,124</u></u>	<u><u>\$ 36,201,663</u></u>

For the years ended December 31, 2017 and 2016, the Trust capitalized approximately \$54,000 and \$18,000 of interest costs, respectively.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 4. Fair Value Measurements

US GAAP establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under US GAAP are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Trust has the ability to access.

Level 2: Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Trust's investments are recorded at fair value as follows:

*Mutual funds* are stated at fair value using quoted market prices. Shares of mutual funds are valued at the net asset value of shares held by the Trust at the reporting date on a recurring basis.

*Equity securities* are stated at fair value using quoted market prices.

*U.S. treasuries* are stated at fair value using quoted market prices.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

There have been no changes in the methodologies used at December 31, 2017 and 2016.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

### 4. Fair Value Measurements (continued)

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

The following table sets forth the Trust's investments by type of fund based on Level 1 inputs as of December 31, 2017 and 2016:

	2017	2016
Mutual funds:		
Large blend	\$ 9,850,784	\$ 10,229,777
Foreign large blend	9,228,508	13,096,063
Foreign small/mid value	8,283,272	7,064,700
Large growth	6,517,053	4,836,734
Money market funds	6,447,681	4,866,405
Precious metals	2,354,561	2,069,946
Diversified emerging markets	1,462,810	5,433,094
Total mutual funds	44,144,669	47,596,719
Equity securities:		
Consumer goods	7,606,317	5,720,699
Financial	1,992,458	1,770,626
Services	1,077,683	837,187
Industrial goods	324,929	286,881
Consumer entertainment	230,288	198,519
Other	-	115,746
Total equity securities	11,231,675	8,929,658
U.S. treasuries	10,140,292	10,031,998
Other	150,353	86,953
Total investments at fair value	\$ 65,666,989	\$ 66,645,328

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 4. Fair Value Measurements (continued)

The Trust's other financial instruments include cash and cash equivalents, receivables, prepaid expense and other assets, accounts payable and other accrued liabilities. The carrying amounts of these assets and liabilities approximate fair value because of the short-term nature of these instruments.

As of December 31, 2017 and 2016, the fair value of investments in limited partnerships was approximately \$159,610,000 and \$129,658,000, respectively. Fair values are based on information provided by the respective investment manager at the most recent valuation date. The Trust utilized the net asset value per share as a practical expedient for the estimation of the fair value of these investments (see Note 2). Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investment existed.

As of December 31, 2017 and 2016, the fair value of investment in real estate was approximately \$563,174,000 and \$568,530,000, respectively, and included land, buildings and improvements, net of accumulated depreciation and construction in progress (see Note 2). The fair value of land is based on the appraised value as of January 1, 2015 and is further adjusted for any purchases or sales subsequent to the appraisal date. The fair value of buildings and improvement are estimated at acquisition cost, net of depreciation. The fair value of construction in progress is estimated at cost. Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investment existed.

As of December 31, 2017 and 2016, the carrying amount of notes payable was approximately \$11,494,000 and \$11,821,000, respectively, which approximates fair value as the interest rate is commensurate with interest rates currently offered by lending institutions for loans of similar terms to companies with comparable credit risk.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 5. Employee Benefit Plans

### a. 401(k) Plan

In 2005, the Trust established a defined contribution plan qualifying under Section 401(k) of the Internal Revenue Code, covering all regular employees who have six months of service and are age 21 or older. Employees may contribute up to 75 percent of included compensation, as defined in the defined contribution plan. The Trust matched 100 percent of employee contributions up to the first 4 percent of included compensation, plus 50 percent of employee contributions up to the next 2 percent of included compensation. Effective January 1, 2018, the Trust matched 100 percent of employee contribution for the first 5 percent of included compensation, plus 50 percent of employee contribution up the next 2 percent of included contribution.

Expenses related to the 401(k) plan totaled approximately \$509,300 and \$504,900 for the years ended December 31, 2017 and 2016, respectively.

### b. 457(b) Plan

Effective September 2013, the Trust established a non-qualified deferred compensation plan called the Queen Lili'uokalani Trust 457(b) Plan, covering a select group of eligible employees and independent contractors of the Trust. Participants can defer a portion of their compensation up to the IRS limit and have the funds invested tax deferred.

Expenses related to the 457(b) plan totaled approximately \$2,500 and \$3,700 for the years ended December 31, 2017 and 2016, respectively.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

### 5. Employee Benefit Plans (continued)

#### c. Postretirement Benefit Plan (continued)

The Trust provides postretirement health benefits to eligible employees based on age and years of service. The plan covers the cost of medical plan coverage subject to a set monthly maximum.

The changes in the obligations and assets of the Trust's postretirement benefit plan and the changes in unrestricted net assets for 2017 and 2016, and the funded status of this plan and amounts related to this plan reflected in the Trust's statements of financial position were as follows:

	<u>2017</u>	<u>2016</u>
Benefit obligation, beginning of year	\$ 1,258,915	\$ 1,383,030
Service cost	46,123	52,299
Interest cost	51,001	60,368
Plan amendments	50,853	-
Actuarial loss (gain)	18,933	(215,155)
Benefits paid	<u>(23,808)</u>	<u>(21,627)</u>
Benefit obligation, end of year	<u>1,402,017</u>	<u>1,258,915</u>
Fair value of plan assets, beginning of year		
Employer contribution	23,808	21,627
Benefits paid	<u>(23,808)</u>	<u>(21,627)</u>
Fair value of plan assets, end of year	<u>-</u>	<u>-</u>
Accrued postretirement benefit liability	<u>\$ (1,402,017)</u>	<u>\$ (1,258,915)</u>
Change in net periodic benefit cost not yet recognized:		
Beginning of year	\$ 669,831	\$ 483,084
Current year	<u>(115,007)</u>	<u>186,747</u>
Current net periodic benefit cost not yet recognized	<u>\$ 554,824</u>	<u>\$ 669,831</u>



## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

### 5. Employee Benefit Plans (continued)

#### c. Postretirement Benefit Plan (continued)

The components of net periodic benefit cost were as follows:

	2017	2016
Service cost	\$ 46,123	\$ 52,299
Interest cost	51,001	60,368
Amortization of unrecognized net transition obligation	(45,222)	(28,408)
Net periodic benefit cost	<u>\$ 51,902</u>	<u>\$ 84,259</u>

The prior service costs that will be amortized into net periodic benefit cost in 2018 are approximately \$37,000.

The following assumptions were used in accounting for the plans at December 31:

	2017	2016
Benefit obligation:		
Discount rate	3.69%	4.12%
Expected long-term rate of return on plan assets	n/a	n/a
Health care trend rates	6.75% - 5%	7% - 5%
Year of ultimate trend	2025	2025
Net periodic benefit cost (years ended):		
Discount rate	4.12%	4.44%
Expected long-term rate of return on plan assets	n/a	n/a
Health care trend rates	7% - 5%	7.25% - 5%
Year of ultimate trend	2025	2025

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 5. Employee Benefit Plans (continued)

### c. Postretirement Benefit Plan (continued)

The following estimated future postretirement benefit payments, which reflect expected future service are expected to be paid in the years indicated:

Years ending December 31,	
2018	\$ 44,059
2019	51,006
2020	61,554
2021	66,523
2022	77,568
2023 – 2027	432,233

The Trust expects to contribute approximately \$44,000 to its postretirement benefit plan in 2018.

Assumed health care cost trend rates could have a significant effect on the amounts reported for the post-retirement medical plan. A one percentage point change in assumed health care cost trend rates would have the following effects:

	<u>1% increase</u>	<u>1% decrease</u>
Post-retirement benefit obligation	\$ 64,149	\$ (53,670)
Total service and interest cost	7,419	(6,078)

## 6. Notes Payable

In 2004, the Trust entered into a commercial term loan agreement with a bank in the original amount of \$1,300,000 to finance the purchase of its main office space and related improvements. In 2012, the Trust amended the loan agreement to extend and amend the terms of the loan. The loan interest rate decreased from 5.31 percent to 3.23 percent and the required monthly principal and interest payments decreased from \$7,836 to \$5,178. The maturity date of the loan was extended to July 1, 2022. There was a balance of approximately \$897,000 and \$929,000 outstanding on the loan at December 31, 2017, and 2016, respectively.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

## 6. Notes Payable (continued)

In 2012, the Trust entered into a \$5,000,000 commercial term loan agreement with the aforementioned bank to fund the construction of its Waianae Coast Children's Center, which was completed in 2012. The loan matures on July 1, 2022, bears interest at 3.23 percent and requires the Trust to make monthly principal and interest payments of \$24,314. There was a balance of approximately \$4,232,000 and \$4,385,000 outstanding on the loan at December 31, 2017, and 2016, respectively.

In 2013, the Trust entered into a commercial term loan agreement with the aforementioned bank in the amount of \$1,210,000 to retire the remaining balance on an original 2008 loan used to finance the purchase of the Wili Pa Loop property and related improvements for the Maui Children's Center. The loan matures on November 8, 2023, bears interest at 4.10 percent and requires the Trust to make monthly principal and interest payments of \$6,455. At December 31, 2017 and 2016, the loans had outstanding balances of approximately \$1,085,000 and \$1,118,000, respectively.

On December 4, 2015, the Trust entered into a \$5,500,000 commercial term loan agreement with the aforementioned bank to finance the acquisition of its Kapolei Children's Center. The loan matures on December 8, 2025, bears interest at 3.45 percent and requires the Trust to make monthly principal and interest payments of \$24,544. There was a balance of approximately \$5,280,000 and \$5,390,000 outstanding on the loan at December 31, 2017 and 2016, respectively.

The Trust also has a line of credit with the aforementioned bank in the amount of \$2,500,000. The line of credit bears interest at a variable interest rate and is subject to the Trust's choice of the bank's one-, three- or six-month London Inter-Bank Offer Rates (LIBOR) plus 0.75 percent or the bank's base rate minus a margin of 0.75 percent with a minimum interest rate not less than 1.75 percent, and expires in October 2018. As of December 31, 2017 and 2016, there were no outstanding draws on the line of credit.

All loans, including any outstanding line of credit draws, are secured by approximately \$19 million of marketable securities, and also require the Trust to maintain certain financial covenants related to its loan to value ratio, as defined in the loan agreements. The Trust was in compliance with these requirements as of December 31, 2017.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2017 and 2016

### 6. Notes Payable (continued)

The approximate annual principal payments on notes payable at December 31, 2017 were as follows:

For the years ending	
December 31,	
2018	\$ 339,000
2019	351,000
2020	362,000
2021	375,000
2022	4,495,000
Thereafter	<u>5,572,000</u>
	<u>\$ 11,494,000</u>

### 7. Leases As Lessor

Land held by the Trust as investment property is leased or available for lease under operating lease arrangements which expire through 2089.

Future minimum rental revenues under long-term non-cancelable operating leases as of December 31, 2017 were approximately as follows:

For the years ending	
December 31,	
2018	\$ 21,929,000
2019	21,967,000
2020	21,763,000
2021	21,571,000
2022	21,346,000
Thereafter	<u>867,806,000</u>
Total	<u>\$ 976,382,000</u>

The Trust receives percentage rentals (based on lessees' gross receipts, as defined) on certain of its properties. Percentage rent revenues earned for the years ended December 31, 2017 and 2016, amounted to approximately \$3,392,000 and \$3,401,000, respectively.

# **Lili'uokalani Trust**

Notes to Financial Statements  
December 31, 2017 and 2016

## **8. Commitments**

The Trust entered into contracts with various third parties related to its development projects and construction in progress. At December 31, 2017, these contracts totaled approximately \$12,489,000, of which the Trust had incurred approximately \$8,215,000 as of December 31, 2017.

In October 2012, the Trust executed a promissory note agreement in the amount of \$1,490,235 with a government agency to secure the Trust's commitment to fund its estimated share of costs under a water resource development agreement. The promissory note requires the Trust to pay the full amount of the promissory note within forty five days of receiving supporting evidence of the cost incurred. The note does not bear interest and is secured by approximately \$2,600,000 of marketable securities, as defined in the agreement. As of December 31, 2017, no claim was requested related to the promissory note.

## **Supplementary Information**

## Lili'uokalani Trust

Supplemental Schedule of Land  
December 31, 2017

	<b>Cost Basis</b>	<b>Appraisal Basis (Unaudited)</b>
Investment Land:		
Oahu:		
Waikiki	\$ 1,033,119	\$ 356,282,401
Other Oahu	229,530	9,895,400
Hawaii:		
Kona:		
Developed	49,331	84,584,450
Undeveloped	224,120	61,822,250
Leased for agriculture	112,877	2,450,800
Other Hawaii	1	5,392,800
Total investment land	<u>1,648,978</u>	<u>520,428,101</u>
Land Used for Tax Exempt Purposes --		
Kipuka (program office):		
Hilo	302,816	580,000
Honolulu*	6,819,000	6,819,000
Kona	1	377,300
Kaneohe	703,316	670,000
Kapalama	217,160	2,880,000
Kauai	966,857	780,000
Kapolei*	5,105,614	5,105,614
Maui	883,190	930,000
Punaluu	1	3,638,400
Waianae	514,634	630,000
Total land used for tax exempt purposes	<u>15,512,589</u>	<u>22,410,314</u>
Total land	<u>\$ 17,161,567</u>	<u>\$ 542,838,415</u>

Note: The supplemental "appraisal basis" value of land is stated primarily at the estimated market value on January 1, 2015 as appraised by John Child & Company, in its report dated November 12, 2015. For land sales that were not given a separate tax map key in the appraisal, their appraisal value has been removed in proportion to their cost basis.

\*The Kapolei and Honolulu kipuka were not included in the appraisal described in the note above as the purchases were made in December 2015 and December 2017, respectively. As such, the "appraisal basis" value is based on the purchase price.

See accompanying independent auditor's report.