

Exploratorium

Consolidated Financial Report
June 30, 2016

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RSM US LLP

Independent Auditor's Report

To the Board of Directors
Exploratorium
San Francisco, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the Exploratorium, which comprise the consolidated statements of financial position as of June 30, 2016 and 2015; the related consolidated statements of activities and cash flows for the years then ended; and the related notes to the consolidated financial statements (collectively, 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 the Exploratorium as of June 30, 2016 and 2015, 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 Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 7, 2016 on our consideration of the Exploratorium's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Exploratorium's internal control over financial reporting and compliance.

RSM US LLP

San Francisco, California
October 7, 2016

Exploratorium

Consolidated Statements of Financial Position June 30, 2016 and 2015

	2016	2015
Assets		
Cash and cash equivalents	\$ 1,228,208	\$ 2,797,928
Restricted cash	1,145,817	2,318,737
Contributions receivable, net (Note 2)	1,784,132	808,496
Government receivables	729,375	1,143,414
Accounts receivable	2,288,297	3,243,633
Inventory	1,137,696	1,090,540
Other assets and prepaid expenses	1,992,381	1,451,753
Investments, at fair value (Note 4)	27,242,066	27,081,533
Contributions receivable from Capital Campaign, net (Note 2)	16,410,140	20,242,884
Exhibits, leasehold improvements and equipment (Note 3)	195,621,933	200,545,478
Construction in progress, exhibits	499,295	463,628
Deferred rent (Note 8)	4,513,796	5,110,370
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Total assets	\$ 254,593,136	\$ 266,298,394
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Liabilities and Net Assets		
Line of credit	\$ 1,719,484	\$ -
Trade payables	678,823	743,450
Other accrued expenses	4,761,288	4,457,554
Deferred revenue	5,815,880	6,235,438
Historic tax credit obligation (Note 10)	44,192,544	44,192,544
Term debt, net (Note 7)	49,440,480	55,714,255
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Total liabilities	106,608,499	111,343,241
	<hr/>	<hr/>
Net assets:		
Unrestricted	118,808,220	126,327,633
Temporarily restricted (Note 5)	4,120,022	6,571,125
Permanently restricted (Note 5)	25,056,395	22,056,395
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Total net assets	147,984,637	154,955,153
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Total liabilities and net assets	\$ 254,593,136	\$ 266,298,394
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See notes to consolidated financial statements.

Exploratorium

Consolidated Statements of Activities Years Ended June 30, 2016 and 2015

	2016			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Operating revenue and support:				
Private contributions	\$ 5,443,322	\$ 8,136,176	\$ 3,000,000	\$ 16,579,498
Government grants	5,246,838	-	-	5,246,838
Global Studios—domestic	2,654,325	-	-	2,654,325
Global Studios—foreign	2,709,350	-	-	2,709,350
Admissions	9,571,212	-	-	9,571,212
Membership	2,469,386	-	-	2,469,386
Rentals and other revenue	6,248,331	-	-	6,248,331
Store sales	2,208,181	-	-	2,208,181
Net assets released from restrictions	9,630,256	(9,630,256)	-	-
Total revenues and support	46,181,201	(1,494,080)	3,000,000	47,687,121
Operating expenses:				
Program services:				
Visitor, learner and educator programs	33,678,391	-	-	33,678,391
Global Studios	10,759,217	-	-	10,759,217
Admissions and other	1,593,747	-	-	1,593,747
Store expenses	1,460,078	-	-	1,460,078
Support services:				
General and administrative	4,510,815	-	-	4,510,815
Fundraising and membership	3,992,168	-	-	3,992,168
Total operating expenses	55,994,416	-	-	55,994,416
Change in net assets from operating activities	(9,813,215)	(1,494,080)	3,000,000	(8,307,295)
Capital revenue:				
Private campaign contributions	-	5,428,501	-	5,428,501
Net assets released from restrictions	5,428,501	(5,428,501)	-	-
Total nonoperating revenues	5,428,501	-	-	5,428,501
Financing expense:				
Term loan interest expense	1,862,189	-	-	1,862,189
Historic Tax Credit (HTC) interest expense	885,062	-	-	885,062
Total nonoperating expenses	2,747,251	-	-	2,747,251
Investment activity:				
Investment income	488,733	-	-	488,733
Net realized and unrealized loss	(876,181)	(957,023)	-	(1,833,204)
Total investment activity	(387,448)	(957,023)	-	(1,344,471)
Change in net assets	(7,519,413)	(2,451,103)	3,000,000	(6,970,516)
Net assets, beginning of year	126,327,633	6,571,125	22,056,395	154,955,153
Net assets, end of year	\$ 118,808,220	\$ 4,120,022	\$ 25,056,395	\$ 147,984,637

(Continued)

Exploratorium

Consolidated Statements of Activities (Continued) Years Ended June 30, 2016 and 2015

	2015			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Operating revenue and support:				
Private contributions	\$ 6,406,762	\$ 5,375,748	\$ 400,000	\$ 12,182,510
Government grants	6,818,627	-	-	6,818,627
Global Studios—domestic	4,447,164	-	-	4,447,164
Global Studios—foreign	3,685,112	-	-	3,685,112
Admissions	9,798,190	-	-	9,798,190
Membership	3,150,747	-	-	3,150,747
Rentals and other revenue	7,538,702	-	-	7,538,702
Store sales	2,301,492	-	-	2,301,492
Net assets released from restrictions	10,622,625	(10,622,625)	-	-
Total revenues and support	54,769,421	(5,246,877)	400,000	49,922,544
Operating expenses:				
Program services:				
Visitor, learner and educator programs	34,924,081	-	-	34,924,081
Global Studios	9,389,139	-	-	9,389,139
Admissions and other	2,689,153	-	-	2,689,153
Store expenses	2,296,205	-	-	2,296,205
Support services:				
General and administrative	5,625,843	-	-	5,625,843
Fundraising and membership	4,655,388	-	-	4,655,388
Total operating expenses	59,579,809	-	-	59,579,809
Change in net assets from operating activities	(4,810,388)	(5,246,877)	400,000	(9,657,265)
Capital revenue:				
Private campaign contributions	-	9,768,857	-	9,768,857
Net assets released from restrictions	9,768,857	(9,768,857)	-	-
Total nonoperating revenues	9,768,857	-	-	9,768,857
Financing expense:				
Term loan interest expense	2,203,808	-	-	2,203,808
HTC interest expense	883,965	-	-	883,965
Total nonoperating expenses	3,087,773	-	-	3,087,773
Investment activity:				
Investment income	709,972	-	-	709,972
Net realized and unrealized gains	(717,188)	(82,664)	-	(799,852)
Total investment activity	(7,216)	(82,664)	-	(89,880)
Change in net assets	1,863,480	(5,329,541)	400,000	(3,066,061)
Net assets beginning of year	124,464,153	11,900,666	21,656,395	158,021,214
Net assets end of year	\$ 126,327,633	\$ 6,571,125	\$ 22,056,395	\$ 154,955,153

See notes to consolidated financial statements.

Exploratorium

Consolidated Statements of Cash Flows Years Ended June 30, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Change in net assets	\$ (6,970,516)	\$ (3,066,061)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,030,256	5,901,103
Amortization of financing costs	173,020	173,020
Change in allowance for uncollectible accounts	(1,010)	(127,662)
Change in discount on long-term contributions receivable	(672,807)	(895,795)
Net realized and unrealized loss on investments	1,833,204	799,852
Donated securities	(697,823)	(2,135,686)
Proceeds from sale of donated securities	697,823	2,135,686
Loss on disposal of property and equipment	46,954	17,932
Contributions restricted for investment in museum improvements	(831,993)	(10,916,559)
Changes in assets and liabilities:		
Restricted cash	1,172,920	(2,318,737)
Receivables	375,930	402,555
Inventory	(47,156)	137,388
Other assets and prepaid expenses	(540,628)	740,756
Deferred rent	596,575	299,091
Trade payables and accrued expenses	239,107	391,020
Deferred revenue	(419,558)	593,602
Net cash provided by (used in) operating activities	984,298	(7,868,495)
Cash flows from investing activities:		
Capital expenditures	(1,189,333)	(1,851,446)
Proceeds from sale of fixed assets	-	94,500
Proceeds from sales of investments	20,010,282	10,224,751
Purchases of investments	(22,004,019)	(9,840,376)
Net cash used in investing activities	(3,183,070)	(1,372,571)
Cash flows from financing activities:		
Proceeds from contributions restricted for investment in endowment and museum improvements	5,356,362	16,446,111
Net borrowings on line of credit	1,719,484	-
Payments made on term loan	(6,446,794)	(11,002,003)
Net cash provided by financing activities	629,052	5,444,108

(Continued)

Exploratorium

Consolidated Statements of Cash Flows (Continued) Years Ended June 30, 2016 and 2015

	2016	2015
Net decrease in cash and cash equivalents	\$ (1,569,720)	\$ (3,796,958)
Cash and cash equivalents, beginning of year	<u>2,797,928</u>	<u>6,594,886</u>
Cash and cash equivalents, end of year	<u>\$ 1,228,208</u>	<u>\$ 2,797,928</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest during the year	<u>\$ 2,837,540</u>	<u>\$ 3,095,288</u>

See notes to consolidated financial statements.

Exploratorium

Notes to Consolidated Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies

Nature of organization: The Exploratorium, a California nonprofit organization, is a museum of science, art, and human perception located in San Francisco, California. The Exploratorium creates tools and experiences that help visitors to become active explorers. Some of the tools used include: hundreds of "explore-for-yourself" exhibits; a website with several thousand pages of content; film screenings; workshops for lifelong learners, including day camps for children and family investigations; and evening art and science events for adults. Professional development programs have been and are being created for educators, and are at the forefront of changing the way science is taught. Exhibits created and expertise learned are shared with museums worldwide.

A summary of the Exploratorium's significant accounting policies is as follows:

Principles of consolidation: The accompanying consolidated financial statements include the financial statements of the Exploratorium and Exploratorium Master Holdings, Inc. (Holdings), its wholly owned subsidiary. Exploratorium Solar LLC (Solar), Exploratorium Master Tenant LLC (EMTLLC), and Exploratorium Project LLC (EPLLC) are consolidated into Holdings. As further discussed in Note 10, Holdings and its related entities were created during the year ended June 30, 2011 as vehicles to assist the Exploratorium to partially finance the construction of its new facilities. Inter-organizational transactions and balances have been eliminated in the consolidation.

Basis of presentation: The Exploratorium's consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) on the basis of unrestricted, temporarily restricted, and permanently restricted net assets and under the accrual basis of accounting.

Unrestricted net assets: Unrestricted net assets are not subject to donor-imposed restrictions and include the carrying value of all physical properties (leasehold improvements and furniture and equipment). Items that affect (i.e., increase or decrease) this net asset category include: revenue, principally fees for admission, membership and educational programs, and related expenses associated with the core activities of the Exploratorium. In addition to these exchange transactions, changes in this category of net assets include certain types of philanthropic support, namely, unrestricted contributions, as well as restricted contributions whose donor-imposed restrictions were met during the fiscal year and investment income.

Temporarily restricted net assets: Temporarily restricted net assets represent contributions and other assets received from donors that are limited in use by the Exploratorium in accordance with temporary donor-imposed stipulations. Items that affect this net asset category are restricted contributions, including unconditional pledges, and investment income with donor-imposed restrictions from permanently restricted net assets. These stipulations may expire with time or may be satisfied and removed by the actions of the Exploratorium according to the terms of the contribution. Upon satisfaction of such stipulations, net assets are released from temporarily restricted net assets and recognized as unrestricted net assets.

Permanently restricted net assets: Permanently restricted net assets represent unconditional promises to give by a donor that specifies that the assets donated be maintained permanently, and be invested to provide a permanent source of income. Permanently restricted gifts (endowments) are managed according to the Uniform Prudent Management of Institutional Funds Act (UPMIFA) of the state of California. If the donor does not restrict the allowed use of the income, the Exploratorium classifies income as temporarily restricted net assets until those amounts are appropriated for expenditure by the Exploratorium in a manner consistent with the standard of prudence prescribed by UPMIFA.

Exploratorium

Notes to Consolidated Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

Cash and cash equivalents: Cash and cash equivalents represent cash and short-term investments with original maturities of 90 days or less at purchase, which are not considered investments.

Restricted cash: Restricted cash consists of amounts held in escrow for future rental income from the subtenant occupying a portion of Pier 17.

Accounts and government receivables—non-contribution: The Exploratorium evaluates the collectability of its non-contribution receivables on an ongoing basis and records a provision for potential uncollectible receivables when appropriate. At June 30, 2016 and 2015, the Exploratorium has determined that all non-contribution receivables are fully collectible, and therefore, has not recorded an allowance for doubtful accounts.

Contributions receivable: As of June 30, 2016 and 2015, contributions receivable consist of grants and pledges from either grantmaking foundations or donors and relate substantially to the Exploratorium's capital campaign (see Note 10). As further described in Note 2, these receivables are subject to discount.

Inventory: Inventory, which consists mostly of items available for sale at the museum stores, is stated at the lower of average cost or market (on the first-in, first-out basis).

Exhibits, leasehold improvements and equipment: Upon determination that an exhibit is viable, the Exploratorium capitalizes the costs of construction, which generally include materials and labor. Depreciation is provided on the straight-line method over an estimated useful life of 10 years.

Equipment is recorded at cost or, if donated, at fair value on the date of donation. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets, which range from three to ten years. Leasehold improvements at the Exploratorium's current location have been amortized on a straight-line basis over the shorter of their useful lives or the remaining period of the original lease ranging from 10 years to 64 years.

Fair value of financial instruments: The carrying amounts of the Exploratorium's following financial instruments: contributions and accounts receivable, accounts payable and other accrued expenses, approximate their fair value due to their short maturities. Based on borrowing rates currently estimated to be available to the Exploratorium's donors being consistent with discount rates used historically, long-term contributions receivable also approximate fair value. Investments are reflected at fair value in the consolidated statements of financial position. The carrying value of the term debt approximates fair value based on the timing of the Exploratorium entering into a new debt facility with a new banking consortium, and that it would still be priced similarly in the open market as the market hasn't changed significantly. The carrying value of the line of credit approximates fair value as its interest rate adjusts to changing market conditions. The carrying value of the Historic Tax Credit (HTC) obligation approximates fair value as it equates to the carrying value of the investor's equity interest.

Exploratorium

Notes to Consolidated Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

Fair value measurements: Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value should be based on the assumptions market participants would use when pricing an asset or liability and a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets (observable inputs) and the lowest priority to the Exploratorium's assumptions (unobservable inputs). The Exploratorium groups assets and liabilities at fair value in three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuations are based on quoted prices in active markets for identical assets or liabilities that the Exploratorium has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments.

Level 2: Valuations are not based on quoted prices for identical assets or liabilities, but rather are based on significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, etc.). Fair values are primarily obtained from third-party pricing services for comparable assets or liabilities.

Level 3: Valuations are derived from other valuation methodologies and incorporate certain assumptions and projections that are not observable in the market and significant professional judgment in determining the fair value assigned to such assets or liabilities. Management's estimate of the fair value of the alternative investments in hedge funds and private equity investment partnerships is based on information provided by the fund managers, which in turn is based on the most recent information available to the fund manager for the underlying investments.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

For the fiscal year ended June 30, 2016, the application of valuation techniques applied to similar assets has been consistent. The Exploratorium assesses levels of the investments at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer. For the years ended June 30, 2016 and 2015, there were no such instances.

The fair value of money market funds is based on quoted market prices. Investments in equity instruments and mutual funds traded on national securities exchanges are stated at the last reported sales price on the day of valuation. These financial instruments are classified as Level 1 in the fair value hierarchy.

Investments in fixed income and equity instruments for which quotations are not readily available are valued using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. To the extent the inputs used in the pricing models are observable and timely, these financial instruments are classified as Level 2 in the fair value hierarchy; otherwise, they would be categorized as Level 3.

Exploratorium

Notes to Consolidated Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

Investments in alternative investment funds are valued at fair value based on the applicable ownership of the funds' net asset value (NAV) or equivalent as of the measurement date as a practical expedient, as determined by the Exploratorium, in instances where there is not a readily determinable fair value. In determining fair value, the Exploratorium utilizes valuations provided by the investment funds. The investment funds value securities and other financial instruments on a fair value basis of accounting. The estimated fair values of certain investments of the funds, which may include private placements and other securities for which prices are not readily available, are determined by the managers of the investment funds, which in turn is based on the most recent information available to the fund manager for the underlying investments, including the audited financial statements of the underlying funds, and may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments. The fair value of the Exploratorium's investments in funds generally represents the amount the Exploratorium would expect to receive if it were to liquidate its investments in funds excluding any redemption charges that may apply.

The Exploratorium reviews its investment to identify those for which market value is below cost. The Exploratorium then makes a determination as to whether an investment should be considered other-than-temporarily impaired based on guidelines established by the Financial Accounting Standards Board (FASB). There were no other-than-temporary losses recognized during the years ended June 30, 2016 or 2015. If there were losses, these would have been treated as realized losses in the consolidated statements of activities.

The Exploratorium has various processes and controls in place to ensure fair value is reasonably stated. While the Exploratorium 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 estimate of fair value at the reporting date.

Investments: Investments are stated at fair value and are recorded on the trade or contract date. The fair value of investments is based on quoted market prices, except for alternative investments for which quoted market prices are not available. The fair value of alternative investments consisting of hedge funds, fixed income and private equity investment partnerships (collectively, the funds) is based on the applicable ownership of the funds' net assets or equivalent as of the measurement date, as determined by the Exploratorium. The difference between cost and fair value of investments is reflected as unrealized appreciation (depreciation) on investments, and any change in that amount from the prior year is reported as a component of investment return in the consolidated statements of activities.

Deferred rent: As further described in Note 8, the Exploratorium recognizes rent expense on a straight-line method over the term of its lease with the Port of San Francisco. In addition to the monthly lease payments, the Exploratorium is obligated under the lease agreement to pay for certain costs associated with the lease. These costs have been considered minimum lease payments and, as a result, have been included in the straight-line rent computation.

The Exploratorium uses the same methodology for its Sublease on Pier 17. Rental revenue has been recognized on a straight-line basis over the term of the Sublease. Initial direct costs of approximately \$750,000 associated with the Sublease have been included in the straight-line rent computation. Deferred rent from the above lease with the Port of San Francisco, along with the newly acquired Sublease, has been combined in the deferred rent line item in the consolidated statement of financial position.

Exploratorium

Notes to Consolidated Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

Contributions: Contributions are recognized at fair value as revenue when received or unconditionally promised. An additional discount is added to the present value of contributions, which represents an additional factor in the fair value measurements and are based on management's estimates. Amortization of the discount is included in contributed income. Gifts of cash and other assets are reported as restricted support if received with donor stipulations that limit the use, either for time and/or purpose, of the donated assets. Donor-restricted contributions, whose restrictions are met in the same reporting period as the contribution is recorded, are reported as temporarily restricted contributions with a corresponding release of restrictions. Conditional promises to give are not recognized as revenue until the donor conditions are substantially met. The Exploratorium also receives corporate sponsorships, where revenue is recognized as both an exchange transaction and a contribution. In these cases, the Exploratorium determines the value or benefit the sponsor is receiving, and records that portion to earned revenue, with the remaining portion recorded as a contribution. If multiple deliverables span a period of years, then portions of the exchange transaction could be recorded as deferred revenue until the benefit takes place.

The Exploratorium has been conducting a multi-year, multipurpose capital campaign (the Campaign) for the purpose of the construction of its site located on the San Francisco Waterfront (i.e., the San Francisco Historic Port District) (see Note 10). The Campaign has been designed not only to encompass the renovation and construction of the new facility, but also the design and creation of the exhibits housed at the facility, new program content and an increase in the Exploratorium's endowment. Campaign contributions without a specific purpose restriction are expendable on both capitalizable and non-capitalizable expenditures, including debt repayment.

Pursuant to Board policy, contributions received from donors through the Campaign are released once costs are incurred; however, to the extent costs are capitalized as either construction in progress (leasehold improvements) or exhibit costs in progress, such donations are maintained in temporarily restricted net assets through the completion of the construction phase. The Exploratorium has ongoing exhibit construction as a regular part of its activities. Contributions receivable from the Capital Campaign, as shown in the consolidated statement of financial position, were released once the new facility was placed into service.

Revenue recognition: The Exploratorium recognizes revenues from store sales upon sale of the merchandise.

Admission revenues are recognized upon sale of admission tickets unless purchased in advance of use, in which case revenue is deferred until use.

Revenue from Global Studios is recorded using the percentage-of-completion method for exhibits built for sale. Revenue is recognized pro rata over the term of the lease agreement for rental fleet exhibits. Revenue from government grants is recognized as the related services are provided. Payments under such transactions are generally received on a cost-reimbursement basis.

Membership revenues are considered to be part unrestricted contribution and part exchange transaction. The contribution element is recorded in the period received. The exchange element is recorded as deferred revenue when received and recognized as membership revenue over the duration of the membership period.

Deferred revenue: Deferred revenue consists of annual or multi-year memberships, sponsorships, rental revenue and sublease space rental.

Exploratorium

Notes to Consolidated Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

As noted above, membership revenue is deferred and recognized over the duration of the membership period. To the extent that sponsorships contain earned revenue components as result of specific events etc., those are deferred until the events take place or the benefits are no longer available to the sponsor. Rental revenue that is paid in advance is considered deferred until it becomes earned.

The Exploratorium's Sublease on Pier 17 included a prepayment of three years of space rental. This prepayment has been noted in the consolidated statements of financial position as restricted cash, and the equivalent amount has been recorded to deferred revenue and will be recognized monthly as it is earned over the remaining 12 months.

Contribution of services: The Exploratorium has a substantial number of unpaid volunteers performing various functions who contributed over 20,006 hours (unaudited) and 16,300 hours (unaudited) for the years ended June 30, 2016 and 2015, respectively. The value of this contributed time is not reflected in the consolidated financial statements, as it does not meet the criteria for recognition. The Exploratorium also evaluates and records gifts in kind of professional services as necessary.

Income tax status: The Exploratorium has received rulings from the Internal Revenue Service (IRS) and the California Franchise Tax Board granting it exemption from income taxes. The consolidated subsidiaries of the Exploratorium are organized as for-profit entities subject to tax at the subsidiary level. As of June 30, 2016 and 2015, the Exploratorium was not subject to any income tax as a result of its ownership of its subsidiaries.

The Exploratorium files exempt organization returns and, if applicable, unrelated business income tax returns in the U.S. and California jurisdictions. The Exploratorium's tax returns for the years ended June 30, 2012, 2013, 2014 and 2015 are open for potential IRS/California Franchise Tax Board examination. The subsidiaries are required to file corporate or partnership tax returns in the U.S. federal and California jurisdictions. The subsidiary tax returns for the years ended December 31, 2012, 2013, 2014 and 2015 are open for potential IRS/California Franchise Tax Board examination. To date, neither the Exploratorium nor its subsidiaries have been notified by either taxing authority of any pending examination.

The Exploratorium follows the provisions of FASB Accounting Standards Codification (ASC) 740-10, Income Taxes, relating to accounting for uncertain tax positions. Management evaluated the Exploratorium's tax positions and concluded that there were no material uncertainties in income taxes as of June 30, 2016 or 2015. With few exceptions, the Exploratorium is no longer subject to income tax examinations by the U.S., federal, state or local tax authorities for the years before June 30, 2013.

Functional expense allocations: The costs of providing the various programs and other activities have been summarized on a functional basis in the consolidated statements of activities. Expenses that apply to more than one functional category have been allocated between program services and support services based on the time spent on these functions by specific employees as estimated by management. Indirect expenses are allocated based on the overall number of staff in the various functional categories. Certain marketing material costs are allocated based on the percentage of the publication devoted to each functional area. All other costs are charged directly to the appropriate functional category.

Exploratorium

Notes to Consolidated Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

Long-lived assets: The Exploratorium regularly evaluates whether circumstances have occurred that would indicate the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of such assets may not be recoverable. When factors indicate that such assets should be evaluated for possible impairment, the Exploratorium uses an estimate of the undiscounted cash flows over the remaining life of the assets in measuring whether the assets are recoverable. In the opinion of management, no impairment adjustments were required at June 30, 2016 or 2015.

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

Concentrations of risk: The Exploratorium recognizes there are inherent risks associated with publicly and non-publicly traded securities. Risk is managed through rigorous evaluation before an investment is made, quarterly monitoring of valuations and regular communication with investment managers. To address market risk of investments, the Exploratorium maintains a formal investment policy that sets out performance criteria and investment guidelines, and requires review of the investment managers' performances. Investments are managed by investment managers, who have responsibility for investing the funds in various investment alternatives.

The Exploratorium does transact some activities with organizations located outside the United States. For the years ended June 30, 2016 and 2015, revenues from such activities amounted to \$2,709,350 and \$4,447,164, respectively.

In the regular course of business, the Exploratorium may maintain operating cash balances at a bank in excess of federally insured limits. Management does not believe it is exposed to any significant credit risk on uninsured amounts.

Reclassifications: Certain 2015 balances have been reclassified to conform with the 2016 presentation. These reclassifications have no effect on the Exploratorium's consolidated change in net assets or financial position as previously reported.

Newly adopted accounting pronouncements: In May 2015, the FASB issued Accounting Standards Update (ASU) 2015-07, *Fair Value Measurements*. The ASU amends ASC Topic 820. In summary, entities that value certain investments using the practical expedient will no longer have to disclose such investments in the fair value hierarchy under Topic 820. Effective July 1, 2015, the Exploratorium adopted ASU 2015-07, as shown in Note 4, Fair Value Measurements and Investments. Accordingly, as of June 30, 2016 and 2015, investments amounting to \$6,276,581 and \$6,951,942, respectively, for which fair value was measured using NAV as a practical expedient, have not been categorized in the fair value hierarchy.

Exploratorium

Notes to Consolidated Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

In April 2015, the FASB issued ASU 2015-03, *Interest—Imputation of Interest Subtopic 835-30—Simplifying the Presentation of Debt Issuance Costs* (ASU 2015-03), which changes the presentation of debt issuance costs in financial statements. Under ASU 2015-03, an entity presents such costs on the statement of assets and liabilities as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs is reported as interest expense. Effective July 1, 2015, the Exploratorium adopted ASU 2015-03. Upon adoption, the Exploratorium revised its presentation of deferred financing costs from an asset to a liability, which is a direct deduction to the debt on the consolidated statements of financial position. In addition, the Exploratorium retrospectively revised its presentation of deferred financing costs that were previously presented as an asset as of June 30, 2015, which resulted in a decrease to total assets and total liabilities as of June 30, 2016.

Issued but not adopted accounting pronouncements: In May 2014, the FASB issued ASU 2014-09, *Revenue From Contracts With Customers*. The guidance in this ASU supersedes the revenue recognition requirements in Revenue Recognition (Topic 605). Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In May 2016, ASU 2016-12 was issued, which deferred the effective date of ASU 2014-09 for the Exploratorium to fiscal year ending June 30, 2020. The Exploratorium is currently determining how this ASU may impact revenue recognition on contracts with customers, including those through Global Studios and government funding.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The guidance in this ASU supersedes the leasing guidance in Topic 840, *Leases*. Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The Exploratorium is currently determining how this ASU may impact its financial statements.

Note 2. Contributions Receivable

Contributions receivable represent unconditional promises to give by donors. Contributions that are expected to be collected after one year have been discounted at rates between 4 percent and .71 percent in 2016, and at 4 percent in 2015, and are recorded at the present value of their estimated future cash flows. The discounts on these amounts are computed using risk-free rates applicable to the number of years the contribution is expected to remain outstanding.

Exploratorium

Notes to Consolidated Financial Statements

Note 2. Contributions Receivable (Continued)

Contributions receivable are due as follows as of June 30:

	2016	2015
Contributions receivable (other than Capital Campaign):		
Less than one year	\$ 1,578,938	\$ 812,340
One to five years	211,012	166
Discount on receivables due in more than one year	(2,818)	(10)
Allowance for uncollectible contributions	(3,000)	(4,000)
Total	<u>\$ 1,784,132</u>	<u>\$ 808,496</u>
Contributions receivable (Capital Campaign):		
Less than one year	\$ 3,336,087	\$ 5,255,537
One to five years	11,400,000	11,988,909
More than five years	4,000,000	6,000,000
Discount on receivables due in more than one year	(2,313,947)	(2,989,562)
Allowance for uncollectible contributions	(12,000)	(12,000)
Total	<u>\$ 16,410,140</u>	<u>\$ 20,242,884</u>

As of June 30, 2016 and 2015, contributions receivable from one donor represented 84 percent and 75 percent, respectively, of the total contributions receivable amount.

The Exploratorium has received notification from various donors regarding intention to give gifts to be restricted to the Capital Campaign totaling \$4,854,602 as of June 30, 2016. Such amounts will be recorded as revenue when received or upon satisfying any specific conditions, based on the specified payment schedules provided by the donors. Revenue from these gifts is expected to be recorded as follows:

Years ending June 30:	
2017	\$ 2,082,207
2018	1,772,395
2019	-
2020	-
2021	-
Thereafter	1,000,000
	<u>\$ 4,854,602</u>

Exploratorium

Notes to Consolidated Financial Statements

Note 3. Exhibits, Leasehold Improvements and Equipment

EXNET exhibits held for rental consist of the following as of June 30:

	2016	2015
Leasehold improvements, exhibits and equipment as cost, net	\$ 33,191,833	\$ 32,663,806
Less accumulated depreciation	(15,249,513)	(12,868,666)
	<u>17,942,320</u>	<u>19,795,140</u>
Leasehold improvements—Piers, net	189,268,622	189,062,507
Less accumulated depreciation	(11,589,009)	(8,312,169)
	<u>177,679,613</u>	<u>180,750,338</u>
Total	<u>\$ 195,621,933</u>	<u>\$ 200,545,478</u>

Depreciation and amortization expense for exhibits, leasehold improvements and equipment was \$6,030,256 and \$5,901,103 for the years ended June 30, 2016 and 2015, respectively.

Note 4. Fair Value Measurements and Investments

A summary of the Exploratorium's investments measured at fair value on a recurring basis at June 30, and set forth by level within the fair value hierarchy, is as follows:

Description	2016			
	Level 1	Level 2	Level 3	Total
Money market fund	\$ 218,298	\$ -	\$ -	\$ 218,298
Fixed-income securities:				
Domestic	7,500,870	-	-	7,500,870
Equities:				
Domestic	6,494,803	-	-	6,494,803
International	6,751,514	-	-	6,751,514
	<u>20,965,485</u>	-	-	<u>20,965,485</u>
Investments measured at NAV				6,276,581
	<u>\$ 20,965,485</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 27,242,066</u>

Exploratorium

Notes to Consolidated Financial Statements

Note 4. Fair Value Measurements and Investments (Continued)

Description	2015			
	Level 1	Level 2	Level 3	Total
Money market fund	\$ 648,766	\$ -	\$ -	\$ 648,766
Fixed-income securities:				
Domestic	6,734,440	-	-	6,734,440
Equities:				
Domestic	6,544,188	-	-	6,544,188
International	6,202,197	-	-	6,202,197
	20,129,591	-	-	20,129,591
Investments measured at NAV				6,951,942
	<u>\$ 20,129,591</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 27,081,533</u>

Additional information related to the alternative investments is as follows:

	2016				
	Fair Value	Total Commitments	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Hedge fund	\$ 3,594,026	N/A	N/A	Monthly	30 days' notice
Private equity	102,374	\$ 500,000	N/A	N/A	Upon termination (1)
Hedge fund	1,713,753	N/A	N/A	Quarterly	65 days' notice (2)
Fixed income	866,428	N/A	N/A	Quarterly	60 days' notice
	<u>\$ 6,276,581</u>	<u>\$ 500,000</u>	<u>\$ -</u>		

	2015				
	Fair Value	Total Commitments	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Hedge fund	\$ 4,091,907	N/A	N/A	Monthly	30 days' notice
Private equity	274,974	\$ 500,000	N/A	N/A	Upon termination (1)
Hedge fund	1,710,415	N/A	N/A	Quarterly	65 days' notice (2)
Fixed income	874,646	N/A	N/A	Quarterly	60 days' notice
	<u>\$ 6,951,942</u>	<u>\$ 500,000</u>	<u>\$ -</u>		

(1) This class includes one private equity investment fund. The fund is closed ended and does not allow for withdraws or redemptions. Distributions will be received as the fund terminates.

(2) This class includes one fund that allows for a 65-day redemption notice, but restricts redemptions to 25 percent of the original investment each quarter

Exploratorium

Notes to Consolidated Financial Statements

Note 5. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets were restricted for the following purposes as of June 30:

	2016	2015
Program restrictions (purpose and time restrictions)	\$ 3,448,884	\$ 3,912,489
Exhibits and furniture site (time restrictions)	256,225	252,238
Unappropriated endowment earnings	414,913	2,406,398
	<u>\$ 4,120,022</u>	<u>\$ 6,571,125</u>

Net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restriction or by the passage of time during the year ended June 30:

	2016	2015
Campaign operating initiatives (time and purpose restrictions)	\$ 1,067,677	\$ 1,096,528
Capital campaign initiatives (purpose restrictions)	5,428,501	9,768,857
Program restrictions (time and purpose restrictions)	8,562,579	9,526,097
	<u>\$ 15,058,757</u>	<u>\$ 20,391,482</u>

Permanently restricted net assets generate earnings that are either purpose-restricted for various program initiatives by donors, or unrestricted as to purpose as follows as of June 30:

	2016	2015
Permanently restricted net assets generating purpose-restricted investment earnings	\$ 23,226,623	\$ 20,226,623
Permanently restricted net assets generating earnings with no purpose restriction	1,829,772	1,829,772
	<u>\$ 25,056,395</u>	<u>\$ 22,056,395</u>

Temporary program and permanent purpose restrictions primarily consist of gifts that are restricted for programs such as the Teacher's Institute, and Tinkering Studio and the Arts, among others.

Note 6. Endowment

California enacted UPMIFA effective January 1, 2009. As a result, the Exploratorium reviewed all relevant gift instruments and its organizing documents to determine if it had funds with donor-imposed restrictions that are subject to the state-enacted version of UPMIFA. The Exploratorium continues to review all new gift instruments in relationship to the enacted law.

Interpretation of relevant law: The Board of Directors, with the advice of legal counsel, has determined it holds net assets that meet the definition of endowment funds under UPMIFA. As a result of this interpretation, the corpus of funds subject to UPMIFA is classified as permanently restricted. The corpus represents the fair value of the original gifts as of the gift date and all subsequent gifts where the donor has indicated the gift be retained permanently. The assets with a value in excess of original gifts in donor endowment funds are classified as temporarily restricted net assets until appropriated for expenditure by the Exploratorium.

Exploratorium

Notes to Consolidated Financial Statements

Note 6. Endowment (Continued)

From time to time, the fair value of the assets associated with individual donor-restricted endowment funds may fall below the level classified as permanently restricted net assets. At June 30, 2016 and 2015, the Exploratorium had 11 and one endowment fund with deficiencies of this nature totaling \$382,769 and \$47,062, respectively. These deficiencies are reflected in unrestricted net assets.

In accordance with UPMIFA, the Exploratorium considers the following factors in making a determination as to the appropriation of assets for expenditure: (1) the duration and preservation of the fund, (2) the purposes of the organization and the donor-restricted endowment fund, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of the organization, and (7) the investment policies of the Exploratorium.

Investment and spending policies: The Exploratorium has adopted investment and spending policies for endowed assets that attempt to provide a predictable stream of funding for programs supported by its endowment while seeking to maintain the purchasing power of the endowed assets. The investment and spending policies work together to achieve this objective. The investment policy establishes an achievable return objective through diversification of asset classes.

To accomplish the long-term rate of return objectives, the Exploratorium relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Exploratorium targets a diversified asset allocation with an emphasis on equity-based investments, within prudent risk parameters.

The spending policy determines the amount of money to be distributed annually from the Exploratorium's various endowed funds for operational support. The Exploratorium adopted a spending policy to address underwater funds, defined as those funds with balances below historic gift value. The spending rate formula is arrived at using a target rate of 5 percent of a trailing three-year moving average of the market value of the fund, as approved by the Board of Directors. The spending rate is typically 5 percent per fiscal year; however, the Exploratorium's Finance and Investment Committee approved a one-time increase to 7 percent in the 2015 fiscal year. This was done to ensure compliance with the unrestricted net assets covenant, as outlined in Note 7. The total amounts that were appropriated and spent in fiscal years 2016 and 2015 were \$1,083,264 and \$1,359,347, respectively. Appropriations from the endowment are included in net assets released from restrictions on the consolidated statements of activities.

Exploratorium

Notes to Consolidated Financial Statements

Note 6. Endowment (Continued)

For the years ended June 30, the Exploratorium's endowment net assets changed as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, June 30, 2014	\$ (41,174)	\$ 3,841,605	\$ 21,656,395	\$ 25,456,826
Investment return:				
Investment income	47,428	603,008	-	650,436
Net gains	(53,316)	(678,868)	-	(732,184)
Appropriations	-	(1,359,347)	-	(1,359,347)
Additions	-	-	400,000	400,000
Endowment net assets, June 30, 2015	(47,062)	2,406,398	22,056,395	24,415,731
Investment return:				
Investment income	213,350	237,732	-	451,082
Net losses	(549,056)	(1,145,953)	-	(1,695,009)
Appropriations	-	(1,083,264)	-	(1,083,264)
Additions	-	-	3,000,000	3,000,000
Endowment net assets, June 30, 2016	\$ (382,768)	\$ 414,913	\$ 25,056,395	\$ 25,088,540

Note 7. Debt Obligations

Long-term debt: Effective November 19, 2013, the Exploratorium entered into a debt facility with a banking consortium. The terms of the new facility are as follows:

- Total aggregate indebtedness—\$85,000,000. Each of the three banks involved has an equal share of debt exposure (\$28,333,334).
- Principal and interest payments:
 - Semi-annual interest payments are due on December 31 and June 30 each year. Interest is payable at a fixed rate of 3.451 percent.
 - Annual principal payments are initially due December 31, 2014 and every 12 months thereafter until maturity.
 - Minimum collected pledge debt payment amount is computed at the greater of 75 percent of the collected pledge receipts or 100 percent of the debt service payments then due under the loan, including interest due and payable.
- Excess pledge cash flow—Amounts collected are allowed to be used for the following purposes:
 - Payment of any outstanding principal and/or interest then due and owing under the Loan.
 - Payment for the cost to construct the Water Taxi Dock (the Dock) as defined in, and pursuant to Section 5.11 of, the Ground Lease with the Port of San Francisco (see Note 8).

Exploratorium

Notes to Consolidated Financial Statements

Note 7. Debt Obligations (Continued)

- Funding of Borrower's obligations with respect to the Off-Site Fill as defined in, and pursuant to Section 9.11 of, the Ground Lease (see Note 8).
- Payments due to the HTC Investor Member pursuant to the HTC Documentation (see Note 10).
- As of June 30, 2016, the Exploratorium has paid \$9,750,147 for the above purposes.
- Covenants—The debt facility has financial and nonfinancial covenants due quarterly and annually. The Exploratorium failed its unrestricted net asset covenant and obtained a waiver from the banking consortium for fiscal year 2016.

The loan is secured by the Campaign pledges to be received over a period of time and a \$22.5 million guarantee from a large private foundation. The loan is due and payable on November 19, 2018.

As of June 30, 2016 and 2015, amounts outstanding against this facility were \$49,852,844 and \$56,299,638, respectively. Total interest on this loan was \$1,862,189 and \$2,203,808 during the years ended June 30, 2016 and 2015, respectively.

Breakdown of the term debt as shown on the statements of financial position is as follows:

	2016	2015
Long-term debt	\$ 49,852,844	\$ 56,299,638
Deferred financing fees, net	(412,364)	(585,383)
	<u>\$ 49,440,480</u>	<u>\$ 55,714,255</u>

Line of credit: Effective November 19, 2013, the Exploratorium entered into a revolving line-of-credit debt facility of \$5 million with the lead bank of the above-mentioned consortium. Interest is payable at a variable rate and due monthly. The applicable variable rate is equal to the LIBOR plus 300 basis points. As of June 30, 2016 and 2015, the effective interest rates were 3.47 percent and 3.18 percent. As of June 30, 2016 and 2015, amounts outstanding against this facility were \$1,719,484 and \$0, respectively. The line of credit has a stated maturity date of December 1, 2016. The Exploratorium obtained a forbearance of the 30-day clearance period on the line of credit to December 31, 2016, should the facility be extended beyond the current maturity date.

Note 8. Lease Commitments

Effective November 3, 2010, the Exploratorium entered into a 66-year lease with the City and County of San Francisco operating by and through the San Francisco Port Commission (the Port). The lease provides for the Exploratorium to lease Pier 15 and a portion of Pier 17, both located in the Historic Port District of the Port of San Francisco. The Exploratorium moved both the museum and corporate offices to the Piers in early 2013, upon completion of the renovations. Key provisions of the lease are as follows:

Pier 15:

Initial minimum monthly rent: \$66,107. Upon Bay Delta (see Note 10) relocating from Pier 15 to Pier 17, the monthly rent increased to \$78,805. Bay Delta relocated on May 1, 2011.

Exploratorium

Notes to Consolidated Financial Statements

Note 8. Lease Commitments (Continued)

Rent escalation: The monthly minimum lease payment is subject to consumer price index (CPI) increases every fifth year beginning on the fifth anniversary of the lease commencement. The minimum CPI increase is 10 percent, with a maximum of 20 percent.

Rent incentives: In consideration of the tenant improvements to be constructed by the Exploratorium, the Port is providing the Exploratorium rent incentives equal to the minimum monthly rent from lease commencement through the 50th anniversary of the lease.

Percentage rent: The Exploratorium is obligated to pay a monthly percentage rent (6 percent) based on gross revenues generated on Pier 15 once museum operations commence. If the total computed percentage rent on a quarterly basis exceeds the minimum monthly rent computed before the application of the rent incentives, the Exploratorium will be obligated to pay the Port the differential. For the years ended June 30, 2016 and 2015, the Exploratorium was not obligated for any percentage rent.

Pier 17:

Initial minimum monthly rent: \$66,961. Such initial minimum monthly rent was reduced to \$42,032 for the first six months of the lease.

Rent escalation: The monthly minimum lease payment is subject to a CPI increase of 3 percent each year, effective January 1, 2012, until the application of the rent incentive applicable for Pier 17, or on or about January 2024. Upon entering the rent incentive period, the minimum lease payments will increase by the existing CPI every fifth anniversary. The increase will be no less than 10 percent and no more than 20 percent. Pier 17 rent increases are also subject to a prevailing rental clause.

Rent incentive: In consideration for tenant improvements, which may be made to Pier 17 by the Exploratorium, the Port will provide the Exploratorium a rent incentive to be negotiated prior to the beginning of Pier 17 improvements.

Percentage rent: The Exploratorium will be obligated to pay percentage rent on certain revenues generated on Pier 17 and then, if the Exploratorium expands the museum to Pier 17, on all revenues. Payment provisions are and will be similar to Pier 15. For the years ended June 30, 2016 and 2015, the Exploratorium was not obligated for any percentage rent.

General provisions: The Exploratorium is obligated to pay the Port's "transaction costs" directly associated with the lease. Such payments are due quarterly in advance. The transaction costs, estimated to be approximately \$1.5 million, were substantially paid by June 30, 2013 and have been included in minimum rent for purposes of the deferred rent computation.

The Exploratorium, at its sole expense, was obligated to improve a portion of Pier 17 to allow Bay Delta (a tenant of the Port) to relocate its maritime facility from Pier 15 to Pier 17. Substantially all of these improvements, which totaled approximately \$7.9 million, were incurred by June 30, 2011 and have been included in minimum rent for purposes of computation of deferred rent.

Exploratorium

Notes to Consolidated Financial Statements

Note 8. Lease Commitments (Continued)

The Exploratorium did, at its sole expense, construct a Dock for the exclusive use of the Port. In the event the Exploratorium does not commence construction of the Dock by the fourth anniversary of the lease (December 1, 2014), the Exploratorium will be obligated to compensate the Port, as additional rent, to design and build the Dock. In addition to the hard costs, the Exploratorium will be required to pay an additional amount equal to 10 percent of the hard costs as an administrative burden. The Exploratorium currently estimates the Dock will cost \$700,000 to construct. Since the Exploratorium is obligated under the lease to incur this expense, the estimated construction costs have been included in minimum rent for purposes of computation of deferred rent. The Exploratorium completed the construction of the Dock in fiscal year 2016.

The Exploratorium is potentially obligated to pay and is required to segregate in a separate account, \$50,000 annually on the second through fifth anniversaries of the lease for a substructure reserve. On the sixth anniversary of the lease and every fifth year thereafter, the Exploratorium is to increase the balance in the account to an amount based on the most recent substructure condition report. Interest on the fund shall accrue to the reserve account. The funds in the account are to be used only for the maintenance, repair and replacement of the substructure, if necessary. As of June 30, 2016 and 2015, the balance in this reserve totaled \$200,000 and \$150,000, respectively.

The Port leased the Piers to the Exploratorium on an "as is" basis. The cost of any hazardous waste cleanup was the sole expense of the Exploratorium. The Exploratorium, as part of construction, removed all the hazardous waste as required by the lease and current law. Since completion of this project, there have been no hazardous waste costs to date, and management does not anticipate any more significant costs.

The lease calls for the Exploratorium to expand the museum's footprint to encompass substantially all of Pier 17 under the Phase II construction section of the lease. In order to accomplish this expansion, three events must occur:

1. Bay Delta must vacate the space it currently leases at Pier 17 directly from the Port.
2. The Port Commission must determine that the portion of Pier 17 currently occupied by Bay Delta is no longer needed for maritime use. This determination cannot occur until a maritime use study has been conducted after Bay Delta has vacated the space.
3. The Exploratorium must start construction on the planned Pier 17 renovations by the 16th anniversary of the lease (November 2026).

It is the Exploratorium's intention to expand to Pier 17, even if Bay Delta does not vacate their current space. The Exploratorium may still renovate and expand the museum's footprint to the rest of Pier 17 not currently occupied by Bay Delta, assuming item 3 above is achieved.

Exploratorium

Notes to Consolidated Financial Statements

Note 8. Lease Commitments (Continued)

Future minimum commitments under this agreement are as follows:

Years ending June 30:	
2017	\$ 2,057,797
2018	2,088,324
2019	2,119,767
2020	2,297,184
2021	2,297,184
2022-2077	<u>155,272,347</u>
	166,132,603
Less sublease revenue	<u>(8,338,943)</u>
	<u>\$ 157,793,660</u>

The above lease schedule includes the future minimum rents for Pier 17 only through the 17th anniversary of the lease. While it is the intention of the Exploratorium to expand to whatever portion of Pier 17 it is allowed to (see above), the possibility does exist that the lease for substantially all of Pier 17 could terminate in either 2026 or 2027.

As described in Note 1, the Exploratorium recognizes both lease expense and rent incentives on a straight-line method over the term of the lease. As a result, approximately \$4.5 million and \$5.1 million have been recognized as deferred rent assets as a result of the Port lease on the consolidated statements of financial position as of June 30, 2016 and 2015, respectively. Total lease expense, associated with the Port lease, amounted to approximately \$1.8 million for both of the years ended June 30, 2016 and 2015. These amounts are net of approximately \$1.2 million for both of the years ended June 30, 2016 and 2015, in recognized rent incentives provided by the Port through the rent credit clause of the lease.

The Exploratorium currently has two subtenants resident to Pier 17. One lease expires on September 30, 2018. The other lease, which was entered into on July 1, 2014, expires on June 30, 2024. Important provisions of this new sublease are as follows:

- Prepaid space rental for a period of two years after June 30, 2015. This is considered a restricted cash line item in the amount of \$1,145,817 as outlined in the consolidated statement of financial position. This is also considered deferred space rental revenue as outlined in Note 1.
- Approximately \$750,000 in initial direct costs have been included in the deferred rent calculation, the result of which creates an additional deferred rent asset of \$540,000 that has been combined with the deferred rent asset created under the Port lease (as noted above) in the consolidated statement of financial position.
- The lease agreements allow for the potential of tenant improvements on Pier 17. As of June 30, 2016, tenant improvement hard costs have been incurred, and tenant improvements have been completed. The Exploratorium assessed the value of the tenant improvements and determined that they had very little economic benefit, and therefore, they have not been recorded on the Exploratorium's financial statements.

Exploratorium

Notes to Consolidated Financial Statements

Note 9. Contingencies

The Exploratorium receives funds from and administers various federal and state government-funded programs that are subject to audit by the cognizant governmental agencies. Some of these grants also contain provisions that subject certain assets purchased with governmental funds to be subject to reversion. To date, the Exploratorium has not been required to either refund any grant funding or return any assets purchased with government funding.

Note 10. New Museum Site Construction, Capital Campaign and HTC Arrangement

As detailed in Note 7, the Exploratorium embarked on a multi-year, multipurpose campaign to construct a new and improved museum and educational facility located on Piers 15 and 17 at the San Francisco Historic Port District (Campaign). The majority of the pledges received from the Campaign described above were available for the renovation of Piers 15 and 17. Pier 15 currently houses the Exploratorium's museum space as well as its administrative functions. Pier 17 also currently houses some of the Exploratorium's administrative functions. The most significant cost of the Pier 17 renovations was associated with the renovations necessary to allow Bay Delta to relocate to the north side of Pier 17 from the south side of Pier 15. Internally, the Exploratorium had also earmarked a portion of the Campaign proceeds to fund the planning, design and ultimate construction of the museum. Expenses associated with planning, research and development of the museum space were expensed as incurred.

To supplement the bridge financing obtained during construction, the Exploratorium entered into a Historic Tax Credit Arrangement, whereby tax credits generated from the renovation of Pier 15 were purchased by an investor group. The agreed-upon purchase price was \$1.25 per HTC earned from the project.

The total tax credits earned were approximately \$39 million for a total investor purchase price of approximately \$49 million. To effectuate the HTC Arrangement, the Exploratorium assisted in the creation of various flow-through entities, which have enabled the investor group to take advantage of the tax credits generated, receive a 2 percent annual return on capital, and participate in the depreciation allowed on the improvements for as long as the flow-through entities exist. As described in Note 1, these entities are fully consolidated with the operations of the Exploratorium.

In accordance with the Master Tenant Operating Agreement, the following capital contributions were or are required by the investor member to be paid to the Exploratorium:

- \$10,000—upon close of escrow (received November 3, 2010).
- \$41,078,186—upon completion of all items precedent for Payment 2 (received November 7, 2013).
- \$2,416,952—upon completion of all items precedent for Payment 3 (received November 2013).
- \$687,406—upon completion of all items precedent for Payment 3 as a true-up payment for additional credits earned in excess of the original projections (received January 2014).
- \$4,833,904—payable no earlier than one year from the date of receipt of Part 3 of the Historic Preservation Certificate Application (July 18, 2013) required by the National Park Service. The Exploratorium is required to make a call on this payment. As of June 30, 2016 the Exploratorium has not requested the payment from the investors.

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Notes to Consolidated Financial Statements

Note 10. New Museum Site Construction, Capital Campaign and HTC Arrangement (Continued)

The for-profit tax structure provides for the following:

- EPLLC—This entity was created to house the qualifying rehabilitation expenditures (QRE) incurred through the remodel of Pier 15. The managing member of EPLLC is Holdings, the wholly owned subsidiary of the Exploratorium. Holdings is also a 60 percent member of EPLLC.
- EMTLLC—This entity was created to house the improvements on Pier 15, which do not qualify as QREs. The managing member of EMTLLC is Holdings, which is also a 0.01 percent member of EPLLC. Bay Area Historic Fund, LLP (Investor) is the 99.99 percent member in EMTLLC.
- Solar—This entity, which is a wholly owned subsidiary of Holdings, was created strictly to qualify for certain federal solar grants for qualifying solar expenditures. During the year ended June 30, 2014, Solar received a grant totaling approximately \$1.8 million.

Concurrent with the various agreements entered into by the above entities, the Investor and Holdings entered into an option agreement, whereby the Investor has the right to a put option to take out its investment in EMTLLC. The option period is from April 18, 2018 through and including October 18, 2018. The price of the put, if exercised, is based on a formula as stipulated in the Master Tenant Operating Agreement. In the event the investor member does not exercise the put option, Holdings has a call option whereby Holdings would purchase the investor member's position in EMTLLC. As with the put option, the call option price, if exercised, is based on a formula as stipulated in the Master Tenant Operating Agreement.

Due to these options, the Investor's member capital contributions have been reflected as a liability on the Exploratorium's consolidated financial statements. The HTCs are contingent on the Exploratorium and its related entities' ability to maintain compliance with various rules and regulations. Failure to maintain compliance or to correct noncompliance within a specified time period could result in the recapture of previously taken tax credits.

The HTC obligation will be relieved through a payment to the Investor as it is anticipated the Investor will exercise its put option. The difference between the payment to the Investor and the obligation will be recognized as income at the time of settlement. Management's best estimate of the anticipated payments on the put option and the income on the HTC obligation is approximately \$6.6 million and \$37.6 million, respectively, at June 30, 2016.

In addition, such potential noncompliance may require an adjustment to the capital contributed by EMTLLC's Investor member. Pursuant to a Tax Credit Guaranty Agreement, the Exploratorium and Holdings have guaranteed that in the event of an HTC reduction event, the Investor member will be reimbursed the amount of HTCs available to the Investor member and subject to loss or recapture. In addition, upon any HTC reduction event, the payments required shall also include: (i) any interest payments and penalty charges imposed by the IRS on the Investor member with respect to any reduction in HTCs previously claimed by the Investor member, (ii) any reasonable legal and administrative expenses incurred by the Investor member as a result of such HTC reduction event, and (iii) an amount sufficient to pay any tax liability owed by the Investor member resulting from the receipt of the detailed amounts. As of June 30, 2016, no HTC reduction event has occurred.

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Notes to Consolidated Financial Statements

Note 11. Retirement Plan

The Exploratorium has a defined contribution plan that is a qualified plan under Section 403(b) of the Internal Revenue Code. The plan covers employees who have reached the age of 21, completed one year of service and worked at least 975 hours during any plan year. The plan allows for the Exploratorium, as plan sponsor, to make elective matching contributions to the plan.

During the years ended June 30, 2016 and 2015, the Exploratorium contributed \$1,034,738 and \$1,033,901 to the plan, respectively.

Note 12. Related-Party Transactions

Contributions receivable and recorded contribution revenue from members of the Board of Directors of the Exploratorium or companies or individuals with which the Board of Directors are affiliated were \$18,430,276 and \$6,429,958, respectively, as of and for the year ended June 30, 2016, and \$20,514,506 and \$4,241,185, respectively, as of and for the year ended June 30, 2015.

Note 13. Subsequent Events

The Exploratorium evaluated subsequent events through October 7, 2016, the date on which the consolidated financial statements were available to be issued.