

Exploratorium

Consolidated Financial Report
June 30, 2014

Contents

| | |
|---|------|
| Independent Auditor's Report | 1-2 |
| Financial Statements | |
| Consolidated statements of financial position | 3 |
| Consolidated statements of activities | 4-5 |
| Consolidated statements of cash flows | 6-7 |
| Notes to consolidated financial statements | 8-30 |



Independent Auditor's Report

To the Board of Directors
Exploratorium
San Francisco, CA

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the Exploratorium, which comprise the consolidated statement of financial position as of June 30, 2014, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with 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 consolidated 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 consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Exploratorium as of June 30, 2014, and the changes in its net assets and its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Report on 2013 Comparative Information

The consolidated financial statements of the Exploratorium, as of and for the year ended June 30, 2013, were audited by other auditors whose report dated November 27, 2013 expressed an unmodified opinion on those statements.

McGladrey LLP

San Francisco, CA
October 16, 2014

Exploratorium

Consolidated Statements of Financial Position June 30, 2014 and 2013

| Assets | 2014 | 2013 |
|--|-----------------------|-----------------------|
| Cash and Cash Equivalents | \$ 6,594,885 | \$ 4,884,173 |
| Contributions Receivable, net (Note 2) | 2,872,331 | 467,251 |
| Government Receivables | 1,602,618 | 1,122,719 |
| Accounts Receivable, net | 1,111,158 | 1,501,258 |
| Inventory | 1,227,928 | 1,042,009 |
| Other Assets and Prepaid Expenses | 2,192,511 | 989,119 |
| Deferred Financing Costs, net | 758,403 | 1,376,462 |
| Investments, at fair value (Note 4) | 28,265,760 | 25,140,615 |
| Contributions Receivable From Capital Campaign, net (Note 2) | 24,760,970 | 28,878,065 |
| Exhibits, Leasehold Improvements and Equipment (Note 3) | | |
| Global Studios (EXNET) rental exhibits, net | 611,141 | 798,839 |
| Finished exhibits and components, net | 7,301,771 | 5,717,490 |
| Leasehold improvements and equipment at cost, net | 12,488,405 | 12,628,056 |
| Leasehold improvements—Piers, net | 183,993,861 | 185,847,181 |
| Construction in progress, exhibits | 776,015 | 2,035,881 |
| Deferred Rent (Note 8) | 5,409,461 | 6,565,968 |
| Total assets | \$ 279,967,218 | \$ 278,995,086 |
| Liabilities and Net Assets | | |
| Construction Payables | \$ - | \$ 10,531,767 |
| Trade Payables | 940,980 | 394,050 |
| Other Accrued Expenses | 3,869,003 | 4,636,100 |
| Deferred Revenue | 5,641,836 | 3,025,120 |
| Construction Retainage | - | 5,135,634 |
| Historic Tax Credit Obligation (Note 10) | 44,192,544 | 41,078,186 |
| Term Debt (Note 7) | 67,301,641 | 62,145,180 |
| Total liabilities | 121,946,004 | 126,946,036 |
| Net Assets | | |
| Unrestricted | 124,464,153 | 123,567,206 |
| Temporarily restricted (Note 5) | 11,900,666 | 6,825,449 |
| Permanently restricted (Note 5) | 21,656,395 | 21,656,395 |
| Total net assets | 158,021,214 | 152,049,050 |
| Total liabilities and net assets | \$ 279,967,218 | \$ 278,995,086 |

See Notes to Consolidated Financial Statements.

Exploratorium

Consolidated Statements of Activities Years Ended June 30, 2014 and 2013

| | 2014 | | | Total |
|---|-----------------------|---------------------------|---------------------------|-----------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | |
| Operating revenue and support: | | | | |
| Private contributions | \$ 4,881,077 | \$ 12,710,797 | \$ - | \$ 17,591,874 |
| Government grants | 4,835,109 | - | - | 4,835,109 |
| Global Studios—domestic | 2,008,234 | - | - | 2,008,234 |
| Global Studios—foreign | 1,199,591 | - | - | 1,199,591 |
| Admissions | 10,929,152 | - | - | 10,929,152 |
| Membership | 3,471,720 | - | - | 3,471,720 |
| Rentals and other revenue | 7,334,942 | - | - | 7,334,942 |
| Store sales | 2,560,236 | - | - | 2,560,236 |
| Net assets released from restrictions | 11,368,491 | (11,368,491) | - | - |
| Total revenues and support | 48,588,552 | 1,342,306 | - | 49,930,858 |
| Operating expenses: | | | | |
| Program services: | | | | |
| Visitor, learner and educator programs | 32,903,615 | - | - | 32,903,615 |
| Global Studios | 6,684,047 | - | - | 6,684,047 |
| Admissions and other | 2,830,240 | - | - | 2,830,240 |
| Store expenses | 2,470,268 | - | - | 2,470,268 |
| Support services: | | | | |
| General and administrative | 7,254,624 | - | - | 7,254,624 |
| Fundraising and membership | 4,559,492 | - | - | 4,559,492 |
| Total operating expenses | 56,702,286 | - | - | 56,702,286 |
| Change in net assets from operating activities | (8,113,734) | 1,342,306 | - | (6,771,428) |
| Capital revenue: | | | | |
| Private campaign contributions | - | 12,988,909 | - | 12,988,909 |
| Net assets released from restrictions | 12,988,909 | (12,988,909) | - | - |
| Total nonoperating revenues | 12,988,909 | - | - | 12,988,909 |
| Financing expense: | | | | |
| Term loan interest expense | 2,645,220 | - | - | 2,645,220 |
| HTC interest expense | 1,582,051 | - | - | 1,582,051 |
| Total nonoperating expenses | 4,227,271 | - | - | 4,227,271 |
| Investment activity: | | | | |
| Investment income | 247,214 | - | - | 247,214 |
| Net realized and unrealized gains | 1,829 | 3,732,911 | - | 3,734,739 |
| Total investment activity | 249,043 | 3,732,911 | - | 3,981,954 |
| Change in net assets | 896,947 | 5,075,217 | - | 5,972,164 |
| Net assets, beginning of year | 123,567,206 | 6,825,449 | 21,656,395 | 152,049,050 |
| Net assets, end of year | \$ 124,464,153 | \$ 11,900,666 | \$ 21,656,395 | \$ 158,021,214 |

(Continued)

Exploratorium

Consolidated Statements of Activities (Continued) Years Ended June 30, 2014 and 2013

| | 2013 | | | |
|---|-----------------------|---------------------------|---------------------------|-----------------------|
| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
| Operating revenue and support: | | | | |
| Private contributions | \$ 5,460,575 | \$ 21,664,172 | \$ 6,100,000 | \$ 33,224,747 |
| Government grants | 2,814,911 | - | - | 2,814,911 |
| Global Studios—domestic | 1,256,347 | - | - | 1,256,347 |
| Global Studios—foreign | 1,002,088 | - | - | 1,002,088 |
| Admissions | 5,108,729 | - | - | 5,108,729 |
| Membership | 839,785 | - | - | 839,785 |
| Rentals and other revenue | 4,008,738 | - | - | 4,008,738 |
| Store sales | 1,204,534 | - | - | 1,204,534 |
| Net assets released from restrictions | 117,321,408 | (117,321,408) | - | - |
| Total revenues and support | 139,017,115 | (95,657,236) | 6,100,000 | 49,459,879 |
| Operating expenses: | | | | |
| Program services: | | | | |
| Visitor, learner and educator programs | 24,379,034 | - | - | 24,379,034 |
| Global Studios | 5,771,535 | - | - | 5,771,535 |
| Admissions and other | 1,869,152 | - | - | 1,869,152 |
| Store expenses | 1,442,447 | - | - | 1,442,447 |
| Support services: | | | | |
| General and administrative | 14,538,501 | - | - | 14,538,501 |
| Fundraising and membership | 4,976,721 | - | - | 4,976,721 |
| Total operating expenses | 52,977,390 | - | - | 52,977,390 |
| Change in net assets from operating activities | 86,039,725 | (95,657,236) | 6,100,000 | (3,517,511) |
| Capital revenue: | | | | |
| Private campaign contributions | - | 15,851,092 | - | 15,851,092 |
| Net assets released from restrictions | 15,851,092 | (15,851,092) | - | - |
| Total nonoperating revenues | 15,851,092 | - | - | 15,851,092 |
| Financing expense: | | | | |
| Term loan interest expense | 146,996 | - | - | 146,996 |
| Total nonoperating expenses | 146,996 | - | - | 146,996 |
| Investment activity: | | | | |
| Investment income | 181,792 | - | - | 181,792 |
| Net realized and unrealized gains | 113,463 | 1,383,400 | - | 1,496,863 |
| Total investment activity | 295,255 | 1,383,400 | - | 1,678,655 |
| Change in net assets | 102,039,076 | (94,273,836) | 6,100,000 | 13,865,240 |
| Net assets beginning of year | 20,144,730 | 102,482,685 | 15,556,395 | 138,183,810 |
| Net assets end of year | \$ 122,183,806 | \$ 8,208,849 | \$ 21,656,395 | \$ 152,049,050 |

See Notes to Consolidated Financial Statements.

Exploratorium

Consolidated Statements of Cash Flows Years Ended June 30, 2014 and 2013

| | 2014 | 2013 |
|--|---------------------|---------------------|
| Cash Flows From Operating Activities | | |
| Change in net assets | \$ 5,972,164 | \$ 13,865,240 |
| Adjustments to reconcile change in net assets to net cash used in operating activities: | | |
| Depreciation and amortization | 5,902,028 | 3,228,771 |
| Amortization of financing costs | 250,095 | 338,520 |
| Write-off of prior loan financing fees | 1,233,063 | - |
| Change in allowance for uncollectible accounts | 118,525 | (444,182) |
| Change in discount on long-term contributions receivable | (1,044,079) | (541,908) |
| Net realized and change in unrealized gain on investments | (3,734,739) | (1,496,863) |
| Stock contributions and gifts in kind | (4,626,261) | (3,358,949) |
| Loss on disposal of property and equipment | 397,944 | 380,933 |
| Contributions restricted for investment in museum improvements | (16,616,776) | (36,529,174) |
| Contributions restricted for permanent endowment | - | (6,100,000) |
| Changes in assets and liabilities: | | |
| Receivables | (443,103) | (998,631) |
| Inventory | (185,919) | (419,013) |
| Other assets | (1,203,390) | 55,739 |
| Deferred rent | 1,156,507 | 1,278,076 |
| Trade payables and accrued expenses | (15,887,568) | 1,016,620 |
| Deferred revenue | 2,616,715 | 2,402,755 |
| Net cash used in operating activities | (26,094,794) | (27,322,066) |
| Cash Flows From Investing Activities | | |
| Capital expenditures | (4,443,718) | (53,600,968) |
| Proceeds from sales of investments | 21,794,507 | 21,812,474 |
| Purchase of investments | (16,558,652) | (20,835,315) |
| Net cash provided by (used in) investing activities | 792,137 | (52,623,809) |
| Cash Flows From Financing Activities | | |
| Proceeds from contributions restricted for investment in endowment and museum improvements | 19,607,648 | 42,644,244 |
| Payments for financing fees | (865,098) | (489,989) |
| Draws on construction loan | 19,174,152 | 61,224,457 |
| Payments on construction loan | (81,319,331) | (64,105,213) |
| Proceeds from term loan | 85,000,000 | - |
| Payments made on term loan | (17,698,359) | - |
| Increase in campaign financing loan | - | (3,000,000) |
| Proceeds received from historic tax credit arrangement | 3,114,358 | 41,078,186 |
| Net cash provided by financing activities | 27,013,370 | 77,351,685 |

(Continued)

Exploratorium

Consolidated Statements of Cash Flows (Continued) Years Ended June 30, 2014 and 2013

| | 2014 | 2013 |
|--|----------------------------|----------------------------|
| Net increase (decrease) in cash and cash equivalents | \$ 1,710,713 | \$ (2,594,189) |
| Cash and Cash Equivalents, beginning of year | <u>4,884,173</u> | <u>7,478,362</u> |
| Cash and Cash Equivalents, end of year | <u>\$ 6,594,885</u> | <u>\$ 4,884,173</u> |
| Supplemental Disclosure of Cash Flow Information | | |
| Cash paid for interest during the year | <u>\$ 3,626,931</u> | <u>\$ 2,683,962</u> |
| Supplemental Disclosure of Noncash Investing Activities | | |
| Capital expenditures reflected in construction payables and construction retainage | <u>\$ -</u> | <u>\$ 4,714,542</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 as of June 30, 2014 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 in partially financing 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 (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 represent unconditional promises to give by a donor without any use or time restrictions.

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. 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 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.

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.

Accounts and government receivables—non-contribution: The Exploratorium evaluates the collectibility of its non-contribution receivables on an ongoing basis and records a provision for potential uncollectible receivables when appropriate. At June 30, 2014 and 2013, the Exploratorium has determined that all non-contribution receivables are fully collectible and therefore has not recorded an allowance for doubtful accounts.

Exploratorium

Notes to Consolidated Financial Statements

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

Contributions receivable: As of June 30, 2014 and 2013, 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). The Exploratorium has evaluated the collectibility of these receivables. As a result, an allowance for doubtful accounts of \$143,673 and \$25,147 has been reflected in the consolidated statements of financial position as of June 30, 2014 and 2013, respectively. 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, is stated at the lower of average cost or market (on the first-in, first-out basis).

Global Studios (EXNET) rental exhibits: EXNET rental exhibits are recorded at the cost of construction materials and labor, and are built for rental to other institutions and partners. Depreciation is provided on the straight-line method over the estimated useful life of 10 years.

Finished exhibits, leasehold improvements and equipment: Upon determination that the 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 10 years. Leasehold improvements at the Exploratorium's new 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 66 years.

During 2008 the Exploratorium began capitalizing the costs related to its future site, which was substantially complete as of June 30, 2013. These capitalized costs include capital construction costs and capitalizable costs of exhibits to be housed in the new facility (see Note 10).

Fair value of financial instruments: The carrying amounts of the Exploratorium's financial instruments, which include 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. 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, 2014, 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, 2014 and 2013, 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 investments are valued at fair value based on the applicable ownership of the funds' net assets or equivalent as of the measurement date, as determined by the Exploratorium. 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 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. Depending on the redemption options available for each fund, the investment in funds is classified as Level 2 or Level 3 in the fair value hierarchy.

The Exploratorium reviews its investment to identify those for which market value is below cost. The Exploratorium then makes a determination as to whether the 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, 2014 or 2013. 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 reasonable 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. Investment gains and losses on the funds held for others are allocated monthly to participating funds using the market value method.

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. Most of these required payments had been paid by June 30, 2014; approximately \$530,000 is scheduled to be paid in future years.

Exploratorium

Notes to Consolidated Financial Statements

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

Contributions: Contributions are recognized as revenue when received or unconditionally promised. 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 new site located on the San Francisco Waterfront (i.e., the San Francisco Historic Port District) (see Note 10). The Campaign has been designed to not only encompass the renovation and construction of the new facility, but also the design and creation of the exhibits housed at the new site, 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 of the new site, 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 museum construction was substantially concluded by April 17, 2013. As a result, temporarily restricted net assets associated with the cost of the improvements were released as of June 30, 2013. The Exploratorium has ongoing exhibit construction as a regular part of its activities.

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.

Revenue from Global Studios is recorded using the percentage-of-completion method for exhibits built for sale and is recognized pro-rata over the term of the lease agreement for 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 primarily of annual or multi-year memberships and is recognized as income over the membership period, advance deposits for rental exhibits, museum rentals and field trips that will occur after the fiscal year-end.

Exploratorium

Notes to Consolidated Financial Statements

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

Contribution of services: The Exploratorium has a substantial number of unpaid volunteers performing various functions who contributed over 14,600 hours and 16,000 hours for the years ended June 30, 2014 and 2013, respectively. The value of this contributed time is not reflected in the consolidated financial statements, as it does not meet the criteria for recognition.

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, 2014 and 2013, 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, 2011, 2012, 2013 and 2014 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, 2010, 2011, 2012, and 2013 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 adopted the provisions of FASB Accounting Standards Codification (ASC) 740-10, *Income Taxes*, relating to accounting for uncertain tax positions on July 1, 2009. Management evaluated the Exploratorium's tax positions and concluded that there were no material uncertainties in income taxes as of June 30, 2014 or 2013. 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, 2011.

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.

Capitalized interest: During the construction phase of the new museum, the Exploratorium capitalized interest. Such capitalized interest is being amortized as part of the tenant improvement costs associated with the new museum.

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, 2014 or 2013.

Exploratorium

Notes to Consolidated Financial Statements

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

Use of estimates: The preparation of consolidated financial statements in conformity with 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, 2014 and 2013, revenues from such activities amounted to \$1,199,591 and \$1,002,088, 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.

New accounting pronouncement: In October 2012, the FASB issued Accounting Standards Update (ASU) 2012-05, *Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows*. This ASU amends ASC Topic 230, *Statement of Cash Flows*, to require a non-profit organization to classify cash receipts from the sale of donated financial assets consistently with cash donations received in the statement of cash flows. ASU No. 2012-05 is effective for the fiscal year ended June 30, 2014. The adoption of this ASU has not materially changed how the Exploratorium applies ASC Topic 230.

Pending accounting pronouncements: In April 2013, the FASB issued ASU 2013-06, *Services Received from Personnel of an Affiliate*. This ASU amends ASC Topic 958 to require a recipient not-for-profit entity to recognize all services received from personnel of an affiliate that directly benefit the recipient not-for-profit entity. ASU 2013-06 is effective for the fiscal year ending June 30, 2015. The adoption of this ASU is not expected to materially change how the Exploratorium will apply ASC Topic 958.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. This ASU amends ASC Topic 606. In summary, the core principle of ASC Topic 606 is that an entity recognizes 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. ASU 2014-09 will be effective for the fiscal year ending June 30, 2017. The Exploratorium is currently determining how this ASU may impact revenue recognition on contracts with customers, including those through Global Studios and government funding.

Reclassifications: Certain 2013 balances have been reclassified to conform with the 2014 presentation. These reclassifications have no effect on the Exploratorium's consolidated change in net assets or financial position as previously reported.

Exploratorium

Notes to Consolidated 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 a rate of 4% in both 2014 and 2013, 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. 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. Contributions receivable are due as follows as of June 30:

| | 2014 | 2013 |
|---|----------------------|----------------------|
| Contributions receivable (other than Capital Campaign): | | |
| Less than one year | \$ 2,554,563 | \$ 402,967 |
| One to five years | 364,717 | 78,331 |
| Discount on receivables due in more than one year | (21,211) | (5,238) |
| Allowance for uncollectible contributions | (25,738) | (8,809) |
| Total | <u>\$ 2,872,331</u> | <u>\$ 467,251</u> |
| Contributions receivable (Capital Campaign): | | |
| Less than one year | \$ 5,187,428 | \$ 6,049,502 |
| One to five years | 15,602,580 | 17,621,294 |
| More than five years | 8,000,000 | 10,200,000 |
| Discount on receivables due in more than one year | (3,911,103) | (4,976,393) |
| Allowance for uncollectible contributions | (117,935) | (16,338) |
| Total | <u>\$ 24,760,970</u> | <u>\$ 28,878,065</u> |

The Exploratorium has received notification from various donors of intention to give gifts or to be restricted to the Capital Campaign totaling \$11,055,150 and \$15,503,500 as of June 30, 2014 and 2013, respectively. 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:

| <u>Years Ending June 30,</u> | <u>Amount</u> |
|------------------------------|----------------------|
| 2015 | \$ 3,833,333 |
| 2016 | 2,367,215 |
| 2017 | 2,082,207 |
| 2018 | 1,772,395 |
| 2019 | - |
| Thereafter | 1,000,000 |
| | <u>\$ 11,055,150</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:

| | 2014 | 2013 |
|--|-------------------|-------------------|
| Rental exhibits | \$ 4,176,481 | \$ 4,159,126 |
| Less accumulated depreciation and amortization | (3,565,340) | (3,360,287) |
| | <u>\$ 611,141</u> | <u>\$ 798,839</u> |

Finished exhibits and components consist of the following as of June 30:

| | 2014 | 2013 |
|--|---------------------|---------------------|
| Finished exhibits and components | \$ 11,968,124 | \$ 9,669,949 |
| Less accumulated depreciation and amortization | (4,666,352) | (3,952,459) |
| | <u>\$ 7,301,771</u> | <u>\$ 5,717,490</u> |

Leasehold improvements and equipment consist of the following as of June 30:

| | 2014 | 2013 |
|---|-----------------------|-----------------------|
| Leasehold improvements and equipment at cost, net | \$ 15,108,221 | \$ 13,888,055 |
| Less accumulated depreciation | (2,619,816) | (1,259,999) |
| | <u>\$ 12,488,405</u> | <u>\$ 12,628,056</u> |
| Leasehold improvements—Piers, net | \$ 189,043,650 | \$ 187,472,444 |
| Less accumulated depreciation | (5,049,789) | (1,625,263) |
| | <u>\$ 183,993,861</u> | <u>\$ 185,847,181</u> |

Depreciation and amortization expense for exhibits, leasehold improvements and equipment was \$5,902,029 and \$2,228,771 for the years ended June 30, 2014 and 2013, respectively.

Exploratorium

Notes to Consolidated Financial Statements

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 | 2014 | | | |
|--------------------------|----------------------|---------------------|---------------------|----------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Money market fund | \$ 1,279,598 | \$ - | \$ - | \$ 1,279,598 |
| Fixed-income securities: | | | | |
| Domestic | 6,775,650 | - | - | 6,775,650 |
| Equities: | | | | |
| Domestic | 7,086,710 | - | - | 7,086,710 |
| International | 6,904,696 | - | - | 6,904,696 |
| Alternative investments: | | | | |
| Fixed income | - | 1,774,940 | - | 1,774,940 |
| Hedge funds | - | 2,136,762 | 1,970,480 | 4,107,242 |
| Private equity | - | - | 336,924 | 336,924 |
| | <u>\$ 22,046,654</u> | <u>\$ 3,911,702</u> | <u>\$ 2,307,404</u> | <u>\$ 28,265,760</u> |

| Description | 2013 | | | |
|--------------------------|----------------------|---------------------|---------------------|----------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Money market fund | \$ 453,842 | \$ - | \$ - | \$ 453,842 |
| Fixed-income securities: | | | | |
| Domestic | 5,691,061 | - | - | 5,691,061 |
| Equities: | | | | |
| Domestic | 7,762,606 | - | - | 7,762,606 |
| International | 4,597,795 | - | - | 4,597,795 |
| Alternative investments: | | | | |
| Fixed income | - | 2,655,557 | - | 2,655,557 |
| Hedge funds | - | 1,866,197 | 1,770,442 | 3,636,639 |
| Private equity | - | - | 343,115 | 343,115 |
| | <u>\$ 18,505,304</u> | <u>\$ 4,521,754</u> | <u>\$ 2,113,557</u> | <u>\$ 25,140,615</u> |

A reconciliation of the beginning and ending balances of the fair value measurements using significant unobservable inputs (Level 3) during the fiscal years ended June 30 is as follows:

| | Alternative Investments | |
|----------------------------|-------------------------|---------------------|
| | 2014 | 2013 |
| Balance, beginning of year | \$ 2,113,557 | \$ 1,932,379 |
| Net unrealized gains | 193,847 | 181,178 |
| Balance, end of year | <u>\$ 2,307,404</u> | <u>\$ 2,113,557</u> |

The total net unrealized gains included in the consolidated statements of activities attributable to Level 3 investments still held was \$193,847 and \$181,178 for the fiscal years ended June 30, 2014 and 2013, respectively.

Exploratorium

Notes to Consolidated Financial Statements

Note 4. Fair Value Measurements and Investments (Continued)

Additional information related to the alternative investments is as follows:

| | | 2014 | | | Redemption | Redemption |
|----------------|---------------------|-------------------|-------------------|--|-------------------------|-------------------------------|
| | | Total | Unfunded | | Frequency | Notice |
| Fair Value | | Commitments | Commitments | | (if Currently Eligible) | Period |
| Hedge fund | \$ 2,136,762 | N/A | N/A | | Monthly | 30 days notice |
| Private equity | 336,924 | \$ 500,000 | \$ 156,885 | | N/A | Upon Termination ¹ |
| Hedge fund | 1,970,480 | N/A | N/A | | Quarterly | 65 days notice ² |
| Fixed income | 1,774,940 | N/A | N/A | | Quarterly | 60 days notice |
| | <u>\$ 6,219,106</u> | <u>\$ 500,000</u> | <u>\$ 156,885</u> | | | |

¹ This class includes one private equity investment fund. Redemption is not allowed from these funds.

² The fund allows for a 65-day redemption notice but restricts redemptions to 25% of original investment each quarter.

| | | 2013 | | | Redemption | Redemption |
|----------------|---------------------|-------------|-------------|--|-------------------------|------------------|
| | | Total | Unfunded | | Frequency | Notice |
| Fair Value | | Commitments | Commitments | | (if Currently Eligible) | Period |
| Hedge fund | \$ 1,866,197 | N/A | N/A | | Monthly | None |
| Private equity | 343,115 | N/A | N/A | | N/A | N/A ¹ |
| Hedge fund | 1,770,442 | N/A | N/A | | Quarterly | N/A ² |
| Fixed income | 2,655,557 | N/A | N/A | | Quarterly | 30 days notice |
| | <u>\$ 6,635,311</u> | | | | | |

¹ The fund allows for a five-day redemption notice but restricts redemptions to 25% of original investment each quarter.

² The fund is illiquid and will only be redeemed upon termination.

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:

| | 2014 | 2013 |
|--|----------------------|---------------------|
| Program restrictions (purpose and time restrictions) | \$ 7,591,571 | \$ 3,711,461 |
| Exhibits and furniture site (time restrictions) | 467,490 | 1,899,702 |
| Unappropriated endowment earnings | 3,841,605 | 1,214,286 |
| | <u>\$ 11,900,666</u> | <u>\$ 6,825,449</u> |

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

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:

| | 2014 | 2013 |
|---|----------------------|-----------------------|
| Campaign operating initiatives (purpose restrictions) | \$ 1,155,629 | \$ 113,264,250 |
| Capital campaign initiatives (purpose restrictions) | 12,988,909 | 15,851,092 |
| Program restrictions (purpose restrictions) | 10,212,862 | 5,440,558 |
| | <u>\$ 24,357,400</u> | <u>\$ 134,555,900</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:

| | 2014 | 2013 |
|---|----------------------|----------------------|
| Permanently restricted net assets generating purpose-restricted investment earnings | \$ 19,826,623 | \$ 19,826,623 |
| Permanently restricted net assets generating earnings with no purpose restriction | 1,829,772 | 1,829,772 |
| | <u>\$ 21,656,395</u> | <u>\$ 21,656,395</u> |

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, 2014 and 2013, the Exploratorium had one endowment fund with deficiencies of this nature totaling \$64,029 and \$289,840, 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 calculated over a 12-trailing-quarter average, times the spending rate as approved by the Board of Directors. The spending rate is typically 5% per fiscal year.

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, 2012 | \$ (581,369) | \$ 799,761 | \$ 15,556,395 | \$ 15,774,787 |
| Investment return: | | | | |
| Investment income | 32,651 | 136,769 | - | 169,420 |
| Net gains | 258,878 | 1,084,378 | - | 1,343,256 |
| Appropriations | - | (806,622) | - | (806,622) |
| Additions | - | - | 6,100,000 | 6,100,000 |
| Endowment net assets, June 30, 2013 | (289,840) | 1,214,286 | 21,656,395 | 22,580,841 |
| Investment return: | | | | |
| Investment income | 15,602 | 210,254 | - | 225,856 |
| Net gains | 233,064 | 3,188,274 | - | 3,421,338 |
| Appropriations | - | (771,209) | - | (771,209) |
| Endowment net assets, June 30, 2014 | \$ (41,174) | \$ 3,841,605 | \$ 21,656,395 | \$ 25,456,826 |

Note 7. Debt Obligations

Construction loan: The Exploratorium entered into a Credit Agreement on November 1, 2010 with Bank of America as the lead lender of a lending consortium. The Credit Agreement provided that the Exploratorium may borrow up to \$100,000,000 for purposes of construction of its new facilities located at Piers 15 and 17 and for operating working capital. This debt was restructured effective April 5, 2013. As further described below, the restructured debt obligation was then refinanced in November 2013 with a new bank consortium.

The Credit Agreement had two components:

Construction loan: During the availability period (defined as 30 months commencing November 2010), the Exploratorium may not borrow more than the lesser of the Borrowing Base, as defined, or \$95,000,000. The Borrowing Base is defined as the sum of (i) the amount of cash on hand, plus (ii) seventy-five percent (75%) of the amount of Eligible Pledge Receivables, as defined by the Agreement, plus (iii) eighty percent (80%) of the amount of Eligible Pledge Receivables (in the form of Donor Guarantees with Bank of America), plus (iv) upon reaching 70% completion, the amount of the Second Payment as defined in the Master Tenant Operating Agreement (see Note 10).

Working capital loan: The Exploratorium may not borrow more than \$5,000,000 during the period beginning November 2010 through the maturity date of the loan (see below).

Both loans were subject to interest-only payments of the existing LIBOR rate plus 3.5% (3.695% as of June 30, 2013). Upon the end of the availability period, the Exploratorium had the option to convert the above-described construction loan to a term loan. The debt obligation was refinanced prior to any conversion.

Exploratorium

Notes to Consolidated Financial Statements

Note 7. Debt Obligations (Continued)

As noted above, the Exploratorium restructured the debt obligation described above effective April 5, 2013. An amendment to this agreement was signed on August 14, 2013 to extend the terms of the construction period to September 30, 2013. This was necessary for the Exploratorium to close out construction and complete change orders to minimize costs. The total restructured debt facility remained at a maximum aggregate debt ceiling of \$100 million but was bifurcated into two separate debt agreements as follows:

Construction debt, including a working capital loan: During the availability period (defined April 5, 2013 to the earlier of September 30, 2013 or achievement of a lien-free construction), the Exploratorium could not borrow more than the borrowing base (as defined) or \$72.5 million. The borrowing base was defined as an amount equal to the lesser of (a) the Borrowing Base Sublimit; or (b) the sum of (i) 75% of the amount of Eligible Pledge Receivables, which are due no more than five years after the date of calculation, plus (ii) 80% of the amount of a named Support Agreement.

A working capital loan for a maximum borrowing amount of \$5 million was also provided.

Line of credit: During the availability period (defined as April 5, 2013 to the earlier of September 30, 2013 or achievement of a lien-free construction), the Exploratorium could not borrow more than \$22.5 million. The line of credit was fully collateralized by the guarantee of a charitable private foundation.

Interest on both loans was at LIBOR plus 3.5%. As of June 30, 2013, the Exploratorium had internally designated \$3 million in an interest payment reserve account, which is presented as a component of cash and cash equivalents. Collateral on the loans includes contributions receivable from the capital campaign, the leasehold improvements at the Piers, and certain equipment.

As of June 30, 2013, the Exploratorium had \$42,587,431 outstanding on the construction portion of the restructured credit agreement and \$19,557,748 outstanding on the line-of-credit portion of the restructured credit agreement. Interest incurred on the construction loan has been capitalized as part of leasehold improvements—Piers on the accompanying consolidated statements of financial position and amounted to \$3,382,589 as of June 30, 2013.

The Exploratorium had no outstanding amounts due against the working capital loan as of June 30, 2013. Interest incurred on the working capital loan is expensed as incurred and amounted to \$63,461 for the year ended June 30, 2013.

Effective November 19, 2013, the Exploratorium entered into a new debt facility with a new 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%.
 - Annual principal payments are initially due December 31, 2014 and every 12 months thereafter until maturity.

Exploratorium

Notes to Consolidated Financial Statements

Note 7. Debt Obligations (Continued)

- Minimum collected pledge debt payment amount is computed at the greater of 75% of the collected pledge receipts or 100% of the debt service payments then due under the loan, including interest due and payable. In the event that 100% of the collected pledge receipts are not used to repay debt, in accordance with the calculation so stipulated, the difference between that paid to the bank and the amount of pledge receipts collected are considered to be “excess pledge cash flow” and will be required to be deposited with the lead bank as agent for the consortium on a quarterly basis.
- Excess pledge cash flow—Amounts deposited as described above will be allowed to be used in this priority:
 - 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).
 - 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).
- Covenants—The debt facility has the following covenants:
 - Financial statements of the Exploratorium (all prepared on the GAAP basis):
 - Annual audited financial statements—Due 120 days after year-end.
 - Interim internal financial statements—Due 45 days after the quarters ended September 30, December 31 and March 31.
 - Annual tax returns—Due 15 days after filing but in no event later than June 30 of the following year.
 - Semi-annual pledge collection schedule—Due no later than 60 days after each reporting period (June 30 and December 31).
 - Annual operating budget with list of operating and nonoperating items—Due no later than 60 days after June 30.
 - Annual audited financial statements from the Guarantor—Due within 210 days of the guarantor’s fiscal year-end.
 - Annual adjusted unrestricted net assets should be no less than zero at the end of each fiscal year.

The loan is secured by the Campaign pledges to be received over a period of time and a \$25 million guarantee from a large private foundation. The loan is due and payable on November 19, 2018.

Exploratorium

Notes to Consolidated Financial Statements

Note 7. Debt Obligations (Continued)

As of June 30, 2014, amounts outstanding against this facility were \$67,301,640. Total interest on this loan was \$1,545,742 during the year ended June 30, 2014.

Campaign financing loan: In 2011 the Exploratorium received a loan from a donor of \$3,000,000 to use as a form of collateral. The terms stipulated that the Exploratorium place the \$3,000,000 in a segregated account and pay the donor (as interest) the amount of earnings on the segregated account. The interest rate on this account was 0.24%. As a result of the restructuring described above, the Exploratorium repaid this loan in April 2013.

Note 8. Lease Commitments

The Exploratorium was obligated under an operating lease with the City of San Francisco (Recreation and Parks Department) for the space it occupied in The Palace of Fine Arts through February 28, 2013. The lease included an adjustment clause that provided for an annual increase in rent at the lesser of the current Consumer Price Index (CPI) or 3%. Additionally, the Exploratorium had a Special Use Permit with the United States Department of the Interior, National Park Service, for the space it occupied for offices and Global Studios in The Presidio of San Francisco. The period of authorization to use the occupied space was a one-year period that expired on December 31, 2002. Since January 1, 2003, the Exploratorium had been operating under a month-to-month agreement. During January 2013, the Exploratorium moved its entire operations to Pier 15 and had no further obligation on either of the above-described leases.

Rent expense for the operating leases discussed above amounted to approximately \$564,000 for the year ended June 30, 2013.

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 2013, upon completion of the renovations. Key provisions of the lease are as follows:

Pier 15:

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

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

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.

Exploratorium

Notes to Consolidated Financial Statements

Note 8. Lease Commitments (Continued)

Percentage rent: The Exploratorium is obligated to pay a monthly percentage rent (6%) 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. As of June 30, 2014 and 2013, the Exploratorium is 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% each year, effective January 1, 2012, until the application of the rent incentive applicable for Pier 17, or in 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% and no more than 20%. 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. As of June 30, 2014 and 2013, the Exploratorium is 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, have been 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 BayDelta (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.

The Exploratorium will, 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% of the hard costs as an administrative burden. The Exploratorium currently estimates the Dock will cost \$530,000 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 has commenced planning for the construction of the Dock in fiscal year 2015.

Exploratorium

Notes to Consolidated Financial Statements

Note 8. Lease Commitments (Continued)

The Exploratorium is obligated to pay \$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, 2014 and 2013, the balance in this reserve totaled \$100,000 and \$50,000, respectively.

The Exploratorium is also potentially obligated to pay up to \$400,000 for dredging costs incurred during a certain period after lease commencement. As of June 30, 2014, the Exploratorium has not incurred any costs associated with dredging.

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. BayDelta 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 BayDelta is no longer needed for maritime use. This determination cannot occur until a maritime use study has been conducted after BayDelta 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 BayDelta 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 BayDelta, 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:

| <u>Years Ending June 30,</u> | <u>Amount</u> |
|------------------------------|------------------------------|
| 2015 | \$ 1,906,883 |
| 2016 | 1,996,637 |
| 2017 | 2,057,797 |
| 2018 | 2,088,324 |
| 2019 | 2,119,767 |
| 2020-2024 | 11,485,921 |
| 2025-2029 | 9,431,190 |
| 2030-2034 | 6,754,881 |
| 2035-2039 | 7,430,369 |
| 2040-2044 | 8,173,406 |
| 2045-2049 | 8,990,746 |
| 2050-2054 | 9,889,821 |
| 2055-2059 | 10,878,803 |
| 2060-2064 | 11,966,684 |
| 2065-2069 | 13,163,352 |
| 2070-2074 | 14,479,687 |
| 2075-2077 | 7,221,856 |
| | <u>130,036,127</u> |
| Less sublease revenue | <u>(402,255)</u> |
| | <u><u>\$ 129,633,872</u></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.

Concurrent with entering into the lease with the Port, the Exploratorium assumed, as substitute landlord, a lease previously held by the Port. The lease is with an unrelated third party. The lease expired on December 31, 2013; however, the Exploratorium extended the lease term through March 31, 2014, at which date the tenant vacated the premises.

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 \$5.4 million and \$6.6 million have been recognized as deferred rent assets on the consolidated statements of financial position as of June 30, 2014 and 2013, respectively. Total lease expense, associated with the Port lease, amounted to approximately \$2.1 million for both years ended June 30, 2014 and 2013. These amounts are net of approximately \$1.2 million and \$0.8 million for the years ended June 30, 2014 and 2013, respectively, in recognized rent incentives provided by the Port through the rent credit clauses of the lease.

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. 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 new 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 BayDelta 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.

As of June 30, 2013, the Exploratorium was substantially complete with all construction costs and was in the final stages of negotiating contractor change orders, which were settled in full by September 2013. As noted above, the museum officially opened to the public on April 17, 2013. As detailed in Note 7, the Exploratorium has had various credit facilities to provide funding during the construction phase and to allow for long-term contribution receivables to be collected over time. To supplement the bridge financing obtained, the Exploratorium entered into an HTC Arrangement, whereby tax credits generated from the renovation of Pier 15 were purchased by an investor group. The agreed-upon purchase price is \$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. In November 2012, the Exploratorium, through one of its related entities, received an investor payment of approximately \$41 million, which is reflected on the consolidated statements of financial position as an HTC obligation. 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% 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).

Exploratorium

Notes to Consolidated Financial Statements

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

- \$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 October 16, 2014, the Exploratorium has not requested the payment from the investors.

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% 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% member of EPLLC. Bay Area Historic Fund, LLP (Investor) is the 99.99% 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 Historical Tax Credit 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 Historical Tax Credit obligation is approximately \$6.6 million and \$37.6 million, respectively, at June 30, 2014.

Exploratorium

Notes to Consolidated Financial Statements

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

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, 2014, no HTC reduction event has occurred.

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, 2014 and 2013, the Exploratorium contributed \$1,000,045 and \$904,450 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 \$24,059,804 and \$26,189,290, respectively, as of and for the year ended June 30, 2014, and \$6,111,025 and \$4,936,901, respectively, as of and for the year ended June 30, 2013.

Note 13. Subsequent Events

The Exploratorium evaluated subsequent events through October 16, 2014, the date on which the consolidated financial statements were available to be issued.