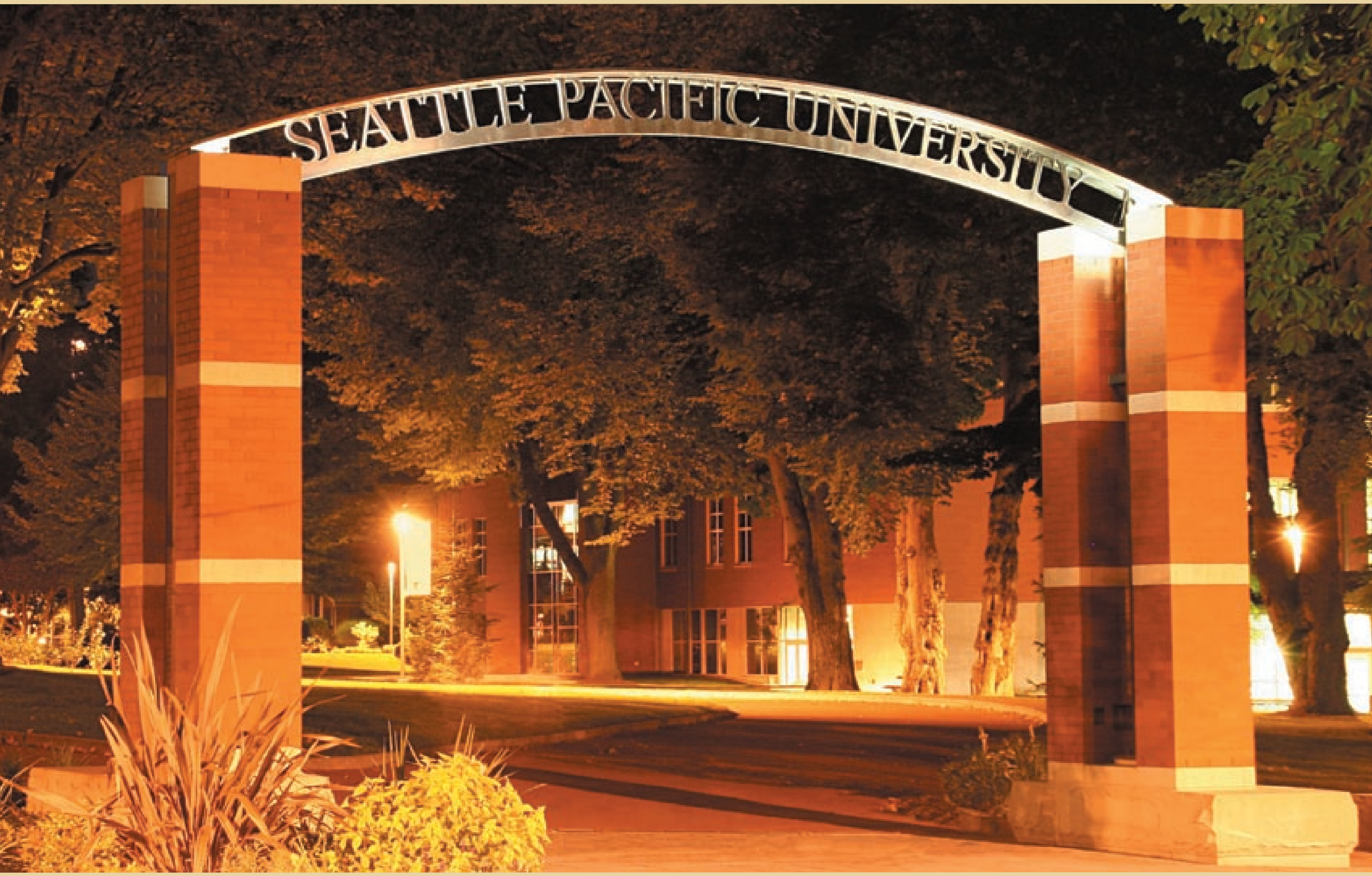
Year Ending June 30, 2006
Financial Report



Engaging the culture, changing the world®

Seattle Pacific
UNIVERSITY

About Seattle Pacific University

Founded in 1891, Seattle Pacific University is a premier Christian university that equips people to engage the culture and change the world. Its comprehensive academic program serves nearly 3,900 undergraduate and graduate students, as well as 2,900 adult learners per academic quarter in continuing education centers across Washington state. Known for both their competence and character, SPU graduates are bringing about positive change in communities around the globe.

Academically, Seattle Pacific University offers 55 undergraduate majors and 42 minors. The University's curriculum is carried out through the College of Arts and Sciences and the schools of Business and Economics; Education; Health Sciences; Theology; and Psychology, Family, and Community. Graduate studies include 12 master's degrees and three doctoral programs: educational leadership, clinical psychology, and organizational psychology.

The University's physical plant includes a 43-acre main campus near the heart of downtown Seattle; a 965-acre wilderness campus on Blakely Island in the San Juan Islands; and the 301-acre Camp Casey campus on Whidbey Island.

Cover photo: *The Tiffany Loop Arch forms the gateway to the historic center of the Seattle Pacific University campus. The brick and wrought-iron Arch is inscribed with the names of the University's seven presidents and pays special tribute to the Tiffany family. Orrin Tiffany was president of Seattle Pacific College from 1916 to 1926, and Grace English Tiffany, his wife, served as dean of women from 1917 to 1922.* Photo by Rod Hoekstra.

Contents

Independent Auditors' Report

The Board of Trustees
Seattle Pacific University:

We have audited the accompanying consolidated statements of financial position of Seattle Pacific University (the University) as of June 30, 2006 and 2005, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the University as of June 30, 2006 and 2005, and the changes in their net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

Seattle, Washington
October 23, 2006

Consolidated Statements of Financial Position

For the Years Ended June 30, 2006 and 2005

(in thousands)

	June 30, 2006	June 30, 2005
ASSETS		
Cash and cash equivalents	$ 19,788	$ 19,463
Student accounts receivable, net	2,240	2,239
Governmental grants and other receivables	1,927	1,402
Inventories and prepaid expenses	1,783	1,018
Student loans	1,588	1,362
Investments	32,111	25,457
Total current assets	59,437	50,941
Student loans, net of allowance of $204 in 2006 and $209 in 2005	5,790	6,140
Other receivables and prepaid expenses	7,833	5,666
Investments	41,716	38,609
Investments restricted for capital projects or debt retirement	8,323	–
Land, buildings, and equipment, net	117,018	119,375
Total assets	$ 240,117	$ 220,731
LIABILITIES AND NET ASSETS		
Liabilities		
Note payable to bank — line of credit	$ –	$ 5,850
Accounts payable, accrued expenses, and other liabilities	8,822	8,884
Bonds payable	3,470	3,170
Trust and annuity obligations	1,502	1,373
Student deposits and prepaid fees	1,526	1,220
Deferred revenue	4,321	3,661
Total current liabilities	19,641	24,158
Bonds payable	86,605	77,505
Trust and annuity obligations	11,292	8,565
Investments managed on behalf of charities	6,824	6,410
Unrealized loss on interest rate swaps	651	4,920
Governmental student loan programs	6,493	6,410
Other liabilities	3,072	2,218
Total liabilities	134,578	130,186
Net assets		
Unrestricted		
Available for operational activities	$ 19,600	$ 8,093
Funds held for long-term investment as endowment	18,126	13,513
Net investment in land, buildings, and equipment	31,207	35,249
Total unrestricted net assets	68,933	56,855
Temporarily restricted		
Split interest agreement funds	7,863	5,965
Unexpended funds received for specific purposes	2,514	3,247
Total temporarily restricted net assets	10,377	9,212
Permanently restricted		
Endowment funds	22,191	20,612
Split interest agreement funds restricted for endowment	4,038	3,866
Total permanently restricted net assets	26,229	24,478
Total net assets	105,539	90,545
Total liabilities and net assets	$ 240,117	$ 220,731

See accompanying notes to consolidated financial statements

Consolidated Statements of Activities

For the Years Ended June 30, 2006 and 2005
(in thousands)

	June 30, 2006	June 30, 2005
OPERATING UNRESTRICTED NET ASSETS ACTIVITY		
Revenues and other support		
Student charges:		
Tuition and fees:		
Regular term undergraduate tuition and fees	$ 64,283	$ 58,076
Less: grants and scholarships	(23,321)	(20,745)
Net regular term undergraduate tuition and fees	40,962	37,331
Graduate tuition and fees	8,520	7,673
Continuing education, summer school, and other special programs	3,136	3,240
Net tuition and fees	52,618	48,244
Student housing and dining fees	12,021	11,558
Net student charges	64,639	59,802
Private gifts and grants	3,271	2,872
Public service activities	2,275	2,055
Government grants, primarily for student aid	1,518	1,335
Distributions from endowment to support operations, grants, and scholarships	1,169	1,133
Other revenue and support	2,574	2,659
Net assets released from restrictions	1,350	1,009
Total operating revenues and other support	76,796	70,865
Expenses		
Instruction:		
Regular term degree programs	29,708	27,897
Continuing education, summer school, and other special programs	1,902	2,173
Total instruction	31,610	30,070
Student housing and dining expenses	12,699	12,877
Student services	12,198	12,403
Institutional support	12,160	11,407
Academic support	3,829	3,789
Public service	1,594	1,370
Total operating expenses	74,090	71,916
Excess (deficit) of unrestricted revenues and other support over expenses from operating activities	2,706	(1,051)
NONOPERATING UNRESTRICTED NET ASSETS ACTIVITY		
Investment income, realized and unrealized gains	7,468	4,954
Endowment distributions for operations, grants, and scholarships	(1,169)	(1,133)
Other, principally unrealized gain (loss) on interest rate swaps related to bonds	4,269	(1,399)
Change in value of split interest agreements	(411)	94
Cumulative effect of change in accounting principle	(785)	–
Increase in unrestricted net assets from nonoperating activities	9,372	2,516
Net change in unrestricted net assets	12,078	1,465
TEMPORARILY RESTRICTED NET ASSETS ACTIVITY		
Private gifts and grants	2,125	2,887
Change in value of split interest agreements	390	1,218
Net assets reclassified to permanently restricted	–	(7,788)
Net assets released from restrictions	(1,350)	(1,009)
Net change in temporarily restricted net assets	1,165	(4,692)
PERMANENTLY RESTRICTED NET ASSETS ACTIVITY		
Private gifts and grants	1,579	563
Change in value of split interest agreements	172	–
Net assets reclassified from temporarily restricted	–	7,788
Net change in permanently restricted net assets	1,751	8,351
Increase in total net assets	14,994	5,124
Total net assets, beginning of year	90,545	85,421
Total net assets, end of year	$ 105,539	$ 90,545

See accompanying notes to consolidated financial statements

Consolidated Statements of Cash Flows

For the Years Ended June 30, 2006 and 2005
(in thousands)

	June 30, 2006	June 30, 2005
OPERATING ACTIVITIES		
Increase in net assets	$ 14,994	$ 5,124
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	7,360	7,290
Amortization of bond issuance costs	894	33
Provision for doubtful accounts	(8)	101
Net realized and unrealized gain on investments	(6,585)	(4,495)
Contributions restricted for endowments and capital projects	(2,582)	(606)
Contributions of remainder interest in trusts managed by others	–	(2,269)
Loss on disposal of plant assets	3	291
Change in value of split interest agreements	(151)	(1,312)
Other, principally unrealized (gain) loss on interest rate swaps related to bonds	(4,269)	1,399
Cumulative effect of change in accounting principle	785	–
Cash provided (used) by changes in operating assets and liabilities:		
Student accounts receivable	2	5
Government grants and other receivables	(525)	78
Student loans	129	(101)
Inventories and prepaid expenses	(765)	(192)
Other receivables	198	120
Accounts payable, accrued liabilities, and other liabilities	(467)	457
Student deposits and prepaid fees	306	42
Deferred revenue	660	285
Investments managed on behalf of charities	414	328
Governmental student loan programs	83	79
Net cash provided by operating activities	10,476	6,657
INVESTING ACTIVITIES		
Proceeds from sale of investments	2,074	4,907
Purchase of investments	(4,647)	(4,895)
Proceeds from collections of notes receivable	17	39
Purchase of restricted investments	(8,323)	–
Issuance of notes receivable	(30)	(338)
Purchase of land, buildings, and equipment	(5,212)	(4,365)
Net cash used by investing activities	(16,121)	(4,652)
FINANCING ACTIVITIES		
Payment of short-term line of credit	(5,850)	(6,000)
Proceeds from borrowing under short-term line of credit	–	5,850
Payments on long-term debt	(82,420)	(2,771)
Proceeds from issuance of long-term debt	91,820	–
Bond issuance costs	(3,144)	–
Contributions restricted for endowments and capital projects	2,582	606
Annuity payments and other	88	491
Net cash transactions related to split interest agreements	2,894	(960)
Net cash provided (used) by financing activities	5,970	(2,784)
Net increase (decrease) in cash and cash equivalents	325	(779)
CASH AND CASH EQUIVALENTS		
Beginning of year	19,463	20,242
End of year	$ 19,788	$ 19,463
Supplemental disclosure of cash flow information —		
Cash paid during the year for interest, net of amount capitalized	$ 4,575	$ 4,555
Acquisition of property, plant, and equipment through accounts payable	$ 411	$ 256

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

Years Ended June 30, 2006 and 2005

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

General

Seattle Pacific University is a private nonprofit institution of Christian higher education based in Seattle, Washington. The University offers degree programs for undergraduate and graduate students through the College of Arts and Sciences and the schools of Business and Economics; Education; Health Sciences; Theology; and Psychology, Family, and Community. The University offers degrees in 55 undergraduate major programs and 42 minor areas of study, 12 master's programs, and three doctoral programs.

Basis of Presentation

The accompanying financial statements are the consolidated statements of Seattle Pacific University (the University) and Seattle Pacific Foundation (the Foundation). The University has a controlling financial interest in the Foundation through direct ownership of the majority voting interest in the Foundation. The University's Board of Trustees appoints Foundation directors.

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting and include the accounts of the University and the Foundation. All significant inter-company transactions and balances have been eliminated.

Resources received by the University are classified into three net asset categories according to the presence or absence of donor-imposed restrictions. A description of the three net asset categories follows.

Unrestricted net assets

Unrestricted net assets include amounts not subject to donor-imposed restrictions and net assets received during the year that were subject to temporary donor-imposed restrictions satisfied during the same year.

Temporarily restricted net assets

Temporarily restricted net assets include amounts that are subject to donor-imposed time or use restrictions that have not been met. At June 30, 2006 and 2005, $7,871,000 and $6,209,000, respectively, are restricted by the passage of time, primarily related to net assets held in irrevocable trusts, and $2,506,000 and $3,003,000, respectively, are restricted by use requirements.

Permanently restricted net assets

Permanently restricted net assets include amounts subject to donor-imposed restrictions where the corpus is invested in perpetuity and only the income and appreciation is made available for program operations and scholarships in accordance with donor restrictions. Included on June 30, 2006 and 2005, are irrevocable trusts restricted for endowment use at maturity valued at $4,038,000 and $3,866,000, respectively. Generally only the original gift value of an endowment that has donor restrictions is considered permanently restricted, unless otherwise expressly stipulated in the agreement with the donor.

Revenue and Expense Recognition

Revenues from sources other than contributions are reported as increases in unrestricted net assets. Contributions, including unconditional promises to give, are recognized as revenue in the period received and reported as increases in the appropriate category of net assets based on the presence or absence of donor-imposed restrictions. Contributions other than cash are recorded at their fair market value at the date of gift or at net realizable value if the assets are intended for sale. Contributions that the donor restricts where the restrictions are met within the same fiscal year as the contribution is received are recorded as increases in unrestricted net assets. Expirations of temporary restrictions on net assets are reported as reclassifications from temporarily restricted net assets to unrestricted net assets. All expenses are reported as decreases in unrestricted net assets. Except as restricted by donors, gains and losses on investments are reported as increases or decreases in unrestricted net assets. Temporary restrictions on gifts to acquire long-lived assets are considered met in the period the assets are acquired or placed into service.

Cash and Cash Equivalents

Cash and cash equivalents consist of all cash balances and short-term, highly liquid investments with original maturities at the date of purchase of three months or less. Cash equivalents totaled $18,651,000 and $19,036,000 at June 30, 2006 and 2005, respectively.

Investments

Investments are stated at fair value. The fair value of all equity and debt securities with readily determinable fair market values are based on quotations obtained from national securities exchanges. Real estate held for investment or sale is reported based on independent appraisals. If an independent appraisal is not available for real estate, the investment is recorded at an amount that approximates fair market value based on the judgment of Foundation management. These investments are intended by management to be long-term investments primarily held or maintained for use as endowments managed by the Foundation.

Alternative investments are investments for which there is no readily determinable published value. They include institutional funds, private equity funds, and limited liability companies. Institutional funds are multi-strategy, commingled equity and bond funds. Private equity funds are primarily comprised of investments in limited partnerships. The partnerships generally represent restricted investment securities whose values have been estimated by the managing partner of the partnership in the absence of readily ascertainable market values. The limited liability companies are primarily invested in real estate. The Foundation reviews and evaluates the values provided by the investment managers and agrees with the valuation methods and assumptions used in determining the fair value of the alternative investments. Because of the inherent uncertainty of the valuation of nonmarketable and restricted investments, the estimated fair values of these investments may differ significantly from the values that would have been used had a ready market for the securities existed. These differences could be material.

At June 30, 2006, the University had certain endowment investments related to donor-restricted endowment funds for which the fair value of assets was $118,000, which was less than the cost basis of $124,000.

Investments Restricted for Capital Projects or Debt Retirement

Investments restricted for capital projects or debt retirement include unspent proceeds from bond issues that are invested in guaranteed investment contracts and are restricted for future construction and capital project funds.

Credit Risk and Fair Value of Financial Instruments

The University grants credit primarily to student borrowers in the Pacific Northwest in the normal course of operations. The credit risk with respect to these receivables is generally considered minimal due to the wide dispersion of receivables.

The carrying amount of cash and cash equivalents, student loans and accounts receivable, governmental grants and other receivables, and accounts payable approximates fair market value due to the short-term maturities of these instruments. The carrying amount of the University's notes receivable and notes payable approximates fair value as they bear interest at variable interest rates or fixed rates which approximate current market rates for notes with similar maturities and credit quality.

Bond Issuance Costs

Bond issuance costs include amounts paid by the University in connection with the issuance of the Series 2005 WHEFA Bonds. Amortization of issuance costs is calculated using the straight-line method over the 25-year term of the bonds. Remaining unamortized bond issuance costs related to series 2000 bonds of $820,000 were written off during 2006. Amortization expense related to bond issuance costs in the years 2006 and 2005 was $894,000 and $33,000, respectively.

Land, Buildings, and Equipment

Land, buildings, and equipment are carried at cost or, if donated, at the fair market value on the date of donation. The University uses the straight-line method of depreciation to allocate the cost of assets over the estimated useful lives. Estimated useful lives range from three years for computers to 50 years for buildings.

Estates and Trusts

Trusts in which either the University or the Foundation is named as irrevocable remainder beneficiary, but not as trustee, are recorded in the consolidated financial statements as contribution income when the trustee notifies the University and the ownership percentage and valuation are determined. The portions of these trusts that are restricted for endowment use at the time of trust maturity are classified as permanently restricted net assets.

Deferred Revenues

Deferred revenues consist of payments of tuition and fees related to future academic terms.

Investments Managed on Behalf of Charities

The Foundation manages the assets of an unrelated foundation and is trustee for several special needs trusts in which the University is remainder beneficiary. Those assets and a corresponding liability are included in the accompanying consolidated financial statements.

Recently Adopted Accounting Standards

In March 2005, the Financial Accounting Standards Board (FASB) issued Interpretation No. 47 (FIN 47), Accounting for Conditional Asset Retirement Obligations, an interpretation of Statement of Financial Accounting Standards No. 143 (SFAS 143). This interpretation clarified that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. The types of asset retirement obligations that are covered by FIN 47 are those for which an entity has a legal obligation to perform when an asset is retired. The timing and method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. SFAS 143 requires the fair value of a liability for a legal obligation associated with an asset retirement be recorded in the period in which the obligation is incurred. When the liability is initially recorded, the cost of the asset retirement is capitalized.

The University adopted FIN 47 effective June 30, 2006. Since SFAS 143 requires retrospective application to the inception of the liability, the initial asset retirement obligation was calculated using a discount rate of 3.67%, which represents the University's risk-free rate.

The effect of the adoption of FIN 47 reflects the accretion of the liability and the depreciation of the capitalized retirement asset from the liability inception date through June 30, 2006.

The financial statement impact of adopting FIN 47, as described above, relates to estimated costs to remove asbestos that is contained within the University's facilities. The net effect of adopting this standard increases net property, plant, and equipment by $208,000, increases asset retirement obligation liabilities by $1,025,000, and decreases unrestricted net assets $817,000 relative to what these figures would have been absent the retrospective adoption of this standard. Of the $817,000 reduction in unrestricted net assets, $785,000 is related to liability accretion and depreciation expense prior to July 1, 2005, and $32,000 is related to liability accretion and depreciation expense for the current fiscal year.

Taxes

The University and the Foundation are exempt from federal income taxes pursuant to Section 501(c)(3) and Section 509(a)(3) of the Internal Revenue Code except for unrelated business taxable income as defined in sections 511 through 515 of the Internal Revenue Code. Accordingly, the financial statements do not include a provision for federal income tax. In addition, the University presently is exempt from real and personal taxes on a majority of its educational and other noncommercial properties of the University and the Foundation.

Reclassifications

Certain reclassifications have been made to the 2005 consolidated financial statements to conform to the classifications used in 2006.

Use of Estimates

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

NOTE B – STUDENT ACCOUNTS RECEIVABLE:

Student accounts receivable consists of amounts due from students for tuition, room, board, and other enrollment-related charges. At June 30, 2006 and 2005, amounts due for subsequent summer term charges are recorded as a receivable with the related revenue reflected as deferred revenue. Student accounts receivable consists of the following balances:

	June 30, 2006 ($000)	June 30, 2005 ($000)
Amounts due from charges for prior academic terms	$ 1,439	$ 1,367
Amounts due for summer term earned subsequent to year-end	1,385	1,457
	2,824	2,824
Allowance for doubtful accounts	(584)	(585)
Net student accounts receivable balance	$ 2,240	$ 2,239

NOTE C – INVESTMENTS:

Investments are composed of pooled investment funds, marketable securities, and real estate. The University's pooled investments are composed of three investment pools maintained by the Foundation for various trusts, annuities, pooled income, and endowment funds. The investment pools are managed by the Foundation through an investment committee of its directors.

	June 30, 2006 ($000)	June 30, 2005 ($000)
Pooled investments:		
Cash and short-term investments	$ 3,089	$ 1,435
Institutional funds, common stock	39,832	34,247
Institutional funds, bond mutual funds	5,598	7,192
Private equities	8,711	7,496
Notes receivable	1,973	1,823
Real estate	8,280	6,246
Total pooled investments	67,483	58,439
Equity securities	79	189
Debt securities	70	64
Real estate held for investment or sale	6,195	5,374
Total investments	$ 73,827	$ 64,066

The following schedule summarizes investment return and its classification on the Statement of Activities:

	June 30, 2006 ($000)	June 30, 2005 ($000)
Investment income	$ 883	$ 459
Net realized and unrealized gains on investments	6,585	4,495
Investment income, realized and unrealized gains	$ 7,468	$ 4,954
Operating:		
Endowment distributions for operations, grants, and scholarships	$ 1,169	$ 1,133
Nonoperating:		
Net gain on endowments, net of distributions	3,262	3,246
Net gains on other investments	3,037	575
Investment income, realized and unrealized gains	$ 7,468	$ 4,954

NOTE D – CONTRIBUTIONS RECEIVABLE:

Contributions receivable at June 30, 2006 and 2005, are reflected in the other receivable balances on the Statement of Financial Position. The recorded balances include pledges that have been discounted at a range of 3.00-5.00% based on the risk-free rate of return and are due to be collected as follows:

	June 30, 2006 ($000)	June 30, 2005 ($000)
Contributions expected to be collected:		
Within one year	$ 195	$ 214
One to five years	503	597
More than five years	–	100
	698	911
Less discount to present value	(71)	(108)
Less allowance for uncollectible contributions receivable	(35)	(45)
Total contributions receivable	$ 592	$ 758

NOTE E – LAND, BUILDINGS, AND EQUIPMENT:

Land, buildings, and equipment consist of the following:

	June 30, 2006 ($000)	June 30, 2005 ($000)
Land	$ 17,207	$ 17,207
Buildings and improvements	131,953	131,784
Equipment	13,792	13,141
Library books	6,549	6,122
Construction in progress	1,866	887
	171,367	169,141
Less accumulated depreciation	(54,349)	(49,766)
Net land, buildings, and equipment	$ 117,018	$ 119,375

NOTE F – NOTES AND BONDS PAYABLE:

As of June 30, 2006 and 2005, bonds payable issued through the Washington Higher Education Facilities Authority (WHEFA) consist of the following:

	Interest Rate Mode	Maturity Dates	June 30, 2006 ($000)	June 30, 2005 ($000)
Series 2000A Bonds	Variable Demand Rate	2003-2030	$ –	$ 60,375
Series 2000B Bonds	Variable Demand Rate	2005-2030	–	20,300
Series 2005 Bonds	Variable Auction Rate	2005-2030	90,075	–
			$ 90,075	$ 80,675

The weekly variable auction rate in effect on June 30, 2006, was 3.96%, and the monthly variable demand rate in effect on June 30, 2005, was 2.62%.

In December 2005, the University issued the Series 2005 bonds for the purposes of refinancing the outstanding Series 2000A and B bonds and for capital improvement projects on campus. The underlying letter of credit that supported the Series 2000A and B bonds was also cancelled at the time of the issuance of the Series 2005 bonds. The Series 2005 bonds are supported by an underlying insurance policy with Radian Asset Assurance, Inc. The underlying insurance contains restrictive defined financial ratios and measures as defined in the policy. As of June 30, 2006 and 2005, the University was in compliance with the ratios and measures required under the insurance policy and letter of credit. WHEFA is a financing conduit through the State of Washington for private higher education institutions in the State. The tax-exempt bonds are obligations of the University and are not guaranteed by the State.

Principal payments on the June 30, 2006, obligations are due as follows during the next five fiscal years and thereafter:

	Principal ($000)
2006-2007	$ 3,470
2007-2008	3,480
2008-2009	3,485
2009-2010	3,485
2010-2011	3,495
Thereafter	72,660
	$ 90,075

For the fiscal years ended June 30, 2006 and 2005, the University incurred $4,155,000 and $4,451,000, respectively, in total interest costs related to long-term debt. In 2005, all interest incurred was charged against operations. In 2006, $4,195,000 was charged against operations and $142,000 was paid out of bond proceeds.

The University maintains a $10,000,000 revolving line of credit at a floating interest rate. As of June 30, 2006, there were no draws outstanding against this line. Short-term and other interest costs for the years ended June 30, 2006 and 2005, were $40,000 and $20,000, respectively.

NOTE G – ACCOUNTING FOR INTEREST RATE SWAPS:

The University uses variable-rate debt to finance the acquisition of property, plant, and equipment as indicated in Note F. These debt obligations expose the University to variability in interest payments due to changes in interest rates. If interest rates increase, interest expense increases. Conversely, if interest rates decrease, interest expense decreases.

The University believes it is prudent to limit the variability of a portion of its interest payments. It is the University's objective to hedge a minimum of 30-50% of its variable-rate interest payments related to this debt, depending on the existing interest rate environment. To meet this objective, the University entered into interest rate swaps to manage fluctuations in cash flows resulting from interest rate risk.

The University swapped its variable-rate cash flow exposure on the debt obligations for fixed-rate cash flows by entering into receive-variable, pay-fixed interest rate swaps. Under the interest rate swaps, the University receives variable interest rate payments and makes fixed interest rate payments, thereby creating the equivalent of fixed-rate debt. In September 2000, the University acquired a 20-year amortizing swap from Lehman Brothers with a June 30, 2006, notional amount of $20,300,000 at a fixed rate of 4.85%. In November 2001, the University acquired 10-year and 7-year swaps from Bank of America at a notional amount of $40,000,000 at 3.89% and $12,000,000 at 3.58%, respectively. In January 2006, the University acquired a 25-year accreting and amortizing swap from Bank of America. The value of this swap will increase over time as the previous swaps expire and decrease as principal payments are made on the bonds to maintain a consistent level of overall variable-rate exposure. As of June 30, 2006, the accreting and amortizing swap had a notional amount of $5,205,000 at 3.71%. There was no cash exchanged at the time of acquisition of these swaps due to the relationship between the variable rates and the swap rate at that time.

Changes in the fair market value of the interest rate swap are reported as unrealized gains or losses on interest rate swaps related to bonds on the Statement of Activities. For the year ended June 30, 2006, the valuation of the swaps resulted in a net unrealized gain of $4,269,000 due to fixed interest rates for the remaining term of the swap being higher than they were at June 30, 2005, relative to the stated fixed rate for the swaps. The offsetting liability related to a cumulative loss is reported on the Statement of Financial Position as unrealized loss on interest rate swap. Providing that the University holds the swaps to maturity, the value of the derivatives will be zero. These swapping transactions can be terminated at market rates at any time during the term of the swap.

The University does not enter into these derivative instruments for any purpose other than cash flow hedging purposes and does not speculate for investment purposes using derivative instruments.

NOTE H – SPLIT INTEREST AGREEMENTS:

The University and Foundation have entered into a variety of charitable remainder trusts for which the Foundation is the trustee. For trusts with a fixed-percentage payment obligation (straight unitrusts) established prior to and including 1998, an estimated liability has been recorded representing the expected cash flow to named beneficiaries, discounted primarily at 11.4%. Expected cash flows are based upon estimated earnings of 11.4% and a life expectancy of a pool of similar trusts. For all unitrusts established after 1998, the present value of these estimated payments was determined on the basis of published actuarial factors for ages of the respective beneficiaries discounted using current Internal Revenue Service established rates, which have ranged between 4.6% and 8.0%. The difference between the fair value of the assets received and the estimated remainder interest has been recorded as deferred revenue. Investments related to these agreements are reflected as investments in the accompanying consolidated financial statements.

NOTE I – ANNUITY OBLIGATIONS:

The University and Foundation have entered into a variety of charitable gift annuities where the University agrees to pay a donor and named beneficiaries a fixed amount per year for the life of the annuitant(s), or a stated term. In exchange, the University receives assets valued in excess of the present value of the annuity. The charitable gift annuity payments are general obligations of the University, and the present value of these gift annuity obligations totaled $3,262,000 and $592,000 at June 30, 2006 and 2005, respectively.

NOTE J – RETIREMENT PLAN:

The University participates in a 401(a) defined contribution retirement plan. The plan provides for employer contributions that are directed by participants to investment funds of Teachers Insurance and Annuity Association or Fidelity Investments. All faculty and staff at least 21 years of age with one year of full-time employment participate in the plan. Contributions to the plan are made by the University and are funded as the liability occurs. The University's contributions to the plan were $2,296,000 and $2,159,000 for the years ended June 30, 2006 and 2005, respectively. The University also provides a 403(b)(7) supplemental retirement plan funded by individual employee contributions. These contributions are voluntary, and the plan is open to all employees.

NOTE K – FUNDRAISING EXPENSE:

Institutional support expense reflected on the Statement of Activities includes $2,367,000 and $2,167,000 of fundraising expenses for the years ended June 30, 2006 and 2005, respectively.

NOTE L – RELATED PARTY TRANSACTIONS:

On December 21, 2004, the University issued a market-rate amortizing 20-year mortgage note in the amount of $329,000 in connection with the sale of residential real estate on University land to a member of management. The sale was in conjunction with the University's housing assistance programs for employees and made under an equity sharing agreement based on the current fair market value of the property. The agreement provides the right to the University to purchase the property back at its option for a price below market value.

NOTE M – COMMITMENTS AND CONTINGENCIES:

Commitments

The investment pools managed by the Foundation participate in 15 venture and private equity investment programs through Commonfund Asset Management Company, Inc., a wholly owned subsidiary of The Common Fund for Nonprofit Organizations, and through Alexander Hutton Venture Partners. The University has committed to invest $19,243,000 in these programs. At June 30, 2006, a cumulative total of $14,817,000 has been invested. The remaining $4,426,000 will be invested in one or more installments, and in amounts and on dates specified by the private equity investment managers.

Contingencies

The University is an equity owner of the College Liability Insurance Company (CLIC). For the fiscal year ending June 30, 2006, the University had a $382,160 contingent liability for its portion of a $2,000,000 letter of credit issued to CLIC by a bank. The University is a guarantor of this letter of credit and would be liable for its share of the contingency if CLIC were to fail to repay amounts borrowed under the letter of credit.

The University receives and expends monies under Federal grant programs and is subject to audits by cognizant governmental agencies. Management believes that any liabilities resulting from such audits would not have a material impact on the consolidated financial statements of the University.

The University provides a guarantee to Credit Union Northwest on loans they provide in support of the University's Housing Assistance Program (HAP) for faculty and staff. The HAP provides down-payment assistance loans on a need basis to faculty and staff moving into the Seattle area or purchasing a first home. These loans are supported with a secured deed of trust against the underlying property. There are currently 13 such loans outstanding that are due between 2006 and 2016. Since the inception of the HAP in 1991, no guarantees have been exercised by the credit union. As of June 30, 2006, the loan portfolio balance held by the credit union was $412,000. The University's exposure under the loan guarantees is limited to the difference between the value of the secured deed of trust held by the credit union and the remaining principal balance of the related loan. The University believes the value of the secured deeds of trust held by the credit union exceeds the loan balances as of June 30, 2006.

The University is subject to legal proceedings and claims that arise in the ordinary course of its business. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect the financial position of the University, the changes in their net assets, and their cash flows in conformity with U.S. generally accepted accounting principles.

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