PEPPERDINE UNIVERSITY

CONSOLIDATED FINANCIAL STATEMENTS

July 31, 2012 and 2011

PEPPERDINE UNIVERSITY

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Report of Independent Auditors

To the Board of Regents of
Pepperdine University

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of activities and cash flows, present fairly, in all material respects, the consolidated financial position of Pepperdine University and its subsidiaries (the "University") at July 31, 2012 and 2011, and the changes in its consolidated net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

November 21, 2012

PricewaterhouseCoopers LLP, 350 S. Grand Avenue, Los Angeles, CA 90071
T: (213) 356 6000, F: (813) 637 4444, www.pwc.com/us

PEPPERDINE UNIVERSITY
Consolidated Statements of Financial Position
At July 31, 2012 and 2011
(In thousands)

	2012	2011
ASSETS		
Cash and cash equivalents	$ 73,625	$ 50,172
Student receivables, less allowance for doubtful accounts of $1,410 and $1,374, respectively	1,183	1,838
Other accounts receivable	3,119	4,822
Prepaid expenses, inventories and other assets	4,903	5,459
Student loans, less allowance for loan losses of $1,707 and $1,697, respectively	23,812	24,513
Contributions receivable, net	28,905	27,752
Investments	767,261	779,682
Assets held as trustee or agent	124,459	121,656
Property, facilities and equipment, net	341,180	346,678
Total assets	$1,368,447	$1,362,572
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable and accrued liabilities	$ 15,730	$ 18,341
Accrued salaries and wages	3,364	3,216
Student deposits, advance payments and deferred revenue	10,012	8,613
Asset retirement obligations	5,720	5,460
U.S. government-funded student loans	15,006	14,685
Trust and agency obligations	74,951	72,198
Long-term obligations	239,422	226,978
Total liabilities	364,205	349,491
Net assets:		
Unrestricted	595,418	575,703
Temporarily restricted	103,043	132,378
Permanently restricted	305,781	305,000
Total net assets	1,004,242	1,013,081
Total liabilities and net assets	$1,368,447	$1,362,572

See accompanying notes to consolidated financial statements.

PEPPERDINE UNIVERSITY
Consolidated Statement of Activities
For the year ended July 31, 2012
(In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Student tuition and fees	$ 269,884	$ -	$ -	$ 269,884
Less student aid	(81,350)	-	-	(81,350)
Net student tuition and fees	188,534	-	-	188,534
Room and board	32,465	-	-	32,465
Private gifts and grants	10,905	6,058	5,960	22,923
Endowment support	31,527	115	361	32,003
Government grants	3,624	3	-	3,627
Sales and services	6,273	-	-	6,273
Other revenue	4,344	18	1,054	5,416
Net assets released from restriction	26,744	(26,881)	137	-
Total revenues	304,416	(20,687)	7,512	291,241
EXPENSES				
Instruction and research	84,163	-	-	84,163
Academic support	49,506	-	-	49,506
Student services	48,806	-	-	48,806
Public service	15,009	-	-	15,009
Auxiliary enterprises	23,744	-	-	23,744
Management and general	46,608	-	-	46,608
Membership development	1,824	-	-	1,824
Fundraising	7,707	-	-	7,707
Total expenses	277,367	-	-	277,367
Change in net assets before nonoperating revenues and expenses	27,049	(20,687)	7,512	13,874
NON-OPERATING REVENUES AND EXPENSES				
Adjustment of actuarial liability	-	(5,635)	(2,030)	(7,665)
Investment income:				
Dividends	6,632	1,776	1	8,409
Interest	1,135	5	147	1,287
Other	7,599	16	4	7,619
Investment expenses	(3,246)	(901)	-	(4,147)
Net realized and unrealized investment losses	(16,788)	(6,585)	(3,723)	(27,096)
Foreign currency translation	(2,606)	-	-	(2,606)
Other	(60)	2,676	(1,130)	1,486
Total nonoperating revenues and expenses	(7,334)	(8,648)	(6,731)	(22,713)
Change in net assets	19,715	(29,335)	781	(8,839)
Net assets at beginning of year	$ 575,703	$ 132,378	$ 305,000	$ 1,013,081
Net assets at end of year	$ 595,418	$ 103,043	$ 305,781	$ 1,004,242

See accompanying notes to consolidated financial statements.

PEPPERDINE UNIVERSITY
Consolidated Statement of Activities
For the year ended July 31, 2011
(In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Student tuition and fees	$ 264,767	$ -	$ -	$ 264,767
Less student aid	(80,214)	-	-	(80,214)
Net student tuition and fees	184,553	-	-	184,553
Room and board	31,821	-	-	31,821
Private gifts and grants	13,622	5,519	8,644	27,785
Endowment support	31,377	197	263	31,837
Government grants	3,602	6	-	3,608
Sales and services	6,800	-	-	6,800
Other revenue	3,953	956	409	5,318
Net assets released from restriction	3,529	(3,184)	(345)	-
Total revenues	279,257	3,494	8,971	291,722
EXPENSES				
Instruction and research	82,314	-	-	82,314
Academic support	50,950	-	-	50,950
Student services	46,590	-	-	46,590
Public service	14,895	-	-	14,895
Auxiliary enterprises	19,802	-	-	19,802
Management and general	48,176	-	-	48,176
Membership development	1,989	-	-	1,989
Fundraising	7,699	-	-	7,699
Total expenses	272,415	-	-	272,415
Change in net assets before nonoperating revenues and expenses	6,842	3,494	8,971	19,307
NON-OPERATING REVENUES AND EXPENSES				
Adjustment of actuarial liability	-	3,113	1,386	4,499
Investment income:				
Dividends	7,602	2,306	17	9,925
Interest	1,206	4	85	1,295
Other	6,956	56	-	7,012
Investment expenses	(2,991)	(932)	-	(3,923)
Net realized and unrealized investment gains	32,367	9,253	9,528	51,148
Foreign currency translation	2,434	-	-	2,434
Other	6	(3,980)	(3,160)	(7,134)
Total nonoperating revenues and expenses	47,580	9,820	7,856	65,256
Change in net assets	54,422	13,314	16,827	84,563
Net assets at beginning of year	521,281	119,064	288,173	928,518
Net assets at end of year	$ 575,703	$ 132,378	$ 305,000	$ 1,013,081

See accompanying notes to consolidated financial statements.

PEPPERDINE UNIVERSITY
Consolidated Statements of Cash Flows
For the Years Ended July 31, 2012 and 2011
(In thousands)

CASH FLOWS FROM OPERATING ACTIVITIES	2012	2011
Change in net assets	$ (8,839)	$ 84,563
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	19,781	18,670
Provision for doubtful accounts	200	500
Provision for loan losses	-	200
Loss on early extinguishment of debt	333	-
Non-cash gifts	(8,876)	(2,416)
Adjustment of actuarial liability	7,665	(4,499)
Contributions restricted for long-term investment	(2,931)	(3,292)
Income restricted for long-term investment	(361)	(263)
Premium on issuance of long-term debt	8,488	-
Loss from sale of property, facilities and equipment	200	122
Net realized and unrealized losses (gains) on investments	27,096	(51,148)
Change in assets and liabilities:		
Student receivables	454	659
Other accounts receivable	1,703	2,838
Contributions receivable	(2,072)	1,909
Prepaid expenses, inventories and other assets	(759)	303
Accounts payable and accrued liabilities	(1,028)	1,424
Accrued salaries and wages	148	117
Student deposits, advance payments and deferred revenue	1,428	(1,303)
Net cash and cash equivalents provided by operating activities	42,630	48,384
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales of investments	163,060	91,407
Purchases of investments	(168,193)	(128,388)
Purchases of property, facilities and equipment	(13,977)	(18,065)
Student loans repaid	4,319	4,239
Student loans issued	(3,618)	(2,992)
Net cash and cash equivalents used in investing activities	(18,409)	(53,799)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from contributions restricted for long-term investment	3,851	6,775
Income restricted for long-term investment	361	263
Proceeds from issuance of long-term obligations	50,000	-
Principal payments on long-term obligations	(45,000)	-
Increase in U.S. government student loan funds	321	292
Investment (losses) income and gains on annuities payable	(2,435)	2,711
Payment of trust and agency obligations	(7,866)	(8,933)
Net cash and cash equivalents provided by financing activities	(768)	1,108
Net change in cash and cash equivalents	23,453	(4,307)
Cash and cash equivalents at beginning of year	50,172	54,479
Cash and cash equivalents at end of year	$ 73,625	$ 50,172

See accompanying notes to consolidated financial statements.

1. Nature of Operations

Pepperdine University (the "University") is an independent private Christian university committed to the highest standards of academic excellence and Christian values, where students are strengthened for lives of purpose, service, and leadership. The University enrolls approximately 7,500 students in its five colleges and schools. Seaver College, the University's undergraduate liberal arts college, the School of Law, and the School of Public Policy are headquartered on 830 acres in the Santa Monica Mountains overlooking the Pacific Ocean in Malibu, California. The Graduate School of Education and Psychology and the George L. Graziadio School of Business and Management are headquartered at the University's West Los Angeles, California graduate campus.

Mr. George Pepperdine, the founder of Western Auto Supply Company, established George Pepperdine College in 1937. He envisioned a college with the highest academic standards guided by the spiritual and ethical ideals of Christian faith. University status was achieved in 1970 with the addition of the graduate and professional schools. Through the generosity of Mrs. Frank Roger Seaver, the University's Malibu campus of Seaver College opened in 1972. Since then, the Malibu campus expanded to include the School of Law in 1978, and the Drescher Graduate Campus in 2003.

The University operates seven consolidated affiliated companies: Wave Enterprises, Inc., Wave Property, Inc., Wave Services, Inc., Pepperdine University (USA) in London, UK, Pepperdine University, Lausanne (Switzerland) Branch, Cinderella Immobiliare, S.R.L (Florence, Italy) and Pepperdine Argentina, S.R.L. All material transactions and balances between the University and its affiliates have been eliminated in consolidation.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Consolidated Financial Statements of the University are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP") and with the provisions of the American Institute of Certified Public Accountants' *Audit and Accounting Guide for Not-for-Profit Organizations*. In preparing the Consolidated Financial Statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities and revenues and expenses for the periods presented. Significant items which could be materially affected by such estimates include: the allowance for doubtful accounts, the allowance for loan losses, contributions receivable, investments, assets held as trustee or agent, accounts payable and accrued liabilities and trust and agency obligations. The University's actual results could differ significantly from management's estimates. Management also utilizes certain estimates based on square footage to allocate depreciation, interest expense and central plant operations expense to the functional expense categories included on the Consolidated Statements of Activities.

Income Taxes

As a not-for-profit educational institution, the University is exempt from Federal and California income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue and Taxation Code, except for taxes on unrelated business income. Since the University's unrelated business income for the years ended July 31, 2012 and 2011 was immaterial, no provision for income taxes has been made in the accompanying Consolidated Financial Statements.

Net Assets

The University is required to classify its net assets into the following three categories according to donor-imposed restrictions or provisions of law:

Unrestricted net assets represent resources that are not restricted, either temporarily or permanently, by donor-imposed stipulations. They are available for support of all organizational operations and services.

Temporarily restricted net assets represent contributions and other assets whose use are limited by donor-imposed stipulations. These restrictions are temporary in that they either expire by the passage of time or by the fulfillment of certain obligations of the University pursuant to those stipulations.

Permanently restricted net assets represent contributions and other assets whose use by the University are limited by donor-imposed stipulations. These restrictions are permanent in that they neither expire by passage of time nor be otherwise removed by the University. Income from these assets can be unrestricted or restricted based on donor stipulations.

During the year ended July 31, 2012, $21.9 million of net assets related to capital projects completed in prior years were released from restriction. The University does not believe that this correction has a material impact to the current or previously issued financial statements.

Revenue Recognition

Student tuition and fees and room and board are recorded as revenues in the period the services are rendered. Private gifts, including unconditional promises to give, are recognized as revenue in the period received and are reported as increases in the appropriate category of net assets. Conditional or contingent grant awards are not recorded as revenue until the conditions on which they depend have been substantially met. Grants received from departments or agencies of the government considered to be exchange transactions are not recorded as revenue until related costs are incurred. These revenues are subject to audit by government authorities. A receivable is recorded to represent expenditures incurred prior to the fiscal year end for which cash reimbursement has not been received. Endowment support, limited to the payout calculated under the Total Rate of Return methodology, is comprised of ordinary income earned on endowment and quasi-endowment assets as well as accumulated gains earned on endowment and quasi-endowment assets in previous years.

Concentrations of Financial Aid

A significant number of students attending the University receive financial assistance from U.S. government student financial aid programs. These programs require the University to comply with record keeping, eligibility and other requirements. Failure to comply with such U.S. government requirements could result in the loss of U.S. government financial assistance to the University's students and adversely impact the operations of the University.

Cash and Cash Equivalents

Cash and cash equivalents includes cash on hand, cash in checking and savings accounts, money-market funds, cash held by external investment managers and short-term investments with an original maturity of three months or less. Other short-term resources held by external investment managers are classified as investments.

Student Receivables

Student receivables are carried at cost, less an allowance for doubtful accounts.

Management believes that the allowance for doubtful accounts is adequate. Management uses available information to recognize losses on student receivables. Future additions to the allowance may be necessary based on changes in economic conditions and other factors.

Student Loans

Student loans are recorded at the contractual amounts owed by students adjusted for unamortized discounts, premiums, unearned income, undisbursed funds, deferred loan fees and the allowance for loan losses. Interest income is recorded on the accrual basis of accounting in accordance with the terms of the receivables, except that interest accruals are discontinued when the payment of principal or interest is 90 or more days past due or when repayment of principal and interest in full is doubtful. Payments received on non-accrual loans are applied to the principal outstanding until the loan is restored to accrual status.

A student loan is impaired when it is probable that the University will be unable to collect all amounts due according to the contractual terms of the loan agreement. The measurement of impairment may be based on (i) the present value of the expected future cash flows of the impaired loan discounted at the loan’s original effective interest rate or (ii) the observable market price of the impaired loan. If the recorded investment of the loan exceeds the measure of impairment, a valuation allowance is recorded in the amount of the excess. The University measures impairment by utilizing a discounted cash flow analysis. The University’s income recognition policies for impaired loans are consistent with those for non-accrual loans. All loans designated as impaired are either placed on non-accrual status or are designated as restructured. Payments received on impaired loans are applied to the principal outstanding until the loan is returned to accrual status.

On an ongoing basis, management monitors the student loan portfolio and evaluates the adequacy of the allowance for loan losses. In determining the adequacy of the allowance for loan losses, management considers such factors as historical loss experience, known problem loans, assessment of economic conditions and other appropriate data to identify the risks in the student loan portfolio. The amount of the allowance for loan losses is based on estimates and the University’s actual losses may vary from management’s estimates. Loans deemed by management to be uncollectible are charged to the allowance for loan losses. Recoveries on loans previously charged off are credited to the allowance for loan losses. Provisions for loan losses are charged to expense and credited to the allowance for loan losses in amounts that are deemed appropriate by management based upon its evaluation of the known and inherent risks in the student loan portfolio.

Management believes that the allowance for loan losses is adequate. Management uses available information to recognize losses on loans. Future additions to the allowance may be necessary based on changes in economic conditions and other factors.

Contributions Receivable

Contributions, including unconditional promises to give, are recognized as revenue in the period received and are reported as increases in the appropriate category of net assets. Contributions where donor restrictions are met in the same fiscal year as the contribution is made are reported as unrestricted support. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received in future periods are discounted at a credit-adjusted interest rate.

Investments

Investments are stated at fair value and all related transactions are recorded on the trade date. The fair value of investments is based on quoted market prices from national security exchanges, except for alternative investments for which quoted market prices are not available. The fair value of certain alternative investments, which include limited partnerships in venture capital, real estate and other private debt and equity funds, is typically Net Asset Value (“NAV”), provided by the external investment managers or general partners, adjusted for receipts and disbursements of cash and distributions of securities if the date of valuation is prior to the University’s fiscal year end. Such valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments and other pertinent information. The University believes the carrying amount of these financial instruments is a reasonable estimate of fair value. For those investments that are not traded on a ready market, the estimates of their fair value may differ from the value that would have been used had a ready market for those investments existed.

Realized and unrealized gains and losses are accounted for within unrestricted net assets, or as changes in temporarily or permanently restricted net assets if so stipulated by the donor of such assets.

Pooled Assets

The University manages two separate investment pools designated as Pool A and Pool D. Pooled investments and allocation of pooled investment income are accounted for using the unit market value method.

The Total Rate of Return methodology is utilized for Pool A which consists primarily of funds functioning as endowment, including both quasi and true endowment funds. The annual total payout is calculated based on an approved spending rate that is applied to a five-year monthly average market value of Pool A funds. For fiscal years 2012 and 2011 the approved spending rate was 5.0%.

Funds invested in Pool A seek capital appreciation in an effort to achieve increased long-term returns. As a result, the current yields from dividends and interest income on funds invested in Pool A may be lower than the total payout. Using the Total Rate of Return methodology, when income and dividends generated by Pool A are insufficient to provide the full amount of the total payout, the remainder may be appropriated from Pool A’s accumulated undistributed realized gains. For the year ended July 31, 2012, $15.4 million of Pool A’s accumulated gains were appropriated. For the year ended July 31, 2011, there were no appropriations of Pool A’s accumulated gains.

Pool D is the charitable gift annuity reserve pool and is invested in accordance with California State Insurance Commission requirements.

Endowment

The University's endowment consists of approximately 366 individual donor-restricted endowment funds and 50 University-designated endowment funds for a variety of purposes. The net assets associated with endowment funds, including funds designated by the University to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The University has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as allowing the University to appropriate for expenditure or accumulate so much of an endowment fund as the University determines is prudent for the uses, benefits, purposes, and duration for which the endowment funding is established, subject to the intent of the donor as expressed in the gift instrument. As a result of this interpretation, the University classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of donor-restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the University in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the University considers the following factors in making a determination to appropriate or accumulate endowment funds:

1) The duration and preservation of the fund
2) The purposes of the University 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 University
7) The investment policies of the University

Additionally, the University is the irrevocable income and principal beneficiary of the Blanche E. Seaver Endowed Trust which was recorded at $125.2 million and $129.0 million at July 31, 2012 and 2011, respectively.

Derivatives

From time to time, the University enters into derivative transactions either as part of its overall investment asset allocation or as a specific hedge or risk management tool. Derivatives used as part of the asset allocation strategy are recorded at fair value with realized and unrealized gains and losses reflected in the Consolidated Statements of Activities. These derivatives are included in the investment portfolio.

Derivatives used to economically hedge specific operations, such as interest rate swaps and foreign currency contracts, are discussed under the heading, "Foreign Currency Management."

Assets Held As Trustee or Agent

The University uses the actuarial method of recording charitable gift annuities and charitable remainder trusts. When a gift is received, the fair value of the gift received is recorded as an asset and the present value of the related amounts due is recorded as a liability based on United States Internal Revenue Service life expectancy tables and the remainder is recorded as private gift and grant revenue in the appropriate net asset category on the Consolidated Statements of Activities. Investment income is credited, and annuity payments, direct costs of funds management, and investment losses are charged to the related liability. In situations where trust assets are not readily convertible to cash, annuitant payments have been made by the University. For life contingent gifts, the liability is adjusted annually based on the changes in the expected life. This adjustment is reflected as an adjustment of the actuarial liability on the Consolidated Statements of Activities. At July 31, 2012 and 2011, the estimated future payments to be made by the University have been discounted at 1.2% per annum and 2.4% per annum, respectively.

Remainder interests in real estate are recorded at their estimated fair value at the date of gift. Investment income and gains are credited, and direct costs of asset management and investment losses are charged to the related net asset category.

The University and its consolidated subsidiaries have legal title, either in their name or as trustee, to the charitable gift annuities, charitable remainder trusts, and life estates subject to life interests of the beneficiaries. No significant financial benefit can be realized until the contractual obligations are released.

Contributions to the University's deferred compensation plan under Section 457(b) and 457(f) of the United States Internal Revenue Code are carried at fair value with an equal and offsetting obligation to pay the employees as a component of trust and agency obligations on the Consolidated Statements of Financial Position.

Property, Facilities and Equipment

Property, facilities and equipment are stated at cost or, if received by gift, at fair value at the date of the gift. Depreciation on buildings, improvements, furniture, fixtures and equipment is provided on a straight-line basis over the estimated useful lives as described in the table below:

Asset Class	Useful Life
Furniture and Other Equipment	10-15 years
Computer Hardware and Software	2-10 years
Motor Vehicles	5 years
Buildings	20-70 years
Land Improvements	20 years

Amounts spent for repairs and maintenance are charged to expense as incurred. When assets are sold or retired, the associated cost and accumulated depreciation are removed. Any gain or loss from such disposition is recorded as a component of other non-operating revenues and expenses on the Consolidated Statements of Activities.

Debt Issuance Costs

Capitalized debt issue costs are included in prepaid expenses, inventories, and other assets and are amortized over the life of the related debt using the effective interest method.

U.S. Government-Funded Student Loans

Funds provided by the United States government under the Federal Perkins Loan Program are loaned to qualified students and may be loaned again after their collection. These funds are ultimately refundable to the U.S. government and as such are included as liabilities in the Consolidated Statements of Financial Position.

Student Loan Securitizations

The University sold student loans to trusts (also known as special purpose entities or an "SPE") in securitization transactions. These SPE's typically issued securities in the form of notes and certificates that may be structured into several classes with senior classes having priority of payment over subordinated classes. In these transactions, the University typically retained residual interests in the SPE's, which are commonly referred to as retained interests.

Student loan securitizations require specific credit enhancements in the form of over-collateralization, which must be met before the University receives cash flows related to each retained interest. As the student loans sold into the SPE's generate cash flows, they are initially used to pay down the balance of the senior and subordinated debt certificates issued by the SPE's until such time as the ratio of securitized student loans to SPE debt certificates reaches the over-collateralization requirement specified by the terms of each securitization entity. This over-collateralization amount is a component of retained interest in student loan securitizations. After the over-collateralization requirement and the other requirements specified in the pooling and servicing agreement have been met, the University begins to receive the cash flows from any retained interests held by the University on a periodic basis.

The University is also obligated by pledge to the issuing SPE to fund loan defaults, up to a maximum amount, as specified in each SPE. The University includes the expected cash outflows resulting from the default pledge as a component of retained interest in student loan securitizations. When the present value of the expected default pledge payments to the SPE is in excess of the present value of the expected cash flows to be received from the SPE, the sales of student loans to the SPE will result in a net liability to the University. Net liabilities resulting from the sales of student loans to an SPE will be classified by the University as a component of accounts payable and accrued liabilities on the Consolidated Statements of Financial Position.

The fair value of retained interests in student loan securitizations is determined based on estimates prepared by management. As such, the estimated cash flows to be received after being released by the respective SPE are discounted at interest rates determined by management to be rates that market participants would use in similar circumstances. Management also estimates the cash flows to be paid under default pledges to the respective SPE and discounts such cash flows at a risk-free interest rate. To the extent that the future cash inflows (from the retained interest) and outflows (from the default pledge) are materially different from management's estimates, the University's retained interest in student loan securitizations would be written down through a charge to operations.

Foreign Currency Management

The University uses derivative financial instruments to reduce its net exposure to currency fluctuations. As such, the University enters into forward contracts and purchases currency futures (principally the Euro, the British pound, Argentinian Peso, and Swiss francs) to economically hedge forecasted cash flows denominated in foreign currencies. The purpose of the University's foreign currency hedging activities is to reduce the risk that eventual United States dollar net cash outflows resulting from costs outside the U.S. will be adversely affected by changes in exchange rates.

For the years ended July 31, 2012 and 2011, the University recorded approximately $2.6 million in net losses and $2.4 million in net gains on foreign currency hedging transactions, respectively.

Reclassifications

Certain amounts were reclassified for the year ended July 31, 2011 to conform to year ended July 31, 2012 presentation.

3. Student Receivables

Student receivables consist of the following at July 31, 2012 and 2011:

	2012	2011
	(In thousands)	
Graziadio School of Business and Management. ...	$1,456	$1,872
Seaver College.	556	711
Graduate School of Education and Psychology	521	565
Other	60	64
Gross student receivables	2,593	3,212
Allowance for doubtful accounts.	(1,410)	(1,374)
	$1,183	$1,838

Activity in the allowance for doubtful accounts was as follows:

	For the year ended July 31,	
	2012	2011
	(In thousands)	
Beginning balance	$1,374	$1,418
Provision for doubtful accounts	200	500
Accounts charged off	(462)	(776)
Recoveries of previously charged off accounts	298	232
Net charge-offs	(164)	(544)
Ending balance	$1,410	$1,374

4. Student Loans

Student loans consist of the following at July 31, 2012 and 2011:

	2012	2011
	(In thousands)	
Perkins	$14,242	$14,464
Weingart	9,676	10,317
Other	1,601	1,429
Gross student loans	25,519	26,210
Allowance for loan losses	(1,707)	(1,697)
	$23,812	$24,513

Activity in the allowance for loan losses was as follows:

	For the year ended July 31, 2012	2011
	(In thousands)	
Beginning balance	$1,697	$1,632
Provision for loan losses	-	200
Loans charged off	(169)	(235)
Recoveries of previously charged-off loans	179	100
Net charge offs	10	(135)
Ending balance	$1,707	$1,697

The following is an aging of student loans at July 31, 2012:

	Current	1-60 days past due	61-120 days past due	> 120 days past due	Total
		(In thousands)			
Perkins	$12,498	$ 497	$152	$1,095	$14,242
Weingart	9,062	368	83	163	9,676
Other	1,372	78	20	131	1,601
	$22,932	$ 943	$255	$1,389	$25,519

5. Contributions Receivable

Unconditional promises to give with payments due in future periods are reported as temporarily or permanently restricted support. Unconditional promises to give are recorded at their discounted present value based on a credit-adjusted interest rate. At July 31, 2012, the discount rate applied to contributions receivable ranged from 0.16% per annum to 1.63% per annum and at July 31, 2011 ranged from 0.19% per annum to 3.06% per annum.

The following table provides a summary of contributions receivable by expected collection date at July 31, 2012 and 2011:

	2012	2011
	(In thousands)	
In one year or less	$ 1,018	$ 2,977
Between one and five years	9,043	9,515
More than five years	19,106	15,669
	29,167	28,161
Less discount	(262)	(409)
	$28,905	$27,752

The following table provides a summary of the intended use of contributions receivable at July 31, 2012 and 2011:

	2012	2011
	(In thousands)	
General support	$18,038	$15,896
Endowment	7,891	8,627
Educational and administrative programs	1,608	2,046
Facilities and equipment	1,368	1,183
	$28,905	$27,752

During the years ended July 31, 2012 and 2011, the University received payments on prior year promises to give of $1.7 million and $3.1 million, respectively.

Contributions receivable include assets held by external trustees totaling $22.0 million at July 31, 2012 and $20.0 million at July 31, 2011.

In the event contributions receivable are deemed uncollectable, they are charged to expense as a component of "Other non-operating revenues and expenses." Receivables written off during the years ended July 31, 2012 and 2011 amounted to $400,000 and $4.5 million, respectively.

During the years ended July 31, 2012 and 2011 promises to give in the net amount of $8.0 million and $14.9 million were received but not recognized, respectively. Promises to give may not be recognized because a donor has not provided sufficient documentation, the promise is conditional, or the promise is revocable.

6. Investments

The University's investments consist of the following at July 31, 2012 and 2011:

	2012		2011	
	Cost	Fair Value	Cost	Fair Value
	(In thousands)			
Cash and cash equivalents	$ 2,554	$ 2,554	$ 29,161	$ 29,161
Absolute return	59,429	75,450	62,785	80,374
Assets held by trustee	12,250	125,176	14,112	130,838
Blended mutual funds	12,314	12,925	12,763	13,470
Bonds	9,843	9,860	3,040	3,057
Fixed income	53,161	53,853	52,684	55,003
Notes receivable	18,612	15,377	20,421	17,272
Opportunistic distressed	34,362	37,047	23,304	25,673
Private equity	120,701	130,801	114,564	120,670
Natural resources	36,328	42,255	22,801	28,115
Private real estate	57,997	43,711	70,890	52,741
Public equity	166,032	184,258	165,046	198,804
Real estate	23,527	30,979	19,088	21,544
Other investments	5,305	3,015	5,250	2,960
	$612,415	$767,261	$615,909	$779,682
Unrestricted	419,586	449,063	426,517	458,526
Temporarily restricted	43,059	45,995	48,355	52,313
Permanently restricted	149,770	272,203	141,037	268,843
	$612,415	$767,261	$615,909	$779,682
Pooled investments	522,471	561,761	532,155	581,456
Separately invested	89,944	205,500	83,754	198,226
	$612,415	$767,261	$615,909	$779,682

The fair value of endowment funds (permanently restricted and funds functioning as endowment) totaled $608.0 million and $622.6 million at July 31, 2012 and 2011, respectively.

7. Endowment Activities

Changes in endowment net assets for the year ended July 31, 2012 are as follows:

	Unrestricted Appropriations	Unrestricted Principal	Temporarily Restricted	Permanently Restricted	Total
			(In thousands)		
Endowment net assets, beginning of year	$13,564	$289,380	$51,137	$268,499	$622,580
Investment income	45	4,815	1,767	11	6,638
Net realized and unrealized appreciation	-	(1,433)	8,862	(3,723)	3,706
Private gifts and grants	5	136	-	4,339	4,480
Transfer of assets from assets held as trustee or agent to endowment assets	-	792	500	2,094	3,386
Endowment support (appropriation of endowment assets for expenditure)	31,527	(16,015)	(15,512)	-	-
Net (expenditures) reinvestments of endowment assets	(34,385)	2,261	(1,830)	1,117	(32,837)
Endowment net assets, end of year	$10,756	$279,936	$44,924	$272,337	$607,953

Designations of endowment funds for the year ended July 31, 2012 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
		(In thousands)		
Donor-restricted funds	$ (4,729)	$40,621	$272,337	$308,229
University-designated funds	295,421	4,303	-	299,724
Total	$290,692	$44,924	$272,337	$607,953

Changes in endowment net assets for the year ended July 31, 2011 are as follows:

	Unrestricted Appropriations	Unrestricted Principal	Temporarily Restricted (In thousands)	Permanently Restricted	Total
Endowment net assets, beginning of year	$15,574	$255,642	$41,412	$251,963	$564,591
Investment income	82	5,730	2,310	37	8,159
Net realized and unrealized appreciation	-	37,877	23,907	9,978	71,762
Private gifts and grants	-	4,680	-	2,409	7,089
Transfer of assets from assets held as trustee or agent to endowment assets	-	335	(2)	3,800	4,133
Endowment support / (appropriation of endowment assets for expenditure)	31,377	(16,755)	(14,622)	-	-
Net (expenditures) reinvestments of endowment assets	(33,469)	1,871	(1,868)	312	(33,154)
Endowment net assets, end of year	$13,564	$289,380	$51,137	$268,499	$622,580

Designations of endowment funds for the year ended July 31, 2011 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
		(In thousands)		
Donor-restricted funds	$ 4,892	$47,171	$268,499	$320,562
University-designated funds	298,052	3,966	-	302,018
Total	$302,944	$51,137	$268,499	$622,580

The University has recorded deficiencies resulting from the decline in fair value of endowment funds to amounts below the original gift amount as a reduction of unrestricted net assets. Such deficiencies totaled $10.3 million and $7.8 million and affected 164 and 112 endowments with a market value of $73.7 million and $50.8 million at July 31, 2012 and 2011, respectively. Of these deficiencies, $8.5 million and $6.7 million were attributable to donor-restricted true endowment funds at July 31, 2012 and July 31, 2011, respectively.

8. Assets Held as Trustee or Agent

The University's assets held as trustee or agent consist of the following at July 31, 2012 and 2011:

	2012		2011	
	Cost	Fair Value	Cost	Fair Value
	(In thousands)			
Cash and cash equivalents	$ -	$ -	$ 822	$ 822
Publicly traded stocks	7,088	7,713	8,990	9,552
Bonds	834	870	1,830	1,901
Mutual funds	62,434	67,675	59,685	68,292
Notes receivable	6,958	6,996	4,370	4,408
Real estate	28,814	29,300	25,055	26,560
Alternative investments	2,936	1,366	2,775	1,132
Other investments	9,182	10,539	7,639	8,989
	$118,246	$124,459	$111,166	$121,656
Unrestricted	$ 19,300	$ 19,462	$ 13,166	$ 13,813
Temporarily restricted	77,849	84,207	77,054	86,820
Permanently restricted	19,344	18,951	19,409	19,383
Agency	1,753	1,839	1,537	1,640
	$118,246	$124,459	$111,166	$121,656
Pooled investments	$ 26,719	$ 27,357	$ 27,808	$ 30,229
Separately invested	91,527	97,102	83,358	91,427
	$118,246	$124,459	$111,166	$121,656

9. Pooled Investments

The following table sets forth data for the University's investment pools at July 31, 2012 and 2011:

	2012		2011	
	Pool A	Pool D	Pool A	Pool D
Per unit fair value at end of year	$ 355.97	$ 113.42	$ 372.04	$ 120.01
Number of units owned at end of year:				
Unrestricted	1,077,926	67,531	1,081,027	67,531
Temporarily restricted	12,086	66,412	10,662	79,647
Permanently restricted	489,797	96,425	471,194	94,578
Agency	1,752	-	3,263	-
Total units	1,581,561	230,368	1,566,146	241,756
Average annual income per unit	$2.76	$3.09	$3.65	$2.30

Investment expenses for the years ended July 31, 2012 and 2011 includes investment management fees totaling $3.8 million and $3.1 million, respectively.

10. Property, Facilities and Equipment

Property, facilities and equipment consist of the following at July 31, 2012 and 2011:

	2012	2011
	(In thousands)	
Land	$ 25,712	$ 25,712
Buildings and improvements	391,246	388,859
Furniture, fixtures and equipment	64,546	61,039
Construction in progress	28,575	22,320
Total cost	510,079	497,930
Less: accumulated depreciation	(168,899)	(151,252)
	$341,180	$346,678

11. Retained Interest in Student Loan Securitizations

The University's retained interests in student loan securitizations accretes over the estimated lives of the underlying loans using the interest method and amortizes as cash is received or paid. Under normal amortization, cash flows available to the retained interest in student loan securitizations are computed as the difference between the cash flows received from the student loan borrowers and the sum of (a) servicing fees, (b) trustee, custodian and back-up servicing fees, (c) interest and principal due on the senior and subordinated securities and (d) third-party credit enhancement fees. Rights to receive this excess cash flow are subject to certain conditions specified in each related trust document designed to provide additional credit enhancement to holders of the senior and subordinated securities in the trust. The University estimates expected cash flows to or from the University taking into consideration estimated defaults, recoveries, early terminations, guarantee payments by the University, and other factors. Cash flows ultimately available to the remainder interest will be dependent upon actual default rates, recovery experience and early termination experience. Higher default rates and/or lower recovery experience than estimated by management could reduce the cash flows available to the retained interests and increase the obligations of the University under the default pledges. To the extent events occur which cause the actual retained interest cash flows to be materially less than those estimated, the University would be required to reduce the carrying value of the retained interest and record a charge to income in the period in which the event occurred or became known to management.

The following table provides a summary of the changes in retained interest in student loan securitizations:

	For the year ended July 31,	
	2012	2011
	(In thousands)	
Beginning balance……	$964	$1,094
Payments received……	(35)	(1)
Guarantee payments made……	53	30
Fair value adjustments……	(10)	(159)
Ending balance……	$ 972	$ 964

The net asset related to retained interest in student loan securitizations is included as a component of other accounts receivable on the Consolidated Statements of Financial Position. There were no student loan securitizations completed in fiscal year 2012 or 2011.

12. Lines of Credit

At July 31, 2012 and at July 31, 2011, the University had a $500,000 line of credit with no expiration date, available to fund the purchase of up to $5.0 million worth of foreign currency forward contracts for the funding of its international programs at Comerica Bank's prime rate plus 3.0% per annum.

There have been no borrowings on the lines of credit in place at July 31, 2012 or July 31, 2011 at any time since the facilities were established.

13. Long-Term Obligations

Long term obligations consist of the following at July 31, 2012 and 2011:

	2012	2011
	(In thousands)	
CEFA 5.00% Refunding Revenue Bonds (Pepperdine University) Series 2003 A, due 2033	$ -	$ 45,000
CEFA 5.00% Refunding Revenue Bonds (Pepperdine University) Series 2005 A, due 2035-2036	92,365	92,365
CEFA 5.00% Refunding Revenue Bonds (Pepperdine University) Series 2005 B, due 2033	16,340	16,340
Pepperdine University Taxable Bonds Series 2009 A 5.45% interest, due 2019	50,000	50,000
California Infrastructure and Economic Development Bank Refunding Revenue Bonds Series 2010, 5.00% due 2019-2029	15,345	15,345
CEFA Revenue Bonds (Pepperdine University) Series 2012, 3.00%-5.00% due 2013 -2033	50,000	-
	224,050	219,050
Net premium on long-term obligations	15,372	7,928
	$239,422	$226,978

At July 31, 2012, principal payments on the preceding obligations are due as follows:

	(In thousands)
2013 – 2014	$ 1,490
2014 – 2015	1,535
2015 – 2016	1,580
2016 – 2017	1,645
2017 – 2018	1,710
2018 – 2019	1,775
2019 – 2020	52,940
2020 – 2021	3,085
2021 – 2022	3,245
2022 – 2023	3,405
2023 – 2024	3,580
2024 – 2025	3,760
2025 – 2026	3,950
2026 – 2027	4,150
2027 – 2028	4,355
2028 – 2029	4,575
2029 – 2030	4,810
2030 – 2031	3,190
2031 – 2032	3,355
2032 – 2033	19,855
2033 – 2034	3,695
2034 – 2035	45,060
2035 – 2036	47,305
	$224,050

14. Net Assets

At July 31, 2012 and 2011, temporarily and permanently restricted net assets were available for the following purposes:

	2012		2011	
	Temporarily Restricted	Permanently Restricted	Temporarily Restricted	Permanently Restricted
	(In thousands)			
Educational program support	$ 43,326	$185,753	$ 45,100	$186,695
Student services and athletics	1,225	3,396	1,385	3,380
Student loans and scholarships	22,795	94,874	24,909	92,646
Annuities and remainder trusts	29,793	6,396	32,954	8,212
Facilities	2,525	4,619	24,394	4,618
Public service	21	6,881	77	6,087
Other	3,358	3,862	3,559	3,362
	$103,043	$305,781	$132,378	$305,000

15. Operating Lease Commitments

The University leases facilities for use primarily in its graduate programs. Future minimum lease payments expiring through 2019 under these non-cancelable operating leases at July 31, 2012 are as follows:

	(In thousands)
2012– 2013	9,075
2013– 2014	9,467
2014– 2015	9,794
2015– 2016	9,857
2016– 2017	10,300
2017– 2018	9,352
2018– 2019	3,076
	$60,921

Leases on facilities contain renewal options and rent escalation clauses based on the Consumer Price Index.

16. Employee Retirement and Deferred Compensation Plans

The University participates in a defined contribution plan, which provides retirement benefits for eligible employees. Benefits for the plan are funded by contributions from the University and its employees. The contributions are non-refundable and fully vested. There are no prior service costs. The University contributed $8.8 million and $8.7 million to these plans for the years ended July 31, 2012 and 2011, respectively.

In July 2002 the University established a deferred compensation program for senior administrators, tenured Full Professors, highly paid and certain other employees under Sections 457(b) and 457(f) of the Internal Revenue Code. Under this plan, eligible employees may defer a limited amount of their compensation to future years. Although deferred by employees for tax purposes, amounts contributed to these plans by the University are treated as an expense in the year earned. Contributions to these deferred compensation plans for the years ended July 31, 2012 and 2011 were $763,000 and $788,000, respectively.

17. Faculty and Staff Housing

The University sells condominium units to certain faculty and staff. The sales terms include restrictions on the buyers' eligibility and include a resale price based on a defined index that is not controlled by the University. The University has a right of first refusal to purchase the units when offered for sale by the owner. The University has historically exercised this right and then subsequently sold the units within a short period of time. For the years ended July 31, 2012 and 2011, the University sold five and 12 units with associated sales values of $2.1 million and $6.4 million, respectively. Should all 122 of the units be available for purchase at July 31, 2012 and 2011, and the University elected to exercise its right of first refusal on all of the units it did not already own, the total value associated with these transactions would be $48.2 million and $51.8 million, respectively. At July 31, 2012 and 2011, the University held legal title to 14 and nine units with a value of $7.4 million and $4.6 million, respectively.

The land associated with the condominium units has been leased to the homeowner’s associations for 99 years from the date of completion of the construction. Monthly rents are paid to the University for the grounds, utilities and other services subject to adjustments based on the Consumer Price Index and on the costs of furnishing utilities and services.

At July 31, 2012, the University guaranteed the performance of $20.5 million in mortgage loans obtained by its faculty and staff. These mortgage loans were issued by independent third-party lenders and all of the proceeds of these loans were used to facilitate the purchase of on-campus housing.

At July 31, 2012 and 2011, University-owned notes receivable from on-campus housing sales amounted to $1.0 million. These amounts are included as a component of investments on the Consolidated Statements of Financial Position. The notes bear interest at various rates ranging between 5.50% per annum and 7.25% per annum and are collateralized by deeds of trust. Interest income recognized by the University related to these notes was $64,500 and $108,000 for the years ended July 31, 2012 and 2011, respectively. No allowance for loan losses has been recorded against these loans based on their collateralization and prior collection history. At July 31, 2012 there were no past due amounts related to these notes receivable.

18. Supplemental Cash Flow Information

	For the year ended July 31,	
	2012	2011
	(In thousands)	
Cash paid during the period for:		
Interest.	$11,765	$11,184
Accrued capitalized asset additions	1,552	1,594

19. Derivative Financial Instruments

The University may enter into interest rate cap, floor, and other swap transactions. These instruments involve, to varying degrees, elements of credit, interest rate and market risk. The contract or notional amounts do not represent exposure to credit loss. Risk originates from the inability of counter parties to meet the terms of the contracts and from market movements in securities values and interest rates. The University controls the credit risk of interest rate cap, floor and swap agreements through credit approvals, limits and monitoring procedures.

Under the terms of the swaps, the University received cash that has been recorded as revenue. Additionally, at July 31, 2012 and 2011, the University has recognized liabilities equal to the estimated fair value of the swaps. The swap liabilities are included as a component of accounts payable and accrued liabilities on the accompanying Consolidated Statements of Financial Position. The mark-to-market changes in value of the swap are included as a component of other non-operating revenues and expenses in net assets on the accompanying Consolidated Statements of Activities. At the end of each swap, the University will pay the swap counter party the cumulative out-performance of three-month LIBOR over the S&P 500 total return index, if any, as determined at that time. If the University extends the swaps through the extended end date, during the extended period the University has the option of canceling the swap each quarter end. Any payment due from the University is due at the end of the initial swap period, or if extended by the University, at the earlier of the cancellation date or the extended swap end date. The University's exposure under each swap is not capped, and each swap may be terminated by the swap counter party prior to the end of its term under certain circumstances, including the downgrade of the University's long-term debt rating below A3 by Moody's Investor's Service. Additionally, if the swaps have not been terminated, the University may be required to post collateral if the value of the swap is determined to be outside a range set forth in the swap agreements and the University's long-term debt rating is below Baa1 according to Moody's Investor's Service.

The following table provides a summary of the University's swaps:

Trade Date	Notional Amount	Cash Received	Swap Liability at July 31, 2012	Swap Liability at July 31, 2011	Initial End Date	Actual or Extended End Date
			(In thousands)			
December 28, 2001	$7,000	$1,095	$-	$ 312	December 2011	March 2012
December 18, 2002	25,000	4,000	-	1,134	December 2012	December 2032

20. Natural Expenses

The University's classifications of expenses in the Consolidated Statements of Activities by natural expense category are as follows:

	For the year ended July 31, 2012	2011
	(In thousands)	
Personnel	$162,485	$158,364
Depreciation	19,710	18,492
Professional services	19,698	19,277
Travel and development	11,879	11,132
Interest	11,083	11,124
Rentals	10,880	10,361
Student meals	6,758	6,348
Advertising and promotion	5,942	5,332
Maintenance	5,299	5,073
Supplies	4,978	4,699
Utilities	4,680	5,154
Insurance	4,428	4,025
Equipment	3,576	6,157
Other	5,971	6,877
	$277,367	$272,415

21. Commitments and Contingencies

In the normal course of operations, the University is named as a defendant in lawsuits and is subject to periodic examinations by regulatory agencies. After consultation with legal counsel, management is of the opinion that liabilities, if any, arising from such litigation and examinations would not have a material effect on the University's consolidated financial position or change in net assets.

The University receives and expends monies under U.S. government grant programs and is subject to audits by related U.S. governmental agencies. Management believes that any liabilities resulting from such audits will not have a material impact on the University.

At July 31, 2012, the University had open commitments to invest approximately $110.6 million with investment managers and/or limited partnerships over approximately seven years.

At July 31, 2012, the University's maximum exposure under guarantees of Guaranteed Access To Education ("GATE") student loans totaled approximately $43,000. Since 1997, the University has sold approximately $14.8 million of GATE student loans into securitization trusts.

At July 31, 2012, the University had outstanding commitments for capital expenditures in connection with the various construction projects of approximately $2.5 million. The University expects to fund these costs principally through the proceeds of bonds issued and unrestricted net assets available. Accordingly, no liability has been recorded in the accompanying Consolidated Statements of Financial Position.

As discussed in Note 17, the University guarantees the performance of certain mortgages for on-campus condominiums.

22. Fair Value of Financial Instruments

Financial instruments include cash and cash equivalents, student receivables, other accounts receivable, student loans, contributions receivable, investments, assets held as trustee or agent, U.S. government-funded student loans, trust and agency obligations, long-term obligations and various off-balance sheet items. The fair value of certain alternative investments, which include limited partnerships in venture capital, real estate and other private debt and equity funds, is based on valuations provided by the external investment managers or general partners, generally using NAV as a practical expedient, adjusted for receipts and disbursements of cash and distributions of securities if the date of valuation is prior to the University's fiscal year end. Such valuations generally reflect discounts for illiquidity and consider variables such as financial performance of investments, recent sales prices of investments and other pertinent information. These estimates are subjective in nature and involve uncertainties and matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. In addition, the fair value estimates presented do not include the value of anticipated future operating activities and the value of assets and liabilities that are not considered financial instruments. The University uses the following methods and assumptions in estimating the fair value disclosures for its financial instruments:

Financial Assets

The carrying values of cash and cash equivalents, student receivables, other accounts receivable, student loans, contributions receivable, and assets held as trustee or agent are considered to approximate fair value. When possible, the fair value of investments and assets held as trustee or agent are determined by reference to quoted market prices. When quoted market prices are not available, fair value is estimated by reference to market values for similar securities or by discounting cash flows at an appropriate risk rate taking into consideration the varying degrees of risk specific to each financial asset. Determination of the fair value of student loans receivable, which are primarily federally sponsored student loans with United States Government mandated interest rates and repayment terms subject to significant restrictions as to their transfer and disposition could not be made without incurring excessive costs.

Financial Liabilities

The carrying value of trust and agency obligations is considered to approximate fair value. The fair value of the University's CEFA and other bonds payable is based on recent trading information available to the University for its debt, or for debt with similar terms and remaining maturities. The fair value for notes payable were estimated based upon the discounted amount of future cash flows utilizing current rates offered for debt of similar remaining maturities.

Off-Balance Sheet and Derivative Financial Instruments

The fair value of interest rate caps, floors and swaps, forward treasury contracts and interest rate futures, to the extent used by the University, are based on quoted market prices. The fair values of foreign currency derivatives are based on pricing models using currency market rates. These amounts are reflected as a component of prepaid expenses, inventories and other assets on the University's Consolidated Statements of Financial Position.

The carrying amount of the University's financial instruments at July 31, 2012 and 2011 are the same as their estimated fair values with the exception of CEFA and other bonds payable which have the values outlined below:

	2012		2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(In thousands)			
CEFA and other bonds payable	$239,422	$257,623	$226,978	$227,439

In accordance with ASC 820, fair value is defined as the price the University would receive to sell an asset or pay a liability in an orderly transaction between the market participants at the reporting date. ASC 820 also establishes a three-level hierarchy for presenting valuations, based on the transparency of inputs used to value investments and other relevant assets. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Valuation inputs may be observable or unobservable, and refer to the assumptions that a market participant would consider significant to value an asset or liability. The determination of "observable" requires judgment by the University. In general, the University considers observable inputs to be data that are readily available, regularly updated, reliable, and verifiable. Unobservable inputs may be used when observable inputs are not readily available or current. In this situation, one or more valuation techniques may be used including the market approach (inputs based on recent market transactions or comparables) or the income approach (discounted cash flow).

The three levels of the fair value hierarchy under ASC 820 are as follows:

- Level 1 – Quoted prices available in active markets for identical investments.
- Level 2 – Quoted prices in active markets for similar investments; quoted prices for identical investments in markets that are inactive; and prices based on observable inputs other than an unadjusted quoted price.
- Level 3 – Prices based on significant unobservable inputs.

The following table summarizes the valuations of the University's investments and other relevant assets as of July 31, 2012, based on their placement within the fair-value hierarchy:

	Level 1	Level 2	Level 3	Total
		(In thousands)		
Investments				
Cash and cash equivalents	$ 2,554	$ -	$ -	$ 2,554
Absolute return	-	2,557	72,893	75,450
Assets held by trustee	123,458	1,718	-	125,176
Blended mutual funds	12,594	331	-	12,925
Bonds	-	9,860	-	9,860
Fixed income	50,044	1,068	2,741	53,853
Notes receivable	-	-	15,377	15,377
Opportunistic distressed	-	-	37,047	37,047
Private equity	-	-	130,801	130,801
Natural resources	-	18,413	23,842	42,255
Private real estate	-	4,640	39,071	43,711
Public equity	118,756	65,502	-	184,258
Real estate	-	-	30,979	30,979
Other investments	-	-	3,015	3,015
Total investments	$307,406	$104,089	$355,766	$767,261
Assets held as trustee				
Publicly traded stocks	$ 7,713	$ -	$ -	$ 7,713
Bonds	870	-	-	870
Mutual Funds	67,675	-	-	67,675
Notes Receivable	-	-	6,996	6,996
Real Estate	-	-	29,300	29,300
Alternative investments	-	-	1,366	1,366
Other investments	8,204	254	2,081	10,539
Total assets held as trustee	84,462	254	39,743	124,459
Total	$391,868	$104,343	$395,509	$891,720
Liabilities at fair value				
Derivative contracts/swap	$ -	$ -	$ -	$ -
Total.	$ -	$ -	$ -	$ -

PEPPERDINE UNIVERSITY

Notes to Consolidated Financial Statements

The following summary table illustrates the valuations of the University's investments and other relevant assets as of July 31, 2011, based on their placement within the fair-value hierarchy:

	Level 1	Level 2	Level 3	Total
		(In thousands)		
Investments				
Cash and cash equivalents	$ 29,161	$ -	$ -	$ 29,161
Absolute return	-	2,305	78,069	80,374
Assets held by trustee	126,347	4,491	-	130,838
Blended mutual funds	13,470	-	-	13,470
Bonds	-	3,057	-	3,057
Fixed income	50,070	-	4,933	55,003
Notes receivable	-	-	17,272	17,272
Opportunistic distressed	-	-	25,673	25,673
Private equity	-	-	120,670	120,670
Natural resources	-	11,736	16,379	28,115
Private real estate	-	17,389	35,352	52,741
Public equity	130,777	68,027	-	198,804
Real estate	-	-	21,544	21,544
Other investments	-	-	2,960	2,960
Total investments	$349,825	$107,005	$322,852	$779,682
Assets held as trustee				
Cash and cash equivalents	$ 822	$ -	$ -	$ 822
Publicly traded stocks	9,552	-	-	9,552
Bonds	1,901	-	-	1,901
Mutual funds	68,292	-	-	68,292
Notes receivable	-	-	4,408	4,408
Real estate	-	-	26,560	26,560
Alternative investments	-	-	1,132	1,132
Other investments	6,629	220	2,140	8,989
Total assets held as trustee	87,196	220	34,240	121,656
Total	$437,021	$107,225	$357,092	$901,338
Liabilities at fair value				
Derivative contracts/swap	$ -	$ 1,446	$ -	$ 1,446
Total.	$ -	$ 1,446	$ -	$ 1,446

Level 1 generally includes the University's investments in mutual funds and common stock that are regularly traded in active markets where quoted prices may be easily obtained.

Level 2 generally includes the University's investments in debt securities and certain unlisted equity funds that offer a high degree of liquidity and transparency. Debt security prices are obtained from pricing services, or from brokers. Non-listed equity funds that consistently transact on a daily, weekly, or monthly basis are valued at reported NAV. Level 2 investments may also be priced using model-based valuation techniques where all assumptions are observable. This includes the University's interest rate swaps which are valued via discounted cash flow analysis taking into account contractual terms and the current yield curve.

Level 3 generally includes the University's alternative investments, which consist of hedge funds, private equity funds, real estate funds, and other fund of funds. These investments do not typically transact on a regular basis, nor do they have readily determinable fair values. Therefore, the University relies heavily on investment manager-reported valuations, usually in the form of NAV. The University performs due diligence around all reported NAV's to ensure the values are accurate and appropriate. Level 3 also includes the University's real property. Oil and gas interests are valued by discounting future expected royalty revenues, while real property is valued based on a number of different approaches including third party appraisals, market comparisons, and discounted future rental revenues. Finally, Level 3 includes the University's life insurance policies, which are valued at the present value of the future distributions expected to be received over the term of the agreement.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future values. In addition, while the University believes that 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.

The following table sets forth a reconciliation of beginning and ending balances, separately for each major category of assets for financial instruments designated as Level 3 for the year ended July 31, 2012 (in thousands):

Beginning Balance July 31, 2011	Realized Gains	Unrealized Gains	Purchase Cost	Total Proceeds	Transfers into Level 3	Transfers out of Level 3	Ending Balance July 31, 2012
			(In thousands)				
$357,092	$11,360	$3,965	$45,354	($30,470)	$8,317	($109)	$395,509

All net realized and unrealized gains in the table above are reflected in the accompanying consolidated Statement of Activities.

The University uses the NAV to determine the fair value of all the underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. The following table lists investments in other investment companies (in partnership format) by major category for the year ended July 31, 2012:

Investment Category	Strategy	NAV in Funds	# of Funds	Remaining Life	Amount of Unfunded Commitments	Redemption Terms	Redemption Restrictions
		(In thousands, except # of funds)					
Absolute Return (level 2 & 3)	US and non-US investments in relative value, event driven, long/short and directional	$ 75,453	85	Open Ended	$ -	Ranges between quarterly with 30, 45, 60 or 90 days notice, semi annual with 90 days notice, annual with 45, 60 or 90 days notice	2.3% of NAV is locked up in side-pockets
Public Natural Resources (level 2)	US and non-US Investments in upstream, midstream, and downstream natural resources	18,413	3	Approx 7 years	-	Redemptions are not permitted during the life of the fund	N/A
Private Natural Resources (level 3)	US and non-US Investments in upstream, midstream, and downstream natural resources	23,842	11	Approx 7 years	18,981	Redemptions are not permitted during the life of the fund	N/A
Private Real Estate (level 2)	US and non-US real estate	4,640	1	Approx 7 years	-	Redemptions are not permitted during the life of the fund	N/A
Private Real Estate (level 3)	US and non-US real estate	39,071	21	Approx 7 years	16,307	Redemptions are not permitted during the life of the fund	N/A
Public Equity (level 2)	US and non-US equity securities	65,502	11	Open Ended	-	Ranges from daily to monthly	N/A
Fixed Income (level 2 & 3)	US and non-US fixed income securities	13,668	17	Open Ended	-	Daily	N/A
Opportunistic Distressed (level 3)	US and non-US distressed debt securities	37,047	10	Approx 7 years	19,201	Redemptions are not permitted during the life of the fund	N/A
Private Equity (level 3)	US and non-US equity securities	130,801	55	Approx 7 years	56,114	Redemptions are not permitted during the life of the fund	N/A
Total		$408,437			$110,603		

The University uses the NAV to determine the fair value of all the underlying investments which (a) do not have a readily determinable fair value and (b) prepare their financial statements consistent with the measurement principles of an investment company or have the attributes of an investment company. The following table lists investments in other investment companies (in partnership format) by major category for the year ended July 31, 2011:

Investment Category	Strategy	NAV in Funds	# of Funds	Remaining Life	Amount of Unfunded Commitments	Redemption Terms	Redemption Restrictions
		(In thousands, except # of funds)					
Absolute Return (level 2 & 3)	US and non-US investments in relative value, event driven, long/short and directional	$ 80,374	25	Open Ended	$ -	Ranges between quarterly with 30, 45, 60 or 90 days notice, semi annual with 90 days notice, annual with 45, 60 or 90 days notice	3.5% of NAV is locked up in side-pockets
Private Natural Resources (level 2)	US and non-US Investments in upstream, midstream, and downstream natural resources	11,736	1	Approx 7 years	-	Redemptions are not permitted during the life of the fund	N/A
Private Natural Resources (level 3)	US and non-US Investments in upstream, midstream, and downstream natural resources	16,379	10	Approx 7 years	14,972	Redemptions are not permitted during the life of the fund	N/A
Private Real Estate (level 2)	US and non-US real estate	17,390	2	Approx 7 years	-	Redemptions are not permitted during the life of the fund	N/A
Private Real Estate (level 3)	US and non-US real estate	35,319	18	Approx 7 years	28,367	Redemptions are not permitted during the life of the fund	N/A
Public Equity (level 2)	US and non-US equity securities	68,028	9	Open Ended	-	Ranges from daily to monthly	N/A
Fixed Income (level 3)	US and non-US fixed income securities	4,933	4	Open Ended	-	Daily	N/A
Opportunistic Distressed (level 3)	US and non-US distressed debt securities	25,673	16	Approx 7 years	49,910	Redemptions are not permitted during the life of the fund	N/A
Private Equity (level 3)	US and non-US equity securities	120,669	48	Approx 7 years	48,360	Redemptions are not permitted during the life of the fund	N/A
Total		$380,501			$141,609		

23. Asset Retirement Obligations

The University recognizes liabilities for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation is conditional on a future event. The fair value of a liability for a conditional asset retirement obligation is recognized in the period in which it occurred if a reasonable estimate of fair value can be made.

At July 31, 2012 and 2011, $5.7 million and $5.5 million of conditional asset retirement obligations are included within accounts payable and accrued liabilities in the Consolidated Statements of Financial Position, respectively.

The following table illustrates the change in conditional asset retirement obligations during the year ended July 31, 2012:

Abatement Timeframe	Average Abatement Date	Conditional Asset Retirement Obligation at July 31, 2011	Add: 2012 Accretion	Less: 2012 Costs Incurred	Conditional Asset Retirement Obligation at July 31, 2012
			(In thousands)		
10 years	2016	$ 694	$ 34	$ 2	$ 726
11-20 years	2022	3,684	178	-	3,862
21-30 years	2036	19	1	-	20
31-40 years	2044	947	46	-	993
41-50 years	2048	109	5	2	112
51+ years	2061	7	-	-	7
		$5,460	$ 264	$ 4	$5,720

24. Subsequent Events

The University has performed an evaluation of subsequent events through November 21, 2012 which is the date these financial statements were issued. There are no subsequent events which require disclosure.