

The Nature Conservancy

Consolidated Financial Statements

For the year ended June 30, 2016

And report thereon



Report of Independent Auditors

To the Board of Directors of
The Nature Conservancy

We have audited the accompanying consolidated financial statements of The Nature Conservancy and its chapters and affiliates (the "Conservancy"), which comprise the consolidated Statement of Financial Position as of June 30, 2016, and the related consolidated Statements of Activities and Cash Flows for the year then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Nature Conservancy and its chapters and affiliates as of June 30, 2016, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.



Other Matter

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying summarized consolidated statements of financial position as of June 30, 2016 and 2015, the summarized consolidated statements of activities for the year ended June 30, 2016 and 2015, and the schedule of functional expenses for the year ended June 30, 2016, with summarized totals for the year ended June 30, 2015 are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. The information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

We previously audited the consolidated statement of financial position as of June 30, 2015, and the related consolidated statements of activities and changes in net assets and of cash flows for the year then ended (not presented herein), and in our report dated October 9, 2015, we expressed an unmodified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying summarized financial information as of June 30, 2015 and for the year then ended is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

PricewaterhouseCoopers LLP

December 12, 2016

The Nature Conservancy
Consolidated Statement of Financial Position
As of June 30, 2016

(Amounts in thousands)

Assets

Cash and cash equivalents		\$	67,342
Restricted cash and cash equivalents			14,257
Restricted short-term investments			25,000
Government grants and contracts receivable			33,264
Pledges receivable, net			231,868
Securities pledged under securities lending agreement			24,479
Other assets			55,288
Property and equipment, net of accumulated depreciation and amortization			129,166
Investments			
Investments - Capital fund	794,938		
Investments - Split interest arrangements	284,344		
Investments - Endowment fund	<u>1,115,398</u>		
Total investments			2,194,680
Conservation lands			1,832,270
Conservation easements			<u>2,089,865</u>
Total assets			<u><u>\$ 6,697,479</u></u>

Liabilities

Accounts payable and accrued liabilities		\$	129,769
Payable under securities lending agreement			24,479
Deferred revenue and refundable advances			91,899
Bonds and notes payable			361,219
Split interest arrangements payable			<u>174,871</u>
Total liabilities			<u><u>782,237</u></u>

Net assets

Unrestricted			
Undesignated	559,363		
Land, easements, and capital funds	3,440,943		
Board-designated quasi endowment and similar funds	<u>816,123</u>		
Total unrestricted			4,816,429
Temporarily restricted			736,344
Permanently restricted			<u>362,469</u>
Total net assets			<u>5,915,242</u>
Total liabilities and net assets			<u><u>\$ 6,697,479</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

The Nature Conservancy
Consolidated Statement of Activities
For the year ended June 30, 2016

(Amounts in thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Support and revenues				
Dues and contributions	\$ 261,715	\$ 304,069	\$ 12,489	\$ 578,273
Contributed goods and services	19,571	5,010	-	24,581
Land and easements contributed for conservation	33,406	-	-	33,406
Government grants and contracts	109,744	-	-	109,744
Investment loss	(28,250)	(31,095)	-	(59,345)
Other income	45,601	-	-	45,601
Total support and revenues before sales of conservation land and easements and net assets released from restrictions	441,787	277,984	12,489	732,260
Sales of conservation land and easements to governments and others	71,690	-	-	71,690
Net assets released from restrictions	272,502	(272,502)	-	-
Total support and revenues	<u>785,979</u>	<u>5,482</u>	<u>12,489</u>	<u>803,950</u>
Expenses				
Program expenses				
Conservation activities and actions	449,722	-	-	449,722
Book value of conservation land and easements sold or donated to governments and others	102,909	-	-	102,909
Total program expenses	<u>552,631</u>	<u>-</u>	<u>-</u>	<u>552,631</u>
Support services expenses				
General and administration	146,862	-	-	146,862
Fund-raising				
General fund-raising	77,214	-	-	77,214
Membership development	35,969	-	-	35,969
Total support services expenses	<u>260,045</u>	<u>-</u>	<u>-</u>	<u>260,045</u>
Total expenses	<u>812,676</u>	<u>-</u>	<u>-</u>	<u>812,676</u>
Increase/(decrease) in net assets	(26,697)	5,482	12,489	(8,726)
Reclassification of net assets	(3,516)	(111)	3,627	-
Total increase/(decrease) in net assets	<u>(30,213)</u>	<u>5,371</u>	<u>16,116</u>	<u>(8,726)</u>
Net assets at beginning of year	4,846,642	730,973	346,353	5,923,968
Net assets at end of year	<u>\$ 4,816,429</u>	<u>\$ 736,344</u>	<u>\$ 362,469</u>	<u>\$ 5,915,242</u>

The accompanying notes are an integral part of these consolidated financial statements.

The Nature Conservancy
Consolidated Statement of Cash Flows
For the year ended June 30, 2016

(Amounts in thousands)

Reconciliation of change in net assets to cash used in operating activities:

Change in net assets		\$	(8,726)	
Non-cash adjustments:				
Contributed land and easements	\$	(36,257)		
Losses on disposition of land, easements, and property		34,792		
Realized/Unrealized investment losses		44,945		
Change in value of split interest investments		1,259		
Change in value of interest rate swaps		13,165		
Depreciation and amortization		14,426	72,330	
Changes in assets and liabilities:				
Increase in receivables		(23,837)		
Decrease in restricted cash		563		
Increase in other assets		(1,762)		
Decrease in split interests arrangements payable		(108)		
Increase in other liabilities		5,273	(19,871)	
Cash provided by (used in) land activities:				
Proceeds from sales of land and easements		78,884		
Purchases of land and easements		(155,555)	(76,671)	
Contributions for long-term purposes			(12,506)	
Net cash used in operating activities				\$ (45,444)

Investing activities:

Proceeds from sale of capital and endowment investments		1,353,497		
Purchases of capital and endowment investments		(1,327,053)		
Purchases of property and equipment, net		(14,833)		
Proceeds from notes receivable		(16,840)		
Net cash used in investing activities				(5,229)

Financing activities:

Proceeds from securities lending program		9,103		
Repayments of securities lending program		(9,103)		
Purchases of split interest investments		(15,168)		
Proceeds from split interest arrangements		31,009		
Principal payments on debt		(32,242)		
Proceeds from issuance of debt		16,820		
Proceeds from restricted contributions		12,506		
Net cash provided by financing activities				12,925

Net change in cash and cash equivalents				(37,748)
Cash and cash equivalents, beginning of year				105,090
Cash and cash equivalents, end of year				\$ 67,342

Supplemental data

Interest paid				\$ 16,262
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The accompanying notes are an integral part of these consolidated financial statements.

ACCOUNTING POLICY FOOTNOTES

The following notes present disclosures of the significant accounting policies and related information relating to balances and amounts contained in the consolidated statements of financial position and activities. These notes are an integral part of the consolidated financial statements.

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2016

1. ORGANIZATION

The Nature Conservancy (“The Conservancy”) is a global conservation organization. The mission of The Conservancy is to conserve the lands and waters on which all life depends. The Conservancy conducts its activities throughout the United States, Canada, Latin America, the Caribbean, Europe, Africa, Asia, and the Pacific.

The Conservancy’s primary sources of revenue are contributions from the public (including gifts of land), investment income, government grants, and sales of conservation interests to government agencies or other conservation buyers. These resources are used to help solve critical challenges by significantly improving the health of globally important natural systems that enhance the lives of people around the world. Working with partners – including indigenous communities, governments, and businesses – The Conservancy pursues solutions that protect and restore natural systems, use nature sustainably, and broaden support for conservation.

2. CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements are presented on the accrual basis of accounting and include the accounts of all The Conservancy’s chapters and affiliates, both domestic and international, including those which are separately incorporated, receive gifts, and perform conservation activities in the name of The Conservancy. All significant intercompany transactions have been eliminated.

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

3. CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Cash and Cash Equivalents, Restricted Cash, and Restricted Short-term Investments

Cash represents operating cash held in bank accounts in high quality financial institutions in the United States and 35 other countries. The cash in non-U.S. accounts is uninsured, but is limited per country to amounts that, in the opinion of management, are not material to the financial statements. Cash equivalents represents short-term, highly liquid investments with maturities of three months or less when purchased. Restricted cash represents monies held in trust related to requirements of specific conservation project agreements. Restricted short-term investments represent certificates of deposit held in trust related to requirements of specific conservation project agreements.

Government Grants and Contracts Receivable/Deferred Revenue and Refundable Advances

The Conservancy receives grants and contracts from federal, state, and local agencies to be used for specific programs or land purchases. The excess of reimbursable expenditures over cash receipts is included in government grants receivable, and any excess of cash receipts over reimbursable expenditures is included in deferred revenue and refundable advances.

Pledges Receivable

Pledges receivable represent unconditional promises to give and are reported at fair value by discounting the expected future pledge payments at the prime interest rate at the balance sheet date, and accordingly are categorized as Level 3 assets. The primary unobservable input used in the fair

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value measurement of The Conservancy's pledges receivable is the discount rate. Significant fluctuations in the discount rate could result in a material change. The discount rate used in the present value technique to determine fair value of pledges receivable is revised at each measurement date to reflect current market conditions and the creditworthiness of donors. In addition, management evaluates payment history and market conditions to estimate allowances for doubtful pledges. Changes in the fair value of pledges receivable are reported in the consolidated statement of activities as contribution revenue except for changes in the allowance which are reported as program expenses at each subsequent reporting date. Pledges receivable past due by 90 days are, in the opinion of management, not material to the financial statements.

Not recorded as pledges receivable are \$94,954,000, that are conditioned upon The Conservancy raising matching gifts or acquiring certain conservation lands. Conditional promises to give are recognized as contributions when the donor-imposed conditions are substantially met.

Securities Lending Agreement

The Conservancy lends certain securities in its investment portfolio to qualified borrowers on a short-term, fully collateralized basis in exchange for interest to help offset custodial fees. Collateral in the form of cash in US dollars, securities issued or guaranteed by the US government, or irrevocable letters of credit issued by banks independent of the borrowers is marked-to-market on a daily basis, and the borrower is required to deliver the difference between the daily market value of the collateral and 102% of the loaned securities' original fair market value if denominated in US dollars or 105% if denominated in foreign currency. The lending agent, in its agreement with The Conservancy, guarantees the repayment of the loan in the event the borrower defaults. The Conservancy retains all the benefits of ownership including rights to dividends, interest, and other cash distributions pertaining to the loaned securities. The Conservancy also retains the right to redeem the loaned securities prior to the stipulated redemption date.

At June 30, 2016, The Conservancy recorded \$24,479,000 in securities pledged as collateral under its securities lending program and an equal amount payable to the borrowers under the agreement. These amounts are reflected in assets and liabilities in the consolidated statement of financial position.

Property and Equipment

Property and equipment are carried at cost. Depreciation and amortization is provided using the straight-line method for all depreciable assets over their estimated future lives as follows:

Building and improvements	5 – 30 years
Computer equipment and software	3 – 5 years
Furniture, fixtures, and other	4 – 25 years

Concentration of Credit Risk

The Conservancy's excess cash is invested with high quality institutions, the largest concentrations of which are invested in U.S. Agencies (66.0%), certificates of deposit (22.7%), and Repurchase Agreements (10.7%). 100% of the repurchase agreements are backed by U.S. Treasuries and U.S. Agencies.

Pursuant to its investment policy, The Conservancy's investments cannot have more than 10% of their assets at market value in securities of any one issuer, be they short-term or long-term, other than the U.S. Government and its Agencies. At June 30, 2016, the single largest non-U.S. Government issuer

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exposure was 5.56% of the Capital and Endowment Fund long term investments. This issue is in the form of a global commingled equity fund.

Investments

Investments are carried at estimated fair market value and reported in three distinct categories:

- *Capital fund* – excess working capital and funds held primarily for the future acquisition of conservation land, easements, and for funding other conservation projects.
- *Split interest arrangements* – donations that are held in trust by The Conservancy or third party trustees, representing beneficial interests in trusts.
- *Endowment fund* – funds held as long-term capital to generate income for The Conservancy's operations.

Endowment Investment and Spending Policies

The Conservancy's Endowment ("Endowment") includes both donor-restricted endowment funds and funds allocated to quasi endowments, which by Board policy function as endowments. The amount of Endowment income provided each year for operations is established by the Finance Committee of the Board, through its adoption of an annual endowment spending rate and spending rate base. The spending rate for the year ended June 30, 2016 was 5.0% of the average fair market value of the 60 months of calendar years 2010 through 2014.

The Conservancy recognizes that risk must be assumed to achieve its stated long-term investment objectives. Therefore, asset allocations and ranges are necessarily diverse, and consider liquidity needs. The Conservancy has considered its ability to withstand short and intermediate term variability and concluded that the portfolio can tolerate some interim fluctuations in market values and rates of return in order to achieve its objectives. However, The Conservancy realizes that market performance varies and that the portfolio's investment objectives may not be achievable during short-term periods.

The Conservancy has chosen not to manage its underlying assets directly, but to utilize independent investment managers. To maintain prudent diversification and to manage risk, The Conservancy's portfolio is divided among 50 to 60 separate managers.

Conservation Lands and Easements

The Conservancy records land and land interests at cost if purchased or at fair value at the date of acquisition, if all or part of the land was received as a donation. Fair value is generally determined by appraisal at the time of acquisition and is not subsequently adjusted. Upon sale or gift, the book value of the land or land interest is reported as a program expense and the related proceeds, if any, are reported as revenue in the consolidated statement of activities.

Conservation land is real property with significant ecological value. These properties are either managed in an effort to protect the natural biological diversity of the property, or transferred to other organizations who will manage the lands in a similar fashion.

Conservation easements are comprised of listed rights and/or restrictions over the owned property that are conveyed by a property owner to The Conservancy, almost always in perpetuity, in order to protect the owned property as a significant natural area, as defined in federal tax regulations. These

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intangible assets may be sold or transferred to others so long as the assignee agrees to carry out, in perpetuity, the conservation purposes intended by the original grantor. Conservation easements, by their very nature, do not generate material amounts of cash inflow annually.

Bonds and Notes Payable

The Conservancy uses debt, both fixed and variable, primarily to finance the acquisition of conservation lands and easements. Debt is reported at carrying value. At June 30, 2016, The Conservancy is in compliance with all debt covenants.

In order to partially insulate itself from the variable nature of the interest rates on its outstanding debt, The Conservancy has three interest rate swap agreements. The Conservancy pays a fixed rate of 4.373% on \$95,375,000 in return for receipt of variable rate interest in the amount of 3-month LIBOR and pays a fixed rate of 2.962% on \$190,000,000 in return for receipt of variable rate interest in the amount of 67% of 3-month LIBOR. The Conservancy pays a fixed rate of 3.56% on \$25,053,000 in return for receipt of variable rate interest in the amount of 67% of 1-month LIBOR. Maturities of the swap agreements range from 2027 to 2033 and the counterparty to these swaps has the option to terminate at their discretion. The fair value of these interest rate swap agreements are reflected in the accompanying consolidated statement of financial position as accounts payable and accrued liabilities.

Due to the nature of certain variable rate bond agreements, The Conservancy may receive notice of an optional tender on its variable-rate bonds, in which case The Conservancy would have an obligation to purchase the bonds tendered if unable to secure a different source of financing at that time. At June 30, 2016, The Conservancy had a standby liquidity support agreement with a financial institution to support the original principal amount of \$50,000,000 of the variable rate demand obligations. Under this agreement, the financial institution agreed to supply additional liquidity to The Conservancy up to that amount, with which The Conservancy could purchase the bonds if The Conservancy could not remarket the bonds. In the event of a draw on the \$50,000,000 liquidity support line, the due date would be September 14, 2018.

Interest expense incurred on total notes payable for 2016 was \$18,054,000.

Split Interest Arrangements

The Conservancy enters into split interest arrangements whereby donations are held in trust by The Conservancy or third party trustees and invested. Agreed-upon amounts of the invested funds are payable to the donor or the donor's designee for a specified period of time or until the donor's death, after which time The Conservancy may use the investments for operations or a restricted use specified by the donor. The donated trust asset investments are recorded at fair value based on the latest available information.

The Conservancy utilizes the 2012 Individual Annuity Reserving table to actuarially calculate the liability associated with the estimated donor payments under these arrangements. The Conservancy determines the discount rate to be used in the month the split interest arrangements are entered into with the donor and these rates have ranged from 1% to 9%. The present value of the actuarially determined liability resulting from these gifts is recorded at the date of gift and adjusted annually thereafter to reflect fair value.

Net Assets

The Conservancy's net assets are reported in the following three classes:

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- *Unrestricted net assets* – Revenues derived from dues, unrestricted contributions, government grants and contracts, investment income (other than the temporarily restricted portion of true endowment investment income), and other inflows of assets whose use by The Conservancy is not limited by donor-imposed restrictions. Certain unrestricted net assets have been designated by the Board of Directors to be maintained as quasi endowment funds.
- *Temporarily restricted net assets* – Contributions and other inflows of assets whose use by The Conservancy is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of The Conservancy, such as usage for specific programs, including certain overhead and indirect costs, or for spending from true endowment investment income.

When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and are reported on the consolidated statements of activities as net assets released from restrictions.

- *Permanently restricted net assets* – Contributions and other inflows of assets whose use by The Conservancy is limited by donor-imposed stipulations that the principal must be maintained permanently by The Conservancy. The total amount of permanently restricted net assets on the consolidated statements of financial position includes the donor-restricted endowment funds as well as amounts contributed to create a permanent capital fund. This revolving fund is used to finance capital projects and donations to this fund are to be maintained in perpetuity for only this purpose.

Classification of endowment net assets

The Board of Directors of The Conservancy (“Board”) has approved management’s interpretation of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as enacted by the Council of the District of Columbia. UPMIFA requires the preservation of the fair value of the original gifts as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary.

The Endowment includes both donor-restricted endowment funds and funds designated by the Board to function as endowments. The Conservancy classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, and (b) 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 the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by The Conservancy.

The Conservancy considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the endowment fund;
- The purposes of the institution and the endowment fund;
- General economic conditions;
- The possible effect of inflation or deflation;
- The expected total return from income and appreciation of investments;
- Other resources of the institution; and

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- The investment policy of the institution.

Endowments with Eroded Corpus

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or The Conservancy requires to be retained as principal in perpetuity. Deficiencies of this nature that are netted in unrestricted net assets were \$3,034,000 as of June 30, 2016. These deficits resulted from unfavorable market fluctuations that occurred shortly after the investment of newly established endowments and authorized appropriation that was deemed prudent.

4. CONSOLIDATED STATEMENT OF ACTIVITIES

Contributions

Unconditional donor promises to give cash and other assets are reported at fair value at the date that there is sufficient verifiable evidence documenting that a promise was made by the donor and received by The Conservancy. The promises are reported as either temporarily or permanently restricted support if received with donor stipulations that sufficiently limit the use of the donated assets.

The Conservancy recognizes contributed professional services from third parties and contributed goods and trade lands as revenue and as expense or assets, at the fair value of those services or goods when received. Trade lands are real property with minimal ecological value. These properties are sold to provide funds for The Conservancy to carry out its conservation work. During the fiscal year ended June 30, 2016 contributed goods and services totaled \$24,581,000 and contributed trade lands that is reflected as Dues and contributions in the accompanying consolidated statement of activities totaled \$4,382,000.

Government Grants and Contracts

Government grants and contracts are considered to be exchange transactions, the majority of which are cost-reimbursable grants. Revenue, including approved indirect cost recovery, is recognized when allowable costs have been incurred. The Conservancy's costs incurred under its government grants and contracts are subject to audit by government agencies. Management believes that disallowance of costs, if any, would not be material to the consolidated financial position or consolidated changes in net assets of The Conservancy.

Program expense allocation

Operating expenses are allocated to program and support categories based on separate cost center types as defined below. Conservation land and easements that are acquired by The Conservancy, but not sold or donated, are reflected as an increase in conservation land and easements on the consolidated statements of financial position and are excluded from the program expense categories on the consolidated statements of activities.

The Conservancy accounts for its program expenditures in the following categories:

- *Conservation Activities and Actions* – Expenditures related to the broad spectrum of activities and actions critical to advancing The Conservancy's mission. Expenditures related to understanding, monitoring, maintaining, restoring, and managing natural areas owned by The Conservancy and others are included, as well as expenditures for developing and enhancing The Conservancy's ability to gather and share ecological information and to assess and evaluate threats to natural systems. In addition, this area includes expenditures to mitigate, prevent, or

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slow the effects of these threats, including investments in the institutional development of domestic and international conservation organizations. Expenditures related to improving public land management and supporting the development of sound global policies, including participating in conferences and events that help establish a common vision for conservation worldwide are included, as well as expenditures associated with community outreach and education of key stakeholders and land users in areas where Conservancy conservation programs reside.

- *General and Administration* – Expenditures related to building and maintaining an efficient business infrastructure, including those related to corporate governance, to support and advance the programmatic conservation objectives of The Conservancy.
- *General Fund-Raising* – Expenditures related to fund-raising strategies that provide the revenue stream for both operations and capital needs to further the accomplishment of The Conservancy’s mission and objectives.
- *Membership Development* – Expenditures related to the acquisition and retention of The Conservancy’s members primarily through the use of a direct-mail program.

5. COMMITMENTS AND CONTINGENCIES

Litigation

The Conservancy is a party to various litigation arising out of the normal conduct of its operations. In the opinion of The Conservancy’s management, the ultimate resolution of these matters will not materially affect the financial position, changes in net assets, or cash flows of The Conservancy.

Leases

The Conservancy has entered into non-cancelable operating leases for office space, which expire at various dates through 2027. Certain of these leases contain rent escalation clauses, usually based on the consumer price index.

Land acquisitions and other commitments

The Conservancy has entered into contracts for the purchase of land and other purchase commitments that have not closed as of June 30, 2016, in the amount of \$20,969,000.

The Conservancy has remaining funding commitments to private equity, real estate, and hedge fund investment managers of \$179,435,000 at June 30, 2016.

6. RETIREMENT PLANS

The Conservancy’s employees are eligible after one month of service to participate in The Nature Conservancy Savings and Retirement Plan (the “Plan”), in which employees can make voluntary, tax-deferred contributions within specified limits. The Plan was established under the provisions of Internal Revenue Code Section 401(k) and has received a favorable determination as to its tax status from the Internal Revenue Service. Certain employees are also eligible to participate in a non-qualified deferred compensation plan created pursuant to Internal Revenue Code Section 457(b). The Conservancy’s contributions to the plans were \$16,375,000 for the year ended June 30, 2016.

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7. INCOME TAXES

The Conservancy has been granted an exemption from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The Internal Revenue Service has classified The Conservancy as other than a private foundation. The Conservancy pays a nominal amount of tax relating to several unrelated business income activities, primarily rental income from debt-financed property. The Conservancy takes no tax positions that it considers to be uncertain.

8. SUBSEQUENT EVENTS

All subsequent events were evaluated through December 12, 2016, which is the date the financial statements were issued.

9. RELATED PARTY TRANSACTIONS

The Conservancy recorded \$10,172,000 in contribution revenue from current and former Board members during fiscal year ended June 30, 2016. Of this amount, \$600,000 is reflected as pledges receivable in the accompanying consolidated statement of financial position.

FOOTNOTE SCHEDULES

The following schedules represent required disclosures of more detailed information regarding certain balances and amounts contained in the consolidated statements of financial position and activities. These are an integral part of the footnotes to the consolidated financial statements.

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10. Pledges receivable

As of June 30, 2016 unconditional promises to give were as follows:

(In thousands)

Amounts due in	
Less than one year	\$ 141,973
One to five years	101,947
More than five years	664
Subtotal	<u>244,584</u>
Less fair value adjustments:	
Discount of 3.5%	5,966
Allowance for doubtful accounts	6,750
Total	<u><u>\$ 231,868</u></u>

11. Other assets

Other assets consisted of the following at June 30, 2016:

(In thousands)

Deposits on land	\$ 1,232
Trade lands	9,013
Other receivables	3,328
Prepaid expenses	7,958
Notes receivable	27,311
Other assets	6,446
Total	<u><u>\$ 55,288</u></u>

12. Property and equipment

Property and equipment consisted of the following at June 30, 2016:

(In thousands)

Land for operations	\$ 7,210
Buildings and improvements	146,133
Construction in progress	11,640
Computer equipment and software	37,627
Furniture, fixtures, and other	22,223
	<u>224,833</u>
Accumulated depreciation and amortization	(95,667)
Total	<u><u>\$ 129,166</u></u>

Depreciation and amortization expense was \$14,426,000 during the year ended June 30, 2016. Of the total assets listed above, \$28,495,000 was fully depreciated at June 30, 2016.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2016

13. Bonds and notes payable

(In thousands)

Unsecured Colorado Educational and Cultural Facilities Authority Revenue Bonds, Tax Exempt, Series 2002A issued in the original principal amount of \$25,053,000, variable interest rate pursuant to rate swap, 0.46% as of June 30, 2016, due July 2024.	\$ 11,213
Unsecured Colorado Educational and Cultural Facilities Authority Revenue Refunding Bonds, Tax Exempt, Series 2012 issued in the original principal amount of \$144,435,000, with a variable interest rate reset weekly, 0.43% as of June 30, 2016, due July 2033.	126,331
Unsecured Taxable Revenue Bonds Series 2009 in the aggregate principal amount of \$100,000,000 issued July 1, 2009, fixed rate of 6.30% due July 2019.	100,000
New York State Environmental Facilities Corporation private bonds issued in the aggregate amount of \$50,000,000 with a fixed interest rate of 3.90%, due June 2024.	35,044
Loans and mortgages, some of which are collateralized by the land and other assets, and payable in monthly or annual installments, including interest ranging from 0% to 6.0%; final payments are due at various dates through 2033.	68,899
Conservation Notes, unsecured notes payable in various amounts with interest ranging from 0.00% to 2.0%, due at various dates through 2021.	13,404
Other notes payable without interest due on demand	6,328
Total	<u>\$ 361,219</u>

The following schedule of amounts due is based on the maturity dates per the debt agreements:

(In thousands)

2017	\$ 122,680
2018	17,635
2019	63,206
2020	125,052
2021	6,288
Thereafter	26,358
Total	<u>\$ 361,219</u>

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2016

14. Net assets

Temporarily restricted net assets are available for the following purposes:

(In thousands)

Land acquisition and other conservation projects	\$	320,670
Time restricted for periods after June 30		140,372
Time and purpose restricted for periods after June 30		172,770
True endowment gains subject to future Board of Directors' appropriation		102,532
Total	<u>\$</u>	<u>736,344</u>

Permanently restricted net assets are restricted in perpetuity; they include donor-restricted endowments and donor-restricted permanent capital funds. The total amount of permanently restricted net assets in the consolidated statement of financial position includes donor-restricted endowment funds of \$196,036,000 displayed in the table below, as well as other amounts such as those contributed to create a permanent capital fund. Permanently restricted net assets in the land preservation fund were \$166,433,000 as of June 30, 2016.

Endowment funds are categorized in the following net asset classes as of June 30, 2016:

(In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	\$ (3,034)	\$ 102,532	\$ 196,036	\$ 295,534
Board-designated endowment funds	819,157	-	-	819,157
Total endowment funds	<u>\$ 816,123</u>	<u>\$ 102,532</u>	<u>\$ 196,036</u>	<u>\$ 1,114,691</u>

Changes in endowment funds by net asset classification for the year ended June 30, 2016 are summarized as follows:

(In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 863,415	\$ 117,534	\$ 177,203	\$1,158,152
Investment returns	(14,507)	(4,909)	-	(19,416)
Contributions and other revenue	-	-	12,192	12,192
Interfund transfers	9,062	2,936	3,105	15,103
Appropriation of assets for expenditure	(54,701)	-	-	(54,701)
Net assets released from restrictions	13,029	(13,029)	-	-
Subtotal endowment funds	<u>816,298</u>	<u>102,532</u>	<u>192,500</u>	<u>1,111,330</u>
Reclassification of net assets	(175)	-	3,536	3,361
Total endowment funds	<u>\$ 816,123</u>	<u>\$ 102,532</u>	<u>\$ 196,036</u>	<u>\$1,114,691</u>

The Nature Conservancy

Notes to Consolidated Financial Statements

June 30, 2016

15. Assets and liabilities carried at fair value

Assets and liabilities carried at fair value are classified in the fair value hierarchy based on the lowest level of input that is significant to the valuation.

Fair value for Level 1 is based upon quoted prices in active markets for identical assets and liabilities. Market price data is generally obtained from exchange or dealer markets.

Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and on model-based valuation techniques, for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers.

Fair value for Level 3 is based on valuation techniques that use significant inputs that are unobservable as they trade infrequently or not at all.

The Conservancy uses the practical expedient to determine the fair value for some of its investments, which permits the use of Net Asset Value (NAV) without adjustment under certain circumstances.

The Conservancy's investment policy allows for the use of derivatives by investment managers and at the portfolio-level to assist in managing asset allocation and exposures. These derivative exposures are exchange-traded and are reported in the fair value of the overall portfolio within Level 1.

In order to partially insulate itself from the variable nature of the interest rates on its outstanding debt, The Conservancy has three interest rate swap agreements that fix the rates on several variable rate bonds. The Conservancy's interest rate swap arrangements have inputs which can generally be corroborated by observable market data and are therefore classified within Level 2. Such inputs include market prices for reference securities, yield curves, credit curves, measures of volatility, prepayment rates, assumptions for nonperformance risk, and correlations of such inputs. The valuation methods described above may produce fair value calculations that may not be indicative of net realized value or reflective of future fair values. The Conservancy believes 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 use of derivative instruments involves the risk of imperfect correlation in movement in the price of the instruments, interest rates, and the underlying hedged assets. As a result, The Conservancy may not achieve the anticipated benefits of hedging strategies. The Conservancy's derivatives contracts held at June 30, 2016 are not accounted as hedging instruments under GAAP.

The following table lists fair value and relevant notional information of derivatives by contract type, as included in the consolidated statement of financial position and statement of activities.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2016

Summary of derivative investments at June 30, 2016:

(\$ in thousands)

	Fair value as of June 30, 2016		Changes in Fair Values		As of June 30, 2016		Number of Contracts
	Location in Consolidated Statement of Financial Position	Amount	Location in Consolidated Statement of Activities	Amount	Collateral Amount	Notional Value	
Futures - US Equity Investments		\$ (356)	Investment loss	\$ (356)	\$ 5,959	\$ (139,416)	1,334
Interest rate swaps	Accounts payable and accrued liabilities	50,657	Other income	(13,165)	-	310,428	3

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2016

Assets and liabilities categorized by input:

(In thousands)

	Level 1	Level 2	Level 3	Total
Investments:				
Short-term investments	\$ 2,238	\$ 69,300	\$ -	\$ 71,538
Repurchase agreements	-	11,905	-	11,905
Fixed income:				
U.S. treasuries	48,762	-	-	48,762
Asset-backed securities	-	48,029	-	48,029
Municipals	-	3,701	-	3,701
Corporate debt	-	184,186	-	184,186
Mortgage-backed securities	-	14,638	-	14,638
U.S. agency bonds	-	104,559	-	104,559
Preferred securities	840	-	-	840
Public equity:				
Consumer discretionary	50,510	-	-	50,510
Consumer staples	11,032	-	-	11,032
Energy	9,090	-	-	9,090
Financial services	23,778	-	-	23,778
Health care	13,085	-	-	13,085
Industrials	22,310	-	-	22,310
Information technology	25,019	-	-	25,019
Materials	13,241	-	-	13,241
Telecom services	3,719	-	-	3,719
Utilities	1,205	-	-	1,205
Other industries	2,144	-	-	2,144
Commingled equity funds	-	-	457,455	457,455
Exchange traded funds	8,526	-	-	8,526
Closed end mutual funds	69,788	-	-	69,788
Derivatives	(337)	-	-	(337)
Hedge funds	-	-	433,352	433,352
Private equity	-	-	218,097	218,097
Private real estate	-	-	59,454	59,454
Split interests, trustee	150,155	92,196	11,283	253,634
Split interests, non-trustee	-	-	31,420	31,420
Total investments at fair value	455,105	528,514	1,211,061	2,194,680
Securities pledged under securities lending agreement	\$ 24,479	\$ -	\$ -	\$ 24,479
Pledges receivable	-	-	231,868	231,868
Total assets measured at fair value	\$ 479,584	\$ 528,514	\$ 1,442,929	\$ 2,451,027
Interest rate swaps liability	\$ -	\$ 50,657	\$ -	\$ 50,657
Payable under securities lending agreement	24,479	-	-	24,479
Total liabilities measured at fair value	\$ 24,479	\$ 50,657	\$ -	\$ 75,136

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2016

Investments included in Level 3 primarily consist of The Conservancy's ownership in alternative investments (principally commingled equity, limited partnership interests in hedge and private equity funds) as well as investments held within private arrangements. The value of certain alternative investments represents the ownership interest in the NAV of the respective partnership. Approximately 77.6% of Level 3 investments held by the partnerships consist of marketable securities and 22.4% are securities that do not have readily determinable fair values. The fair values of the securities held by limited partnerships that do not have readily determinable fair values are determined by the general partner and are based on appraisals, or other estimates that require varying degrees of judgment. If no public market exists for the investment securities, the fair value is determined by the general partner taking into consideration, among other things, the cost of the securities, prices of recent significant placements of securities of the same issuer, and subsequent developments concerning the companies to which the securities relate. The Conservancy has performed significant due diligence around these investments to ensure NAV is an appropriate measure of fair value.

Investments valued using NAV as of June 30, 2016:

(In thousands)

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency</u>	<u>Redemption Notice Period</u>
Global equity funds	\$ 225,966	\$ -	Daily, weekly, monthly, quarterly	2 days, 7 days, 10 business days, 30 days
International equity funds	200,045	-	Daily, monthly, quarterly	6 business days, 14 days, 60 calendar days, 90 days
Domestic equity funds	31,446	-	Monthly	60 days
Hedge funds	433,352	6,583	Monthly, quarterly, semi-annually, annually, biennially, rolling 2, 3 & 4 years	30 - 90 days
Private equity funds	191,050	140,907	N/A	N/A
Real estate funds	59,454	31,945	N/A	N/A
Total	<u>\$ 1,141,313</u>	<u>\$ 179,435</u>		

The Conservancy uses a standard charitable gift calculation model and a discount rate that is commensurate with fair value to determine the present value of split interest agreements where The Conservancy serves as trustee. For split interest agreements where The Conservancy is not the trustee, valuations are based on the values reported by third-party trustees, while noting that the valuation techniques for future distributions expected to be received over the term of the agreement and unobservable inputs - such as discount rates, life expectancies, and trust payouts - may vary widely among trustees. There is no market for these agreements, and they are therefore classified within Level 3.

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2016

Rollforward of Level 3 financial instruments:

(In thousands)

	Fair value as of June 30, 2015	Realized gains (losses)	Unrealized gains (losses)	Purchases	Sales	Fair value as of June 30, 2016
Commingled equity funds	\$ 517,235	\$ 42,910	\$ (56,078)	\$ 38,000	\$ (84,612)	\$ 457,455
Hedge funds	460,292	7,947	(37,782)	56,751	(53,856)	433,352
Private equity	211,920	25,928	(10,277)	41,566	(51,040)	218,097
Real estate	53,507	3,303	4,752	14,205	(16,313)	59,454
Split interest arrangements	46,570	216	(869)	2,693	(5,907)	42,703
Total	<u>1,289,524</u>	<u>80,304</u>	<u>(100,254)</u>	<u>153,215</u>	<u>(211,728)</u>	<u>1,211,061</u>
Pledges receivable	219,519	-	12,349	-	-	231,868
Total investments and pledges	<u>\$1,509,043</u>	<u>\$ 80,304</u>	<u>\$ (87,905)</u>	<u>\$ 153,215</u>	<u>\$ (211,728)</u>	<u>\$ 1,442,929</u>

Of the net realized and unrealized losses of \$7,601,000 in the table above, \$19,950,000 are reflected in the accompanying statement of activities as investment losses. The remaining amounts include a \$12,349,000 increase in pledges, of which a net \$12,599,000 increase is reflected in the accompanying statement of financial position and statement of activities as the result of pledge payments and pledge contributions. The remaining \$250,000 decrease is reflected as conservation activities and actions program expense.

Changes in unrealized gains/losses related to Level 3 investments held at June 30, 2016 were \$(27,195,000).

Investment losses consisted of the following for the year ended June 30, 2016:

(In thousands)

Dividends and interest income	\$ 22,086
Realized and unrealized losses	(44,945)
Change in value of split interest arrangements	(26,186)
Management expenses	(10,300)
Total investment losses	<u>\$ (59,345)</u>

The Nature Conservancy
Notes to Consolidated Financial Statements
June 30, 2016

16. Leases

The following is a schedule of future minimum lease payments for all operating leases as of June 30, 2016:

(In thousands)

2017	\$	6,050
2018		5,401
2019		3,907
2020		3,578
2021		2,809
Thereafter		5,519
Total minimum lease payments	\$	<u>27,264</u>

Rent expense was \$12,740,000 for the year ended June 30, 2016.

The Nature Conservancy
Supplemental Schedules
For the years ended June 30, 2016 and 2015

SUPPLEMENTAL SCHEDULES

Following are supplemental schedules:

Consolidated statements of financial position as of June 30, 2016 (with comparative totals as of June 30, 2015)

Summarized consolidated statements of activities for the year ended June 30, 2016 (with comparative totals for the year ended June 30, 2015)

Schedule of functional expenses as reported in the consolidated statement of activities for the year ended June 30, 2016 by natural account classification (with comparative totals for the year ended June 30, 2015).

While these schedules are not required under Generally Accepted Accounting Principles, they provide useful additional detail to help the user of these financial statements understand how funds are spent, as well as providing prior year comparisons.

The Nature Conservancy
Supplemental Schedule - Consolidated Statements of Financial Position
As of June 30, 2016 and 2015

<i>(Amounts in thousands)</i>	2016	2015
Assets		
Cash and cash equivalents	\$ 67,342	\$ 105,090
Restricted cash	14,257	14,820
Restricted short-term investments	25,000	25,000
Government grants and contracts receivable	33,264	21,776
Pledges receivable, net	231,868	219,519
Collateral received under securities lending agreement	24,479	33,582
Deposits on land and other assets	55,288	36,546
Property and equipment, net of accumulated depreciation and amortization	129,166	132,261
Investments - Capital fund	794,938	820,909
Investments - Split interest arrangements	284,344	301,444
Investments - Endowment fund	1,115,398	1,160,816
Conservation lands	1,832,270	1,809,805
Conservation easements	2,089,865	2,030,932
Total assets	<u>\$ 6,697,479</u>	<u>\$ 6,712,500</u>
Liabilities		
Accounts payable and accrued liabilities	\$ 129,769	\$ 103,482
Payable under securities lending agreement	24,479	33,582
Deferred revenue and refundable advances	91,899	99,748
Bonds and notes payable	361,219	376,741
Split interest arrangements payable	174,871	174,979
Total liabilities	<u>782,237</u>	<u>788,532</u>
Net assets		
Unrestricted		
Undesignated	559,363	8,875
Land, easements, and capital funds	3,440,943	3,969,854
Board-designated quasi endowment and similar funds	816,123	867,913
Total unrestricted	<u>4,816,429</u>	<u>4,846,642</u>
Temporarily restricted	736,344	730,973
Permanently restricted	362,469	346,353
Total net assets	<u>5,915,242</u>	<u>5,923,968</u>
Total liabilities and net assets	<u>\$ 6,697,479</u>	<u>\$ 6,712,500</u>

The Nature Conservancy
Supplemental Schedule - Summarized Consolidated Statements of Activities
For the years ended June 30, 2016 and 2015

<i>(Amounts in thousands)</i>	2016	2015
Support and revenues		
Dues and contributions	\$ 602,854	\$ 545,069
Land and easements contributed for conservation	33,406	99,544
Government grants and contracts	109,744	99,209
Investment income	(59,345)	44,199
Sales of conservation land and easements to governments and others	71,690	101,238
Other	<u>45,601</u>	<u>58,296</u>
Total support and revenues	803,950	947,555
Expenses		
Program expenses	552,631	573,205
General and administration	146,862	136,586
Fund-raising		
General fund-raising	77,214	64,793
Membership development	<u>35,969</u>	<u>26,462</u>
Total expenses	812,676	801,046
Increase in net assets	(8,726)	146,509
Net assets at beginning of year	<u>5,923,968</u>	<u>5,777,459</u>
Net assets at end of year	<u>\$ 5,915,242</u>	<u>\$ 5,923,968</u>

The Nature Conservancy
Supplemental Schedule - Schedules of Functional Expenses
For the year ended June 30, 2016 with summarized totals for the year ended June 30, 2015

(Amounts in thousands)

	<u>Program expenses</u>		<u>Support services expenses</u>			<u>Totals</u>	
	<u>Conservation activities and actions</u>	<u>General and administration</u>	<u>Fund-raising</u>	<u>Membership development</u>	<u>Total Support services expenses</u>	<u>2016 Total expenses</u>	<u>2015 Total expenses</u>
Personnel	\$ 206,724	\$ 82,262	\$ 57,203	\$ 3,782	\$ 143,247	\$ 349,971	\$ 328,647
Contract, professional fees	75,916	10,817	4,340	13,528	28,685	104,601	95,004
Grants and allocations	60,300	42	27	-	69	60,369	63,986
Supplies	8,647	4,182	666	1,076	5,924	14,571	14,339
Telecommunications	1,502	1,341	208	22	1,571	3,073	3,391
Postage and mailing service	1,504	252	342	10,149	10,743	12,247	10,703
Occupancy	2,383	10,106	248	3	10,357	12,740	12,032
Equipment rental and maintenance	3,881	1,485	186	-	1,671	5,552	5,950
Printing and publication	4,641	143	949	6,616	7,708	12,349	10,075
Travel	16,003	4,091	3,085	81	7,257	23,260	22,621
Conferences and meetings	8,869	1,918	2,000	33	3,951	12,820	10,857
Interest	18,096	1	-	-	1	18,097	17,919
Depreciation and amortization	7,276	7,149	1	-	7,150	14,426	8,894
Equipment	2,981	142	2	-	144	3,125	3,763
Taxes and licenses	1,202	1,403	104	28	1,535	2,737	2,504
Utilities, repairs, maintenance, and construction	6,130	2,047	134	-	2,181	8,311	8,651
Insurance	2,932	2,209	41	-	2,250	5,182	4,506
Real estate taxes	4,730	1,018	10	-	1,028	5,758	5,649
Closing costs	954	585	-	-	585	1,539	2,777
Contributed goods and services non-cash expense	5,987	9,225	6,892	633	16,750	22,737	24,787
All other	9,064	6,444	776	18	7,238	16,302	6,797
Subtotal	449,722	146,862	77,214	35,969	260,045	709,767	663,852
Book value of conservation land and easements sold or donated to government and others	102,909	-	-	-	-	102,909	137,194
Total	<u>\$ 552,631</u>	<u>\$ 146,862</u>	<u>\$ 77,214</u>	<u>\$ 35,969</u>	<u>\$ 260,045</u>	<u>\$ 812,676</u>	<u>\$ 801,046</u>