

# **Lili`uokalani Trust**

Financial Statements and Supplemental Schedule  
December 31, 2008 and 2007  
Together with Independent Auditor's Report



A Hawaii Limited Liability Partnership

## Independent Auditor's Report

To the Trustees of  
Lili'uokalani Trust:

We have audited the accompanying statements of financial position of Lili'uokalani Trust (the Trust) as of December 31, 2008 and 2007, and the related statements of activities, functional expenses and cash flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Trust as of December 31, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for that portion marked "unaudited", on which we express no opinion, has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*KMH LLP*

KMH LLP

Honolulu, Hawaii  
August 31, 2009

# Lili'uokalani Trust

## Statements of Financial Position December 31, 2008 and 2007

	<u>Assets</u>	
	<u>2008</u>	<u>2007</u>
Current Assets:		
Cash and cash equivalents	\$ 3,664,225	\$ 2,202,267
Accounts receivable	1,184,667	1,445,156
Prepaid expenses and other assets	930,097	975,517
Total current assets	5,778,989	4,622,940
Property and equipment, net	18,103,448	17,017,979
Investments:		
Marketable securities	52,220,909	24,205,681
Limited partnerships	43,796,617	21,194,234
Real estate	33,309,237	31,077,239
Deferred rent receivable	16,817,466	17,479,115
Prepaid pension benefit costs	-	931,226
Total assets	<u>\$ 170,026,666</u>	<u>\$ 116,528,414</u>
	<u>Liabilities and Net Assets</u>	
Current Liabilities:		
Accounts payable and other accrued liabilities	\$ 1,209,114	\$ 938,498
Accrued vacation	812,131	748,333
Deferred revenue	635,000	667,000
Notes payable	53,000	30,000
Total current liabilities	2,709,245	2,383,831
Accrued pension benefits	1,932,904	-
Accrued postretirement benefits	1,182,449	1,088,034
Deferred revenue, less current portion	2,284,117	2,184,339
Notes payable, less current portion	2,456,322	1,182,232
Total liabilities	<u>10,565,037</u>	<u>6,838,436</u>
Commitments and Contingencies		
Net Assets:		
Unrestricted:		
Board designated for set aside liabilities	2,930,189	3,002,684
Undesignated	156,462,920	106,623,484
Temporarily restricted	159,393,109	109,626,168
Temporarily restricted	68,520	63,810
Total net assets	<u>159,461,629</u>	<u>109,689,978</u>
Total liabilities and net assets	<u>\$ 170,026,666</u>	<u>\$ 116,528,414</u>

See accompanying notes to financial statements.



**Lili'uokalani Trust**

Statements of Functional Expenses

For the Years Ended December 31, 2008 and 2007

	2008				2007				
	Support Services			Total	Support Services			Total	
	Program Services	Program Support	Endowment Management		Program Services	Program Support	Endowment Management		
Salaries	\$ 6,064,302	\$ 1,432,861	\$ 543,459	\$ 1,976,320	\$ 5,565,000	\$ 1,392,677	\$ 429,555	\$ 1,822,232	\$ 7,387,232
Real Property Taxes	-	31,204	5,729,771	5,760,975	-	23,736	6,589,146	6,612,882	6,612,882
Financial Assistance	2,961,987	81	-	81	2,483,539	-	-	-	2,483,539
Employee Benefits and Payroll Taxes	1,387,596	300,144	91,496	391,640	1,281,035	345,958	74,568	420,526	1,701,561
Income Tax	-	-	35,724	35,724	-	-	-	-	-
Excise Taxes	-	-	1,257,504	1,257,504	-	-	1,138,251	1,138,251	1,138,251
Professional Services	-	331,333	624,484	955,817	13,208	107,581	62,543	170,124	183,332
Repairs and Maintenance	486,954	59,544	46,214	105,758	677,589	63,422	8,626	72,048	749,637
Trustees' Fees	-	215,000	215,000	430,000	-	189,000	166,500	355,500	355,500
Insurance	324,377	58,181	76,222	134,403	488,203	95,933	41,727	137,660	625,863
Utilities	314,112	97,920	11,604	109,524	253,642	66,146	5,669	71,815	325,457
Other Expenses	10,930	230,454	56,646	287,100	3,816	86,553	42,500	129,053	132,869
Travel And Meals	137,894	21,815	24,772	46,587	92,086	25,639	-	25,639	117,725
Supplies	141,169	136,105	10,760	146,865	130,663	162,118	13,123	175,241	305,904
Security	13,167	9,171	122,038	131,209	-	8,932	121,394	130,326	130,326
Occupancy Expense	29,362	25,792	38,687	64,479	24,043	27,637	41,456	69,093	93,136
Telephone	116,883	23,600	3,872	27,472	92,305	19,691	4,677	24,368	116,673
Real Estate Management Fees	-	-	13,021	13,021	-	-	8,854	8,854	8,854
Equipment Rental	57,848	42,804	2,844	45,648	62,687	32,318	3,536	35,854	98,541
Education	58,595	21,852	-	21,852	35,714	19,144	-	19,144	54,858
Conferences	22,320	39,805	13,093	52,898	37,408	3,164	19,776	22,940	60,348
Leasing Commission	-	-	29,813	29,813	-	-	29,814	29,814	29,814
Dues	(4,809)	9,929	13,156	23,085	12,712	9,109	8,591	17,700	30,412
Publications	740	2,552	1,035	3,587	4,508	32,653	508	33,161	37,669
General Real Estate Expenses	-	-	71,130	71,130	-	-	73,644	73,644	73,644
Grants Awarded	-	-	-	-	2,292	-	-	-	2,292
Total expenses before depreciation and amortization	12,123,427	3,090,147	9,032,345	12,122,492	11,260,450	2,711,411	8,884,458	11,595,869	22,856,319
Depreciation and Amortization	713,234	61,088	1,045,001	1,106,089	588,688	123,379	1,090,973	1,214,352	1,803,040
Total	\$ 12,836,661	\$ 3,151,235	\$ 10,077,346	\$ 13,228,581	\$ 11,849,138	\$ 2,834,790	\$ 9,975,431	\$ 12,810,221	\$ 24,659,359

See accompanying notes to financial statements.

## Lili'uokalani Trust

### Statements of Cash Flows

For the Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash Flows from Operating Activities:		
Increase in net assets	\$ 49,771,651	\$ 25,275,171
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Net realized gains on sales of real estate	(61,586,978)	(24,695,588)
Net realized and unrealized losses (gains) on investments	9,354,835	(275,213)
Depreciation and amortization	1,819,325	1,803,040
Decrease (increase) in accounts receivable	260,489	(69,078)
Decrease (increase) in prepaids expenses and other assets	45,420	(51,575)
Decrease in deferred rent receivable	661,649	2,335,606
Decrease (increase) in prepaid benefit cost	2,864,130	(453,139)
Increase in accounts payable and other accrued liabilities	270,616	7,409
Increase in accrued vacation	63,798	26,892
Increase in deferred revenue	67,778	143,970
Increase in accrued postretirement benefits	94,415	46,251
Net cash provided by operating activities	<u>3,687,128</u>	<u>4,093,746</u>
Cash Flows from Investing Activities:		
Proceeds from the sales or maturities of marketable securities	15,918	36,328,914
Purchases of marketable securities	(37,385,981)	(38,955,137)
Proceeds from the sales or maturities of limited partnership interests	280,486	605,459
Purchases of limited partnership interests	(22,882,869)	(18,891,812)
Proceeds from the sales of real estate	73,523,551	24,853,236
Purchases of real estate	(14,932,322)	(7,161,782)
Purchases of property and equipment	(2,141,043)	(362,228)
Net cash used in investing activities	<u>(3,522,260)</u>	<u>(3,583,350)</u>
Cash Flows from Financing Activities:		
Proceeds from notes payable	1,350,000	-
Repayment of notes payable	(52,910)	(28,855)
Net cash used in financing activities	<u>1,297,090</u>	<u>(28,855)</u>
Net increase in cash	1,461,958	481,541
Cash and Cash Equivalents at Beginning of Year	<u>2,202,267</u>	<u>1,720,726</u>
Cash and Cash Equivalents at End of Year	<u>\$ 3,664,225</u>	<u>\$ 2,202,267</u>

See accompanying notes to financial statements.

# Lili`uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 1. Summary of Operations and Significant Accounting Policies

### a. Operations

Lili`uokalani Trust (the Trust) was created in 1909 by the late Queen Lili`uokalani, Hawaii's last reigning monarch. The Trust is dedicated to providing support and services to orphan and destitute children, with preference given to those of Hawaiian ancestry. Income of the Trust is derived principally from rental income received from long-term leases on owned real estate, sales of certain real property located in the state of Hawaii and investment income realized from its investment portfolios.

### b. Basis of Presentation

The Trust's net assets and activities are classified based on the existence or absence of donor-imposed restrictions as follows:

- **Unrestricted Net Assets** – Net assets not subject to donor-imposed stipulations. The portion of unrestricted net assets that the board of trustees has designated for a specific purpose is presented separately from the undesignated net assets in the accompanying statements of financial position. The board of trustees retains full control over such designated funds and may use them for any purpose.
- **Temporarily Restricted Net Assets** – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Trust and/or the passage of time.
- **Permanently Restricted Net Assets** – Net assets subject to donor-imposed stipulations that must be maintained permanently by the Trust. The donors of these assets generally permit the use of the income earned on related investments for general or specific purposes. The Trust has no permanently restricted net assets.

### c. Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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. Significant items subject to such estimates and assumptions include the carrying amount of real property, investments, prepaid/accrued pension benefit costs, and accrued postretirement benefits. Actual results could differ from those estimates.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 1. Summary of Operations and Significant Accounting Policies (continued)

### d. Income Taxes

The Trust has been recognized by the Internal Revenue Service as exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code (Code) and is classified as a private operating foundation under Section 4942. As an exempt private operating foundation, the Trust is not subject to the excise tax on net investment income for private foundations. To maintain its private operating foundation status, the Code requires the distribution, for charitable purposes, of 85 percent of the lesser of adjusted net income or the minimum investment return (i.e., five percent of the aggregate fair market value of investment assets less cash deemed to be held for charitable purposes). The distribution must not be less than 2/3 of minimum investment return.

In each of the years 2008 and 2007, the Trust has expended sufficient amounts for charitable purposes or utilized distribution carryovers from prior years to not incur a tax for failure to distribute income that is imposed by the aforementioned section of the Code.

### e. Cash and Cash Equivalents

The Trust primarily maintains its cash in bank deposit accounts and had approximately \$968,000 and \$2,408,000 in excess of federally insured limits at December 31, 2008 and 2007, respectively. In addition, effective September 29, 2008, the U.S. Treasury Department established a guaranty program to insure money market fund balances from September 19, 2008. The Trust has not experienced losses in these accounts and management believes there is no significant credit risk related to cash.

The Trust considers cash on hand, deposit accounts and financial instruments with original maturities of three months or less at the date of purchase to be cash and cash equivalents.

### f. Accounts Receivable

Accounts receivable consist primarily of percentage rent due from lessees. Management determines the allowance for doubtful accounts by identifying troubled accounts and using historical experience applied to an aging of accounts. Accounts receivable are written off when deemed uncollectible and recoveries of previously written off receivables are recorded when received. For the years ended December 31, 2008 and 2007, respectively, management determined that an allowance for uncollectible accounts was not considered necessary.

# Lili`uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 1. Summary of Operations and Significant Accounting Policies (continued)

### g. Prepaid Expenses and Other Assets

Prepaid expenses and other assets consist primarily of deferred leasing commissions. Deferred leasing commissions are amortized on a straight-line basis over the term of the related leases.

### h. Property and Equipment

Property and equipment are recorded at cost, except that land acquired in the original deed of trust is recorded at the appraisal value at date of grant. All Trust property and equipment is considered exempt. Exempt property represents property used for program services. Maintenance and repairs are expensed as incurred and expenditures for renewals or betterments are capitalized.

Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

Furniture, fixtures and equipment	3 to 7 years
Buildings and improvements	Shorter of lease term or 30 years

### i. Investments

Investments include marketable securities, non-controlling interests in for-profit limited partnerships, and real estate. Investments in marketable securities consist of mutual funds and U.S. treasury bonds and are stated at fair value based on quoted market prices. Because the Trust has virtually no influence over partnership operating and financial policies, investments in limited partnerships are reported at cost. Under the cost method, income recognized is limited to distributions received, except that distributions that exceed the Trust's share of earnings after the date of investment are applied to reduce the carrying value of the investment. Investments in real estate are reported at the lower of cost or fair value.

Investments are considered to be impaired when a decline in fair value below carrying value is judged to be other than temporary. The Trust evaluates these investments for other-than-temporary impairment at least on an annual basis, and more frequently when economic or market concerns warrant such evaluation. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in investment income and a new cost basis in the investment is established.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 1. Summary of Operations and Significant Accounting Policies (continued)

### j. Deferred Rent Receivable

The Trust, as lessor, has lease agreements that provide for scheduled rent increases over the terms of the leases. Rental income is recognized on a straight-line basis over the term of the lease. The difference between rental income per the lease agreements and amounts recognized on a straight-line basis is recorded as deferred rent receivable on the accompanying statements of financial position.

### k. Deferred Revenue

Deferred revenue consists of rents received in advance of the due date and lease extension premiums. Lease extension premiums are amortized on a straight-line basis over the life of the related leases.

### l. Employee Benefit Plans

The Trust accounts for its employee benefit plans in accordance with Statement on Financial Accounting Standards (SFAS) No. 158, *“Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R).”* SFAS No. 158 requires the Trust to recognize on its statement of financial position the funded status of defined benefit pension and other postretirement benefit plans. The Trust must recognize actuarial gains and losses, prior service cost, and any remaining transition amounts from the initial application of SFAS Nos. 87 and 106 when recognizing a plan’s funded status, with the offset to unrestricted net assets.

### m. Donations

The Trust reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. 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 reported in the statements of activities as net assets released from restrictions.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 1. Summary of Operations and Significant Accounting Policies (continued)

### n. Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

Long-lived assets (individual assets or asset groups) are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If future net cash flows are less than the carrying value of an asset, an impairment loss is recognized to the extent the asset's carrying value exceeds its fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

### o. Fair Value Measurements

Effective January 1, 2008, the Trust adopted SFAS No. 157, "*Fair Value Measurements*," which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States of America and expands disclosures about fair value measurements. SFAS No. 157 applies to all financial instruments that are being measured and reported on a fair value basis (see Note 3).

### p. Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return.

In December 2008, the FASB issued Staff Position No. FIN 48-3, which allows nonpublic enterprises to elect to defer the effective date of FIN 48 to fiscal years beginning after December 15, 2008. The Trust has elected to defer the application of FIN 48 to the year ending December 31, 2009. The cumulative effect of applying the provisions of FIN 48, if any, will be reported as an adjustment to the opening balance of retained earnings for the year ending December 31, 2009. Management does not believe the adoption of FIN 48 will have a significant impact on the Trust's financial position or results of operations.

# Lili`uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 1. Summary of Operations and Significant Accounting Policies (continued)

### p. Recent Accounting Pronouncements (continued)

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events", which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 provides: (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transaction that may occur for potential recognition or disclosure in the financials statements; (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This statement is effective for periods ending after June 15, 2009. Management does not believe the adoption of SFAS 165 will have a significant impact on the Trust's financial position or results of operations.

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles," which establishes the Codification as the single source of authoritative U.S. generally accepted accounting principles (U.S. GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Trust will adopt SFAS No. 168 on September 16, 2009 and will change or eliminate citations for previous standards in future financial statements and other documents.

### q. Reclassifications

Certain reclassifications were made to prior years' financial statements to conform to the 2008 presentation. Such reclassifications had no impact on the previously reported change in net assets.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 2. Investments

### a. Marketable securities

Investments stated at fair value at December 31, 2008 and 2007 were as follows:

	<u>Fair Value</u>	<u>Cost</u>	<u>Unrealized (Losses)/Gains</u>
2008:			
Mutual funds	\$ 47,173,031	\$ 56,412,029	\$ (9,238,998)
Treasury inflation protected securities	<u>5,047,878</u>	<u>5,000,000</u>	<u>47,878</u>
	<u>\$ 52,220,909</u>	<u>\$ 61,412,029</u>	<u>\$ (9,191,120)</u>
2007:			
Mutual funds	<u>\$ 24,205,681</u>	<u>\$ 24,533,129</u>	<u>\$ (327,448)</u>

### b. Limited partnerships

At December 31, 2008, the fair value and carrying value of the Trust's limited partnership interests were approximately \$36,400,000 (unaudited) and \$43,800,000, respectively. At December 31, 2007, the fair value and carrying value of the Trust's limited partnership interests were approximately \$22,000,000 (unaudited) and \$21,200,000, respectively.

The Trust has formal commitments with various limited partnerships to acquire interests in the partnerships up to agreed upon amounts. The Trust, at the discretion of the limited partnerships, may be called upon to fully fund their commitments. At December 31, 2008 and 2007, the Trust had outstanding funding commitments of approximately \$6,800,000 and \$3,900,000, respectively.

Of the Trust's 32 investments in limited partnerships, 28 are in an unrealized loss position. These investments have been in an unrealized loss position for less than one year.

Management evaluates limited partnerships for other than temporary impairment at least annually, and more frequently when economic conditions or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the partnerships, and (3) the intent and ability of the Trust to retain its investment in the partnership for a period of time sufficient to allow for any anticipated recovery in fair value.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 2. Investments (continued)

### b. Limited partnerships (continued)

Management believes that the decline in fair value is indicative of the ongoing effects of the global liquidity crisis rather than specific concerns with respect to any individual limited partnership investment. The Trust believes that the declines in fair value are temporary in nature and the Trust has the intent and it believes the ability to hold these investments until they have recovered their cost basis. The Trust anticipates that these investments will recover within 12 to 24 months, but it is possible that a recovery may occur beyond this time period or not at all. The Trust believes it has sufficient liquidity to meet its operating needs without the sale of these investments. As a result of the factors discussed above, the Trust does not believe that its limited partnership investments are other than temporarily impaired at December 31, 2008.

### c. Real estate

Investment in real estate at December 31, 2008 and 2007 consisted of the following:

2008:	Held for			Total
	Use	Sale	Development	
Land	\$ 1,079,279	\$ 982,158	\$ 207,053	\$ 2,268,490
Building and improvements	32,227,956	-	-	32,227,956
	33,307,235	982,158	207,053	34,496,446
Accumulated depreciation and amortization	(11,463,473)	-	-	(11,463,473)
	21,843,762	982,158	207,053	23,032,703
Construction in progress (see Note 10)	497,141	8,195,723	1,583,400	10,276,264
Investment in real estate, net	<u>\$ 22,340,903</u>	<u>\$ 9,177,881</u>	<u>\$ 1,790,453</u>	<u>\$ 33,309,237</u>
2007:	Held for			Total
	Use	Sale	Development	
Land	\$ 864,682	\$ 3,329,533	\$ 207,053	\$ 4,401,268
Building and improvements	32,302,957	-	-	32,302,957
	33,167,639	3,329,533	207,053	36,704,225
Accumulated depreciation and amortization	(10,485,124)	-	-	(10,485,124)
	22,682,515	3,329,533	207,053	26,219,101
Construction in progress (see Note 10)	440,422	3,159,475	1,258,241	4,858,138
Investment in real estate, net	<u>\$ 23,122,937</u>	<u>\$ 6,489,008</u>	<u>\$ 1,465,294</u>	<u>\$ 31,077,239</u>

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 2. Investments (continued)

### c. Real estate (continued)

Real estate held for use primarily represents property that the Trust leases to third parties under non-cancelable leases (see Note 9).

Real estate held for sale consists of the Trusts' interest in the land under three condominium properties and a commercial site in Kona.

In 2007, the Trust entered into an agreement with Kawaihāo Church (Church) to acquire the Church's minority leased fee interest in the land underlying a condominium building for an initial purchase price of \$3,290,000. The initial purchase price was allocated to the cost basis of each apartment unit. Any contingent payments relating to future sales of apartment units made to the Church will be accounted for as an adjustment to the cost basis of each unit in the year such unit is sold.

The purchase agreement also contains additional payments contingent on the future sales of apartment units. Under the agreement, the Trust is required to pay to the Church 8.2 percent of the gross sales price, as defined, of each apartment unit sold and closed by the Trust within five years of the Trust's purchase of the Church's interest. The agreement allows the 8.2 percent share per apartment unit payment to the Church to be reduced by the Trust for the allocated amount of the initial purchase price to each unit.

For the year ended December 31, 2008, the Trust received proceeds of approximately \$61,600,000 and recognized a gain of approximately \$57,800,000 related to sales of its condominium properties. Through December 31, 2008, the Trust has made contingent payments to the Church of approximately \$1,494,000 and estimates that the maximum amount of future contingent payments would approximate \$506,000.

For the year ended December 31, 2008, the Trust also received proceeds of approximately \$11,300,000 and recognized a gain of approximately \$3,300,000 related to the sale of its commercial site in Kona. Included in the proceeds are reimbursements of approximately \$8,500,000 for construction costs incurred by the Trust under a sales agreement with an unrelated third party. The sales agreement requires the Trust to perform various off/on site construction with a maximum reimbursement of \$12,200,000. The Trust has incurred approximately \$9,300,000 of costs related to its construction requirements as defined in the agreement. The Trust does not expect to incur construction costs in excess of its maximum allowable reimbursement under the agreement.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 2. Investments (continued)

### c. Real estate (continued)

Real estate held for development includes land acquisition costs, initial planning costs and capitalized interest related to various parcels of land in Kona.

## 3. Fair Value Measurements

SFAS No. 157 establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under SFAS No. 157 are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.

Level 2: Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The Trust's investments are recorded at fair value as follows:

*Mutual funds* are stated at fair value using quoted market prices. Shares of mutual funds are valued at the net asset value of shares held by the Plan at the reporting date on a recurring basis.

*U.S. Treasury bonds* are traded in active markets; quoted prices are obtained for similar assets, and fair values are recorded on a recurring basis.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

### 3. Fair Value Measurements (continued)

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The table below presents the balances of investments measured at fair value on a recurring basis as of December 31, 2008.

	Total	Fair Value as of December 31, 2008		
		Level 1	Level 2	Level 3
Mutual funds	\$ 47,173,031	\$ 47,173,031	\$ -	\$ -
U.S. Treasury bonds	5,047,878	-	5,047,878	-
Total	<u>\$ 52,220,909</u>	<u>\$ 47,173,031</u>	<u>\$ 5,047,878</u>	<u>\$ -</u>

There have been no changes in the methodologies used at December 31, 2008 and 2007.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Trust believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The Trust's other financial instruments include cash and cash equivalents, receivables, prepaid expense and other assets, accounts payable and other accrued liabilities. The carrying amounts of these assets and liabilities approximate fair value because of the short-term nature of these instruments.

As of December 31, 2008 and 2007, the carrying amounts of notes payable of approximately \$2,500,000 and \$1,200,000, respectively, approximate fair value as the interest rate is commensurate with interest rates currently offered by lending institutions for loans of similar terms to companies with comparable credit risk.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

### 4. Temporarily Restricted Net Assets

Temporarily restricted net assets at December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Operations:		
U.S. Department of Education Summer Food Service Program	\$ 568	\$ 568
Other/Emergency Fund	<u>67,952</u>	<u>63,242</u>
Total	<u>\$ 68,520</u>	<u>\$ 63,810</u>

Net assets in the amount of approximately \$10,000 and \$11,000 were released from donor restrictions in 2008 and 2007, respectively, by incurring expenses satisfying the restricted purposes related to the applicable programs.

### 5. Designated Net Assets

The Trustees have designated \$3,018,000 for the renovation of its Waianae Coast Children's Center. On March 19, 2007, the Trust received a private letter ruling from the Internal Revenue Service approving the designated amount as a qualifying distribution for the tax year ended December 31, 2006. The set aside is reduced as related expenditures are incurred. In 2008 and 2007, the Trust recorded expenditures related to the renovation of the Waianae Coast Children's Center of approximately \$72,000 and \$15,000, respectively.

### 6. Property and Equipment

Property and equipment at December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Land	\$ 3,587,975	\$ 3,160,369
Building and improvements	23,806,214	22,568,981
Furniture, fixtures and equipment	<u>2,575,046</u>	<u>2,399,281</u>
	29,969,235	28,128,631
Accumulated depreciation and amortization	<u>(11,959,564)</u>	<u>(11,145,881)</u>
	18,009,671	16,982,750
Construction in progress (see Note 10)	<u>93,777</u>	<u>35,229</u>
Property and equipment, net	<u>\$ 18,103,448</u>	<u>\$ 17,017,979</u>

## **Lili`uokalani Trust**

Notes to Financial Statements  
December 31, 2008 and 2007

### **6. Property and Equipment (continued)**

For the years ended December 31, 2008 and 2007, the Trust capitalized approximately \$110,000 and \$66,000 of interest costs, respectively.

### **7. Employee Benefit Plans**

#### **a. 401(k) Plan**

In 2005, the Trust established a defined contribution plan qualifying under Section 401(k) of the Internal Revenue Code, covering all employees who have six months of service and are age 21 or older. Employees may contribute up to 75 percent of included compensation, as defined in the defined contribution plan. The Trust matches 100 percent of employee contributions up to the first 3 percent of included compensation, plus 50 percent of employee contributions up to the next 2 percent of included compensation.

Expenses related to the Plan totaled approximately \$280,000 and \$265,000 for the years ended December 31, 2008 and 2007, respectively.

#### **b. Defined Benefit Pension and Post retirement Benefit Plans**

The Trust has a non-contributory defined benefit pension plan (the Plan) covering substantially all of its employees. The Plan's benefits are based on years of service and the employee's compensation during the last several years of employment. The Trust's funding policy is to contribute annually the amount consistent with the minimum funding standards as required by applicable federal regulations.

Effective December 31, 2004, the Plan was curtailed. Upon the effective date of the curtailment, accrual of benefits ceased and no individual is able to become an eligible participant of the Plan.

The Trust also provides post retirement health benefits to eligible employees based on age and years of service. The plan covers the cost of medical plan coverage subject to a set monthly maximum.

The changes in the obligations and assets of the Trust's defined benefit plans and the changes in unrestricted net assets for 2008 and the funded status of these plans and amounts related to these plans reflected in the Trust's statements of financial position were as follows:

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

### 7. Employee Benefit Plans (continued)

#### b. Defined Benefit Pension and Post retirement Benefit Plans (continued)

	Pension Benefits	Postretirement Benefits
Benefit obligation, December 31, 2007	\$ 7,605,794	\$ 1,088,034
Service cost	-	49,572
Interest cost	467,432	66,567
Assumption changes	-	-
Actuarial (gain)/loss	10,697	(4,839)
Benefits paid	<u>(163,476)</u>	<u>(16,885)</u>
Benefit obligation, December 31, 2008	<u>7,920,447</u>	<u>1,182,449</u>
Fair value of plan assets, December 31, 2007	8,537,020	-
Actual return on plan assets	(2,536,001)	-
Employer contribution	150,000	16,885
Benefits paid	<u>(163,476)</u>	<u>(16,885)</u>
Fair value of plan assets, December 31, 2008	<u>5,987,543</u>	-
Accrued postretirement benefits	<u>\$ (1,932,904)</u>	<u>\$ (1,182,449)</u>
Change in net periodic benefit cost not yet recognized:		
As of December 31, 2007	\$ 850,833	\$ (63,167)
Current year	<u>(3,054,943)</u>	<u>21,557</u>
Current net periodic benefit cost not yet recognized	<u>\$ (2,204,110)</u>	<u>\$ (41,610)</u>

## Lili`uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

### 7. Employee Benefit Plans (continued)

#### b. Defined Benefit Pension and Post retirement Benefit Plans (continued)

The changes in the obligations and assets of the Trust's defined benefit plans and the changes in unrestricted net assets for 2007 and the funded status of these plans and amounts related to these plans reflected in the Trust's statements of financial position were as follows:

	Pension Benefits	Postretirement Benefits
Benefit obligation, December 31, 2006	\$ 7,489,394	\$ 1,041,783
Service cost	-	49,900
Interest cost	445,785	60,511
Assumption changes	(233,818)	(23,850)
Actuarial (gain)/loss	45,356	(26,233)
Benefits paid	(140,923)	(14,077)
Benefit obligation, December 31, 2007	<u>7,605,794</u>	<u>1,088,034</u>
Fair value of plan assets, December 31, 2006	7,967,481	-
Actual return on plan assets	560,462	-
Employer contribution	150,000	14,077
Benefits paid	(140,923)	(14,077)
Fair value of plan assets, December 31, 2007	<u>8,537,020</u>	<u>-</u>
Prepaid benefit cost/(accrued postretirement benefits)	<u>\$ 931,226</u>	<u>\$ (1,088,034)</u>
Change in net periodic benefit cost not yet recognized:		
As of December 31, 2006	\$ 573,738	\$ (129,968)
Current year	<u>277,095</u>	<u>66,801</u>
Current net periodic benefit cost not yet recognized	<u>\$ 850,833</u>	<u>\$ (63,167)</u>

The Trust does not expect any plan assets to be returned to the Trust during calendar year 2009.

The overall expected long-term rate of return on assets assumption is based on the expected returns of various asset classes weighted by the pension plan's asset allocation.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

### 7. Employee Benefit Plans (continued)

#### b. Defined Benefit Pension and Post retirement Benefit Plans (continued)

The percentage of pension plan assets by asset category and target allocation ranges were as follows:

Asset category:		Target Ranges
Mutual Funds – Equity	63%	40 – 70%
Mutual Funds – Fixed Income	31%	20 – 50%
Other	6%	0 – 20%
Total	100%	

It is the Trust's policy to invest pension plan assets in a diversified portfolio consisting of an array of asset classes within the above target asset allocation ranges. The investment risk of the assets is limited by appropriate diversification both within and between asset classes. The assets are managed with a view to ensuring that sufficient liquidity will be available to meet expected cash flow requirements.

The following estimated future benefit payments, which reflect expected future service for the post retirement benefit plan, are expected to be paid in the years indicated:

Years ending December 31,	Pension Plan	Post retirement Benefit Plan
2009	\$ 299,467	\$ 23,979
2010	341,722	30,781
2011	384,519	39,045
2012	411,208	49,313
2013	446,564	58,153
2014 – 2018	2,713,333	370,634

The Trust expects to make contributions to its defined benefit pension and post retirement benefit plans in 2009 estimated at approximately \$150,000 and \$20,000, respectively.

# Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

## 7. Employee Benefit Plans (continued)

### b. Defined Benefit Pension and Post retirement Benefit Plans (continued)

The following assumptions were used in accounting for the plans at December 31:

	Pension Plan		Post retirement Benefit Plan	
	2008	2007	2008	2007
Benefit obligation:				
Discount rate	6.25%	6.25%	6.25%	6.25%
Expected long-term rate of return on plan assets	6.00%	6.00%	n/a	n/a
Health care trend rates	n/a	n/a	9% - 5%	10% - 5%
Year of ultimate trend	n/a	n/a	2015	2013
Net periodic benefit cost (years ended):				
Discount rate	6.25%	6.00%	6.25%	6.00%
Expected long-term rate of return on plan assets	6.00%	6.00%	n/a	n/a
Health care trend rates	n/a	n/a	10% - 5%	10% - 5%
Year of ultimate trend	n/a	n/a	2013	2012

The components of net periodic benefit cost were as follows:

	Pension Plan		Post retirement Benefit Plan	
	2008	2007	2008	2007
Service cost	\$ -	\$ -	\$ 49,572	\$ 49,900
Interest cost	467,432	445,785	66,567	60,511
Expected return on plan assets	(508,036)	(471,866)	-	-
Amortization of net (gain)	(209)	-	-	-
Amortization of unrecognized net transition obligation	-	-	16,718	16,718
Net periodic benefit cost	<u>\$ (40,813)</u>	<u>\$ (26,081)</u>	<u>\$ 132,857</u>	<u>\$ 127,129</u>

The estimated transition obligation for the post retirement benefit plan that will be amortized from unrestricted net assets into net periodic pension benefit cost during 2009 is \$16,718.

During 2008, the Trustees approved the termination of the defined benefit pension plan subject to management's evaluation of the cost/benefit of such action. The Trust is required to offer an annuity to plan participants otherwise benefits may be paid out in a lump sum settlement.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

### 8. Notes Payable

In 2004, the Trust entered into a term loan agreement with a bank in the original amount of \$1,300,000 to finance the purchase of its main office space and related improvements. The loan bears interest at 5.31 percent and requires the Trust to make monthly principal and interest payments of \$7,836. The maturity date of the loan is September 28, 2014. Any repayments of the loan made prior to September 28, 2007 are subject to penalties. The loan is secured by approximately \$10 million of marketable securities, and also requires the Trust to maintain certain financial covenants related to its loan to value ratio, as defined in the loan agreement. The Trust was in compliance with these requirements as of December 31, 2008 and 2007. There was a balance of approximately \$1,184,000 and \$1,212,000 outstanding on the loan at December 31, 2008 and 2007, respectively.

On February 19, 2008, the Trust entered into a promissory note with a bank in the original amount of \$1,350,000 to finance the purchase of the Wili Pa Loop property and related improvements for the Maui Children's Center. The maturity date of the loan is February 22, 2017. Any repayments of the loan made prior to February 22, 2011 are subject to penalties. The note bears interest in three 36 month interest rate periods at the ends of which, the rate will be adjusted to match the current market commercial rate for similar loans at that date until repayment of the loan. The note bore an interest rate of 4.64 percent during the year ended December 31, 2008. There was a balance of approximately \$1,325,000 outstanding on the note at December 31, 2008.

The Trust also has a \$5,000,000 line of credit with a bank, of which \$1,000,000 was available during the year. \$4,000,000 of the line of credit was used during the year to fulfill a standby letter of credit requirement of a development agreement with an unrelated third party (beneficiary). If the Trust is unable to complete their portion of the development agreement, the beneficiary may draw down on the letter of credit. The line of credit allows the Trust to obtain LIBOR rate advances and base rate advances. LIBOR rate advances bear interest at LIBOR plus 0.875 percent. Base rate advances bear interest at the base rate of the financial institution, as defined, less 0.75 percent. The line of credit expires on October 1, 2009. There were no outstanding draws on the line of credit as of December 31, 2008 and 2007. Subsequent to year end, the terms of the standby letter of credit were met by the Trust and the standby letter of credit expired on June 13, 2009.

## Lili'uokalani Trust

Notes to Financial Statements  
December 31, 2008 and 2007

### 8. Notes Payable (continued)

The approximate annual principal payments on notes payable at December 31, 2008 were as follows:

For the years ending	
December 31,	
2009	\$ 53,000
2010	56,000
2011	58,000
2012	61,000
2013	65,000
Thereafter	<u>2,216,322</u>
	<u>\$ 2,509,322</u>

### 9. Leases As Lessor

Land held by the Trust as investment property is leased or available for lease under operating lease arrangements which expire through 2079.

Future minimum rental revenues under non-cancelable operating leases as of December 31, 2008 were approximately as follows:

For the years ending	
December 31,	
2009	\$ 17,172,000
2010	17,112,000
2011	17,139,000
2012	17,365,000
2013	17,329,000
Thereafter	<u>647,828,000</u>
Total	<u>\$ 733,945,000</u>

The Trust receives percentage rentals (based on lessees' gross receipts, as defined) on certain of its properties. Percentage rent revenues earned for the years ended December 31, 2008 and 2007, amounted to approximately \$3,174,000 and \$3,310,000, respectively.

## **Lili`uokalani Trust**

Notes to Financial Statements  
December 31, 2008 and 2007

### **10. Commitments**

The Trust entered into contracts with various third parties related to its development projects and construction in progress. At December 31, 2008, these contracts totaled approximately \$19,321,000, of which the Trust had incurred approximately \$15,464,000 as of December 31, 2008.

## **Supplementary Information**

## Lili'uokalani Trust

Supplemental Schedule of Land  
December 31, 2008

	<u>Cost Basis</u>	<u>Appraisal Basis (Unaudited)</u>
Investment in land:		
Oahu:		
Waikiki	\$ 1,634,370	\$ 249,620,000
Other Oahu	247,791	14,114,000
Hawaii:		
Kona:		
Developed	49,331	102,078,000
Undeveloped	224,120	126,080,000
Leased for agriculture	112,877	3,302,000
Other Hawaii	1	6,896,000
Total investment in land	<u>2,268,490</u>	<u>502,090,000</u>
Land used for tax exempt purposes:		
Children's centers:		
Hilo	302,816	580,000
Kona	-	1,342,000
Kaneohe	703,316	910,000
Kapalama	217,160	2,500,000
Kauai	966,858	875,000
Maui	883,190	1,353,000
Punaluu	1	4,540,000
Waianae	514,634	890,000
Total land used for tax exempt purposes	<u>3,587,975</u>	<u>12,990,000</u>
Total land	<u>\$ 5,856,465</u>	<u>\$ 515,080,000</u>

Note: The supplemental "appraisal basis" value of land is stated primarily at the estimated market value on January 1, 2008 as appraised by John Child & Company, in its report dated October 6, 2008. For land sales that were not given a separate tax map key in the appraisal, their appraisal value has been removed in proportion to their cost basis. Land purchases subsequent to the appraisal have been included in the appraisal basis at cost.

See accompanying independent auditor's report.