KPMG

PACE UNIVERSITY

Financial Statements

June 30, 2005 and 2004

(With Independent Auditors' Report Thereon)

KPMG

KPMG LLP
345 Park Avenue
New York, NY 10154

Independent Auditors' Report

The Board of Trustees
Pace University:

We have audited the accompanying balance sheets of Pace University (the University) as of June 30, 2005 and 2004, and the related statements of changes in unrestricted net assets, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pace University as of June 30, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

February 2, 2006

PACE UNIVERSITY

Balance Sheets

June 30, 2005 and 2004

Assets		**2005**	**2004**
Cash and cash equivalents	$	330,400	1,160,267
Student accounts receivable (net of allowance for doubtful accounts of $1,641,000 and $1,479,000 in 2005 and 2004, respectively)		8,241,823	7,820,509
Grants and other receivables		18,763,305	12,969,836
Prepaid expenses and other assets		8,958,314	6,490,383
Contributions receivable, net (note 4)		9,700,927	8,513,261
Investments (notes 3 and 10)		102,620,249	94,922,494
Student loans receivable (net of allowance for doubtful accounts of $1,764,000 and $1,710,000 in 2005 and 2004, respectively)		14,680,542	14,426,225
Funds held by bond trustees, at fair value (note 7)		9,020,771	11,408,466
Plant assets (notes 5 and 7)		280,405,970	275,777,636
Total assets	$	452,722,301	433,489,077
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued liabilities (notes 12, 13, and 14)	$	28,415,389	26,565,526
Notes payable (note 6)		20,179,461	44,940,000
Liability under derivative instrument (note 7)		2,729,162	—
Deferred revenues and deposits		5,313,684	8,413,755
Liability under split-interest agreements		707,008	889,867
Long-term debt (notes 7 and 8)		132,621,237	81,718,954
Deferred compensation (note 10)		6,058,801	6,364,883
Deferred rental revenue (note 9)		14,162,946	15,107,142
Accrued postretirement benefit obligation (note 11)		55,064,907	54,249,374
U.S. Government grants refundable		12,946,692	12,636,714
Total liabilities		278,199,287	250,886,215
Net assets:			
Unrestricted		80,998,822	98,913,391
Temporarily restricted (note 15)		43,070,323	35,091,135
Permanently restricted (note 15)		50,453,869	48,598,336
Total net assets		174,523,014	182,602,862
Total liabilities and net assets	$	452,722,301	433,489,077

See accompanying notes to financial statements.

PACE UNIVERSITY

Statements of Changes in Unrestricted Net Assets

Years ended June 30, 2005 and 2004

	Operating	Nonoperating	Total 2005	Total 2004
Revenues:				
Tuition and fees, net (note 16)	$ 196,332,709	—	196,332,709	190,930,915
Government grants and contracts	220,302	—	220,302	150,000
State appropriations	1,190,014	—	1,190,014	1,261,892
Contributions (note 17)	1,526,137	—	1,526,137	1,253,909
Investment return (note 3)	643,225	610,204	1,253,429	1,404,362
Investment return on funds held by bond trustees	—	422,395	422,395	(166,419)
Sales and services of auxiliary enterprises	21,691,095	—	21,691,095	18,728,668
Other sources (note 9)	8,638,327	—	8,638,327	7,686,847
Net assets released from restrictions	19,490,868	—	19,490,868	21,765,699
Total revenues	249,732,677	1,032,599	250,765,276	243,015,873
Expenses (notes 17 and 19):				
Instruction	109,046,553	—	109,046,553	101,266,677
Research	2,722,436	—	2,722,436	2,995,047
Academic support	35,154,141	—	35,154,141	34,614,396
Student services	31,761,484	—	31,761,484	30,779,374
Institutional support	47,020,713	—	47,020,713	43,280,238
Auxiliary enterprises	32,594,748	—	32,594,748	26,292,123
Total expenses	258,300,075	—	258,300,075	239,227,855
Unrealized depreciation in fair value of derivative instrument (note 7)	—	(2,729,162)	(2,729,162)	—
Loss on refunding of long-term debt (note 7)	—	(7,650,608)	(7,650,608)	—
Insurance recoveries and FEMA aid (note 21)	—	—	—	1,550,526
(Decrease) increase in unrestricted net assets	$ (8,567,398)	(9,347,171)	(17,914,569)	5,338,544

See accompanying notes to financial statements.

PACE UNIVERSITY

Statements of Changes in Net Assets

Years ended June 30, 2005 and 2004

	2005	2004
(Decrease) increase in unrestricted net assets	$ (17,914,569)	5,338,544
Changes in temporarily restricted net assets:		
Government grants and contracts	6,674,257	8,160,311
Private gifts and grants (note 17)	11,779,136	14,717,508
Investment return (note 3)	8,985,117	11,607,671
Change in value of split-interest agreements	31,546	(7,228)
Net assets released from restrictions	(19,490,868)	(21,765,699)
Increase in temporarily restricted net assets	7,979,188	12,712,563
Changes in permanently restricted net assets:		
Contributions (note 17)	1,538,536	2,055,781
Investment return (note 3)	22,521	28,449
Change in value of split-interest agreements	296,534	130,478
Interest on student loans, net	(2,058)	875
Increase in permanently restricted net assets	1,855,533	2,215,583
(Decrease) increase in net assets	(8,079,848)	20,266,690
Net assets at beginning of year	182,602,862	162,336,172
Net assets at end of year	$ 174,523,014	182,602,862

See accompanying notes to financial statements.

PACE UNIVERSITY

Statements of Cash Flows

Years ended June 30, 2005 and 2004

		2005	2004
Cash flows from operating activities:			
(Decrease) increase in net assets	$	(8,079,848)	20,266,690
Adjustments to reconcile (decrease) increase in net assets to net cash (used in) provided by operating activities:			
Net appreciation in fair value of investments		(8,270,904)	(11,560,856)
Liability under derivative instrument		2,729,162	—
Loss on refunding of long-term debt		7,650,608	—
Change in value of split-interest agreements		(328,080)	(123,250)
Deferred rental revenue		(944,196)	(944,196)
Depreciation		12,638,085	11,908,394
Amortization		147,547	135,574
Write-off of fixed assets		12,202	26,585
Revenues and losses restricted for permanent investment		(1,558,999)	(2,085,105)
Increase in student accounts receivable		(421,314)	(1,325,056)
(Increase) decrease in government grants and other receivables		(5,793,469)	686,293
Decrease (increase) in prepaid expenses and other assets		916,697	(1,281,226)
Increase in contributions receivable, net		(622,791)	(4,548,606)
Increase in accounts payable and accrued liabilities		1,849,863	2,183,287
(Decrease) increase in deferred revenues and deposits		(3,100,071)	1,993,205
Increase in accrued postretirement benefit obligation		815,533	1,754,224
Increase in U.S. Government grants refundable		309,978	407,860
Net cash (used in) provided by operating activities		(2,049,997)	17,493,817
Cash flows from investing activities:			
Increase in student loans receivable		(254,317)	(761,122)
Decrease in deferred compensation		(306,082)	(309,792)
Purchase of plant assets		(13,480,098)	(17,301,265)
Purchase of investments		(23,360,890)	(167,007,209)
Proceeds from sale of investments		23,934,039	165,237,197
Net cash used in investing activities		(13,467,348)	(20,142,191)
Cash flows from financing activities:			
Revenues and losses from contributions restricted for permanent investment		1,558,999	2,085,105
Increase in contributions receivable restricted for permanent investment		(564,875)	(1,464,109)
Decrease in liabilities under split-interest agreements, net		145,221	90,699
Increase in notes payable		97,333,525	73,740,000
Repayment of notes payable		(122,094,064)	(72,200,000)
Bond issuance costs		(5,774,444)	—
Proceeds from long-term debt		116,475,000	2,000,000
Repayment of indebtedness		(74,779,579)	(2,173,887)
Decrease (increase) in funds held by bond trustees		2,387,695	(361,510)
Net cash provided by financing activities		14,687,478	1,716,298
Net decrease in cash and cash equivalents		(829,867)	(932,076)
Cash and cash equivalents at beginning of year		1,160,267	2,092,343
Cash and cash equivalents at end of year	$	330,400	1,160,267
Supplemental disclosure:			
Interest paid	$	6,456,299	5,435,255
Assets acquired under capital lease		3,798,523	—

See accompanying notes to financial statements.

(1) Nature of Operations

Pace University (the University) is an independent, coeducational, nonsectarian, not-for-profit institution of higher education with campuses in New York City and Westchester County. The University was founded in 1906 and was granted college status in 1948 by the New York State Board of Regents. It is exempt from Federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code.

The University considers teaching and learning its highest priorities. The University's commitment to the individual needs of students is at the heart of its mission. Offering access and opportunity to qualified men and women, the University embraces persons of diverse talents, interests, experiences, and origins who have the will to learn and the desire to participate in University life. The University offers a wide range of academic and professional programs at the graduate and undergraduate levels in six colleges and schools. The University is accredited by major accrediting entities.

(2) Summary of Significant Accounting Policies

The significant accounting policies followed by the University are described below:

(a) Basis of Presentation

The University's financial statements are prepared on the accrual basis of accounting in accordance with standards established by the Financial Accounting Standards Board for external financial reporting by not-for-profit organizations. Accordingly, net assets of the University and changes therein are classified and reported as follows:

Unrestricted net assets – Net assets that are not subject to donor-imposed restrictions.

Temporarily restricted net assets – Net assets subject to donor-imposed restrictions that will be met either by actions of the University or the passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed restrictions that stipulate that they be maintained permanently by the University, but permit the University to expend part or all of the income derived therefrom.

Revenues and gains and losses on investments and other assets are reported as changes in unrestricted net assets unless limited by explicit donor-imposed restrictions or by law. Expenses are reported as decreases in unrestricted net assets. Expiration of temporary restrictions on net assets is reported as net assets are released from restrictions.

(b) Contributions

Contributions, including unconditional promises to give (pledges), are reported as revenues in the period received or pledged. Contributions with purpose or time restrictions are reported as increases in temporarily restricted net assets and are reclassified to unrestricted net assets when the purpose or time restrictions are met. Contributions subject to donor-imposed stipulations that the corpus be maintained permanently are recognized as increases in permanently restricted net assets.

Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met. Contributions of assets other than cash are

(Continued)

recorded at their estimated fair value. The University reports contributions of plant assets as increases in unrestricted net assets unless the donor places restrictions on their use. Contributions to be received after one year are discounted at a risk-free rate. Amortization of the discount is recorded as additional contribution revenue in accordance with the donor-imposed restrictions, if any, on the contribution. An allowance is recorded for uncollectible contributions based on management's judgment, past collection experience, and other relevant factors.

(c) Government Grants and Contracts

Government grants and contracts are primarily considered conditional and, therefore, revenue is recorded when the qualified expense is incurred.

(d) Cash Equivalents

The University considers all highly liquid debt instruments with maturities of three months or less at the time of purchase to be cash equivalents, except for those that are purchased by the University's investment managers as part of their investment strategies.

(e) Plant Assets

Plant assets are stated as follows:

- Land and land improvements – at cost.
- Buildings, building improvements, and leasehold improvements – at cost.
- Furniture and equipment – at cost.
- Library books – at nominal amount of $1 per volume.

Depreciation of plant assets is computed on a straight-line basis over their estimated useful lives. No depreciation is computed in the year assets are acquired and a full year's depreciation is computed in the year of disposition. Depreciable lives of land improvements, buildings, building improvements, and leasehold improvements range from 5 years to 90 years and the depreciable lives of furniture and equipment range from 2 years to 20 years.

(f) U.S. Government Grants Refundable

Funds provided by the U.S. Government under the Federal Perkins and Nursing Student Loan programs are loaned to qualified students and may be reloaned after collection. These funds are ultimately refundable to the Government and are presented in the accompanying balance sheets as a liability.

(Continued)

(g) Split-Interest Agreements

The University's split-interest agreements with donors consist primarily of irrevocable charitable remainder trusts, for which the University serves as trustee, and charitable gift annuities. Assets associated with such split-interest agreements are included in investments. Contributions are recognized at the date the trusts are established or when funds are transferred from the donor to the University after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted annually for changes in the value of the assets, accretion of the discount, and other changes in the estimates of future benefits. Such adjustments are reflected as change in value of split-interest agreements in the accompanying financial statements.

(h) Operations

The statements of changes in unrestricted net assets distinguish between operating and nonoperating activities. Nonoperating activities principally include investment return in excess of (or less than) amounts authorized for spending by the University's board of trustees (see note 3), investment return on funds held by bond trustees, unrealized appreciation (depreciation) in fair value of derivative instruments, loss on defeasance of long-term debt, and other nonrecurring transactions.

(i) Accounting Estimates

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

(j) Other Significant Accounting Policies

Other significant accounting policies are set forth in the following notes.

(3) Investments and Investment Return

Investments are carried at fair value based upon quoted market prices or values provided by the University's external investment managers if no quoted market prices exist.

Alternative investments are less liquid than the University's other investments and consist of three hedge funds and a fixed income return fund. Such alternative investments are carried at estimated fair values as provided by the investment managers. Those estimated fair values may differ significantly from the values that would have been used had a ready market for those securities existed. These estimated values are reviewed and evaluated by management.

The following tabulation summarizes the composition of investments at June 30, 2005 and 2004:

	2005		2004	
	Cost	**Fair value**	**Cost**	**Fair value**
Cash and cash equivalents	$ 816,822	810,416	1,468,538	1,468,538
Cash and cash equivalents – deferred compensation (note 10)	3,797,410	3,802,507	3,942,416	3,948,843
Common stocks	1,185,980	1,210,281	1,374,535	1,387,747
Mutual funds:				
Equity	34,271,391	38,762,762	49,658,262	52,062,560
International equity	8,481,612	9,782,211	3,965,719	3,859,697
Fixed income	25,290,755	26,205,253	22,282,084	22,116,553
Distressed debt investment	1,177,855	1,437,817	938,641	1,070,593
Real estate investments	5,753,604	6,400,547	347,591	361,447
Mutual funds – deferred compensation (note 10)	2,050,981	2,350,932	2,191,785	2,488,677
Alternative investments	9,917,531	10,528,083	4,790,913	4,868,196
U.S. Government bonds	526,966	508,790	512,529	498,178
Municipal bonds	780,028	820,650	779,850	791,465
	$ 94,050,935	102,620,249	92,252,863	94,922,494

Investments include $2,118,619 and $2,312,066 of assets held under split-interest agreements at June 30, 2005 and 2004, respectively.

The University maintains an investment pool for certain investments. The pool is managed to achieve the maximum prudent long-term total return. The University's board of trustees has authorized a policy designed to preserve the value of these investments in real terms (after inflation) and provide a predictable flow of funds to support operations. This policy permits the use of total return (dividend and interest income and investment gains) at a rate (spending rate) of 5% of the three-year moving average fair value of the pooled investments. In accordance with the above spending rate, $2,797,218 and $2,960,337 of investment return was made available for the years ended June 30, 2005 and 2004, respectively, to support operations of the University. In addition, the University also utilized investment return of $254,014 and $114,603 in fiscal 2005 and 2004, respectively.

The following summarizes the University's total investment return (excluding investment return on assets held under split-interest and deferred compensation arrangements) and its classification in the financial statements for the years ended June 30, 2005 and 2004:

	Unrestricted	Temporarily restricted	Permanently restricted	Total
2005:				
Dividends and interest on investments (net of expenses of $398,668)	$ 382,961	1,603,257	3,945	1,990,163
Net appreciation in fair value of investments	870,468	7,381,860	18,576	8,270,904
Total return on investments	1,253,429	8,985,117	22,521	10,261,067
Investment return appropriated for operations	643,225	2,408,007	—	3,051,232
Excess of total return on investments over investment return appropriated for operations	$ 610,204	6,577,110	22,521	7,209,835

	Unrestricted	Temporarily restricted	Permanently restricted	Total
2004:				
Dividends and interest on investments (net of expenses of $345,946)	$ 106,340	1,369,994	3,292	1,479,626
Net appreciation in fair value of investments	1,298,022	10,237,677	25,157	11,560,856
Total return on investments	1,404,362	11,607,671	28,449	13,040,482
Investment return appropriated for operations	521,174	2,553,766	—	3,074,940
Excess of total return on investments over investment return appropriated for operations	$ 883,188	9,053,905	28,449	9,965,542

(Continued)

(4) Contributions Receivable

Unconditional promises to give are reported in the financial statements as contributions receivable and as revenue of the appropriate net asset class. Contributions receivable due more than one year from the date of the financial statements are recorded net of a discount to reflect the present value of future cash flows. Contributions receivable consist of the following at June 30, 2005 and 2004:

	2005	2004
Amounts expected to be collected in:		
Less than one year	$ 1,644,288	1,285,639
One to five years	5,878,391	6,021,619
More than five years	4,312,065	3,250,000
	11,834,744	10,557,258
Less discount to present value, from 3.9% to 6.5%	(1,425,422)	(1,411,906)
Less allowance for uncollectible amounts	(708,395)	(632,091)
	$ 9,700,927	8,513,261

(5) Plant Assets

Plant assets at June 30, 2005 and 2004 consist of the following:

	2005	2004
Land	$ 11,285,092	11,285,092
Land improvements	6,068,602	5,964,748
Buildings and building improvements	282,035,333	276,457,546
Furniture and equipment	97,931,277	86,421,437
Library books	929,470	899,490
Total	398,249,774	381,028,313
Less accumulated depreciation	(117,843,804)	(105,250,677)
	$ 280,405,970	275,777,636

Included in buildings and building improvements is $16,227,000 relating to a building received in exchange for use of land. See note 9 for a discussion on the Judicial Training Institute. Additionally, included in furniture and equipment at June 30, 2005 is telephone equipment under capital leases of $3,800,000.

(6) Notes Payable

On June 29, 2005, in conjunction with the refinancing of short-term notes payable and the refunding of a portion of the Dormitory Authority of the State of New York Series 1997 and Series 2000 bonds, the University entered into a $25,000,000 unsecured working capital line of credit expiring on June 30, 2006. The line of credit bears interest at the Prime/Fed Funds Rate of the lending institution minus the applicable Prime/Fed Funds Margin, as defined, or LIBOR plus the applicable LIBOR Margin, as defined. The

Prime/Fed Funds Margin ranges from 1.75% to 2.5% and the LIBOR margin ranges from 0.25% to 0.75%. Both margins are dependent upon the University's bond rating by Moody's. The line of credit requires that the outstanding balance be reduced to zero for a period of 30 consecutive days during the period the line of credit is held available to the University. The unsecured line of credit replaced the two-tranche secured line described below. On June 30, 2005 all amounts outstanding under the two-tranche line were transferred to the unsecured line. At June 30, 2005, the outstanding balance on the unsecured line of credit was $18,820,000.

Prior to the refinancing of short-term notes payable, to meet its short-term working capital needs, the University had a two-tranche $60,000,000 secured line of credit, which expired on July 1, 2005. Tranche A was for $35,000,000 and interest was based on the Prime/Fed Funds rate of the banking institution minus 1.75% or LIBOR plus 0.75%. Tranche B was for a maximum of $25,000,000 and interest was based on the Prime/Fed Funds rate of the banking institution minus 1.25% or LIBOR plus 1.25%. The line of credit was secured by certain investments of the University. As noted above, on June 29, 2005 the two-tranche secured line of credit was replaced by the unsecured line of credit. At June 30, 2004, $35,000,000 and $9,940,000 were outstanding under Tranche A and Tranche B, respectively.

Interest expense on the unsecured and secured (two-tranche) notes payable for the years ended June 30, 2005 and 2004 was $1,314,727 and $865,333, of which $231,337 was capitalized in plant assets in 2004. The average interest rate on the lines of credit was 3.4% and 2.33% in fiscal years 2005 and 2004, respectively.

As of June 30, 2005, the University has standby letters of credit outstanding for $1,296,211 against the unsecured line of credit.

On May 1, 2004, the University entered into a revolving financing agreement with Sallie Mae, Inc., to fund its School as Lender Program, a program designed to provide financial assistance in the form of loans to graduate students (Student Loans). All outstanding amounts are secured by Student Loans owned by the University. Under this agreement, the University sells and Sallie Mae is obligated to purchase all the Student Loans owned by the University within 90 days from the date the Student Loans are made. The proceeds from the sale of the Student Loans are applied to any outstanding principal balance under the revolving finance agreement. Under the University's semester schedule, no principal outstanding under the revolving financing agreement should exceed 180 days.

As of June 30, 2005, the outstanding balance under this agreement was $1,359,461. Interest expense for the year ended June 30, 2005 was $294,990. Student Loans of $1,038,641 are outstanding at June 30, 2005 under this program securing the outstanding principal balance under the revolving finance agreement.

The University earns interest on the outstanding balance of the Student Loans until it is sold to Sallie Mae, and it earns a premium on the sale to Sallie Mae. During 2005, the University earned $1,371,235, net of interest expense of $294,990 on the line outstanding, from Sallie Mae.

(7) Long-Term Debt

Long-term debt at June 30, 2005 and 2004 consists of the following:

	2005	2004
Long-term leases of the Dormitory Authority of the State of New York (DASNY or the Authority) (a):		
Revenue Bonds, Pace University issue, $73,975,000, Series 2005A, due serially to 2029 at an effective interest rate of 3.303% per annum	$ 73,975,000	—
Revenue Bonds, Pace University issue, $42,500,000, Series 2005B, due serially to 2035 at an interest rate of 3.5% the first year, and 4.5% per annum, thereafter	42,500,000	—
Revenue Bonds, Pace University issue, $26,075,000, Series 2000, due serially to 2029 at interest rates ranging from 4.75% to 5.88% per annum, plus unamortized original issue premium of $22,895 and $235,614, at June 30, 2005 and 2004, respectively. ($21,905,000 was refunded in 2005 including unamortized premium of $203,807)	2,512,895	25,080,614
Revenue Bonds, Pace University issue, $60,000,000, Series 1997, due serially to 2026 at interest rates ranging from 5% to 5.75% per annum, net of unamortized original issue discount of $89,271 and $604,273 at June 30, 2005 and 2004, respectively. ($44,935,000 was refunded in 2005 including unamortized discount of $488,760)	8,215,729	53,825,727
Bonds payable to the U.S. Department of Housing and Urban Development (HUD) (b):		
Bonds issued to Briarcliff College assumed by Pace University as a result of a purchase agreement in 1977 with Briarcliff College maturing in annual installments ranging from $42,000 to $101,000 through 2016:		
1961 issue, $548,000, at 3.5%	180,000	202,000
1966 issue, $1,115,000, at 3%	508,000	544,000
Bonds issued to the College of White Plains assumed by Pace University as a result of a consolidation in 1975 with the College of White Plains, maturing in annual installments ranging from $20,000 to $45,000 through 2016 with interest at 3%	550,000	567,500
Long-term notes payable (c)	4,179,613	1,499,113
Total long-term debt	$ 132,621,237	81,718,954

(a) The Series 2005A bonds were issued on June 1, 2005, to (i) refund a portion of the DASNY Pace University Insured Revenue Bonds, Series 1997 and Series 2000, (ii) fund the debt service reserve fund for the Series 2005A bonds and (iii) pay the costs of issuance of the Series 2005A bonds. At

June 30, 2005, $3,755,270 of debt service reserve funds and $253,998 of construction funds were included in funds held by bond trustees.

In June 2005, the University entered into a floating-to-fixed-rate swap agreement (the Derivative Instrument) as a hedge on a portion of its DASNY Series 2005A insured revenue bonds. Under the Derivative Instrument, the University receives the one-month London InterBank Offered Rate (LIBOR) (3.11% at June 30, 2005) and pays a fixed rate of 3.303% on the notional amount of $73,975,000 through June 2029. The University has the option to terminate the Derivative Instrument at its discretion. A payment will either be received or paid by the University depending on the interest rate environment at the time of termination. The fair value of the Derivative Instrument of $(2,729,162) is reflected on the accompanying June 30, 2005 balance sheet under liability as derivative instrument and the accompanying 2005 statement of changes in unrestricted net assets as unrealized depreciation in fair value of derivative instrument.

The Series 2005B bonds were issued to fund the cost of a surety bond for the debt service reserve fund for the Series 2005 bonds, pay the cost of issuance of the Series 2005B bonds, and refinance certain indebtedness of the University incurred to pay for various capital improvement projects including construction and equipping of the health and fitness center located on the Pleasantville Campus; the installation of Sprinkler Systems at various student housing facilities; the renovation of facilities located at 106 Fulton Street and 163 William Street on the New York City Campus; renovations to the Student Union in New York City, Law School Campus in White Plains, New York and the Schimmel Theatre in New York City; as well as installation of fire alarm and public address systems and replacement of roofs at various locations. At June 30, 2005, $144,087 of debt service funds and $154,282 of construction funds were included in funds held by bond trustees.

The Series 2000 Revenue Bonds payable to the Authority were issued to finance the acquisition and renovation of a 15-story building located in lower Manhattan. The 76,000-square-foot building is being used by the University for student and staff housing and other related activities. Under the Series 2000 bond agreement, the University maintains a debt service reserve fund on deposit with a trustee. At June 30, 2005 and 2004, $892,714 and $3,111,655, respectively, of debt service reserve funds and $30,136 and $29,495, respectively, of rebate funds were included in funds held by bond trustees.

The Series 1997 Revenue Bonds payable to the Authority were issued to finance various projects and retire other indebtedness of the University as follows: retirement of the credit agreement with The Chase Manhattan Bank used to initially finance the construction of the Goldstein Center; expansion of instructional space at the law school on the White Plains campus; technology initiatives, including various acquisitions of equipment and installation of networks and connections; renovation and repair projects (including preservation and enhancement) to extend the useful lives of various facilities; acquisition of property adjacent to the White Plains campus; and retirement of the remaining principal outstanding on the Series 1985 Revenue Bonds. Under the Series 1997 bond agreement, the University maintains a debt service reserve fund on deposit with a trustee. At June 30, 2005 and 2004, $2,373,035 and $7,179,242, respectively, of debt service reserve funds and $1,385,250 and $1,056,072, respectively, of building and equipment reserve funds were included in funds held by bond trustees.

The Series 1997, 2000, 2005A, and 2005B Revenue Bonds are secured by mortgages on certain of the University's properties, security interest in certain fixtures, furnishings, and equipment, and pledges of revenues limited in each year to the greatest amount payable by the Authority in any bond year for the principal.

In connection with the partial refunding of the Series 1997 and 2000 Bonds, the University recognized a loss of $7,650,608, inclusive of the write-off of deferred financing cost of $2,259,599 and debt discount, net, of $284,953, which is included in the accompanying statements of unrestricted net assets.

(b) The bond issues are secured by first mortgages on the dormitory facilities and liens on and pledges of the net revenues derived from the operation of the facilities.

(c) On August 27, 2003, the University entered into a $2,000,000 note payable at an interest rate of 9.32%. The note is payable over 36 months with the final payment due August 31, 2006.

The University entered into several capital leases, expiring through February 1, 2010, related to purchase of communication and networking equipment, and systems. At June 30, 2005, the amount outstanding under these capital leases is $3,335,046.

Interest incurred for the years ended June 30, 2005 and 2004 was $5,641,696 and $4,801,259, respectively.

Financial Covenants DASNY Series 2005

Pursuant to the June 1, 2005 loan agreements related to the DASNY Series 2005 insured revenue bonds, the University is required to adhere to certain financial covenants regarding maximum annual debt service and the maintenance of unrestricted investments and limiting the University's right to incur any additional indebtedness without consent from DASNY and the bond insurer.

The University must maintain debt service (interest on all outstanding indebtedness and principal on all outstanding long-term indebtedness) at or below 6% of annual unrestricted gross revenues.

The University must maintain a level of Unrestricted Investments, as defined, (as adjusted for market fluctuation) divided by Outstanding Indebtedness, as defined, equal to (i) at least 25% as of each June 30 and December 31 through December 31, 2007; (ii) at least 27.5% as of each June 30 and December 31 occurring from January 1, 2008 through December 31, 2009 and (iii) at least 30% as of each June 30 and December 31 occurring subsequent to December 31, 2009.

These covenants supersede the requirements pursuant to the agreements related to the DASNY Series 2000 and 1997 insured revenue bonds which are described below.

Prior to June 1, 2005, pursuant to the March 1, 2000 and December 4, 1996 loan agreements related to the DASNY Series 2000 Revenue Bonds and DASNY Series 1997 Revenue Bonds, respectively, the University was required to adhere to financial covenants outlined in these agreements, including the Expendable Net Assets Maintenance Requirement which required the University to maintain expendable net assets (unrestricted and temporarily restricted net assets, exclusive of plant equity, and inclusive of postretirement benefit obligation) at a market value equal to at least 50% of outstanding long-term indebtedness and the Additional Indebtedness restriction which required the University to not incur additional long-term indebtedness without written consent.

In fiscal year 2004, the University advised both its Bond Insurer and DASNY that it failed to achieve the Expendable Net Assets Maintenance Requirement for the fiscal year ended June 30, 2004 in that the ratio is approximately 0.15 rather than the 0.50 required under the 2000 and 1996 loan agreements. Additionally, the University advised its Bond Insurer and DASNY that it entered into additional long-term debt in fiscal year 2004 without prior written consent. The University requested that the Bond Insurer waive any possible events of default arising under the 2000 and 1996 agreements which could result from these violations.

In February 2005, the University received waivers from the Bond Insurer for the Expendable Net Assets Maintenance Requirement covenant violation and the Additional Indebtedness default from June 30, 2004 through June 30, 2005.

(8) Debt Service – Long-Term Debt

Debt service relating to long-term debt for the next five years is as follows:

	Long-term leases to DASNY	Bonds payable to HUD	Long-term notes payable	Total
June 30, 2006:				
Principal	$ —	94,000	1,468,751	1,562,751
Interest, reserves, and fees	4,602,314	44,765	289,281	4,936,360
	$ 4,602,314	138,765	1,758,032	6,499,111
June 30, 2007:				
Principal	$ —	102,000	939,292	1,041,292
Interest, reserves, and fees	5,027,314	41,760	179,742	5,248,816
	$ 5,027,314	143,760	1,119,034	6,290,108
June 30, 2008:				
Principal	$ 2,210,000	104,000	880,617	3,194,617
Interest, reserves, and fees	5,027,314	38,580	110,616	5,176,510
	$ 7,237,314	142,580	991,233	8,371,127
June 30, 2009:				
Principal	$ 3,230,000	105,000	597,450	3,932,450
Interest, reserves, and fees	4,898,664	35,335	46,436	4,980,435
	$ 8,128,664	140,335	643,886	8,912,885
June 30, 2010:				
Principal	$ 3,985,000	108,000	293,503	4,386,503
Interest, reserves, and fees	4,721,780	32,060	8,919	4,762,759
	$ 8,706,780	140,060	302,422	9,149,262

(9) Judicial Training Institute

On April 5, 2000, the University entered into a loan agreement with the Authority for the issuance of up to $17,500,000 State Judicial Institute at Pace University Insured Lease Revenue Bonds, Series 2000 (the Bonds) dated July 1, 2000. In July 2000, bonds with a face value of $16,105,000 plus accrued interest were issued. Proceeds from the Bonds were used to finance the construction of a judicial training facility on the University's White Plains campus to serve as the New York State Judicial Training Institute (the Institute). The Institute was established to serve as a statewide center for continuing education, training, and research for all judges and justices of the Unified Court System (the System). The bonds are due serially through 2020 at interest rates ranging from 4.5% to 5.5% per annum with interest payable every October 1 and principal, sinking fund installments, and interest payable every April 1. These bonds are solely payable from certain revenues, funds, and assets pledged by the System as security for the payment thereof, including certain rental payments to be made by the System to the University pursuant to an agreement of sublease, also dated April 5, 2000, in amounts sufficient to pay the principal, sinking fund installments, and interest on the bonds. Payments to be made under the sublease have been assigned to the Authority pursuant to an assignment of sublease and rent agreement, dated April 5, 2000, between the University and the Authority that requires the System to make payments to the Authority by March 31 of each year. The loan agreement between the Authority and the University is without recourse to the University and the University's obligation thereunder on account of payments due on the Series 2000 Bonds are payable solely from the aforesaid rental payments as received under the sublease with the System. The obligation of the System to make payments of rent under the sublease is subject to annual appropriations by the State of New York for such purpose. The bond proceeds and related obligation are not included in the accompanying financial statements.

On April 23, 2003, the City of White Plains issued a certificate of occupancy evidencing completion of the judicial training facility and the University recorded the value ($16,208,704) of the building and a corresponding deferred rental revenue. The deferred rental revenue will be recognized on a straight-line basis over the life of the land lease, May 1, 2003 through June 30, 2020. For each of the years ended June 30, 2005 and 2004, $944,196 was recognized as rental revenue.

(10) Retirement and Deferred Compensation Plans

The University has defined contribution retirement annuity plans with Teachers' Insurance and Annuity Association of America and College Retirement Equities Fund, Fidelity Investments, and T. Rowe Price which cover substantially all full-time employees. The University makes annual plan contributions which are vested immediately for the benefit of the participants. The University's contributions under the plan for the years ended June 30, 2005 and 2004 amounted to $6,335,201 and $6,110,926, respectively.

The University offered a deferred compensation plan to substantially all full-time employees. Amounts deferred are invested by the University in consultation with the participant. Such amounts consist of cash and cash equivalents and mutual funds and are included in investments ($6,153,439 in 2005 and $6,437,520 in 2004) in the accompanying balance sheets and continue to be the assets of the University subject to claims of its creditors. Contributions to this plan have been limited since the enactment of the Tax Reform Act of 1986.

(11) Postretirement Benefits Other than Pensions

The University sponsors a plan to provide certain health care and life insurance benefits for retirees. The University's employees may become eligible for these benefits if they retire while working for the University. Benefits and eligibility may be modified from time to time. In accordance with the 2001 plan amendment, postretirement health care and life insurance benefits coverage for employees hired after October 1, 2000 has been eliminated.

Information with respect to this unfunded plan as of and for the years ended June 30, 2005 and 2004 is as follows:

		2005	**2004**
Change in benefit obligation:			
Benefit obligation at beginning of year	$	52,472,274	51,816,193
Service cost		730,391	992,901
Interest cost		3,098,891	3,189,946
Benefits paid		(1,917,352)	(1,668,407)
Actuarial loss (gain)		4,794,541	(1,858,359)
Benefit obligation at end of year		59,178,745	52,472,274
Change in plan assets:			
Fair value of plan assets at beginning of year		—	—
Employer contribution		1,917,352	1,668,407
Benefits paid		(1,917,352)	(1,668,407)
Fair value of plan assets at end of year		—	—
Funded status		(59,178,745)	(52,472,274)
Prior service cost		(7,459,784)	(8,556,181)
Unrecognized net loss		11,573,622	6,779,081
Accrued postretirement benefit obligation	$	(55,064,907)	(54,249,374)

The net periodic postretirement benefit expense for 2005 and 2004 includes the following components:

		2005	**2004**
Service cost	$	730,391	992,901
Interest cost		3,098,891	3,189,946
Amortization of prior service cost		(1,096,397)	(1,096,397)
Amortization of net loss		—	336,181
Net periodic postretirement benefit expense	$	2,732,885	3,422,631

(Continued)

	2005	2004
Benefit obligation weighted average assumptions as of June 30, 2005 and 2004:		
Discount rate	5.25%	6.50%
Benefit cost weighted average assumptions for the years ended June 30, 2005 and 2004:		
Discount rate	6.50%	6.25%

For measurement purposes, a 9.75% annual rate of increase in the medical per capita cost of covered health care benefits was assumed for pre-age and post-age 65 coverage for the year ended June 30, 2005, decreasing to 4.5% in 2011 and remaining at that level thereafter. A 6% annual rate of increase in the Medicare Part B premiums was assumed for the year ended June 30, 2005. The health care cost trend rate assumption has a significant effect on the accrual. A 1% increase in the rate translates to an increase in the accumulated postretirement benefit obligation of $7,826,357 in 2005 ($6,804,297 in 2004) and an increase in the service and interest cost of $530,549 in 2005 ($654,862 in 2004). A 1% decrease in the rate translates to a decrease in the accumulated postretirement benefit obligation of $6,366,007 in 2005 ($5,521,943 in 2004) and a decrease in the service and interest cost of $427,470 in 2005 ($515,683 in 2004).

Projected plan contributions and benefit payments for each of the next five fiscal years and the five years thereafter are as follows:

2006	$ 2,670,497
2007	2,916,617
2008	3,172,437
2009	3,380,985
2010	3,536,057
2011 through 2015	20,355,037

In December 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Act) became law. The University has not yet determined the effects of the Act; therefore, the measures of accumulated postretirement benefit obligation and net periodic postretirement benefit cost do not reflect the effects, if any, associated with the Federal subsidy provided by the Act. The University is still in the process of reviewing the impact of the Act in order to conclude whether the benefits provided by the postretirement medical benefits are actuarially equivalent to Part D under the Act. Specific authoritative guidance could require the University to change previously reported information.

(12) Faculty Retirement Incentive Plan

During fiscal 2000, the University offered an early retirement incentive plan (the Plan) to qualified faculty. Under the Plan, qualified faculty had the option of (1) electing to receive one and one-half years of base salary at the last full-time salary prior to retirement paid over eighteen months immediately following retirement, or (2) teaching an annual one half of the normal course load compensated at the rate of 75% of regular annual base salary and continuation of benefits for three years. At June 30, 2005, no amounts were due under the Plan. At June 30, 2004, the present value (discounted at 6.5%) of the amounts due under the Plan was $305,412, and is included in accounts payable and accrued liabilities in the accompanying balance sheets.

(13) Operating Leases

The University leases office, student housing and classroom space under several lease agreements expiring at various dates through October 31, 2021. The minimum annual rentals in connection with such leases are as follows:

		Amount
Year ending June 30:		
2006	$	10,475,892
2007		10,846,014
2008		5,834,549
2009		5,884,587
2010		5,861,783
2011 and thereafter		54,753,431
	$	93,656,256

Total rental expense for the years ended June 30, 2005 and 2004 was $14,726,208 and $8,096,989, respectively. Included in accounts payable and accrued liabilities is a deferred rent obligation of $2,527,509 at June 30, 2005, which represents straight-lining the total minimum lease payments over the lease terms.

(14) Self-Insurance

Effective January 1, 1993, the University established a self-insurance plan for employee medical benefits, exclusive of those benefits provided by Health Maintenance Organizations (HMOs). Under the provisions of this plan, insurance carriers provide claims processing and administrative functions, as well as stop-loss coverage for claims (on a calendar year basis) in excess of $9,056,827 and $7,679,948 for the years ended December 31, 2005 and 2004, respectively. The expense for this program for the years ended June 30, 2005 and 2004 was approximately $7,452,000 and $6,990,000, respectively. A liability for claims incurred but not reported of approximately $871,000 and $879,000 as of June 30, 2005 and 2004, respectively, is included in accounts payable and accrued liabilities in the accompanying balance sheets.

(15) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets at June 30, 2005 and 2004 are principally available to support the Lubin School of Business, scholarships and fellowships, and academic chairs. Certain temporarily restricted net assets available to support the Lubin School of Business are expendable only for projects approved by the donor's designee.

Permanently restricted net assets at June 30, 2005 and 2004 are restricted to investment in perpetuity, with investment return principally available to support scholarships and fellowships and academic chairs.

(16) Scholarships and Fellowships

Tuition and fees are presented net of amounts awarded to students to defray their cost of attending the University. The amount awarded totaled $44,689,350 and $43,269,891 for the years ended June 30, 2005 and 2004, respectively.

(17) Expenses

Expenses are reported in the statements of changes in unrestricted net assets in categories recommended by the National Association of College and University Business Officers. The University's primary program services are instruction and research. Expenses reported as academic support, student services, and auxiliary enterprises are incurred in support of these primary program services. Institutional support includes fund-raising expenses of $3,924,828 and $3,297,522 for the years ended June 30, 2005 and 2004, respectively. For purposes of reporting fund-raising expenses, the University includes only those fund-raising costs incurred by its Philanthropy office. Contributions and private gifts and grants for the years ended June 30, 2005 and 2004 were $14,843,809 and $18,027,198, respectively.

(18) Fair Value of Financial Instruments

The carrying amount of cash, student accounts receivable, grants and other receivables, accounts payable and accrued liabilities, and notes payable approximates fair value because of the short maturity of these financial instruments. The fair value of investments and contributions is disclosed in notes 3 and 4, respectively.

A reasonable estimate of the fair value of loans receivable from students under government loan programs could not be made because the notes are not salable and can only be assigned to the U.S. Government or its designees. The fair value of the loans receivable from students under University loan programs approximates carrying value.

The carrying amount of long-term debt approximates fair value because these financial instruments bear interest at various rates, which, when averaged, are not significantly different from current market rates for loans with similar maturities and credit quality.

(19) Allocation of Certain Expenses

The University allocates operation and maintenance of plant, depreciation, and interest and other debt-related expenses based upon building square footage and the use of each facility. For the year ended June 30, 2005 (with comparative totals for 2004), the following allocation of expenses was included in the accompanying statements of changes in unrestricted net assets:

	Allocated expenses				
	Operation and maintenance of plant	Depreciation	Interest and other debt-related expenses	Direct expenses	Total per statement of changes in unrestricted net assets
Instruction	$ 7,156,142	3,029,487	889,903	97,971,021	109,046,553
Research	133,395	56,472	14,496	2,518,073	2,722,436
Academic support	5,068,518	2,145,711	550,789	27,389,123	35,154,141
Student services	3,694,276	1,563,938	696,511	25,806,759	31,761,484
Institutional support	3,541,239	1,499,151	2,135,640	39,844,683	47,020,713
Auxiliary enterprises	10,259,644	4,343,326	3,113,270	14,878,508	32,594,748
Total 2005	$ 29,853,214	12,638,085	7,400,609	208,408,167	258,300,075
Total 2004	$ 23,394,894	11,908,394	5,643,417	198,281,150	239,227,855

(20) Contingency

The University is involved in various legal proceedings and claims arising in the normal course of business. Management of the University does not expect the ultimate resolution of these actions to have a material adverse effect on the University's financial position.

(21) Impact of September 11, 2001 Events

As a result of the September 11, 2001 attack on the World Trade Center, the leased space and all equipment, furniture, and fixtures where the University's World Trade Institute (WTI) operated were totally destroyed.

The University had insurance policies covering loss of physical property, as well as business interruption. In addition, the University qualified for Federal Emergency Management Agency (FEMA) aid for the build out of replacement space lost at the World Trade Center. During the fiscal year ended June 30, 2004, the University recorded insurance recoveries and FEMA aid totaling $1,550,526. As of June 30, 2004, all claims related to the events of September 11, 2001 were completely settled.