

Kamehameha Schools and Subsidiaries

**Consolidated Financial Statements
and Supplemental Schedules**

June 30, 2007 and 2006

**Kamehameha Schools
and Subsidiaries
Index
June 30, 2007 and 2006**

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Report of Independent Auditors

To Board of Trustees
Kamehameha Schools

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of activities and cash flows present fairly, in all material respects, the financial position of Kamehameha Schools and Subsidiaries (the "Schools") at June 30, 2007, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These consolidated financial statements are the responsibility of the Schools' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. The consolidated financial statements of the Schools as of June 30, 2006 and for the year then ended were audited by other auditors whose report dated October 24, 2006 expressed an unqualified opinion on those statements and included an explanatory paragraph that described the change in accounting principle discussed in Note 1 to the consolidated financial statements.

Our audit for the year ended June 30, 2007 was made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary information included in Schedules 1 and 2 for the year ended June 30, 2007 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole. The supplementary information included in Schedules 1 and 2 for the years ended June 30, 2006, 2005, 2004, and 2003 were audited by other auditors, whose report dated October 24, 2006 expressed an opinion that the schedules were fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.



Honolulu, Hawaii
November 14, 2007

Kamehameha Schools and Subsidiaries
Consolidated Balance Sheets
June 30, 2007 and 2006
(All dollars in thousands)

	2007	2006
Assets		
Cash and cash equivalents	\$ 65,639	\$ 50,498
Investments	6,584,085	5,735,415
Amounts receivable for securities sold	133,636	201,630
Collateral received for loaned securities	643,621	466,038
Receivables, net	25,596	18,581
Property and equipment, net	802,168	750,437
Real estate held for development and sale	23,014	29,089
Deferred charges and other	93,159	80,017
Total assets	<u>\$ 8,370,918</u>	<u>\$ 7,331,705</u>
Liabilities and Net Assets		
Obligation to repay securities lending collateral	\$ 643,621	\$ 466,038
Notes payable	270,208	243,020
Amounts payable for securities purchased	88,295	261,216
Accounts payable and accrued expenses	72,930	71,064
Accrued pension liability	27,851	47,832
Accrued postretirement benefits	26,090	23,465
Deferred compensation payable	9,809	9,276
Deferred income and other	18,952	31,488
Total liabilities	<u>1,157,756</u>	<u>1,153,399</u>
Commitments and contingencies		
Net assets – unrestricted	<u>7,213,162</u>	<u>6,178,306</u>
Total liabilities and net assets	<u>\$ 8,370,918</u>	<u>\$ 7,331,705</u>

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

Kamehameha Schools and Subsidiaries
Consolidated Statements of Activities
Years Ended June 30, 2007 and 2006
(All dollars in thousands)

	2007	2006
Revenues, gains, and other support		
Tuition and fees	\$ 25,281	\$ 20,917
Less: Financial aid	(11,614)	(9,198)
Net tuition and fees	<u>13,667</u>	<u>11,719</u>
Net realized and unrealized gains on investments	1,010,413	559,685
Rental	190,622	189,600
Investment income, net	108,098	112,916
Net gain on property sales	81,340	183,273
Other	4,873	2,545
Total revenues, gains, and other support	<u>1,409,013</u>	<u>1,059,738</u>
Expenses		
Educational programs	215,986	190,592
Management and general		
Rental	105,349	96,402
Other	70,566	50,854
Total expenses	<u>391,901</u>	<u>337,848</u>
Change in net assets before cumulative effect of a change in accounting principle and application of SFAS No. 158	1,017,112	721,890
Cumulative effect on prior years of changing to fair value accounting for investments	-	136,783
Adjustment to initially apply SFAS No. 158	17,744	-
Change in net assets	<u>1,034,856</u>	<u>858,673</u>
Net assets		
Beginning of year	<u>6,178,306</u>	<u>5,319,633</u>
End of year	<u>\$ 7,213,162</u>	<u>\$ 6,178,306</u>

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

Kamehameha Schools and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended June 30, 2007 and 2006
(All dollars in thousands)

	2007	2006
Cash flows from operating activities		
Change in net assets	\$ 1,034,856	\$ 858,673
Adjustments to reconcile change in net assets to net cash used in operating activities		
Depreciation and amortization	38,245	36,606
Net realized and unrealized gains on investments	(1,010,413)	(559,685)
Net gain on property sales	(81,340)	(183,273)
Cumulative effect of change in accounting principle	-	(136,783)
Initial adoption of SFAS No. 158	(17,744)	-
Changes in operating assets and liabilities		
Receivables, net	(7,015)	1,188
Real estate held for development and sale	(1,464)	(1,476)
Deferred charges and other	(13,142)	(28,294)
Accounts payable, accrued expenses, and other liabilities	(9,749)	(8,965)
Other	(450)	(2,693)
Net cash used in operating activities	<u>(68,216)</u>	<u>(24,702)</u>
Cash flows from investing activities		
Proceeds from sales of property and equipment	88,905	200,381
Purchases of property and equipment	(89,553)	(72,344)
Proceeds from sales of investments	10,186,916	13,160,336
Purchases of investments	<u>(10,130,099)</u>	<u>(13,276,269)</u>
Net cash provided by investing activities	<u>56,169</u>	<u>12,104</u>
Cash flows from financing activities		
Proceeds from borrowings	40,000	10,000
Repayment of borrowings	<u>(12,812)</u>	<u>(11,860)</u>
Net cash provided by (used in) financing activities	<u>27,188</u>	<u>(1,860)</u>
Net increase (decrease) in cash and cash equivalents	15,141	(14,458)
Cash and cash equivalents		
Beginning of year	<u>50,498</u>	<u>64,956</u>
End of year	<u>\$ 65,639</u>	<u>\$ 50,498</u>
Supplemental disclosure of cash flow information		
Income taxes paid	\$ 4,945	\$ 4,687
Interest paid	\$ 11,875	\$ 13,394
Supplemental disclosure of noncash investing activities		
Donation of artwork	\$ 450	\$ -
Transfer of property and equipment, net to real estate held for development and sale	\$ -	\$ 630

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

Kamehameha Schools and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2007 and 2006

1. Summary of Significant Accounting Policies

Description of the Organization

Kamehameha Schools (the "Schools") is a charitable trust established under Hawaii law and operates under the terms of the Will of Bernice Pauahi Bishop, deceased. The Schools are governed by a Board of Trustees (the "Trustees") and subject to the jurisdiction of the First Circuit Court of the State of Hawaii (the "Court"). The primary assets of the Schools are lands and properties located in the State of Hawaii (the "State") and debt and equity investments.

The Schools provide a variety of educational services for students of Hawaiian ancestry, including early education, campus-based programs, and other extension and enrichment and summer school programs. Early education programs are conducted in various facilities throughout the State. The campus-based programs include campuses on the islands of Oahu, Maui, and Hawaii which serve students from kindergarten through grade 12. The Schools are also engaged in summer programs, educational partnerships, and other outreach programs that are intended to provide educational opportunities to a greater population of students of Hawaiian ancestry. In addition, the Schools provide a significant amount of scholarships for post-secondary education.

Principles of Consolidation

The consolidated financial statements of Kamehameha Schools and Subsidiaries (the "Organization") include the accounts of the Schools, Bishop Holdings Corporation and its Subsidiaries ("BHC"), Ke Ali'i Pauahi Foundation ("KAPF"), and Newport Kohala, LLC.

The consolidated financial statements of BHC include the accounts of:

- Pauahi Management Corporation ("PMC") and its wholly-owned subsidiaries – KDP Limited; KBH, Inc.; Lake Manassas Limited Liability Company; RTJ Limited Liability Company; and Paradise Petroleum, Inc. dba Ali'i Petroleum.
- P&C Insurance Company, Inc.
- Kamehameha Investment Corporation and its wholly-owned subsidiaries – Keauhou Community Services, Inc.; Paki, Inc.; Keauhou Resort Development Corporation; and Keauhou Kona Resort Company.

Bishop Holdings Corporation is a taxable holding corporation with subsidiaries primarily involved in property investment and management, the development and sale of real estate, investments in equity and debt instruments, and the ownership and operation of a golf course. Bishop Holdings Corporation also has a captive insurance company, providing property and liability coverage for the Schools and its affiliates.

KAPF is a charitable organization whose exclusive purpose is to actively engage in fundraising, scholarship, and development activities for the Schools.

In addition, under accounting principles generally accepted in the United States of America ("GAAP"), certain investments may be considered as entities for consolidation should they meet specified criteria. As of June 30, 2007 and 2006, Newport Kohala, LLC met these criteria. Newport Kohala, LLC is a single-member limited liability company formed exclusively to execute the Schools' absolute return investment strategies and is managed by an independent investment management firm.

All significant intercompany transactions and accounts have been eliminated in consolidation.

Kamehameha Schools and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2007 and 2006

Basis of Financial Statement Presentation

The Organization's consolidated financial statements have been prepared on the accrual basis of accounting, and are presented in conformity with GAAP. Net assets, revenues, gains and other support, and expenses are classified based on the existence or absence of donor-imposed restrictions. KAPF's temporarily and permanently restricted net assets amounted to \$10.0 million and \$9.3 million at June 30, 2007 and 2006, respectively. As the amounts are not significant, all net assets of the Organization and changes therein are classified and reported as unrestricted net assets.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP 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 consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include unrestricted demand deposits and all highly liquid deposits with an original maturity of three months or less. Cash and cash equivalents are held in financial institutions located in the State and other states, and an investment company. Cash balances are maintained in excess of depository institution insurance limits. Cash equivalents held by external investment managers are classified as investments in the consolidated balance sheets and are not included in cash and cash equivalents.

Investments

Marketable Debt and Equity Securities – The Schools and KAPF

Investments in marketable debt and equity securities are reported at fair value based on quoted market prices. Unrealized gains and losses are included in the change in net assets.

Marketable Debt and Equity Securities – BHC

Investments in marketable debt and equity securities are considered available for sale and reported at fair value, based on quoted market prices. Unrealized gains and losses are included in the change in net assets. Realized gains and losses on the disposition of marketable debt and equity securities are calculated using the cost method.

Other Investments – The Schools

Effective July 1, 2005, the Schools changed its accounting policy for other investments to the fair value method rather than the previous policy of the equity or cost method. Other investments include limited partnerships, hedge funds, commingled funds and other equity securities that do not have a readily determinable fair value. Management believes that the fair value method provides a more relevant measure of the ability of the Schools' assets to support current and future operations, provides better information to measure investment performance and follows the predominant industry practice. The result of the Schools' change to the fair value method was an increase in net assets of \$136.8 million which is presented as a cumulative effect of a change in accounting principle as of July 1, 2005 in the accompanying consolidated statements of activities.

Other investments are generally reported at fair value based on information provided by the respective external investment managers at the most recent valuation date and adjusted for cash flows from the valuation date to fiscal year end, if applicable. These valuations involve assumptions and methods that are reviewed by management. Because other investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investment existed. Unrealized gains and losses on other investments are included in the change in net assets. In addition,

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

certain other investments contain lock up periods where capital contributions may not be readily distributed.

Receivables

Notes receivable are recognized from the sale of residential leasehold lots to lessees under the single-family and multi-family residential land sales program and mortgage agreements from the sale of real estate to developers. The residential leasehold interests were sold under various collateralized financing arrangements with 12- to 15-year terms and monthly payments of both principal and interest or interest only. Annual interest rates range from 7% to 10% with a weighted average interest rate of approximately 7% at June 30, 2007 and 2006. The sale of leasehold lots under the financing arrangements is accounted for using the cost-recovery method whereby no profit is recognized until cash payments are received.

Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. The Organization provides for depreciation on property and equipment using the straight-line method over the estimated useful lives of the assets as follows:

	Years
Land improvements	30
Buildings and improvements	30
Equipment	5 to 10

The Organization reviews its long-lived assets, such as property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss exists for an asset held for use when the cash flows expected to be generated by an asset are less than the carrying amount. Measurement of the impairment loss is based on the fair value of the asset.

Real Estate Held for Development and Sale

Real estate assets held for development and sale include land acquisition and holding costs, site development, construction, and other project-related costs. The Organization capitalizes development costs as required by Statement of Financial Accounting Standards ("SFAS") No. 67, *Accounting for Costs and Initial Rental Operation of Real Estate Projects*. Interest costs related to the development of real estate property are capitalized in accordance with SFAS No. 34, *Capitalization of Interest Costs*.

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, management uses estimated expected future net cash flows (undiscounted and excluding interest costs) to measure the recoverability of real estate assets held for development. The recoverability of real estate assets held for sale is determined by comparing appraised value or the net present value of the estimated expected future cash flows (using a discount rate commensurate with the risks involved) to the carrying amount of the asset. The estimate of expected future net cash flows is inherently uncertain and relies to a considerable extent on assumptions regarding current and future economic conditions. If in future periods, there are changes in estimates or assumptions, the changes could result in an adjustment to the carrying amount of real estate. No impairment losses were recognized in 2007 and 2006.

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

Vacation

Professional teaching employees are employed under one-year contracts for school years ending in mid-August. School years comprise a "teaching period" from mid-August to mid-June and a "professional improvement period" for the balance of the year. Vacations for these employees are provided during the professional improvement period.

Substantially all the Schools' employees, except for professional teaching employees, earn vacation benefits and are entitled to receive payments for unused vacation benefits based upon their regular salary at the time of their termination of employment.

Revenue Recognition

Profits on sales of real estate are recognized in full when title has passed, minimum down payment criterion is met, the terms of any note received are such as to satisfy continuing investment requirements and collectibility of the note is reasonably assured, the risks and rewards of ownership have been transferred to the buyer, and there is no substantial continuing involvement with the property. If any of the aforementioned criteria are not met, the profit is deferred and recognized under either the installment, cost recovery, deposit, or percentage-of-completion methods. Costs are charged to cost of sales on the basis of the relative sales value of the units sold to the total sales value of all units in the project.

Lease rental income is recognized on a straight-line basis ratably over the fixed term of the respective leases.

Income Taxes

In a ruling dated February 9, 1939, and as reaffirmed in 1969, 1986, and 2000, the Internal Revenue Service ("IRS") determined that the Schools were exempt from federal income taxes under IRC Section 501(c)(3) as they were organized and operated for educational purposes within the meaning of IRC Section 170(b)(1)(A)(ii). KAPF is also exempt from federal income tax under IRC Section 501(c)(3) and qualifies as a supporting organization as described in IRC Section 509(a)(3). To the extent that the Schools and KAPF receive unrelated business income, such earnings are subject to unrelated business income tax.

Income taxes for BHC are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. BHC utilizes the percentage method of allocating its consolidated tax liability among its subsidiaries.

Commitments and Contingencies

Liabilities for loss contingencies, including environmental remediation costs, arising from claims, assessments, litigation, fines and penalties, and other sources, are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated.

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

Pension and Other Postretirement Benefits

On June 30, 2007, the Organization adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. SFAS No. 158 requires the recognition of the difference between the benefit obligation and fair value of plan assets on the consolidated balance sheet. In addition, the Organization is required to recognize, as part of unrestricted net assets, the gains and losses due to differences between actuarial assumptions and actual experience and any effects on prior service due to plan amendments that arise during the period which are not yet recognized as net periodic benefit costs.

The following table summarizes the incremental effects of the initial adoption of SFAS No. 158 on the consolidated balance sheet at June 30, 2007 (in thousands):

	Before		After
	Application of		Application of
	SFAS No. 158	Adjustments	SFAS No. 158
Accrued pension liability	\$ 46,580	\$ (18,729)	\$ 27,851
Accrued postretirement benefits	25,105	985	26,090
Total liabilities	1,175,500	(17,744)	1,157,756
Total net assets – unrestricted	7,195,418	17,744	7,213,162

New Accounting Standards

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of SFAS No. 109*. FIN No. 48 clarifies and provides guidance on the accounting for uncertain tax positions taken or expected to be taken in a tax return. The interpretation will be effective for the Organization's fiscal year ending June 30, 2008, and management is currently reviewing the potential impact of this standard on the consolidated financial statements.

In May 2007, FASB issued FASB Staff Position ("FSP") FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48*. This FSP amends FIN No. 48 and provides guidance on the determination of whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The FSP will be effective with the Organization's initial adoption of FIN No. 48.

In June 2006, the Emerging Issues Task Force ("EITF") issued EITF Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)*. The EITF requires companies to disclose their method of accounting for taxes collected from customers and remitted to government agencies. The disclosure requirements of the EITF will be effective for the Organization's fiscal year ending June 30, 2008.

Reclassifications

Certain balances in the 2006 consolidated financial statements have been reclassified to conform to the 2007 presentation. Such reclassifications had no effect on the change in net assets as previously reported.

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

2. Investments

A summary of investments, at fair value, at June 30, 2007 and 2006 is as follows (in thousands):

	2007	2006
Marketable debt and equity securities		
Common and preferred stocks	\$ 2,076,909	\$ 1,957,083
Fixed income	930,659	702,206
Mutual funds	453,280	197,433
Short-term investments and cash equivalents	121,094	398,728
Other investments		
Hedge funds	1,722,013	1,405,742
Commingled funds	756,400	694,176
Private equity funds	393,385	241,811
Other, including direct financing lease	130,345	138,236
	<u>\$ 6,584,085</u>	<u>\$ 5,735,415</u>

The School's investment policy guides its asset allocation, which allows for the use of derivatives and other strategies which are achieved through limited partnership and mutual funds. These investments pose no off-balance sheet risk to the Schools due to the limited liability structure of the investments.

Investment income for the years ended June 30, 2007 and 2006 was as follows (in thousands):

	2007	2006
Interest and dividend income	\$ 129,819	\$ 129,597
Management fees	<u>(21,721)</u>	<u>(16,681)</u>
	<u>\$ 108,098</u>	<u>\$ 112,916</u>

Securities Lending

The Schools participate in a securities lending program administered by its custodian bank. Under the program, certain equity and fixed income securities of the Schools were lent to participating financial institutions in exchange for collateral which is marked to market daily. Borrowers are required to deliver collateral equal to a minimum of 102% of the securities loaned. As of June 30, 2007 and 2006, the Schools had limited credit exposure to borrowers because the fair value of collateral held by the Schools exceeded the fair value of securities loaned. As of June 30, 2007 and 2006, the fair value of securities loaned amounted to \$630.5 million and \$452.9 million, respectively, and the associated collateral, comprised primarily of money market funds, amounted to \$643.6 million and \$466.0 million, respectively.

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

Direct Financing Lease

BHC holds a 40-year lease for a golf course facility located in Virginia. The lease has been accounted for as a direct financing lease. At June 30, 2007 and 2006, the net investment in the lease was composed of the following (in thousands):

	2007	2006
Total minimum lease payments to be received	\$ 72,867	\$ 74,467
Less: unearned finance charges	<u>(34,829)</u>	<u>(36,532)</u>
Net investment	<u>\$ 38,038</u>	<u>\$ 37,935</u>

Future minimum lease payments to be received under the lease are as follows (in thousands):

Year ending June 30,	
2008	\$ 1,600
2009	1,600
2010	1,600
2011	1,600
2012	2,100
Thereafter	<u>64,367</u>
	<u>\$ 72,867</u>

In addition to fixed minimum rentals, the lease agreement provides for a percentage rental, which is determined based on adjusted gross revenue of the golf club. In January 2004, the Company waived the percentage rent for the calendar years 2004 through 2008 contingent upon the golf club funding certain capital improvements. Accordingly, there was no percentage rent for the years ended June 30, 2007 and 2006. The golf club has the option to purchase the golf club facilities either at the conclusion of the lease term or anytime during the lease term based on amounts specified in the lease agreement.

3. Receivables

Receivables, net, at June 30, 2007 and 2006 were as follows (in thousands):

	2007	2006
Note agreements	\$ 12,765	\$ 16,412
Less: Deferred profit on note agreements	<u>(12,765)</u>	<u>(16,412)</u>
	-	-
Interest	16,187	7,958
Trade	2,963	3,237
Tenant and tuition	6,978	6,768
Other	<u>3,081</u>	<u>5,487</u>
	29,209	23,450
Less: Allowance for doubtful accounts	<u>(3,613)</u>	<u>(4,869)</u>
	<u>\$ 25,596</u>	<u>\$ 18,581</u>

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

4. Property and Equipment

Property and equipment, net, at June 30, 2007 and 2006 consisted of the following (in thousands):

	2007	2006
Educational property and equipment		
Land	\$ 16,201	\$ 16,201
Buildings, improvements and equipment	649,998	636,386
Less: Accumulated depreciation	<u>(171,287)</u>	<u>(148,315)</u>
	<u>494,912</u>	<u>504,272</u>
All other property and equipment		
Land and land improvements	63,987	54,145
Buildings, improvements and equipment	340,625	329,086
Less: Accumulated depreciation and amortization	<u>(201,049)</u>	<u>(187,310)</u>
	203,563	195,921
Construction in progress	<u>103,693</u>	<u>50,244</u>
	<u>\$ 802,168</u>	<u>\$ 750,437</u>

Depreciation and amortization expense amounted to approximately \$38.2 million and \$36.6 million for the years ended June 30, 2007 and 2006, respectively.

For the year ended June 30, 2006, the book values of certain properties, buildings, and improvements were impaired. The properties were adjusted to fair value, which resulted in impairment losses of approximately \$9.5 million. No impairment losses were recorded for the year ended June 30, 2007.

Net gain on property sales for the years ended June 30, 2007 and 2006 consisted of the following (in thousands):

	2007	2006
Property sales	\$ 88,905	\$ 200,381
Less: Cost of property sales	<u>(7,565)</u>	<u>(7,609)</u>
Net property sales	81,340	192,772
Impairment loss on property and equipment	<u>-</u>	<u>(9,499)</u>
	<u>\$ 81,340</u>	<u>\$ 183,273</u>

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

5. Notes Payable

At June 30, 2007 and 2006, unsecured notes payable consisted of the following (columns in thousands):

	2007	2006
Senior promissory notes payable at the rate of 6.89% per annum with annual principal payments of \$11.9 million beginning on June 22, 2004, with final payment on June 22, 2013. The note agreement contains certain restrictions on assumption of additional debt and requires maintenance of a minimum endowment value and a certain liquidity ratio	\$ 71,160	\$ 83,020
Senior promissory notes payable under a \$150.0 million private shelf facility. The note agreement contains certain restrictions and requires maintenance of a minimum endowment value and a certain liquidity ratio:		
Interest rate of 6.80% per annum with annual principal payments of \$952,000 beginning on March 1, 2007, with final payment on March 1, 2027	19,048	20,000
Interest rate of 4.88% per annum with annual principal payments of \$3,333,000 beginning on June 10, 2008, with final payment on June 10, 2028	70,000	70,000
Interest rate of 4.93% per annum with annual principal payments of \$4,000,000 beginning on April 14, 2009, \$3,000,000 beginning on April 14, 2016, \$2,000,000 beginning on April 14, 2022, and \$1,000,000 beginning on April 14, 2028, with final payment due on April 14, 2029	60,000	60,000
Senior promissory notes payable under a \$200.0 million private shelf facility at a rate of 5.15% per annum with annual principal payments of \$10,000,000 beginning on March 1, 2008, with the final payment on March 1, 2012. The note agreement contains certain restrictions and requires maintenance of a minimum endowment value and a certain liquidity ratio	50,000	10,000
	<u>\$ 270,208</u>	<u>\$ 243,020</u>

In 2007, the Schools entered into a \$200 million uncommitted private shelf facility. Notes may be issued under this facility through June 2012 at interest rates determined at the time of issuance.

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

Annual maturities of notes payable are as follows (in thousands):

Year ending June 30,	
2008	\$ 26,146
2009	30,146
2010	30,145
2011	30,145
2012	30,145
Thereafter	123,481
	<u>\$ 270,208</u>

Interest expense incurred for the years ended June 30, 2007 and 2006 is summarized as follows (in thousands):

	2007	2006
Interest expense incurred	\$ 15,401	\$ 14,682
Less: Interest expense capitalized	<u>(2,886)</u>	<u>(1,137)</u>
Interest expense	<u>\$ 12,515</u>	<u>\$ 13,545</u>

6. Income Taxes

Total income tax benefit amounted to approximately \$10.7 million and \$16.4 million for the years ended June 30, 2007 and 2006, respectively. These amounts are included in other management and general expenses in the accompanying consolidated statement of activities.

The components of deferred tax assets and liabilities as of June 30, 2007 and 2006 were as follows:

	2007	2006
Deferred tax assets		
Difference in basis of investments and real estate	\$ 17,468	\$ 17,167
Deferred income	1,736	1,734
Allowance for doubtful accounts	230	571
Net operating loss carryforwards	7,551	7,576
Other	<u>3,282</u>	<u>2,771</u>
	30,267	29,819
Less: Valuation allowance	<u>(22,428)</u>	<u>(25,473)</u>
	<u>7,839</u>	<u>4,346</u>
Deferred tax liabilities		
Tax over book depreciation	<u>(2,239)</u>	<u>(2,046)</u>
	<u>(2,239)</u>	<u>(2,046)</u>
Net deferred taxes	<u>\$ 5,600</u>	<u>\$ 2,300</u>

The change in valuation allowance was a decrease of \$3.0 million and an increase of \$9.6 million for the years ended June 30, 2007 and 2006, respectively.

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portions or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, management believes it is more likely than not that it will realize these deductible differences, net of the existing valuation allowance at June 30, 2007 and 2006. The amount of deferred tax assets considered realizable, however, could be increased in the near term if estimates of future taxable income during the carryforward period are increased. The Organization has passive activity losses of \$17.6 million available to carry forward indefinitely for federal and State tax purposes and have net operating losses of \$1.8 million expiring through June 30, 2026.

In fiscal year 2007, the State settled for \$3.8 million (taxes, penalties, and interest included) with respect to the examinations of the Schools and Kamehameha Activities Association ("KAA") for the years ended June 30, 1992 through 1996, and the State of New York settled for \$250,000 (taxes, penalties, and interest included) with respect to the examination of KAA for the year ended June 30, 1999. In fiscal year 2006, the State cancelled its assessment and New York City settled for \$3.9 million (taxes and interest included), both in relation to the short year ended July 31, 1998 examination of a Pauahi Holding Company subsidiary, the Schools' former wholly-owned taxable subsidiary.

As of June 30, 2007, there are no significant pending federal or state income tax audits. The federal statute of limitations remains open for the Organization for the years ended June 30, 2004 through 2007.

7. Pension and Other Postretirement Benefits

The Organization has a defined benefit pension plan which covers substantially all employees after satisfying age and length of service requirements. The Organization makes annual contributions to the plan equal to the maximum amount that can be deducted for income tax purposes.

In addition to the Organization's defined benefit pension plan, the Schools sponsor a defined benefit health care plan that provides postretirement medical benefits to eligible full-time employees who meet minimum age and service requirements.

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

The following table reconciles the changes to the benefit obligations and plan assets for the years ended June 30, 2007 and 2006 to the funded status of the plans and amounts recognized in the consolidated financial statements as of June 30, 2007 and 2006 (in thousands):

	Pension Benefits		Postretirement Benefits	
	2007	2006	2007	2006
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 206,636	\$ 224,564	\$ 23,863	\$ 25,457
Service cost	9,469	10,500	1,075	1,286
Interest cost	12,741	11,608	1,462	1,293
Benefits paid	(7,644)	(7,281)	(970)	(955)
Actuarial (gains) losses	592	(32,099)	660	(3,218)
Other	(399)	(656)	-	-
Benefit obligation at end of year	221,395	206,636	26,090	23,863
Change in fair value of plan assets				
Fair value of plan assets at beginning of year	160,023	136,071	-	-
Actual return on plan assets	30,436	18,448	-	-
Employer contributions	11,128	12,911	970	955
Benefits paid	(7,644)	(7,281)	(970)	(955)
Actuarial gains	-	530	-	-
Other	(399)	(656)	-	-
Fair value of plan assets at end of year	193,544	160,023	-	-
Net amount recognized at June 30, 2007	\$ (27,851)		\$ (26,090)	
Reconciliation to funded status				
Funded status at June 30, 2006		(46,613)		(23,863)
Unrecognized prior service cost		3,180		364
Unrecognized actuarial loss (gain)		(4,399)		34
Net amount recognized at June 30, 2006		\$ (47,832)		\$ (23,465)

The accumulated benefit obligation for the pension plan was \$180.3 million and \$167.7 million at June 30, 2007 and 2006, respectively.

The amounts recorded within the change in net assets at June 30, 2007 for the adoption of SFAS No. 158 included the recognition of the following amounts (in thousands):

	Pension Benefits	Postretirement Benefits
Previously unrecognized prior service cost	\$ 2,678	\$ 291
Previously unrecognized actuarial (gains) losses	(21,407)	694
Net amount recognized	\$ (18,729)	\$ 985

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

Net periodic pension cost consisted of the following for the years ended June 30, 2007 and 2006 (in thousands):

	Pension Benefits		Postretirement Benefits	
	2007	2006	2007	2006
Service cost	\$ 9,469	\$ 10,500	\$ 1,075	\$ 1,286
Interest cost	12,741	11,608	1,462	1,293
Expected return on plan assets	(12,835)	(11,371)	-	-
Amortization of prior service cost	501	573	73	(410)
Amortization of net loss	-	1,221	-	28
Amortization of transition asset	-	(472)	-	-
Net periodic pension cost	<u>\$ 9,876</u>	<u>\$ 12,059</u>	<u>\$ 2,610</u>	<u>\$ 2,197</u>

Weighted average assumptions

Benefit obligation				
Discount rate	6.25%	6.25%	6.25%	6.25%
Expected return on plan assets	8.50%	8.50%	N/A	N/A
Rate of compensation increase	4.80%	4.80%	N/A	N/A
Net periodic benefit cost				
Discount rate	6.25%	5.25%	6.25%	5.25%
Expected return on plan assets	8.50%	8.50%	N/A	N/A
Rate of compensation increase	4.80%	4.80%	N/A	N/A

The Schools' overall expected long-term rate of return on plan assets is 8.5%. The expected long-term rate of return on plan assets was projected by the plan's investment consultants based on strategies outlined in the portfolios policies and guidelines.

The assumed healthcare cost trend rates at June 30, 2007 and 2006 were as follows:

	2007	2006
Healthcare cost trend rate assumed for the next year		
Medical benefits	9.00%	10.00%
Drug benefits	11.00%	15.00%
Rate to which the cost trend rate is assumed to decline (ultimate trend rate)		
	5.00%	4.75%
Year that the rate reaches the ultimate trend rate		
	2014	2013

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

The weighted average and target asset allocation of the Organization's pension plan assets is as follows:

	Pension Plan Assets at June 30			
	2007	2006	Targeted	
Asset category			Allocation	Range
Equity securities	62.0 %	65.0 %	60.0 %	47.5 – 72.5%
Debt securities	29.0 %	26.0 %	35.0 %	22.5 – 50.0%
Real estate	9.0 %	9.0 %	5.0 %	2.5 – 10.0%
	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>	

The investment goals for defined benefit pension plan assets are to maximize returns subject to specific risk management policies. The risk management policies permit investments in debt and equity securities, real estate and other inflation-hedging assets. Readily marketable securities are utilized to pay benefit obligations as they become due.

The following benefit payments are expected to be paid from the respective plans as follows (in thousands):

Year ending June 30	Pension	Postretirement
2008	\$ 8,952	\$ 1,019
2009	9,857	1,086
2010	10,414	1,151
1011	11,277	1,240
2012	12,039	1,315
2013–2017	<u>75,364</u>	<u>7,790</u>
	<u>\$ 127,903</u>	<u>\$ 13,601</u>

The expected benefits are based on the same assumptions used to measure the benefit obligation at June 30 and include estimated future employee service.

The Organization expects to contribute \$8.9 million to their pension plan and \$1.0 million to their postretirement medical plan in 2008.

The Organization has employee savings plans under Sections 403(b) and 401(k) of the Internal Revenue Code ("IRC"). The plans cover substantially all the Organization's employees after satisfying service requirements. Participating employees may defer up to 50% (subject to certain limitations) of their pretax earnings to the Section 401(k) plan.

The Organization makes matching contributions to the 401(k) plan up to a maximum 3% of employee pretax earnings. Participants are immediately and fully vested in the Schools' contribution. Contributions to the 401(k) plan for the years ended June 30, 2007 and 2006 amounted to approximately \$2.4 million and \$2.2 million, respectively.

Kamehameha Schools and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2007 and 2006

8. Deferred Compensation Plan

On January 1, 1976, the Schools adopted a deferred compensation plan that allowed employees and others who perform services for the Schools under contract to defer compensation earned. Individual accounts are maintained for each participant and earnings are computed on the basis of alternative investment programs available. The liability has been fully funded and investments are included in marketable debt and equity securities in the consolidated balance sheets.

9. Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- **Cash and cash equivalents, amounts receivable for securities sold, amounts payable for securities purchased, collateral received for loaned securities, obligation to repay securities lending collateral, and accounts payable and accrued expenses:** The carrying amounts approximate fair value because of the short maturity of these instruments.
- **Investments:** The fair value of marketable debt and equity securities is based on quoted market prices, and if applicable, discounted for time restrictions. Different techniques and many factors were considered in estimating the fair value of other investments. Several investments have been valued based on the underlying asset value.
- **Receivables, net:** The fair value of note agreements and mortgage notes is valued at the present value of expected future cash flows discounted at an interest rate commensurate with the risk associated with the respective receivables. The carrying value of interest and other receivables approximates fair value because of the short maturity of these instruments.
- **Notes payable:** The fair value of notes payable is estimated using the current rates at which similar loans would be made by lenders to borrowers with similar credit ratings and similar remaining maturities.

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

The following table presents the carrying amounts and estimated fair values of the Organization's financial instruments at June 30, 2007 and 2006 (in thousands):

	2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 65,639	\$ 65,639	\$ 50,498	\$ 50,498
Investments	6,584,085	6,584,085	5,735,415	5,735,415
Amounts receivable for securities sold	133,636	133,636	201,630	201,630
Collateral received for loaned securities	643,621	643,621	466,038	466,038
Receivables, net	25,596	36,750	18,581	32,178
Obligation to repay securities lending collateral	643,621	643,621	466,038	466,038
Notes payable	270,208	260,430	243,020	232,166
Amounts payable for securities purchased	88,295	88,295	261,216	261,216
Accounts payable and accrued expenses	72,930	72,930	71,064	71,064

10. Commitments and Contingencies

Rental Income

The majority of land and buildings are generally leased under long-term lease arrangements. At June 30, 2007, future rental income from these leases based on present effective minimum rentals is summarized as follows (in thousands):

Year ending June 30,	
2008	\$ 109,086
2009	106,909
2010	97,103
2011	89,633
2012	84,938
Thereafter	<u>1,086,743</u>
	<u>\$ 1,574,412</u>

Percentage rental income, based on stipulated percentages of gross lessees' sales, amounted to approximately \$14.4 million and \$14.7 million for each of the years ended June 30, 2007 and 2006, respectively.

Capital Commitments

At June 30, 2007 and 2006, the Schools were committed under agreements with certain partnerships and corporations to invest an additional \$565 million and \$448 million, respectively.

At June 30, 2007 and 2006, open construction, renovation, major repair and other contracts amounted to \$59 million and \$57 million, respectively.

Kamehameha Schools and Subsidiaries
Notes to Consolidated Financial Statements
June 30, 2007 and 2006

Litigation

There are various claims and complaints against the Schools that are incidental to its operations. Management, after consideration with in-house legal counsel, is of the opinion that the ultimate resolution of these matters will not have a material adverse effect on the consolidated financial statements.

Trustee Matters

The Trustees receive an annual retainer of \$30,000, payable monthly, and will receive a meeting fee of \$1,500 per meeting, except for the chairperson, who will receive \$2,000 per meeting. On January 23, 2004, the Court approved increasing the maximum number of meetings from 45 to 90 during a 12-month period. The Trustees elected to waive compensation for meetings in excess of 45 during the calendar years 2004 through 2007. For the years ended June 30, 2007 and 2006, total Trustee compensation amounted to \$521,500 and \$500,000, respectively.

Supplemental Schedules

Kamehameha Schools and Subsidiaries
Schedules of Trust Spending
Years Ended June 30, 2007, 2006, 2005, 2004 and 2003
(All dollars in thousands)

Schedule 1

	2007	2006	2005	2004	2003
Trust spending, net					
Campus-based programs					
Kapalama	\$ 75,584	\$ 75,342	\$ 74,931	\$ 75,871	\$ 72,336
Hawaii	26,314	24,509	22,400	20,806	12,798
Maui	25,121	24,253	20,286	18,559	12,946
Outreach programs					
Community Education (includes funding for Ho'okako'o, a not-for-profit organization, of \$1,850 \$2,517, \$790, \$1,327 and \$280 for the years ended June 30, 2007 2006, 2005, 2004 and 2003, respectively)	60,275	42,674	36,793	35,115	27,872
Scholarships	17,899	14,662	15,650	16,176	16,637
Educational support services	10,702	8,372	5,821	4,716	2,267
Ke Ali'i Pauahi Foundation	451	559	378	730	1,984
Other program expenditures	9,177	8,654	9,845	10,948	6,810
Base spending	225,523	199,025	186,104	182,921	153,650
Less: Tuition, fees and other educational income, net	(13,614)	(12,978)	(10,313)	(7,787)	(4,557)
Base distributions	211,909	186,047	175,791	175,134	149,093
Major repairs	10,427	4,341	5,738	5,529	5,837
Capital projects	20,689	18,060	36,995	90,618	127,176
Interest on debt	7,734	7,335	7,734	4,776	1,360
Debt financing of capital projects	952	-	-	(60,000)	(70,000)
In-kind transactions	1,500	-	-	-	-
Total trust spending before reserve activity	253,211	215,783	226,258	216,057	213,466
Reserve activity – operating, net	(3,000)	5,000	(3,800)	4,500	6,000
Total trust spending	\$ 250,211	\$ 220,783	\$ 222,458	\$ 220,557	\$ 219,466
Average fair value of Endowment	\$ 6,136,107	\$ 5,803,821	\$ 5,614,498	\$ 5,461,640	\$ 5,392,443
Trust spending rate before reserve activity	4.1%	3.7%	4.0%	4.0%	4.0%
Trust spending rate	4.1%	3.8%	4.0%	4.0%	4.1%

See accompanying Report of Independent Auditors and notes to schedules of trust spending.

Kamehameha Schools and Subsidiaries

Notes to Schedules of Trust Spending

Years Ended June 30, 2007, 2006, 2005, 2004 and 2003

1. Background and Purpose

The Schools' spending policy governs annual trust spending from their Endowment to support its educational purpose. The spending policy targets annual trust spending at 4% of the average fair value of the Endowment plus the net income, if any, generated from the Schools' agriculture and conservation lands. The spending policy also provides for actual trust spending to vary annually at a range of 2.5% to 6.0%.

The schedule is prepared on a cash basis and presents the total distributions made from the Endowment to fund educational programs (trust spending) by major program and activity. It also presents the trust spending rates for five fiscal years through June 30, 2007.

2. Trust Spending and Trust Spending Rate

Trust spending represents the amounts spent during the fiscal year on educational programs by major program and activity. The campus-based and outreach program costs represent direct and indirect costs of providing these programs. The Educational Support Services programs represent the costs of administering scholarships, financial aid, admissions, ancestry verification and other supporting functions for educational programs. Ke Ali'i Pauahi Foundation expenditures represent the direct and indirect costs of providing scholarship and financial aid programs. Other program expenditures represent the direct and indirect costs related to certain educational services that benefit the various campus-based and outreach programs. Indirect costs, which represents the portion of the finance, operations, and legal services cost that support the Schools' educational programs and purpose are allocated to education based on various methods depending on the type of cost including headcount, square footage, and proportion in relation to the other estimates based on management's best judgment. Major repairs, capital projects, interest on debt, net borrowing of debt and repayment of principal, and in-kind transactions are directly attributable to education. Reserve activity represents the funding of an operating reserve, as approved by the Court, to ensure assets are readily available for unanticipated educational program expenses. Reserve activity may also include returning funds to the Endowment if there are sufficient operating reserves.

For the purposes of this schedule, trust spending on educational programs includes major repairs and capital projects, an allocation of indirect costs, borrowing of debt, repayment of principal and the reserve activity. These items are not included in educational program expenses on the consolidated statements of activities. The trust spending rates are determined by dividing the total trust spending before reserve activity and the total trust spending by the average fair value of the Endowment.

3. Endowment and Average Fair Value of the Endowment

The Endowment consists of all consolidated investment assets of the Schools except agriculture and conservation lands and reserve funds as defined in the Schools' investment policy. The average fair value of the Endowment is initially based on the average of the five prior fiscal June 30 year-end fair values and over time will be based on the average of the prior 20-quarter-end fair values. Accordingly, the trust spending rates for the years ended June 30, 2007, 2006, 2005, 2004, and 2003 are based on the estimated average fair values over the last five fiscal years utilizing the respective year-end and/or quarter-end values. The fair values for these fiscal years were based primarily on internal and external appraisals, to the extent available, and tax assessed values for the Hawaii real estate assets and the fair value of the other Endowment assets as reported in the audited consolidated financial statements for these fiscal years, net of any associated debt.

Kamehameha Schools and Subsidiaries
Schedules of Total Return
June 30, 2007

Schedule 2

	Fair Value at June 30, 2007 (In Thousands)	One-Year Total Return %	Three-Year Total Return %	Five-Year Total Return %	Since July 1, 1999 Total Return %
Hawaii real estate CPI+5%	\$ 2,482,146	31.7 7.7	24.6 8.2	19.4 8.0	12.5 7.9
U.S. equity Russell 3000	1,441,380	20.9 20.1	13.0 12.5	12.0 11.5	8.7 3.8
Non-U.S. equity MSCI EAFE net	1,464,445	26.5 27.0	20.9 22.3	16.5 17.7	11.6 7.9
Emerging markets MSCI Emerging Markets net (1/07) Emerging Markets Free Index	607,975	49.4 43.5	40.1 35.4	31.3 27.4	N/A N/A
Fixed Income U.S. Treasury 6.5 Duration Bond (1/07)/ Lehman Brothers Aggregate	886,439	4.9 5.7	4.1 3.8	5.3 4.4	6.1 5.8
Cash equivalents Three-month U.S. Treasury Bill	22,719	6.8 5.2	4.4 3.8	3.2 2.8	3.7 3.4
Venture and private equity CPI+8.75% (7/04)/CPI + 10%	326,078	18.7 11.4	18.7 11.9	9.9 12.3	6.0 12.5
Hawaii targeted investments CPI+8.75% (7/04)/CPI + 10%	1,735	-8.0 11.4	N/A N/A	N/A N/A	N/A N/A
Absolute return CPI+5%	965,939	14.7 7.7	9.7 8.2	N/A N/A	N/A N/A
Energy and other CPI+5%	717,112	10.0 7.7	23.7 8.2	37.2 8.0	38.2 7.9
Real estate (Mainland) CPI +5%	141,680	20.3 7.7	43.8 8.2	26.0 8.0	22.9 7.9
Total endowment	\$ 9,057,648	22.3	17.3	14.5	11.3
Endowment Fund Composite Benchmark		15.5	12.1	10.9	7.5
Cambridge Associates Large Endowment Fund Median CPI+5%		20.2 7.7	16.0 8.2	13.6 8.0	10.3 7.9

See accompanying Report of Independent Auditors and notes to schedules of total return.

Kamehameha Schools and Subsidiaries

Notes to Schedules of Total Return

June 30, 2007

1. **Background and Purpose**

The Schools' investment policy establishes long-term and intermediate-term investment objectives, asset allocation targets, and performance measurement guidelines for the Endowment. The overall long-term investment objective of the Endowment is to earn an average annual real return of 5% net of all investment related expenses.

The purpose of this schedule is to report the Schools' total return results for the Endowment (by asset class) as compared to long-term benchmark indices approved in the investment policy. The Schools' Endowment asset classes include:

Hawaii Real Estate

The Hawaii real estate assets can be divided into traditional land holdings, improved commercial properties, real estate held for development and sale, and purchase money mortgages. The traditional land holdings are typically leased to third parties under long-term ground leases while the improved commercial properties are actively managed by various third-party managers to generate space rents. Improved commercial properties are comprised of shopping centers, office buildings, and warehouse facilities.

U.S. Equity

U.S. equity is comprised of marketable equity securities of U.S. companies.

Non-U.S. Equity

Non-U.S. equity is comprised of marketable equity securities of companies in developed markets.

Emerging Markets

Emerging markets is comprised of marketable equity securities of companies in emerging markets.

Fixed Income

Fixed income is comprised of investments in debt securities issued by a corporation, government, or government agency. This asset class also includes, to a lesser degree, money market instruments, which include U.S. Treasury bills, bank certificates of deposit, repurchase agreements, commercial paper, and bankers' acceptances.

Cash Equivalents

Cash equivalents are comprised of investments in debt securities issued by a corporation, government or government agency, and money market instruments.

Venture and Private Equity

Venture and private equity investments are high risk, high potential return investments in illiquid privately placed equity or equity-related securities of nonpublic companies, companies or parts of companies that are being taken private, or public entities. Investments are made in various types of businesses ranging from start-up enterprises to privately held middle-market firms to larger public firms seeking private financing for specific projects. The Schools' private equity and venture capital portfolio currently consists primarily of pooled fund investments in limited partnerships.

Absolute Return

Absolute return investments have the general objective of producing relatively stable, positive returns independent of the performance of the broad equity and fixed income markets. Absolute return investments include hedge funds pursuing event-driven, relative value, market neutral, and equity long-short strategies.

Kamehameha Schools and Subsidiaries
Notes to Schedules of Total Return
June 30, 2007

Energy and Other

Energy and other investments are intended to serve as the inflation hedge component of the portfolio. This asset class includes hedge funds, marketable equity securities, direct investments and limited partnership interests in energy-related investments.

Real Estate (Mainland)

Mainland real estate assets consist of pooled and direct investments in residential, office, retail, timberland and a variety of other property types.

2. Fair Values

Fair value of an asset is the amount at which the asset could be exchanged in a current transaction between willing parties. The following methods and assumptions were used to estimate the fair value of each asset class:

Hawaii Real Estate

The fair value of residential real property interests (single-family and multifamily) is estimated by internal appraisals using a discounted cash flow method for leased properties and a sales comparison approach for unleased properties. The fee simple land values used as inputs within the discounted cash flow model for leased properties are based on estimates by external appraisers and are updated internally for current market conditions since the time that the appraisals were performed.

Commercial properties are divided into two primary categories – leased and unleased. In general, commercial properties are externally appraised every three years. The fair value of leased properties is typically estimated by the external appraisers using an income approach, while the value of unleased properties is typically estimated using a sales comparison approach. Prior to June 30, 2003, for the properties that were internally appraised, the fair value of leased properties was estimated by discounting future net cash flows at an appropriate discount rate over a ten-year period and the current tax-assessed values were used to approximate the fair value of unleased commercial properties.

Either current tax-assessed value or external appraised values are used to approximate the fair value of real estate held for future development and sale.

The fair value of purchase money mortgages is estimated by discounting the expected future net cash flows at a discount rate commensurate with the risk associated with the respective receivables.

The fair value of all real property interests is reduced by the fair value of any associated debt.

U.S. Equity, Non-U.S. Equity, and Emerging Markets

The market value of marketable equity securities is based on quoted market prices, and if applicable, discounted for time restrictions.

Fixed Income and Cash Equivalents

The market values of marketable debt securities and cash equivalents are based on quoted market prices.

Kamehameha Schools and Subsidiaries
Notes to Schedules of Total Return
June 30, 2007

Venture and Private Equity

Different techniques and many factors were considered in deriving the fair value of these investments. Several investments have been valued based on the underlying asset value and are based on a number of different factors including, among others, original cost, third-party financing transactions, discounted cash flows and comparable industry multiples. In addition, restricted shares are valued at market prices less illiquidity discounts.

Absolute Return

Different techniques and many factors were considered in deriving the fair value of these investments. These investments have been valued based on the underlying asset value.

Energy and Other

Different techniques have been utilized and factors considered in deriving the fair value of these investments. Marketable instruments are based on quoted market prices, and if applicable, discounted for time restrictions. Hedge funds, direct investments, and limited partnership interests have been valued based on underlying asset values. For certain assets, the fair value was deemed to approximate the carrying value.

Real Estate (Mainland)

Different techniques were considered in deriving the fair value including net operating income divided by a capitalization rate, estimated cash flows discounted at a rate commensurate with risks involved, market comparables, independent appraisals, carrying value of a direct financing lease, and carrying value of operating assets reduced by liabilities.

The fair value is reduced by the carrying value of any debt associated with such properties.

3. Total Return

Total return is calculated using the Modified BAI Method, a time weighted rate of return. Total returns for periods greater than one year are annualized.

4. Benchmark Indices

The benchmarks indices are set forth in the Schools' investment policy. Amendments to the benchmark indices are incorporated when effective and include revised benchmarks, asset class target weights, and blended benchmark allocation methodologies. Certain asset classes may have varying benchmarks and an effective date indicating the current and previous benchmark. Blended portfolio benchmarks are generally weighted based upon the asset class targets set forth in the Schools' approved investment but may be based upon actual weights.