

**UNIVERSITY OF LOUISVILLE
FOUNDATION, INC. AND AFFILIATE**

Accountants' Report and Consolidated Financial Statements

June 30, 2006 and 2005

University of Louisville Foundation, Inc. and Affiliate

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Independent Accountants' Report

Board of Trustees
University of Louisville Foundation, Inc. and Affiliate
Louisville, Kentucky

We have audited the accompanying consolidated statements of financial position of the University of Louisville Foundation, Inc. and Affiliate (Foundation) as of June 30, 2006 and 2005, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Foundation as of June 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

September 22, 2006

BKD, LLP

University of Louisville Foundation, Inc. and Affiliate
Consolidated Statements of Financial Position
June 30, 2006 and 2005
(In Thousands)

	2006	2005
ASSETS		
Cash and cash equivalents	\$ 11,579	\$ 14,706
Accounts, notes, and accrued interest receivable	8,402	4,838
Loan receivable from the University of Louisville Athletic Association, Inc.	4,205	4,900
Prepaid expenses	1,102	871
Contributions receivable	38,125	37,547
Due from University of Louisville	67	-
Investments	688,501	611,830
Funds held in trust by others	44,407	44,957
Restricted investments	7,337	4,285
Other assets	29	-
Capital assets, net	54,528	42,667
Total assets	\$ 858,282	\$ 766,601
 LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	\$ 4,038	\$ 4,323
Funds held in trust for others	46,145	43,451
Bonds payable	53,548	37,729
Other	9,863	8,666
Due to University of Louisville	-	1,802
Total liabilities	113,594	95,971
Net assets:		
Unrestricted:		
Unrestricted - designated	367,840	331,751
Unrestricted - undesignated	19,795	19,029
Total unrestricted	387,635	350,780
Temporarily restricted	47,979	44,982
Permanently restricted	309,074	274,868
Total net assets	744,688	670,630
Total liabilities and net assets	\$ 858,282	\$ 766,601

See notes to consolidated financial statements

University of Louisville Foundation, Inc. and Affiliate
Consolidated Statements of Activities
Years Ended June 30, 2006 and 2005
(In Thousands)

	Unrestricted		Temporarily restricted		Permanently restricted		Totals	
	2006	2005	2006	2005	2006	2005	2006	2005
REVENUES, GAINS AND OTHER SUPPORT								
Gifts	\$ 15,941	\$ 22,703	\$ 2,659	\$ 11,661	\$ 14,706	\$ 9,766	\$ 33,306	\$ 44,130
Research Challenge Trust Fund	-	-	-	-	20,050	8,029	20,050	8,029
Investment income	2,155	1,375	-	-	-	-	2,155	1,375
Endowment income	9,104	10,531	583	616	-	-	9,687	11,147
Net realized and unrealized gain (loss) on investments	62,399	51,820	2,226	910	(550)	735	64,075	53,465
Residence hall income	4,278	4,194	-	-	-	-	4,278	4,194
Change in fair value of interest rate swap agreements	500	666	-	-	-	-	500	666
Other	1,076	1,104	5	4	-	-	1,081	1,108
Net assets released from restrictions:								
Satisfaction of program restrictions	1,964	2,027	(1,964)	(2,027)	-	-	-	-
Expiration of time restrictions	512	1,103	(512)	(1,103)	-	-	-	-
Total revenues, gains and other support	97,929	95,523	2,997	10,061	34,206	18,530	135,132	124,114
EXPENSES								
Contributions to various University departments	3,194	2,625	-	-	-	-	3,194	2,625
Payments on behalf of the University of Louisville for:								
Instruction	3,959	3,977	-	-	-	-	3,959	3,977
Research	18,048	13,140	-	-	-	-	18,048	13,140
Public service	1,347	857	-	-	-	-	1,347	857
Academic support	10,114	10,833	-	-	-	-	10,114	10,833
Student services	153	49	-	-	-	-	153	49
Institutional support	7,130	3,950	-	-	-	-	7,130	3,950
Operation and maintenance of plant	1,723	823	-	-	-	-	1,723	823
Scholarships/fellowships	5,886	6,149	-	-	-	-	5,886	6,149
Payments to annuitants and present value adjustment	507	1,103	-	-	-	-	507	1,103
Interest expense	1,801	1,792	-	-	-	-	1,801	1,792
Residence hall operations, including depreciation	3,125	3,281	-	-	-	-	3,125	3,281
General and administrative, including fundraising	4,087	3,680	-	-	-	-	4,087	3,680
Total expenses	61,074	52,259	-	-	-	-	61,074	52,259
Net change in assets from operations	36,855	43,264	2,997	10,061	34,206	18,530	74,058	71,855
Net assets at beginning of year	350,780	307,516	44,982	34,921	274,868	256,338	670,630	598,775
Net assets at end of year	\$ 387,635	\$ 350,780	\$ 47,979	\$ 44,982	\$ 309,074	\$ 274,868	\$ 744,688	\$ 670,630

See notes to consolidated financial statements

University of Louisville Foundation, Inc. and Affiliate
Consolidated Statements of Cash Flows
Years Ended June 30, 2006 and 2005
(In Thousands)

	<u>2006</u>	<u>2005</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in net assets	\$ 74,058	\$ 71,855
Adjustments to reconcile increase in net assets to net cash used by operating activities:		
Net realized and unrealized gain on investments	(64,075)	(53,465)
Depreciation and amortization expense	2,707	2,652
Change in fair value of interest rate swap agreements	(500)	(666)
Write off of loan receivable from the University of Louisville Athletic Association, Inc.	195	-
Loss on disposals of capital assets	16	-
Transfer of capital assets to affiliates	203	1,443
Contributions restricted for long-term investment	(34,756)	(17,795)
Change in assets and liabilities:		
Accounts, notes, and accrued interest receivable	(3,564)	(3,767)
Prepaid expenses	(42)	66
Contributions receivable	(578)	(10,993)
Accounts payable	(285)	(467)
Funds held in trust for others	2,694	2,346
Other liabilities	1,668	433
Due to University of Louisville	(1,869)	1,437
Net cash used by operating activities	<u>(24,128)</u>	<u>(6,921)</u>
 CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(254,206)	(375,818)
Sales of investments	239,108	377,828
Purchases of capital assets	(14,749)	(3,438)
Proceeds from disposals of capital assets	2	-
Payments received on loan receivable from University of Louisville Athletic Association, Inc.	500	500
Net cash used by investing activities	<u>(29,345)</u>	<u>(928)</u>
 CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from contributions restricted for investment in endowment	34,756	17,795
Proceeds from issuance of bonds payable	16,166	-
Principal payments of bonds payable	(350)	(265)
Payment of bond issuance costs	(226)	-
Net cash provided by financing activities	<u>50,346</u>	<u>17,530</u>
 Net (decrease) increase in cash and cash equivalents	(3,127)	9,681
Cash and cash equivalents at beginning of year	14,706	5,025
Cash and cash equivalents at end of year	<u>\$ 11,579</u>	<u>\$ 14,706</u>
 Supplemental cash flow data:		
Cash paid for interest (net of amount capitalized)	<u>\$ 2,347</u>	<u>\$ 1,759</u>

See notes to consolidated financial statements

University of Louisville Foundation, Inc. and Affiliate

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

1. Organization and Summary of Significant Accounting Policies

a. Organization

The accompanying consolidated financial statements include the balances and transactions of the University of Louisville Foundation, Inc. and ULH, Inc. (ULH) (collectively "Foundation"). All material intercompany balances and transactions have been eliminated in consolidation. The University of Louisville Foundation, Inc. has been designated by the University of Louisville (the University) to receive funds derived from gifts and other sources, including funds held in trust by others.

As directed by its Board of Directors, the Foundation transfers funds to the University in satisfaction of donor restrictions. In addition, a portion of the unrestricted resources of the Foundation provides support for a variety of University activities.

ULH began operations on April 23, 2001 and is affiliated with the University of Louisville Foundation, Inc. through certain common management and trustees. ULH leases land and issues revenue bonds for student housing purposes and receives and retains/disposes of real estate, and manages and operates the student housing properties it owns.

b. Cash and cash equivalents

The Foundation considers all liquid investments (not held for long-term purposes) with original maturities of three months or less to be cash equivalents. At June 30, 2006 and 2005, cash equivalents consisted primarily of money market funds.

The Foundation currently uses a commercial bank as its depository. Deposits with the commercial bank are covered by Federal depository insurance up to insurable limits (\$100,000).

c. Investments

Investments in marketable securities are stated at current market value. Investments in real estate through limited partnerships are stated at appraised market values, while other real estate investments are stated at cost on the date of acquisition or fair market value at date of receipt in the case of gifts. Securities not publicly traded are stated at cost, which approximates market. The net realized and unrealized appreciation (depreciation) in market value of investments is reflected in the consolidated statements of activities.

d. Derivatives

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, ULH entered into interest rate swap agreements for its floating rate debt.

Management has not designated the interest rate swap agreements as hedging instruments under the provisions of Statement of Financial Accounting Standards No. 133. As a result, the agreements are recorded at fair value (included in other assets in 2006 and in other liabilities in 2005) with subsequent changes in fair value included in earnings in the accompanying statements of activities.

e. Capital Assets

Capital assets are stated at cost or estimated market value at date of receipt from donors. The provision for depreciation on capital assets is calculated using the straight-line method based on their estimated useful lives.

ULH capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. Total interest capitalized was (in thousands):

	<u>2006</u>	<u>2005</u>
Total interest expense incurred on borrowings for project	\$ 520	\$ -
Interest income from investment of proceeds of borrowings for project	(277)	-
Net interest cost capitalized	<u>\$ 243</u>	<u>\$ -</u>

f. Unrestricted Net Assets

Net appreciation on endowment funds is reported as unrestricted net assets, unless such net appreciation has been restricted by the donor or by law. Market appreciation on unrestricted endowment funds is included in unrestricted net assets in the accompanying consolidated financial statements. In those cases where a donor has placed restrictions on the use of endowment income, any related net appreciation is also subject to the same restriction and is reported as such.

g. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those which have donor-imposed restrictions that will expire in the future, when either the time restriction or purpose restriction has been met, and permanently restricted net assets are those which have donor-imposed restrictions which do not expire.

The expiration of a donor-imposed restriction on a contribution or on endowment income is recognized in the period in which the restriction expires and at that time the related resources are reclassified to unrestricted net assets. A restriction expires when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both.

Donor-imposed restricted contributions and endowment income are reported as unrestricted support if the restrictions are met in the same period as the funds are received.

h. Unrestricted Bequests

The Foundation follows the policy of designating all unrestricted bequests of \$25,000 or greater as funds functioning as endowments.

i. Collections

The Foundation has elected not to capitalize collections which include art, rare books, photographs, letters, journals, manuscripts, and musical instruments. These items represent assets held for public exhibition, education, or research and are not for financial gain. Such items are protected, cared for and preserved.

j. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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.

k. Market Risk and Uncertainties

The Foundation invests in various corporate debt, equity and mutual fund securities, among other investments. Investment securities, in general, are exposed to various risks, such as interest rates, credit and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated statements of financial position.

l. In-Kind Contributions

In addition to receiving cash contributions, the Foundation receives in-kind contributions of library materials and other educational equipment and supplies from various donors. It is the policy of the Foundation to record the estimated fair value of certain in-kind donations as an expense in its consolidated financial statements, and similarly increase gift revenue by a like amount. The Foundation received approximately \$663,000 and \$1,823,000 in in-kind gifts for the years ended June 30, 2006 and 2005, respectively.

m. Functional Allocation of Expenses

The costs of supporting the various programs and other activities have been summarized on a functional basis in the statements of activities. Certain costs have been allocated among the instruction, research, public service, academic support, student services, institutional support, operation and maintenance of plant and scholarships/fellowships categories based on donor intent and other methods.

n. Reclassifications

Certain reclassifications have been made in the 2005 consolidated financial statements to conform to the 2006 presentation. These reclassifications had no effect on the change in total net assets.

o. Tax Status

The Foundation has received a favorable determination letter from the Internal Revenue Service exempting it from federal income taxes under §501(c)(3) of the Internal Revenue Code and a similar provision of state law.

2. Loan Receivable from the University of Louisville Athletic Association, Inc.

In January, 1999, the Foundation made an \$8.5 million dollar unsecured, non-interest bearing loan to the University of Louisville Athletic Association, Inc. (Association) for the construction of Cardinal Park, due upon collection of contributions receivable by the Association. The Association's intent is to repay the \$8.5 million loan with future contributions and gifts, which are currently being solicited from public and private sources as part of a campaign drive to provide funding for the Cardinal Park project. During the year ended June 30, 2006, the Association repaid \$500,000, and the Foundation wrote off \$194,938, leaving an outstanding loan balance of approximately \$4.2 million as of June 30, 2006.

3. Contributions Receivable

Contributions receivable are discounted, using rates on risk-free obligations ranging from 1.2% to 5.9% for 2006 and 3.4% to 4.0% for 2005. Contributions receivable, which are all temporarily restricted, as of June 30, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Less than one year	\$ 20,202	\$ 15,502
One to five years	18,860	19,800
Greater than five years	6,698	10,536
Allowance for doubtful accounts	(4,447)	(3,932)
Unamortized discount	(3,188)	(4,359)
Net contributions receivable	<u>\$ 38,125</u>	<u>\$ 37,547</u>

Conditional promises of gifts depend on the occurrence of a specific and uncertain event. The Foundation has not recorded these types of gifts in the consolidated financial statements. As of June 30, 2006 and 2005 the approximate fair market value of these conditional gifts is as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Bequests	\$ 48,000	\$ 49,243
Other	3,702	4,727
Total	<u>\$ 51,702</u>	<u>\$ 53,970</u>

4. Investments and Investment Income

Investments as of June 30, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Preferred and common stock	\$ 224,932	\$ 232,533
Corporate bonds	17,368	19,495
Mutual funds	291,410	237,234
Real estate	16,164	15,881
Investment in partnerships	64,268	55,188
U.S. government securities	30,369	18,899
Land and buildings	1,733	1,845
Marketable alternatives	41,653	30,755
Annuities	604	-
Total investments	<u>\$ 688,501</u>	<u>\$ 611,830</u>

The Foundation's investments do not have a significant concentration of credit risk within any industry or specific institution.

The market risk inherent in certain of the Foundation's investments is primarily the potential loss arising from adverse changes in quoted market prices on equity securities and in interest rates on fixed income securities. In an effort to mitigate this market risk, the Foundation has adopted a policy of maintaining a diverse investment pool through the use of target asset allocation guidelines. These guidelines require that the Foundation's investment pool be made up of a mix of publicly traded fixed income and equity securities, private equities and other nonmarketable securities, and real estate investments.

The major portion of long-term investments is pooled in the Combined Endowment Fund. The Combined Endowment Fund is the general endowment pool for the Foundation. The Foundation has adopted an investment objective whereby the average annual return over the long term should equal the rate of inflation (measured by the Consumer Price Index) plus the average level of spending (as defined below) from the Combined Endowment Fund. The average annual return for the Combined Endowment Fund was 13.0% and 14.1% in 2006 and 2005, respectively.

The Combined Endowment Fund is pooled using a market value basis, with each individual fund subscribing to, or disposing of, units on the basis of the market value per unit at the end of the prior calendar month during which the transaction takes place. The investment objectives of the Foundation are to preserve the principal of the endowment funds in both absolute and real terms while maximizing, over the long-term, the total rate of return (yield and appreciation) within reasonable risk parameters. In connection with these objectives, the Board of Trustees determines the portion of total return which may be expended. The approved spending policy establishes that 5.5% of the three-year moving average of the Combined Endowment Fund market value as of December 31 be made available for spending in the subsequent fiscal year. Effective January 1999, the Board of Trustees approved a resolution to include an additional 0.5% assessment for development, alumni relations, and support services.

The amount available for spending under the policy was approximately \$23.9 million and \$21.8 million for the years ended June 30, 2006 and 2005, respectively, of which approximately \$17.3 million and \$21.8 million was actually expended for the years then ended. Additionally, the Foundation spent \$1.5 million during the year ended June 30, 2005 of funds made available from previous years' endowment spending budgets.

At June 30, 2006 the historic dollar value of certain endowment funds exceeded market value by an aggregate of approximately \$67,000. As of June 30, 2005 there were no endowments with historic dollar value in excess of market value.

The Foundation maintains the Grawemeyer Fund separate from the Combined Endowment Fund. The Grawemeyer awards are monetary awards for distinguished achievements in the areas of music, religion, education, psychology and world order. These awards, which are paid from accumulated earnings, amount in total to \$200,000 each, payable over five years.

At June 30, 2006, the Foundation had the following commitments under contracts with private equity investment managers to fund capital calls. These capital calls will occur over the term of the respective agreements, which is generally a four-year period (in thousands):

	<u>Total Commitment</u>	<u>Contributed to Date</u>	<u>Remaining Commitment</u>
Endowment Venture Partners III, LP	\$ 7,715	\$ 7,638	\$ 77
Endowment Venture Partners IV, LP	10,000	9,325	675
Endowment Venture Partners V, LP	4,400	3,494	906
Endowment Private Equity Partners IV, LP	5,000	4,555	445
Capital Venture Partners VI, LP	2,100	819	1,281
Capital Private Equity Partners V, LP	3,000	1,402	1,598
Chrysalis Ventures II, LP	2,500	2,012	488
Lone Star	10,000	9,523	477
Triathlon Medical Ventures	2,500	731	1,769
International Private Equity V, LP	3,000	264	2,736
Private Equity Partners VI	3,000	173	2,827
Endowment Venture Partners VII	2,000	86	1,914
Kentucky Seed Fund	1,000	315	685
Crow Holdings Realty Partners IV	5,000	412	4,588
EnCap Oil & Gas	2,800	-	2,800
	<u>\$ 64,015</u>	<u>\$ 40,749</u>	<u>\$ 23,266</u>

5. Funds Held in Trust by Others

The Foundation has been designated by the University as the income beneficiary of various trusts and financial entities which are held and controlled by others. One of these is a perpetual and irrevocable trust known as the University of Louisville Trust (Trust). It was created in 1983 to receive, administer, and invest assets which result from gifts to the Trust. The market value of the Trust was approximately \$18.4 million and \$18.3 million as of June 30, 2006 and 2005, respectively. The Foundation's portion of the market value of the remaining trusts was approximately \$26.0 million and \$26.7 million as of June 30, 2006 and 2005, respectively. These funds are invested in various equities and income producing assets. For the years ended June 30, 2006 and 2005, the Foundation received income of approximately \$1.2 million and \$1.4 million, respectively, from these trusts. These receipts are included in endowment income.

6. Restricted investments

Restricted investments consist of U.S. Government Securities of approximately \$7.3 million and \$4.3 million at June 30, 2006 and 2005, respectively. These investments are restricted by bond indenture for payment of debt service, and repairs and replacement.

7. Capital assets, net

Capital assets, as of June 30, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Residence halls:		
Buildings	\$ 35,633	\$ 35,550
Furniture and fixtures	2,566	2,518
Construction in process	12,595	-
Accumulated depreciation	<u>(5,025)</u>	<u>(3,782)</u>
Net	<u>45,769</u>	<u>34,286</u>
Other:		
Land	821	821
Buildings	4,266	4,266
Other plant assets	9,018	7,576
Accumulated depreciation	<u>(5,346)</u>	<u>(4,282)</u>
Net	<u>8,759</u>	<u>8,381</u>
Total - net	<u>\$ 54,528</u>	<u>\$ 42,667</u>

Pursuant to the lease agreement, ULH agreed to pay the University of Louisville annual ground rental equal to available excess cash flow, as defined in the agreement. For the years ended June 30, 2006 and 2005, ULH recognized ground rental expense of approximately \$225,000 and \$500,000, respectively, which is included in accounts payable at June 30, 2006 and 2005, respectively.

8. Funds Held in Trust for Others

The Foundation is the custodian of funds owned by the Association. The Association is a separate corporation organized for the purpose of promoting the intercollegiate athletic activities of the University. The Foundation serves in an agency capacity and invests funds on behalf of the Association based on a formal trust agreement. As of June 30, 2006 and 2005, the Foundation held approximately \$34.5 million and \$33.3 million, respectively, for the Association's investment purposes.

During the year ended June 30, 2004 the Foundation entered into an agreement with the University Medical Center (UMC) whereby the Foundation will serve in an agency capacity to invest funds on behalf of the UMC. The UMC is a separate corporation organized for the purpose of providing clinical services, instruction, and research activities for University faculty and students. As of June 30, 2006 and 2005, the Foundation held approximately \$2.0 million and \$1.3 million, respectively, for the UMC's investment purposes.

During the year ended June 30, 2005, the Foundation entered into an agreement with Jewish Hospital whereby the Foundation will serve in an agency capacity to invest funds on behalf of Jewish Hospital. Jewish Hospital is a separate corporation organized for the purpose of providing healthcare services. As of June 30, 2006 and 2005, the Foundation held approximately \$9.6 million and \$8.9 million, respectively, for Jewish Hospital's investment purposes.

The Foundation, acting in an agent capacity, does not reflect earnings on investments held in trust for others as these earnings are distributed to the owners of the funds.

9. Bonds Payable

Bonds payable were issued by ULH and consist of the following at June 30, 2006 and 2005 (in thousands):

	<u>Description</u>	<u>Year of Maturity</u>	<u>2006</u>	<u>2005</u>
Series 2001A (non taxable)	Principal payments of \$115 to \$2,935 are due annually beginning 9/1/02 through maturity, and interest is due monthly at variable rates up to 12% (3.99% and 2.30% as of June 30, 2006 and 2005, respectively)	2029	\$ 23,485	\$ 23,735
Series 2002A (non taxable)	Principal payments of \$25 to \$985 are due annually beginning 7/1/05 through maturity, and interest is due monthly at variable rates up to 12% (3.99% and 2.30% as of June 30, 2006 and 2005, respectively)	2032	14,110	14,135
Series 2002B (non taxable)	Principal payments of \$70 to \$100 are due annually beginning 7/1/04 through maturity, and interest is due monthly at variable rates up to 12% (5.96% and 3.84% as of June 30, 2006 and 2005, respectively)	2007	180	255
Series 2005A (non taxable)	Principal payments of \$270 to \$1,060 are due annually beginning 6/1/16 through maturity, and interest is due monthly at fixed rates from 4% to 5%.	Ranging from 2016 to 2035	13,910	-
Series 2005B (taxable)	Principal payments of \$55 to \$390 are due annually beginning 6/1/07 through maturity, and interest is due monthly at a fixed rate of 4.91%.	2016	2,115	-
Total bonds payable			<u>53,800</u>	<u>38,125</u>
Less unamortized premium and discount			<u>(252)</u>	<u>(396)</u>
Bonds payable, net			<u>\$ 53,548</u>	<u>\$ 37,729</u>

The bonds of ULH are secured by a letter of credit and the guaranty of the Foundation. Amounts payable under the guaranty are limited to \$30.0 million in total, and the lesser of (1) \$1.5 million or (2) annual debt service, annually.

Principal payments on the above obligations due in the next five years and thereafter are as follows (in thousands):

For the Year Ended June 30,	Principal Due
2007	\$ 510
2008	665
2009	765
2010	905
2011	1,055
Thereafter	49,900
Total	<u>\$ 53,800</u>

10. Derivative financial instruments (in thousands)

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, ULH entered into interest rate swap agreements for a portion of its floating rate debt. Under the agreements, ULH pays or receives the net interest amount monthly, with the monthly settlements included in interest expense. The agreements are recorded at their fair value with subsequent changes in fair value included in change in fair value of swap agreements in nonoperating (expenses) revenues.

ULH has a swap agreement whereby ULH pays a fixed interest rate of 3.60% on notional amounts of \$14,110 and \$14,135 as of June 30, 2006 and 2005, respectively, in exchange for receiving payments based on a floating interest rate tied to the Municipal Bond Association Index. The floating rate is reset on a weekly basis. The market value of this agreement was approximately \$40 and (\$167) at June 30, 2006 and 2005, respectively, and is included in other assets in 2006 and in other liabilities in 2005 on the statements of financial position. This agreement terminates on July 2, 2007.

ULH also has two swap agreements whereby ULH pays a fixed interest rate of 3.88% and 3.66%, equally divided on notional amounts of \$23,485 and \$23,735 as of June 30, 2006 and 2005, respectively, in exchange for receiving payments based on a floating interest rate tied to the Municipal Bond Association Index. The floating rate is reset on a weekly basis. The market values of these agreements were approximately (\$11) and (\$304) at June 30, 2006 and 2005, respectively, and are included in other assets in 2006 and in other liabilities in 2005 on the statements of financial position. These agreements terminate on September 1, 2006.

11. Other Liabilities

Other liabilities, as of June 30, 2006 and 2005 are as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Payments to unitrusts and annuitants	\$ 6,001	\$ 6,103
Grawemeyer awards	1,664	1,714
Interest rate swap agreements	-	471
Deferred compensation	1,555	64
Miscellaneous	358	314
Asset retirement obligation	285	-
Total	<u>\$ 9,863</u>	<u>\$ 8,666</u>

12. Annuities and Trusts Payable

The Foundation has been the recipient of several gift annuities which require future payments to the donor or their named beneficiaries. The assets received from the donor are recorded at fair value. The Foundation has recorded a liability at June 30, 2006 and 2005 of approximately \$2,186,000 and \$1,794,000, respectively, which represents the present value of the future annuity obligations. The liability has been determined using discounts rates ranging from 3.40 % to 7.78%.

The Foundation administers various charitable remainder trusts. A charitable remainder trust provides for the payment of distributions to the grantor or other designated beneficiaries over the trust's term (usually the designated beneficiary's lifetime). At the end of the trust's term, the remaining assets are available for the Foundation's use. The portion of the trusts attributable to the future interest of the Foundation is recorded in the consolidated statements of activities as temporarily restricted contributions in the period the trust is established. Assets held in the charitable remainder trusts are recorded at fair value in the Foundation's consolidated statements of financial position. On an annual basis, the Foundation revalues the liability to make distributions to the designated beneficiaries based on actuarial assumptions. The present value of the estimated future payments is calculated using discount rates ranging from 4.65% to 8.75%, a rate of return of 8.0%, and applicable mortality tables.

13. Research Challenge Trust Fund

The Research Challenge Trust Fund (RCTF) was created with the passage of the Postsecondary Education Improvement Act of 1997 (HB 1). The objectives of RCTF stated in the bill are to, among other things, support efforts by the University to become a premier, nationally recognized metropolitan university. During the 1998 session of the Kentucky General Assembly, a \$100 million (\$33.3 million to the University) endowment was appropriated from the General Fund Surplus Expenditure Plan of House Bill 321 in support of the research universities' (i.e. the University and other state supported colleges and universities) missions.

The University irrevocably contributed these RCTF funds to the Foundation although earnings from these funds are designated for the University in perpetuity.

State government will provide endowment funds with the provision that the universities match them dollar-for-dollar with donations received to establish endowments for research activities.

14. Expenses

Expenses by natural classification for the years ended June 30, 2006 and 2005 were approximately (in thousands):

	<u>2006</u>	<u>2005</u>
Personal service costs	\$ 27,332	\$ 23,069
Services	23,644	19,763
Equipment repairs	1,131	1,130
Supplies	2,495	2,010
Payments to annuitants	507	1,103
Depreciation and amortization (including depreciation on buildings held as investments)	2,771	2,559
Contributions to various University departments	3,194	2,625
	<u>\$ 61,074</u>	<u>\$ 52,259</u>

15. Fund Raising Expenses

Fund raising expenses were approximately \$3.5 million and \$3.2 million for the years ended June 30, 2006 and 2005, respectively.

16. Louisville Medical Center Development Corporation

The Board authorized the Foundation to assist the Louisville Medical Center Development Corporation (LMCDC) in its efforts to establish a biomedical research park in the vicinity of the University Health Sciences Center campus. The Foundation authorized its President to execute a bank letter of credit guarantee of up to \$1,666,667 towards one-third of the purchase of the LMCDC research park property. Jewish Hospital HealthCare Services and Norton Healthcare have authorized similar letters of credit as security for the remaining two-thirds of the cost of the property.

LMCDC is a not-for-profit corporation formed in 1999 by the City of Louisville, Jewish Hospital HealthCare Services, Norton Healthcare and the University to promote economic growth in the biomedical sector. LMCDC's mission to foster research entails the purchase of real property for lease to businesses related to medicine.

In addition to the Foundation's security interest in one-third of the unencumbered value of the property, the Foundation has the option to purchase a one-third interest in the property prior to any claim being made under the letter of credit for an amount not to exceed the Foundation's guarantee. In the event of purchase, the Foundation would not expect to incur any additional costs other than disposal of the property. The University, as a member organization of LMCDC, is committed to pay its share of the annual interest expense on the debt associated with a letter of credit from its operating funds or its share of revenue from the activities of LMCDC.

17. Net Assets

Net assets of the Foundation are segregated into classes of unrestricted, temporarily restricted, and permanently restricted assets. The following describes the functional classifications of temporarily and permanently restricted net assets as to purpose based upon the intent of donors (in thousands) as of June 30, 2006 and 2005:

June 30, 2006:

	Temporarily Restricted	Permanently Restricted	Total
Instruction	\$ 11,546	\$ 73,658	\$ 85,204
Research	-	80,062	80,062
Public service	-	2,108	2,108
Academic support	181	65,506	65,687
Student services	-	23	23
Institutional support	36,252	3,589	39,841
Scholarships/fellowships	-	79,895	79,895
Auxiliary operations & other	-	4,233	4,233
Total	<u>\$ 47,979</u>	<u>\$ 309,074</u>	<u>\$ 357,053</u>

June 30, 2005:

	Temporarily Restricted	Permanently Restricted	Total
Instruction	\$ 10,955	\$ 79,809	\$ 90,764
Research	-	54,695	54,695
Public service	-	2,049	2,049
Academic support	215	58,959	59,174
Student services	-	179	179
Institutional support	33,618	3,530	37,148
Scholarships/fellowships	-	71,620	71,620
Auxiliary operations & other	194	4,027	4,221
Total	<u>\$ 44,982</u>	<u>\$ 274,868</u>	<u>\$ 319,850</u>

Donor imposed restrictions expired on temporarily restricted net assets during the years ended June 30, 2006 and 2005 as follows (in thousands):

	<u>2006</u>	<u>2005</u>
Temporarily restricted contributions for:		
Research	\$ 639	\$ 566
Academic support	276	293
Scholarships/fellowships	1,054	1,168
Payments to annuitants	<u>507</u>	<u>1,103</u>
Total net assets released from restrictions	<u>\$ 2,476</u>	<u>\$ 3,130</u>

18. Commitments

At June 30, 2006, the Foundation had approximately \$0.5 million in encumbrances outstanding for future expenditures.

19. Disclosures about Fair Value of Financial Instruments

The following methods were used to estimate the fair value of financial instruments.

Fair value is the estimated amount at which financial assets or liabilities could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Because no market exists for certain of these financial instruments and because management does not intend to sell these financial instruments, the Foundation does not know whether the fair values shown represent values at which the respective financial instruments could be sold individually or in the aggregate.

Investments:

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

Contributions receivable:

Carrying amount is a reasonable estimate of fair value.

Bonds payable and interest rate swap agreements:

Fair value is estimated by a third party.

Funds held in trust for others:

Carrying amount approximates fair value.

Annuities and trusts payable:

Fair values of the annuity and trust obligations are based on a calculation of discounted cash flows of the annuity payments under such obligations.