

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

**Accountants' Report and Consolidated Financial Statements**

**June 30, 2008 and 2007**

## University of Louisville Foundation, Inc. and Affiliates

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## Independent Accountants' Report

Board of Directors  
University of Louisville Foundation, Inc.  
and Affiliates  
Louisville, Kentucky

We have audited the accompanying consolidated statements of financial position of the University of Louisville Foundation, Inc. and Affiliates (Foundation) as of June 30, 2008 and 2007, 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 consolidated 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 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*BKD, LLP*

October 3, 2008

**University of Louisville Foundation, Inc. and Affiliates**  
**Consolidated Statements of Financial Position**  
**June 30, 2008 and 2007**  
(In Thousands)

	<b>2008</b>	<b>2007</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 7,611	\$ 20,072
Accounts, notes, and accrued interest receivable	8,306	4,345
Loan receivable from the University of Louisville Athletic Association, Inc.	3,205	3,705
Prepaid expenses and other	1,840	1,332
Contributions receivable	24,708	30,589
Due from University of Louisville	-	1,751
Investments	714,988	800,362
Restricted cash	81,036	5,848
Funds held in trust by others	46,822	48,800
Restricted investments	5,023	4,759
Other assets	366	2
Capital assets, net	55,649	57,157
Total assets	\$ 949,554	\$ 978,722
 <b>LIABILITIES AND NET ASSETS</b>		
Liabilities:		
Accounts payable	\$ 4,527	\$ 3,776
Funds held in trust for others	58,554	57,515
Bonds payable	52,391	53,105
Other	11,297	11,093
Due to University of Louisville	8,819	-
Total liabilities	135,588	125,489
Net assets:		
Unrestricted:		
Unrestricted - designated	418,874	457,470
Unrestricted - undesignated	18,930	22,184
Total unrestricted	437,804	479,654
Temporarily restricted	35,373	43,854
Permanently restricted	340,789	329,725
Total net assets	813,966	853,233
Total liabilities and net assets	\$ 949,554	\$ 978,722

See notes to consolidated financial statements

**University of Louisville Foundation, Inc. and Affiliates**  
**Consolidated Statements of Activities**  
**Years Ended June 30, 2008 and 2007**  
(In Thousands)

	<u>Unrestricted</u>		<u>Temporarily restricted</u>		<u>Permanently restricted</u>		<u>Totals</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
<b>REVENUES, GAINS AND OTHER SUPPORT</b>								
Gifts	\$ 21,559	\$ 17,451	\$ 2,880	\$ 710	\$ 9,629	\$ 13,837	\$ 34,068	\$ 31,998
Research Challenge Trust Fund	-	-	-	-	2,154	1,100	2,154	1,100
Investment income	2,849	2,922	-	-	-	-	2,849	2,922
Endowment income	10,543	12,232	507	411	3	-	11,053	12,643
Net realized and unrealized gain/(loss) on investments	(15,274)	105,808	(3,093)	5,813	(1,978)	4,393	(20,345)	116,014
Residence hall income	6,166	5,742	-	-	-	-	6,166	5,742
Change in fair value of interest rate swap agreements	(2)	(27)	-	-	-	-	(2)	(27)
Other	2,349	1,820	-	6	-	-	2,349	1,826
Net assets released from restrictions:								
Satisfaction of program restrictions	1,429	2,166	(1,429)	(2,166)	-	-	-	-
Reclassifications	(926)	(821)	(330)	(500)	1,256	1,321	-	-
Expiration of time restrictions	7,016	8,399	(7,016)	(8,399)	-	-	-	-
Total revenues, gains and other support	<u>35,709</u>	<u>155,692</u>	<u>(8,481)</u>	<u>(4,125)</u>	<u>11,064</u>	<u>20,651</u>	<u>38,292</u>	<u>172,218</u>
<b>EXPENSES</b>								
Contributions to various University of Louisville departments	2,067	3,064	-	-	-	-	2,067	3,064
Payments on behalf of the University of Louisville for:								
Instruction	4,451	3,507	-	-	-	-	4,451	3,507
Research	18,704	16,978	-	-	-	-	18,704	16,978
Public service	2,367	1,371	-	-	-	-	2,367	1,371
Academic support	12,452	11,274	-	-	-	-	12,452	11,274
Student services	229	113	-	-	-	-	229	113
Institutional support	10,796	7,297	-	-	-	-	10,796	7,297
Operation and maintenance of plant	3,488	631	-	-	-	-	3,488	631
Scholarships/fellowships	6,947	6,287	-	-	-	-	6,947	6,287
Payments to annuitants and present value adjustment	1,126	864	-	-	-	-	1,126	864
Interest expense	1,852	2,440	-	-	-	-	1,852	2,440
Residence hall operations, including depreciation	5,560	4,918	-	-	-	-	5,560	4,918
General and administrative, including fundraising	7,520	4,929	-	-	-	-	7,520	4,929
Total expenses	<u>77,559</u>	<u>63,673</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>77,559</u>	<u>63,673</u>
Net change in assets	<u>(41,850)</u>	<u>92,019</u>	<u>(8,481)</u>	<u>(4,125)</u>	<u>11,064</u>	<u>20,651</u>	<u>(39,267)</u>	<u>108,545</u>
<b>Net assets at beginning of year</b>	<u>479,654</u>	<u>387,635</u>	<u>43,854</u>	<u>47,979</u>	<u>329,725</u>	<u>309,074</u>	<u>853,233</u>	<u>744,688</u>
<b>Net assets at end of year</b>	<u>\$ 437,804</u>	<u>\$ 479,654</u>	<u>\$ 35,373</u>	<u>\$ 43,854</u>	<u>\$ 340,789</u>	<u>\$ 329,725</u>	<u>\$ 813,966</u>	<u>\$ 853,233</u>

See notes to consolidated financial statements

**University of Louisville Foundation, Inc. and Affiliates**  
**Consolidated Statements of Cash Flows**  
**Years Ended June 30, 2008 and 2007**  
**(In Thousands)**

	<u>2008</u>	<u>2007</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
(Decrease)/increase in net assets	\$ (39,267)	\$ 108,545
Adjustments to reconcile (decrease)/increase in net assets to net cash (used in)/provided by operating activities:		
Net realized and unrealized loss/(gain) on investments	20,345	(116,014)
Depreciation and amortization expense	3,720	3,496
Change in fair value of interest rate swap agreements	2	27
Loss on disposals of capital assets	24	34
Transfer of capital assets to affiliates	44	45
Contributions restricted for long-term investment	(11,783)	(14,938)
Net (deductions) additions to annuitant & unitrust funds	1,636	(93)
Change in present value of annuitant & unitrust payments	(510)	851
Change in assets and liabilities:		
Accounts, notes, and accrued interest receivable	(3,961)	4,057
Prepaid expenses	(554)	(111)
Contributions receivable	5,881	7,536
Other assets	(366)	-
Accounts payable	751	(262)
Funds held in trust for others	1,039	11,370
Other liabilities	(24)	1,080
Due to/from University of Louisville	10,570	(1,684)
Net cash (used in)/provided by operating activities	<u>(12,453)</u>	<u>3,939</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of investments	(248,283)	(107,730)
Sales of investments	315,025	110,068
Purchases of capital assets	(2,227)	(6,124)
Payments received on loan receivable from University of Louisville Athletic Association, Inc.	500	500
Net cash provided by/(used in) investing activities	<u>65,015</u>	<u>(3,286)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from contributions restricted for investment in endowment	11,783	14,938
Payments to annuitants	(898)	(608)
Principal payments of bonds payable	(720)	(455)
Payment of bond issuance costs	-	(187)
Net cash provided by financing activities	<u>10,165</u>	<u>13,688</u>
Net increase in cash and cash equivalents	62,727	14,341
Cash and cash equivalents at beginning of year	25,920	11,579
Cash and cash equivalents at end of year	<u>\$ 88,647</u>	<u>\$ 25,920</u>
Supplemental cash flow data:		
Cash paid for interest	<u>\$ 1,856</u>	<u>\$ 2,467</u>

See notes to consolidated financial statements

## University of Louisville Foundation, Inc. and Affiliates

### Notes to Consolidated Financial Statements

June 30, 2008 and 2007

#### 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., ULH, Inc. (ULH), University Holdings, Inc. (UHI), University of Louisville Development Corporation, LLC (ULDC), Nucleus: Kentucky's Life Science and Innovation Center, LLC (Nucleus), and AAF-Louisville, LLC (AAF) (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. The Foundation is presented in the financial statements of the University as a discretely presented component unit.

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.

UHI (originally named Cardinal Real Estate, Inc.) is a non-stock, non-profit corporation created in September 2007 for the benefit of and to carry out the purposes of the University of Louisville Foundation, Inc. UHI provides oversight and management support to various affiliated entities. UHI is affiliated with the University of Louisville Foundation, Inc. through certain common management and directors.

ULDC is a limited liability company created in September 2007, whose sole member is the University of Louisville Foundation, Inc., to develop and manage the real estate operations of the Shelby Campus of the University. UHI is the Manager of ULDC.

Nucleus Healthcare, LLC was formed in February 2008 and subsequently renamed Nucleus: Kentucky's Life Sciences and Innovation Center, LLC (Nucleus). The University of Louisville Foundation, Inc. is the sole member of the corporation and UHI is the Manager. Nucleus had no activity during the fiscal year ended June 30, 2008.

AAF was formed in February 2008, with the University of Louisville Foundation, Inc. as its sole member and UHI as its Manager. AAF had no activity during the fiscal year ended June 20, 2008.

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, 2008 and 2007, cash equivalents consisted primarily of money market funds.

The Foundation currently uses commercial banks as its depository. Deposits with commercial banks exceeding Federal depository insurance approximate \$3.9 million.

c. Restricted Cash

The Foundation classifies all cash held by investment managers of the Combined Endowment Fund as restricted cash. The majority of this cash typically results from the liquidation of investments due to a change in investment managers and is reinvested within seven days. Other amounts result from the receipt of new endowment gifts or cash distributions from the investments and are reinvested in accordance with the investment policy.

d. 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.

e. 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) with subsequent changes in fair value included in earnings in the accompanying statements of activities.

f. 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.

The Foundation has elected to capitalize collections which include art, rare books, photographs, letters, journals, manuscripts, and musical instruments. These items are capitalized at cost, or if a gift, at the fair market value on the date of the gift.

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.

g. 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.

h. 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.

i. Unrestricted Bequests

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

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 those changes could materially affect the amounts reported in the consolidated financial statements.

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 \$870,000 and \$299,000 of in-kind gifts for the years ended June 30, 2008 and 2007, 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 2007 consolidated financial statements to conform to the 2008 presentation. These reclassifications had no effect on the change in total net assets.

o. Tax Status

The University of Louisville Foundation, Inc. and ULH have received favorable determination letters from the Internal Revenue Service exempting them from federal income taxes under §501(c)(3) of the Internal Revenue Code and a similar provision of state law. UHI is a non-profit corporation, while no tax determination request has been filed; one is expected to be filed within the applicable period.

ULDC, Nucleus, and AAF are single-member limited liability corporations of the Foundation, who are considered disregarded entities for tax purposes.

2. Due from/to the University

In accordance with the Foundation's agency agreement with the University, the University receives and disburses monies on behalf of the Foundation. The net amount of these receipts and disbursements is recorded as a due to or from the University in the statements of financial position. Generally, the receivable or payable is cleared within the subsequent month; however, no formal agreement governs the time period in which payments are to be made.

Additionally, in July 2001, the University of Louisville Athletic Association, Inc. (Association) obtained a \$347,000 unsecured, non-interest bearing loan from the Foundation for the refurbishing of the Cardinal Basketball offices. The outstanding loan balance is approximately \$316,000 for each of the years ended June 30, 2008 and 2007 and is included in Due to the University and Due from the University, respectively.

3. Loan Receivable from the Association

In January, 1999, the Foundation made an \$8.5 million dollar unsecured, non-interest bearing loan to the Association for the construction of Cardinal Park, due upon collection of contributions. The Association's intent is to repay the \$8.5 million loan with future contributions and gifts. During the year ended June 30, 2008, the Association repaid \$500,000 leaving an outstanding loan balance of approximately \$3.2 million as of June 30, 2008.

4. Loan Receivable from Louisville Medical Center Development Corporation

In June 2008, the Foundation purchased the promissory note dated June 18, 2003 between the Louisville Medical Center Development Corporation (LMCDC) and A. Thomas & Sons Meat Company, LLC. The outstanding amount of the promissory note at the time of purchase was \$4.5 million. The principal is due upon demand and interest payments are required quarterly at the rate of 6 percent per annum. During the year ended June 30, 2008, LMCDC made a principal payment of \$0.8 million, leaving an outstanding balance of \$3.7 million, which is included in Accounts, notes, and accrued interest receivable.

5. Contributions Receivable

Contributions receivable are discounted, using rates on risk-free obligations ranging from 1.2% to 5.9% for 2008 and 2007. Contributions receivable, which are all temporarily restricted, as of June 30, 2008 and 2007 are as follows (in thousands):

	<u>2008</u>	<u>2007</u>
Less than one year	\$ 12,131	\$ 16,810
One to four years	16,691	14,332
Greater than four years	7,394	5,679
Allowance for doubtful accounts	(8,482)	(3,648)
Unamortized discount	(3,026)	(2,584)
Net contributions receivable	<u>\$ 24,708</u>	<u>\$ 30,589</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, 2008 and 2007 the approximate fair market value of these conditional gifts is as follows (in thousands):

	<u>2008</u>	<u>2007</u>
Bequests	\$ 58,697	\$ 46,017
Other	9,744	3,996
Total	<u>\$ 68,441</u>	<u>\$ 50,013</u>

6. Investments and Investment Income

Investments as of June 30, 2008 and 2007 are as follows (in thousands):

	<u>2008</u>	<u>2007</u>
Preferred and common stock	\$ 142,477	\$ 253,488
Corporate bonds	25,273	15,826
Mutual funds	322,235	347,029
Real estate	11,654	15,238
Investment in partnerships	78,861	77,526
U.S. government securities	21,027	31,547
Land and buildings	1,606	1,670
Marketable alternatives	111,251	57,434
Annuities	604	604
Total investments	<u>\$ 714,988</u>	<u>\$ 800,362</u>

The Foundation invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the investment amounts reported in the statements of financial position.

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 -1.4% and 18.9% in 2008 and 2007, 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 July 2008, the Board of Trustees approved a resolution to include an additional 1.0% assessment for development, alumni relations, and support services.

The amount available for spending under the policy was approximately \$32.0 million and \$27.5 million for the years ended June 30, 2008 and 2007, respectively, of which approximately \$21.5 million and \$22.5 million was actually expended for the years then ended.

At June 30, 2008 and 2007 the historic dollar value of certain endowment funds exceeded market value by an aggregate of approximately \$234,000 and \$2,000, respectively.

At June 30, 2008, the Foundation had the following commitments under contracts with limited partnership 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):

	<b>Total Commitment</b>	<b>Contributed to Date</b>	<b>Remaining Commitment</b>
Endowment Private Equity Partner IV	\$ 5,000	\$ 4,855	\$ 145
Endowment Venture Partners III, LP	7,715	7,638	77
Endowment Venture Partners IV, LP	10,000	9,700	300
Endowment Venture Partners V, LP	4,400	4,088	312
Capital Venture Partners VI, LP	2,100	1,538	562
Capital Private Equity Partners V, LP	3,000	2,475	525
Chrysalis Ventures II, LP	2,500	2,418	82
Triathlon Medical Ventures	2,500	1,247	1,253
International Private Equity V, LP	3,000	1,871	1,129
Private Equity Partners VI	3,000	1,508	1,492
Capital Venture Partners VII	2,000	866	1,134
KY Seed Fund	1,000	431	569
Chrysalis Ventures III, LP	2,500	1,531	969
Capital Int'l Partners VI, LP	3,000	368	2,632
Private Equity Partners VII	4,000	294	3,706
Capital Venture Partners VIII, LP	3,000	233	2,767
Capital South Fund III	2,500	877	1,623
Asia Alternatives Capital Ptnrs II	5,000	71	4,929
Crow Holdings Realty Partners IV	5,000	3,347	1,653
Crow Holdings Realty Partners V	5,000	-	5,000
EnCap Oil & Gas	2,790	1,266	1,524
Enervest Energy XI-B	3,000	1,047	1,953
Lone Star	10,000	9,523	477
Värde Partners IX, LP	5,000	2,000	3,000
Lone Star VI	10,000	1,883	8,117
Lone Star Real Estate	5,000	-	5,000
	<u>\$ 112,005</u>	<u>\$ 61,075</u>	<u>\$ 50,930</u>

7. 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 \$19.2 million and \$20.8 million as of June 30, 2008 and 2007, respectively. The Foundation's portion of the market value of the remaining trusts was approximately \$27.7 million and \$28.0 million as of June 30, 2008 and 2007, respectively. These funds are invested in various equities and income producing assets. For the years ended June 30, 2008 and 2007, the Foundation received income of approximately \$1.8 million and \$1.4 million, respectively, from these trusts. These receipts are included in endowment income.

8. Restricted Investments

Restricted investments consist of U.S. Government Securities of approximately \$5.0 million and \$4.8 million at June 30, 2008 and 2007, respectively. These investments are restricted by bond indenture for payment of debt service, and repairs and replacement.

9. Capital Assets

Capital assets as of June 30, 2008 and 2007 are as follows (in thousands):

	<u>2008</u>	<u>2007</u>
Residence halls:		
Buildings	\$ 50,437	\$ 50,318
Furniture and fixtures	3,310	3,265
Construction in process	26	16
Accumulated depreciation	<u>(8,785)</u>	<u>(6,859)</u>
Net	<u>44,988</u>	<u>46,740</u>
Other:		
Land	971	971
Buildings	4,866	4,866
Other plant assets	13,412	11,448
Construction in process	-	14
Accumulated depreciation	<u>(8,588)</u>	<u>(6,882)</u>
Net	<u>10,661</u>	<u>10,417</u>
Total - net	<u>\$ 55,649</u>	<u>\$ 57,157</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, 2008 and 2007, ULH recognized ground rental expense of approximately \$758,000 and \$389,000, respectively.

#### 10. 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, 2008 and 2007, the Foundation held approximately \$39.2 million and \$38.7 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, 2008 and 2007, the Foundation held approximately \$3.8 million and \$3.1 million, respectively, for the UMC's investment purposes.

During the year ended June 30, 2005, the Foundation entered into an agreement with Jewish Hospital & St. Mary's Healthcare, Inc. (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, 2008 and 2007, the Foundation held approximately \$11.1 million and \$11.4 million, respectively, for Jewish Hospital's investment purposes.

During the year ended June 30, 2007, the Foundation entered into an agreement with the University of Louisville Research Foundation, Inc. on behalf of the School of Dentistry, whereby the Foundation will serve in an agency capacity to invest funds on behalf of the University of Louisville Research Foundation, Inc. As of June 30, 2008 and 2007, the Foundation held approximately \$4.5 million and \$4.3 million, respectively, for the University of Louisville Research Foundation, Inc.'s investment purposes.

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

## 11. Bonds Payable

Bonds payable were issued by ULH and consist of the following at June 30, 2008 and 2007 (in thousands):

	<u>Description</u>	<u>Year of Maturity</u>	<u>2008</u>	<u>2007</u>
Series 2001A (non taxable)	Variable rate demand bonds with 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% (1.59% and 3.75% as of June 30, 2008 and 2007, respectively)	2029	\$ 22,760	\$ 23,160
Series 2002A (non taxable)	Variable rate demand bonds with 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% (1.55% and 3.75% as of June 30, 2008 and 2007, respectively)	2032	14,000	14,060
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% (5.47% as of June 30, 2007)	2007	-	100
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	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	1,955	2,115
Total bonds payable			<u>52,625</u>	<u>53,345</u>
Less unamortized premium and discount			<u>(234)</u>	<u>(240)</u>
Bonds payable, net			<u>\$ 52,391</u>	<u>\$ 53,105</u>

The Foundation, as guarantor of the ULH debt, has a \$24.6 million letter of credit and a \$14.7 million letter of credit securing all principal and interest payments on the Series 2001 and 2002 bonds payable. The provisions of the letters of credit require that, should the bonds fail to be remarketed, and therefore, the letter of credit is drawn upon, such amounts drawn against the letter of credit will be due in sixty equal monthly installments beginning ninety days after the draw.

Amounts payable under the guaranty are limited as follows (in thousands):

<u>Residence Hall</u>	<u>Aggregate limit</u>	<u>Annual limit</u>
Bettie Johnson Hall	\$ 30,000	Lesser of \$1.5 million, or annual debt service.
Kurz Hall	14,460	\$ 1,037
Community Park	31,308	1,121

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

<u>For the Year Ended June 30,</u>	<u>Principal Due</u>
2009	\$ 765
2010	905
2011	1,055
2012	1,165
2013	1,275
Thereafter	47,460
Total	<u>\$ 52,625</u>

## 12. Derivative Financial Instruments

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 paid or received the net interest amount monthly, with the monthly settlements included in interest expense. The agreements were recorded at their fair value with subsequent changes in fair value included in change in fair value of swap agreements in revenues, gains, and other support.

ULH had a swap agreement whereby ULH paid a fixed interest rate of 3.60% on a notional amount of \$14.1 million as of June 30, 2007 in exchange for receiving payments based on a floating interest rate tied to the Municipal Bond Association Index. The floating rate was reset on a weekly basis. The market value of this agreement was approximately \$2,000 at June 30, 2007 and is included in other assets on the statements of financial position. This agreement terminated on July 2, 2007.

### 13. Other Liabilities

Other liabilities, as of June 30, 2008 and 2007 are as follows (in thousands):

	<u>2008</u>	<u>2007</u>
Payments to unitrusts and annuitants	\$ 6,375	\$ 6,148
Grawemeyer awards	1,894	1,816
Deferred compensation	2,297	2,207
Miscellaneous	446	637
Asset retirement obligation	285	285
Total	<u>\$ 11,297</u>	<u>\$ 11,093</u>

### 14. 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, 2008 and 2007 of approximately \$1.7 million and \$2.0 million, 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 Foundation has recorded a liability at June 30, 2008 and 2007 of approximately \$4.7 million and \$4.2 million, respectively, which represents the present value of the future obligations. The liability has been determined using discount rates ranging from 4.10% to 8.75%, a rate of return of 8.0%, and applicable mortality tables.

### 15. 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.

## 16. Expenses

Expenses by natural classification for the years ended June 30, 2008 and 2007 were approximately (in thousands):

	<u>2008</u>	<u>2007</u>
Personal service costs	\$ 33,059	\$ 26,014
Services	31,655	24,622
Equipment repairs	1,610	1,271
Supplies	2,375	1,770
Payments to annuitants	1,126	863
Depreciation and amortization (including depreciation on buildings held as investments)	3,815	3,629
Interest	1,852	2,440
Contributions to various University departments	2,067	3,064
	<u>\$ 77,559</u>	<u>\$ 63,673</u>

## 17. Fund Raising Expenses

Fund raising expenses were approximately \$6.5 million and \$4.6 million for the years ended June 30, 2008 and 2007, respectively.

## 18. Louisville Medical Center Development Corporation

The Board authorized the Foundation to assist LMCDC in its efforts to establish a biomedical research park in the vicinity of the University Health Sciences Center campus.

LMCDC is a not-for-profit corporation formed in 1999 by the City of Louisville, Jewish Hospital, Norton Healthcare, Inc. (Norton), University Medical Center, Inc. (UMC) and the University to promote economic growth in the biomedical sector. On July 1, 2007, Norton and Jewish Hospital withdrew as members of LMCDC, leaving the University and UMC as the sole members. LMCDC's mission to foster research entails the purchase of real property for lease to businesses related to medicine.

In connection with the reorganization, Norton and Jewish Hospital have been released from their guaranties of LMCDC's obligations under the Credit Agreement, and, pursuant to the Amended and Restated Guaranty Agreement dated July 1, 2007, the Foundation has become the sole guarantor of such obligations, up to \$5.0 million. The Foundation's guaranty expires July 15, 2009.

In addition to the Foundation's security interest in the unencumbered value of the property, the Foundation has the option to purchase 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.

19. 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, 2008 and 2007:

June 30, 2008:

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>
Instruction	\$ 980	\$ 71,565
Research	401	91,424
Public service	-	2,051
Academic support	371	72,032
Student services	-	22
Institutional support	24,609	3,630
Scholarships/fellowships	9,012	95,788
Auxiliary operations & other	-	4,277
Total	<u>\$ 35,373</u>	<u>\$ 340,789</u>

June 30, 2007:

	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>
Instruction	\$ 951	\$ 71,092
Research	-	86,569
Public service	-	2,032
Academic support	310	67,231
Student services	-	22
Institutional support	31,194	3,594
Scholarships/fellowships	11,399	94,962
Auxiliary operations & other	-	4,223
Total	<u>\$ 43,854</u>	<u>\$ 329,725</u>

Donor imposed restrictions expired on temporarily restricted net assets during the years ended June 30, 2008 and 2007 as follows (in thousands):

	<b>2008</b>	<b>2007</b>
Temporarily restricted contributions for:		
Research	\$ 185	\$ 774
Academic support	486	525
Scholarships/fellowships	767	867
Payments to annuitants	1,126	864
Net decrease in contributions receivable	5,881	7,535
Total net assets released from restrictions	<u>\$ 8,445</u>	<u>\$ 10,565</u>

## 20. Commitments and Contingencies

### a. Commitments

At June 30, 2008, the Foundation had approximately \$921,000 in encumbrances outstanding for future expenditures.

### b. Loan Guarantees

During the fiscal year ended June 30, 2008, the Foundation became the guarantor on two construction loans for University affiliated student organizations. If the student organization does not meet their scheduled payments, the Foundation could be called upon to make the payments, as well as collection expenses and costs. The total amount approved for loans was approximately \$1.0 million, with \$0.8 million outstanding, as of June 30, 2008.

### c. Lease Guarantees

In December 2006, the Foundation became the guarantor of payments due to University Faculty Office Building, LLC (UFOB) under the Master Lease agreement between the Medical School Practice Association, Inc. (MSPA) and UFOB. The Foundation has guaranteed the full and prompt payment of all amounts due to UFOB including any damages for default and payments to reimburse UFOB for any costs and expenses incurred by UFOB to cure any default by MSPA. The initial lease term is 15 years, beginning in July 2008, the commencement date of the term of the lease. The annual lease payments due from MSPA to UFOB are approximately \$3.5 million, with an annual inflation of 3 percent. The lease payments commenced in July 2008.

## 21. Disclosures about Fair Value of Financial Instruments

The Foundation records financial instruments at their fair value, which approximates carrying value (except bonds payable, as discussed below). The following methods were used to estimate fair value of the 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.

#### Accounts receivables:

Carrying amount is a reasonable estimate of fair value.

#### Bonds payable and interest rate swap agreements:

Fair value is estimated by a third party based on the borrowing rates currently available to the Foundation for debt with similar terms and maturities. The following table presents

estimated fair values and carrying values of the Foundation's bonds payable at June 30, 2008 and 2007 (in thousands):

	<u>2008</u>	<u>2007</u>
Carrying Value	52,391	53,105
Fair Value	52,391	52,870

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.

## 22. Subsequent Events

### a. Metro Government Mortgage Revenue Refunding and Improvement Bonds Series 2008

In July 2008, the Louisville Metro Government issued \$39.8 million of Mortgage Revenue Bonds 2008 Series A and \$43.5 million of Mortgage Revenue Bonds 2008 Series B (Mortgage Revenue Bonds) at a combined net interest cost of 4.2 percent, the proceeds of which were loaned to the Association. The bond proceeds were used on September 1, 2008 to retire the Association's outstanding County of Jefferson Kentucky Government Lease Revenue Bonds, Series 1997, the proceeds of which financed the acquisition, construction, installation and equipping of the sports stadium known as University of Louisville Papa John's Cardinal Stadium (Stadium). Excess funds will be used to finance a portion of the costs of acquisition, construction, installation and equipping of an expansion to the Stadium.

The Foundation is the guarantor of the Mortgage Revenue Bonds, and as such has agreed to maintain a balance of available cash sufficient enough to cover the next debt service payment. In exchange for the Foundation's willingness to serve as guarantor the Association has agreed to pay the Foundation a credit enhancement fee and to exonerate and indemnify the Foundation from all liability in connection with the Mortgage Revenue Bonds, the obligations of the Association under the Loan Agreement and Mortgage, and any and all payments made by the Foundation as guarantor.

### b. Central Station

In July 2008, the Foundation purchased a building, a portion of which is leased by the Association, from Central Station, LLC for \$7.6 million. The purchase was financed with a \$6.0 million mortgage and \$1.6 million cash. Building space is subleased to several corporations, including the University and Association.

### c. Louisville Medical Center Development Corporation

In September 2008, the LMCDC Board of Directors amended the Articles of Incorporation to reflect the assignment of the University's interest as a Member of LMCDC to the Foundation, leaving the Foundation and the UMC as the two Members. Additionally, the Board of Directors authorized the transfer of substantially all assets and liabilities of LMCDC to the Foundation, and then subsequently to the Foundation's affiliate, Nucleus. This transfer has not yet taken place.

d. Bond Remarket Failure

In September 2008, approximately \$4.8 million of the Series 2001 bonds payable failed to remarket and the amounts were drawn against the letter of credit. The Foundation is required to make interest payments on the letter of credit of prime plus 3%, 8% as of September 2008. If these bonds fail to remarket, the principal is due in sixty monthly installments beginning ninety days after the date of failure.