

ULH, Inc.

Accountants' Report and Financial Statements

June 30, 2006 and 2005

ULH, Inc.

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Independent Accountants' Report

Board of Trustees
ULH, Inc.
Louisville, Kentucky

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Organization 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.

BKD, LLP

September 22, 2006

ULH, Inc.

Statements of Financial Position

June 30, 2006 and 2005

(In Thousands)

	<u>2006</u>	<u>2005</u>
ASSETS		
Cash	\$ 458	\$ 383
Accounts receivable	152	89
Restricted investments	7,337	4,285
Prepaid expenses and other	1,004	795
Other assets	29	-
Capital assets, net	45,769	34,286
Total assets	<u>\$ 54,749</u>	<u>\$ 39,838</u>
LIABILITIES AND DEFICIENCY IN NET ASSETS		
Liabilities:		
Accounts payable	\$ 2,790	\$ 3,433
Bonds payable	53,548	37,729
Other liabilities	358	786
Total liabilities	56,696	41,948
Deficiency in net assets	(1,947)	(2,110)
Total liabilities and deficiency in net assets	<u>\$ 54,749</u>	<u>\$ 39,838</u>

See notes to financial statements

ULH, Inc.

Statements of Activities

Years Ended June 30, 2006 and 2005

(In Thousands)

	<u>2006</u>	<u>2005</u>
REVENUES		
Residence hall income	\$ 4,278	\$ 4,194
Other	428	400
Total revenues	<u>4,706</u>	<u>4,594</u>
OPERATING EXPENSES		
Residence hall operations (including depreciation)	3,125	3,281
General and administrative	385	460
Total operating expenses	<u>3,510</u>	<u>3,741</u>
Operating income	<u>1,196</u>	<u>853</u>
NONOPERATING (EXPENSES)/REVENUES		
Interest expense	(1,801)	(1,792)
Change in fair value of interest rate swap agreements	500	666
Other nonoperating (expense) revenue	(13)	6
Transfers from University of Louisville	281	260
Total nonoperating (expenses)/revenues	<u>(1,033)</u>	<u>(860)</u>
Change in net assets	163	(7)
Deficiency in net assets at beginning of year	<u>(2,110)</u>	<u>(2,103)</u>
Deficiency in net assets at end of year	<u>\$ (1,947)</u>	<u>\$ (2,110)</u>

See notes to financial statements

ULH, Inc.

Statements of Cash Flows

Years Ended June 30, 2006 and 2005

(In Thousands)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ 163	\$ (7)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization expense	1,305	1,244
Change in fair value of interest rate swap agreements	(500)	(666)
Loss on disposals of capital assets	13	-
Change in assets and liabilities:		
Accounts receivable	(63)	17
Prepaid expenses and other	(20)	70
Accounts payable	(643)	(535)
Other liabilities	43	(38)
Net cash provided by operating activities	298	85
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(53,162)	(8,987)
Sales of investments	50,110	9,376
Purchase of capital assets	(12,763)	(198)
Proceeds from disposals of capital assets	2	-
Net cash provided by (used in) investing activities	(15,813)	191
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of bonds payable	16,166	-
Principal payments of bonds payable	(350)	(265)
Payment of bond issue costs	(226)	-
Net cash provided by (used in) financing activities	15,590	(265)
Net increase in cash and cash equivalents	75	11
Cash and cash equivalents at beginning of year	383	372
Cash and cash equivalents at end of year	\$ 458	\$ 383
Supplemental information:		
Cash paid for interest (net of amount capitalized)	\$ 2,347	\$ 1,759

See notes to financial statements

ULH, Inc.

Notes to Financial Statements

June 30, 2006 and 2005

1. Organization and Summary of Significant Accounting Policies

a. Organization

ULH, Inc. (ULH) (a Kentucky not-for-profit corporation) is affiliated with the University of Louisville Foundation, Inc. (Foundation) through a common board of directors and certain common management.

ULH's purpose is to (a) lease and/or acquire and operate university housing projects and issue revenue bonds for university housing, and (b) receive and dispose of or retain gifts of real estate independent of the Foundation.

b. Investments

Investments consist of U.S. Treasury money market and time deposits and are stated at estimated market value.

Market value of restricted investments was 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.

c. 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.

d. Capital assets

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

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>

e. Tax status

ULH 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.

f. 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.

g. Functional allocation of expenses

The costs of supporting the residence hall operations have been summarized on a functional basis in the statements of activities. Certain costs have been allocated among the residence hall operations and general and administrative categories based on actual expenses and other methods.

h. Reclassifications

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

2. 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	2,519
Construction in process	12,595	-
Accumulated depreciation	<u>(5,025)</u>	<u>(3,783)</u>
Total - net	<u>\$ 45,769</u>	<u>\$ 34,286</u>

Pursuant to a 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.

3. Bonds Payable

Bonds payable 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 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 will be due in the next five years and thereafter 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>

4. 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.

5. 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, ULH does not know whether the fair values shown represent values at which the respective financial instruments could be sold individually or in the aggregate.

Restricted investments:

Fair value is based on quoted market prices.

Accounts receivable:

The carrying amount is a reasonable estimate of fair value.

Bonds payable:

Fair value is estimated based on the borrowing rates currently available to ULH for debt with similar terms and maturities.

Interest rate swap agreement:

The fair value is estimated by a third party.

The following table presents estimated fair values of ULH's financial instruments at June 30, 2006 and 2005 (in thousands).

	2006		2005	
	<u>Carrying value</u>	<u>Fair value</u>	<u>Carrying value</u>	<u>Fair value</u>
Financial assets:				
Cash	458	458	383	383
Accounts receivable	152	152	89	89
Restricted investments	7,337	7,337	4,285	4,285
Financial liabilities:				
Bonds payable	53,548	53,220	37,729	37,729
Interest rate swaps	29	29	(471)	(471)