

ULH, Inc.

Accountants' Report and Financial Statements

June 30, 2010 and 2009

ULH, Inc.

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Independent Accountants' Report

Board of Directors
ULH, Inc.
Louisville, Kentucky

We have audited the accompanying statements of financial position of ULH, Inc. (ULH) as of June 30, 2010 and 2009, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of ULH'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 ULH as of June 30, 2010 and 2009, 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 27, 2010

ULH, Inc.

Statements of Financial Position

June 30, 2010 and 2009

(In Thousands)

	<u>2010</u>	<u>2009</u>
ASSETS		
Cash	\$ 770	\$ 625
Accounts receivable, less allowance for doubtful accounts of \$14 in 2010 and \$6 in 2009	293	309
Restricted investments	5,557	5,570
Prepaid expenses and other	1,179	1,495
Capital assets, net	<u>42,237</u>	<u>43,582</u>
Total assets	<u>\$ 50,036</u>	<u>\$ 51,581</u>
 LIABILITIES AND DEFICIENCY IN NET ASSETS		
Liabilities		
Accounts payable and accrued liabilities	\$ 2,909	\$ 3,120
Other liabilities	337	538
Bonds payable	<u>51,558</u>	<u>52,128</u>
Total liabilities	54,804	55,786
Deficiency in net assets	<u>(4,768)</u>	<u>(4,205)</u>
Total liabilities and deficiency in net assets	<u>\$ 50,036</u>	<u>\$ 51,581</u>

See notes to the financial statements

ULH, Inc.

Statements of Activities

Years Ended June 30, 2010 and 2009

(In Thousands)

	<u>2010</u>	<u>2009</u>
REVENUES		
Residence hall income	\$ 6,599	\$ 6,353
Other revenue	843	955
Total revenues	<u>7,442</u>	<u>7,308</u>
OPERATING EXPENSES		
Residence hall operations (including depreciation)	6,198	5,461
General and administrative	555	908
Total operating expenses	<u>6,753</u>	<u>6,369</u>
Operating income	<u>689</u>	<u>939</u>
NONOPERATING (EXPENSES)/REVENUES		
Interest expense	(1,475)	(1,493)
Other nonoperating expense	(67)	(52)
Transfers from University of Louisville Foundation, Inc.	290	150
Total nonoperating expenses	<u>(1,252)</u>	<u>(1,395)</u>
Change in net assets	(563)	(456)
Deficiency in net assets at beginning of year	<u>(4,205)</u>	<u>(3,749)</u>
Deficiency in net assets at end of year	<u>\$ (4,768)</u>	<u>\$ (4,205)</u>

See notes to the financial statements

ULH, Inc.

Statements of Cash Flows

Years Ended June 30, 2010 and 2009

(In Thousands)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ (563)	\$ (456)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization expense	1,814	1,858
Loss on bond defeasance	921	-
Loss on disposals of capital assets	5	4
Change in assets and liabilities:		
Accounts receivable	16	(68)
Prepaid expenses and other	4	25
Accounts payable and accrued liabilities	(211)	322
Other liabilities	(201)	95
Net cash provided by operating activities	1,785	1,780
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(43,218)	(37,354)
Sales of investments	43,231	36,807
Purchase of capital assets	(431)	(403)
Net cash used in investing activities	(418)	(950)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of bonds payable	35,844	-
Principal payments of bonds payable	(36,395)	(765)
Payment of bond issue costs	(671)	-
Net cash used in financing activities	(1,222)	(765)
Net increase in cash	145	65
Cash at beginning of year	625	560
Cash at end of year	\$ 770	\$ 625
Supplemental information:		
Cash paid for interest	\$ 1,123	\$ 1,508

See notes to the financial statements

ULH, Inc.

Notes to Financial Statements

June 30, 2010 and 2009

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. Cash

The financial institutions holding ULH's cash accounts are participating in the Federal Deposit Insurance Corporation's (FDIC) Transaction Account Guarantee Program. Under that program, through December 31, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Effective December 31, 2010 through December 31, 2012, deposits held in all noninterest-bearing transaction accounts will be fully insured, regardless of the amount in the account, at all FDIC-insured institutions.

c. Accounts Receivable

Accounts receivable consists of rental charges to tenants and other organizations that have functions hosted at a property. Accounts receivable is recorded net of estimated uncollectible amounts.

d. Investments

Investments consist of money market accounts, agency securities and a guaranteed investment contract. The investments are stated at fair market value, with the exception of the guaranteed investment contract, which is stated at cost, which approximates estimated market value.

These investments are restricted by bond indenture for payment of debt service, and repairs and replacement.

e. 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. During the years ended June 30, 2010 and 2009, ULH did not capitalize any interest.

f. 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. However, ULH is subject to federal income tax on any unrelated business taxable income.

ULH files tax returns in the U.S. federal jurisdiction. With a few exceptions, ULH is no longer subject to U.S. federal examination by tax authorities prior to fiscal year 2007.

g. Uncertain Tax Positions

Financial Accounting Standards Board (FASB) issued ASC Topic 740 – Income Taxes (Topic 740), which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken in a tax return. ULH adopted Topic 740 on July 1, 2009. The adoption of Topic 740 did not result in an adjustment to the financial statements.

h. 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.

i. 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.

j. Subsequent Events

Subsequent events have been evaluated through September 27, 2010, which is the date the financial statements were available to be issued.

k. Reclassifications

Certain reclassifications have been made to the 2009 financial statements to conform to the 2010 financial statement presentation. These reclassifications had no effect on the change in net assets.

2. Investments and Investment Return

Investments at June 30, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u>
U.S. treasury money market	\$ 1,681	\$ 2,736
Money market mutual funds	2,609	-
U.S. agency obligations	309	1,682
Guaranteed investment contracts	958	1,152
	<u>\$ 5,557</u>	<u>\$ 5,570</u>

Total investment return is comprised of the following, and is included in other revenue in the statement of activities for the years ended June 20, 2010 and 2009 (in thousands):

	<u>2010</u>	<u>2009</u>
Interest and dividend income	\$ 157	\$ 180

3. Disclosures about Fair Value of Assets

ASC Topic 20, Fair Value Measurements (Topic 820) defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Following is a description of the inputs and valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying statements of financial position, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include U.S. Treasury money market accounts and money market mutual funds. If quoted market prices are not available, then fair values are estimated by a third party pricing service using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S.

agency obligations. The Level 2 securities are based on quoted market prices of similar securities within an active market. ULH does not have any Level 3 securities

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying statements of financial position measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2010 and 2009 (in thousands):

	2010		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Investments			
U.S. Treasury money market	\$ 1,681	\$ 1,681	
Money market mutual funds	2,609	2,609	
U.S. agency obligations	309	-	\$ 309
	2009		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Investments			
U.S. Treasury money market	\$ 2,736	\$ 2,736	
U.S. agency obligations	1,682	-	\$ 1,682

4. Capital Assets

Capital assets as of June 30, 2010 and 2009 are as follows (in thousands):

	2010	2009
Residence halls:		
Buildings	\$ 50,734	\$ 50,629
Furniture and fixtures	3,586	3,460
Construction in process	211	83
Accumulated depreciation	(12,294)	(10,590)
Total - net	<u>\$ 42,237</u>	<u>\$ 43,582</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, 2010 and 2009, ULH recognized ground rental expense of approximately \$555,000 and \$908,000, respectively. At June 30, 2010 and 2009, the amount outstanding to the University of Louisville

related to the ground leases was approximately \$785,000 and \$928,000, respectively, and is included in accounts payable and accrued liabilities in the statements of financial position.

5. Bonds Payable

Bonds payable consist of the following at June 30, 2010 and 2009 (in thousands):

	<u>Description</u>	<u>Year of Maturity</u>	<u>2010</u>	<u>2009</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%	N/A		\$ 22,295
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%	N/A		13,835
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	\$ 13,815	13,910
Series 2005B (taxable)	Principal payments of \$170 to \$390 are due annually beginning 6/1/07 through maturity, and interest is due monthly at a fixed rate of 4.91%.	2016	1,650	1,820
Series 2009A (non taxable)	Principal payments of \$305 to \$2,610 are due annually beginning 10/01/10 through maturity, and interest is due semi-annually at fixed rates from 2% to 4.5%.	Ranging from 2011 to 2033	13,660	-
Series 2010A (non taxable)	Principal payments of \$765 to \$2,815 are due annually beginning 10/1/10 through maturity, and interest is due semi-annually at a fixed rates from 2.0% to 4.4%	Ranging from 2011 to 2030	22,020	-
Total bonds payable			<u>51,145</u>	<u>51,860</u>
Plus unamortized premium			413	268
Bonds payable, net			<u>\$ 51,558</u>	<u>\$ 52,128</u>

The outstanding debt of ULH is secured by mortgages on the respective properties and is guaranteed by the Foundation. 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	\$ 32,455	\$ 2,938
Kurz Hall	\$ 21,367	\$ 955
Community Park	\$ 31,308	\$ 1,121

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

<u>For the Year Ended June 30,</u>	<u>Principal Due</u>
2011	\$ 1,280
2012	1,370
2013	1,445
2014	1,560
2015	1,665
Thereafter	43,825
Total	<u>\$ 51,145</u>

During the fiscal year ended June 30, 2010, ULH issued Student Housing Industrial Building Refunding Revenue Bonds, Series 2009A and Student Housing Industrial Building Refunding Revenue Bonds, Series 2010A to advance refunding on the outstanding Variable Rate Demand Student Housing Industrial Building Revenue Bonds, Series 2001A and Variable Rate Demand Student Housing Industrial Building Revenue Bonds, Series 2002A. A loss on defeasance of approximately \$921,000 resulted from the advance refunding and is included in residence hall operations expense on the statement of activities for the year ended June 30, 2010.

6. Risks and Uncertainties

a. Current Economic Conditions

The current protracted economic decline continues to present not-for profit organizations with difficult circumstances and challenges, which in some cases have resulted in large declines in the fair value of investments and other assets, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to ULH.

In addition, given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values that could negatively impact ULH's ability to meet debt covenants or maintain sufficient liquidity.