

ULH, Inc.

Accountants' Report and Financial Statements

June 30, 2009 and 2008

ULH, Inc.

Table of Contents:

	Page
Independent Accountants' Report.....	1
Statements of Financial Position.....	2
Statements of Activities.....	3
Statements of Cash Flows.....	4
Notes to Financial Statements.....	5

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, 2009 and 2008, 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, 2009 and 2008, and the changes in its net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, in 2009 ULH changed its method of accounting for fair value measurements in accordance with Statement of Financial Accounting Standards Statement No. 157.

BKD, LLP

September 30, 2009

ULH, Inc.

Statements of Financial Position

June 30, 2009 and 2008

(In Thousands)

	<u>2009</u>	<u>2008</u>
ASSETS		
Cash	\$ 625	\$ 560
Accounts receivable, less allowance for doubtful accounts of \$6 in 2009 and \$23 in 2008	309	241
Restricted investments	5,570	5,023
Prepaid expenses and other	1,495	1,588
Capital assets, net	<u>43,582</u>	<u>44,988</u>
Total assets	<u>\$ 51,581</u>	<u>\$ 52,400</u>
 LIABILITIES AND DEFICIENCY IN NET ASSETS		
Liabilities		
Accounts payable and accrued liabilities	\$ 3,120	\$ 2,798
Bonds payable	52,128	52,908
Other liabilities	<u>538</u>	<u>443</u>
Total liabilities	55,786	56,149
Deficiency in net assets	<u>(4,205)</u>	<u>(3,749)</u>
Total liabilities and deficiency in net assets	<u>\$ 51,581</u>	<u>\$ 52,400</u>

See notes to the financial statements

ULH, Inc.

Statements of Activities

Years Ended June 30, 2009 and 2008

(In Thousands)

	<u>2009</u>	<u>2008</u>
REVENUES		
Residence hall income	\$ 6,373	\$ 6,166
Other revenue	955	945
Total revenues	<u>7,328</u>	<u>7,111</u>
OPERATING EXPENSES		
Residence hall operations (including depreciation)	5,461	5,486
General and administrative	928	695
Total operating expenses	<u>6,389</u>	<u>6,181</u>
Operating income	939	930
NONOPERATING (EXPENSES)/REVENUES		
Interest expense	(1,493)	(1,853)
Change in fair value of interest rate swap agreements	-	(2)
Other nonoperating (expense)/revenue	(52)	(74)
Transfers from University of Louisville Foundation, Inc.	150	150
Total nonoperating expenses	<u>(1,395)</u>	<u>(1,779)</u>
Change in net assets	(456)	(849)
Deficiency in net assets at beginning of year	<u>(3,749)</u>	<u>(2,900)</u>
Deficiency in net assets at end of year	<u>\$ (4,205)</u>	<u>\$ (3,749)</u>

See notes to the financial statements

ULH, Inc.

Statements of Cash Flows

Years Ended June 30, 2009 and 2008

(In Thousands)

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	\$ (456)	\$ (849)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization expense	1,858	1,979
Change in fair value of interest rate swap agreements	-	2
Loss on disposals of capital assets	4	-
Change in assets and liabilities:		
Accounts receivable	(68)	111
Prepaid expenses and other	25	5
Accounts payable and accrued liabilities	322	126
Other liabilities	95	(194)
Net cash provided by operating activities	1,780	1,180
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(37,354)	(21,443)
Sales of investments	36,807	21,179
Purchase of capital assets	(403)	(175)
Net cash used in investing activities	(950)	(439)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments of bonds payable	(765)	(720)
Net cash used in financing activities	(765)	(720)
Net increase in cash	65	21
Cash at beginning of year	560	539
Cash at end of year	\$ 625	\$ 560
Supplemental information:		
Cash paid for interest	\$ 1,508	\$ 1,856

See notes to the financial statements

ULH, Inc.

Notes to Financial Statements

June 30, 2009 and 2008

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 FDIC's Transaction Account Guarantee Program. Under that program, through June 30, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account.

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. During the years ended June 30, 2009 and 2007, these investments earned approximately \$180,000 and \$233,000, respectively, in interest, which is included in other revenue in the 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 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, 2009 and 2008, 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.

In accordance with Financial Accounting Standards Board (FASB) Staff Position No. FIN 48-3, ULH has elected to defer the effective date of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, until its fiscal year ended June 30, 2010. ULH has continued to account for any uncertain tax position in accordance with literature that was authoritative immediately prior to the effective date of FIN 48, such as FASB Statement No. 109, *Accounting for Income Taxes*, and FASB Statement No. 5, *Accounting for Contingencies*.

g. 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.

h. 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.

i. Subsequent Events

Subsequent events have been evaluated through September 30, 2009, which is the date the financial statements were available to be issued.

j. Reclassifications

Certain reclassifications have been made to the 2008 financial statements to conform to the 2009 financial statement presentation. These reclassifications had no effect on the change in net assets.

2. Disclosures about Fair Value of Assets

Effective July 1, 2008, ULH adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 has been applied prospectively as of the beginning of the year.

FAS 157 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. FAS 157 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. 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 balance sheets measured at fair value on a recurring basis and the level within the FAS 157 fair value hierarchy in which the fair value measurements fall at June 30, 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

3. Capital Assets

Capital assets as of June 30, 2009 and 2008 are as follows (in thousands):

	<u>2009</u>	<u>2008</u>
Residence halls:		
Buildings	\$ 50,629	\$ 50,437
Furniture and fixtures	3,460	3,310
Construction in process	83	26
Accumulated depreciation	<u>(10,590)</u>	<u>(8,785)</u>
Total - net	<u>\$ 43,582</u>	<u>\$ 44,988</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, 2009 and 2008, ULH recognized ground rental expense of approximately \$928,000 and \$758,000, respectively. At June 30, 2009 and 2008, the amount outstanding to the University of Louisville related to the ground leases was approximately \$928,000 and \$488,000, respectively, and is included in accounts payable and accrued liabilities in the statements of financial position.

4. Bonds Payable

Bonds payable consist of the following at June 30, 2009 and 2008 (in thousands):

	<u>Description</u>	<u>Year of Maturity</u>	<u>2009</u>	<u>2008</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% (0.31% and 1.59% as of June 30, 2009 and 2008, respectively)	2029	\$ 22,295	\$ 22,760
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% (3.10% and 1.55% as of June 30, 2009 and 2008, respectively)	2032	13,835	14,000
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	1,820	1,955
Total bonds payable			<u>51,860</u>	<u>52,625</u>
Less unamortized premium			<u>268</u>	<u>283</u>
Bonds payable, net			<u>\$ 52,128</u>	<u>\$ 52,908</u>

The Foundation is the guarantor for the outstanding debt of ULH. The Foundation 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):

Residence Hall	Aggregate limit	Annual limit
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 will be due in the next five years and thereafter as follows (in thousands):

For the Year Ended June 30,	Principal Due
2010	\$ 905
2011	1,055
2012	1,165
2013	1,275
2014	1,410
Thereafter	46,318
Total	\$ 52,128

5. Risks and Uncertainties

a. Current Economic Conditions

The current economic environment presents not-for profit organizations with unprecedented 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.

b. Bonds Payable Subject to Remarketing Agreements

The Foundation is subject to remarketing agreements associated with the ULH bonds payable. The bonds are backed by letters of credit which contain provisions for draws upon remarketing failures. The 2001 and 2002 series bonds had remarketing failures during the year ended June 30, 2009; however, these bonds were successfully remarketed as of June 30, 2009.

Due to the uncertainty in the credit markets and the financial strength of the bank issuing the letter of credit, it is a least reasonably possible that the cost of borrowing to ULH will increase and the potential for ongoing failed remarketings will continue.