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INNOVATIVE STUDENT FACILITIES, INC.

RUSTON, LOUISIANA

JUNE 30, 2006 AND 2005

HEARD
McELROY
& VESTAL
LLP
CERTIFIED PUBLIC ACCOUNTANTS

INNOVATIVE STUDENT FACILITIES, INC.

RUSTON, LOUISIANA

JUNE 30, 2006 AND 2005

INNOVATIVE STUDENT FACILITIES, INC.

RUSTON, LOUISIANA

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AUDITED FINANCIAL STATEMENTS

HEARD
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August 8, 2006

The Board of Directors
Innovative Student Facilities, Inc.
Ruston, Louisiana

Independent Auditors' Report

We have audited the statements of financial position of Innovative Student Facilities, Inc. at 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 Innovative Student Facilities' 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 Innovative Student Facilities, Inc. at 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 8, 2006, on our consideration of Innovative Student Facilities' internal control structure over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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INNOVATIVE STUDENT FACILITIES, INC.

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2006 AND 2005

ASSETS	2006	2005
Cash and cash equivalents-Note 2	2,431,635	1,977,541
Investments-Note 3	-	402,373
Accrued interest receivable	-	-
Construction in progress-Note 4	-	-
Property, plant, and equipment, net of accumulated depreciation-Note 5	19,080,394	19,593,917
Total assets	21,512,029	21,973,831
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable (construction cost and retainage)	-	412,090
Accrued interest payable	459,219	459,219
Bonds payable, net of discount-Note 6	21,447,251	21,432,706
Total liabilities	21,906,470	22,304,015
Net assets:		
Unrestricted	(601,026)	(330,184)
Temporarily restricted	206,585	-
Total net assets	(394,441)	(330,184)
Total liabilities and net assets	21,512,029	21,973,831

See accompanying notes to financial statements.

INNOVATIVE STUDENT FACILITIES, INC.

STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006		
	Unrestricted	Temporarily Restricted	Total
Revenue:			
Rent income	1,121,649	224,345	1,345,994
Investment income	61,324	-	61,324
Total revenue	1,182,973	224,345	1,407,318
Net assets released from restrictions	17,760	(17,760)	-
Expenses:			
Amortization of bond discount-Note 6	14,546	-	14,546
Depreciation expense	518,958	-	518,958
Interest expense	918,438	-	918,438
Maintenance expense	17,760	-	17,760
Bank fees	1,873	-	1,873
Total expenses	1,471,575	-	1,471,575
Change in net assets	(270,842)	206,585	(64,257)
Net assets at beginning of year	(330,184)	-	(330,184)
Net assets at end of year	(601,026)	206,585	(394,441)

See accompanying notes to financial statements.

2005		
Unrestricted	Temporarily Restricted	Total
457,138	-	457,138
-	-	-
457,138	-	457,138
-	-	-
14,546	-	14,546
299,011	-	299,011
459,219	-	459,219
-	-	-
-	-	-
772,776	-	772,776
(315,638)	-	(315,638)
(14,546)	-	(14,546)
(330,184)	-	(330,184)

INNOVATIVE STUDENT FACILITIES, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006	2005
Cash flows from operating activities:		
Rent income	1,345,994	457,138
Investment income	61,324	-
Interest paid on bonds	(918,438)	(459,219)
Maintenance expense	(17,760)	-
Bank fees	(1,873)	-
Payment of construction cost and retainage	(412,090)	-
Net cash provided (used) by operating activities	57,157	(2,081)
Cash flows from investing activities:		
Capital expenditures	(5,436)	(8,501,163)
Net sale (purchase) of investments	402,373	9,125,308
Interest received on investments (capitalized)	-	153,111
Interest paid on bonds (capitalized)	-	(459,219)
Net cash provided by investing activities	396,937	318,037
Cash flows from financing activities:		
Proceeds from bond issuance	-	-
Net cash provided by financing activities	-	-
Net increase in cash and cash equivalents	454,094	315,956
Cash and cash equivalents-beginning of year	1,977,541	1,661,585
Cash and cash equivalents-end of year	2,431,635	1,977,541
Reconciliation of change in net assets to net cash provided by operating activities:		
Change in net assets	(64,257)	(315,638)
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Amortization of bond discount	14,546	14,546
Depreciation of property, plant, and equipment	518,958	299,011
(Decrease) in accounts payable	(412,090)	-
Net cash (used) by operating activities	57,157	(2,081)

See accompanying notes to financial statements.

1. Summary of Significant Accounting Policies

Nature of Activities

Innovative Student Facilities, Inc. (the "Corporation") was formed July 1, 2003 to acquire, construct, develop, manage, lease as lessor or lessee, mortgage and/or convey student housing and other facilities (the "Facilities") on the campus of Louisiana Tech University (the "University"). The construction project is funded by Louisiana Local Government Environmental Facilities and Community Development Authority (the "Authority") Revenue Bonds. The proceeds of the bonds have been loaned by the Authority to the Corporation pursuant to a Loan and Assignment Agreement dated July 1, 2003 and are to be used for (1) financing the cost of acquiring immovable property to be purchased by the Board; (2) financing a portion of the cost of the development, design, construction and equipping of the Facilities; (3) paying capitalized interest on the Bonds; (4) funding a debt service reserve fund; and (5) paying the costs of issuance of the Bonds, including the premium for the Financial Guaranty Insurance Policy.

The Corporation will lease the land upon which the Facilities will be constructed for $1 per year from the Board of Supervisors for the University of Louisiana System (the "Board") pursuant to the Ground Lease Agreement dated July 1, 2003. Upon completion of construction, the Board will lease back the Facilities from the Corporation pursuant to an Agreement to Lease with Option to Purchase (the "Facilities Lease") dated July 1, 2003. In accordance with the Facilities Lease, the Board, on behalf of the University, will pay Rental to the Corporation in an amount sufficient to pay debt service and related expenses on the Bonds. The Facilities Lease is a triple net lease and the Board agrees that the Rental shall be an absolute net return to the Corporation free and clear of any expenses, charges, taxes or set-offs whatsoever of any kind, character or nature; the Board shall bear responsibility for the payment of all costs and expenses associated with the ownership, operation and maintenance of the Facilities. Under no circumstances will the Corporation be required to make any payments on the Board's behalf or assume any monetary obligation of the Board under the Facilities Lease.

The Corporation is a nonprofit organization as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal and state income taxes.

Basis of Financial Statements

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of financial position and statement of activities for the period. Actual results could differ from those estimates.

Net assets, revenues, expenses, gains and losses are classified based upon the existence or absence of donor-imposed restrictions.

1. **<u>Summary of Significant Accounting Policies</u> (Continued)**

Cash Equivalents
For financial statement purposes, the Corporation considers all deposits in money market funds to be cash equivalents. Cash equivalents are stated at cost, which approximates market value.

Investments
Investments are composed of collateralized repurchase agreements and are carried at fair value. Unrealized gains and losses are included in the change in temporarily restricted net assets.

Investments consist of the following at June 30:

	2006	
	Cost	Fair Value
Repurchase agreements	-	-

	2005	
	Cost	Fair Value
Repurchase agreements	402,373	402,373

2. **<u>Cash and Cash Equivalents</u>**
Cash and cash equivalents consist of money market funds collateralized by U.S. Treasury securities in the amount of $2,431,635 at June 30, 2006 and $1,977,541 at June 30, 2005. Such money market funds are exposed to custodial credit risk because the money market funds are uninsured and collateralized with securities held by the trust department of J. P. Morgan Chase.

3. **<u>Investments</u>**
On July 1, 2003, the Louisiana Local Government Environmental Facilities and Community Development Authority issued its $21,840,000 Revenue Bonds, the proceeds of which were loaned to Innovative Student Facilities, Inc. Prior to expenditure by Innovative Student Facilities, $14,950,000 of the bond proceeds were invested pursuant to a repurchase agreement by and between Monumental Life Insurance Company (as seller) and J. P. Morgan Trust Company (as buyer and trustee for the bonds). The repurchase agreement was collateralized by treasury and agency securities held at Wells Fargo Bank Minnesota (as custodian). The balance at June 30, 2006 is $-0- and June 30, 2005 is $402,373.

4. **<u>Construction in Progress</u>**
Construction in progress consists of construction completed on the student apartment development. The new development consists of 448-bed apartment style development contained in 4 common areas. Each of the apartment style buildings is two or three stories. At least five percent (5%) of the total units are handicapped accessible. A total of 472 parking spaces are provided as part of the development. The on-campus site comprises approximately ten (10) acres.

The Corporation entered into a contract (the "Architecture Contract") with STBP Architects and ABW Architects (the "Architects") to provide for the design and engineering of the apartment development. Additionally, the Corporation entered into a contract (the "Construction Contract") with Lincoln Builders, Inc. (the "Builder") to provide for the construction of the apartment development.

4. Construction in Progress (Continued)

The Architecture Contract required the Architects to perform the design and engineering of the development as generally described in a master plan prepared for the Board. The Architects have worked concurrently with the Builder, the Corporation and the Corporation's Advisory Committee to design the development. Upon the Corporation's approval of the designed development, the Builder provided the Corporation with a guaranteed maximum price to construct the development including all fees for the Builder and its subcontractors. Construction of the development was completed in three phases–September 2004, December 2004 and April 2005.

All costs recorded in construction in progress are directly related to the construction of the apartment development. Therefore, the entire balance of construction in progress was transferred to property and equipment upon completion of construction in April 2005. Depreciation expense on these assets was $518,958 and $299,011 for the years ended June 30, 2006 and 2005, respectively. Capitalized interest costs included in construction in progress totaled $306,108 for the year ended June 30, 2005. This amount represents interest expense on the bonds before April 2005, which totaled $459,219 in 2005, offset by $153,111 in interest income earned on bond proceeds in the same year. No interest cost was capitalized for the year ended June 30, 2006. Total interest expense paid was $918,438 for the years ending June 30, 2006 and 2005. Of the 2005 amount, $459,219 was included in capitalized construction cost and $459,219 being expensed for the portion paid after construction was completed. There were no further commitments on construction contracts as of June 30, 2006.

5. Property, Plant and Equipment

Property, plant and equipment is depreciated using the straight-line method. Land improvements are depreciated over 20 years, buildings over 40 years, and furniture, fixtures, and equipment over 10 years. At June 30, 2006 and 2005, property, plant and equipment is comprised of the following:

	2006	2005
Land	951,774	951,774
Land improvements	117,700	115,200
Buildings	18,264,216	18,264,171
Furniture, fixtures, and equipment	564,673	561,783
Total	19,898,363	19,892,928
Less-accumulated depreciation	(817,969)	299,011
Net property, plant, and equipment	19,080,394	19,593,917

6. Bonds Payable

During 2003, Louisiana Local Government Environmental Facilities and Community Development Authority Revenue Bonds were issued for the purpose of providing funds to pay for the construction of the campus to be occupied by Louisiana Tech University. Following is a summary of bonds payable at June 30, 2006 and 2005:

	2006	2005
Louisiana Local Government Environmental Facilities and Community Development Authority Revenue Bonds, Series 2003 Serial Bonds, interest rates ranging from 2.0% to 3.575%, principal payments begin July 1, 2006, final maturity July 1, 2013.	2,780,000	2,780,000

6. Bonds Payable (Continued)

	2006	2005
Louisiana Local Government Environmental Facilities and Community Development Authority Revenue Bonds, Series 2003 Term Bonds, $1,045,000 bearing interest at 4.0% due July 1, 2015, $1,875,000 bearing interest at 4.0% due July 1, 2018, $4,200,000 bearing interest at 4.375% due July 1, 2023, $5,305,000 bearing interest at 4.5% due July 1, 2028, $6,635,000 bearing interest at 4.5% due July 1, 2033.	19,060,000	19,060,000
	21,840,000	21,840,000
Less-original issue discount	(392,749)	(407,294)
Total bonds payable	21,447,251	21,432,706

The 2003 bonds were issued at a discount of $436,386. This discount is being amortized over the life of the bonds on the straight-line basis. Amortization expense recorded in the statement of activities totaled $14,546 for the years ended June 30, 2006 and 2005.

The annual debt service requirements to maturity, including principal and interest, for bonds payable as of June 30, 2006 are as follows:

2006	918,438
2007	1,160,988
2008	1,180,500
2009	1,203,562
2010	1,224,918
2011	1,244,775
2012-2016	6,533,975
2017-2021	7,071,125
2022-2026	7,416,143
2027-2031	7,411,676
2032-2034	4,446,425
	39,812,525
Less-interest	(17,972,525)
Outstanding principal	21,840,000

Payments of scheduled principal and interest on the bonds, when due, is insured by Ambac Assurance Corporation.

7. Risks and Uncertainties

As discussed in Note 1, the Corporation is dependent upon the State Legislature appropriating funds to the Board sufficient to make payments of base rental to the Corporation.

OTHER REPORTS

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August 8, 2006

The Board of Directors
Innovative Student Facilities, Inc.
Ruston, Louisiana

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

We have audited the financial statements of Innovative Student Facilities, Inc. as of and for the years ended June 30, 2006 and 2005 and have issued our report thereon dated August 8, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered internal control over financial reporting of Innovative Student Facilities, Inc. in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the financial statements of Innovative Student Facilities, Inc. are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of management, the board of directors, and the State of Louisiana, and is not intended to be and should not be used by anyone other than these specified parties.

Heard, McElroy & Vestal, LLP

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INNOVATIVE STUDENT FACILITIES, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2006

We have audited the financial statements of Innovative Student Facilities, Inc. as of and for the year ended June 30, 2006, and have issued our report thereon dated August 8, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our audit of the financial statements as of June 30, 2006 resulted in an unqualified opinion.

Section I - Summary of Auditor's Reports

a. Report on Internal Control and Compliance Material to the Financial Statements

   Internal Control – No material weaknesses or reportable conditions were noted; no management letter was issued.

   Compliance – No material noncompliance was noted.

b. Federal Awards – Not applicable.

Section II - Financial Statement Findings

No matters were reported.

See accompanying notes to financial statements.

INNOVATIVE STUDENT FACILITIES, INC.

SCHEDULE OF PRIOR YEAR FINDINGS

FOR THE YEAR ENDED JUNE 30, 2006

No prior year findings were reported.

See accompanying notes to financial statements.