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INNOVATIVE STUDENT FACILITIES, INC.

RUSTON, LOUISIANA

JUNE 30, 2007 AND 2006

INNOVATIVE STUDENT FACILITIES, INC.

RUSTON, LOUISIANA

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AUDITED FINANCIAL STATEMENTS

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August 7, 2007

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, 2007 and 2006, 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, 2007 and 2006, 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 7, 2007, 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.

Heard, McElroy & Vestal, LLP

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INNOVATIVE STUDENT FACILITIES, INC.

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2007 AND 2006

ASSETS	2007	2006
Cash and cash equivalents-Note 2	2,554,751	2,431,635
Investments-Note 3	-	-
Construction in progress-Note 4	-	-
Property, plant, and equipment, net of accumulated depreciation-Note 5	18,561,436	19,080,394
Total assets	21,116,187	21,512,029
LIABILITIES AND NET ASSETS		
Liabilities:		
Accrued interest payable	456,769	459,219
Bonds payable, net of discount-Note 6	21,216,797	21,447,251
Total liabilities	21,673,566	21,906,470
Net assets (deficit):		
Unrestricted	(810,215)	(601,026)
Temporarily restricted	252,836	206,585
Total net assets (deficit)	(557,379)	(394,441)
Total liabilities and net assets	21,116,187	21,512,029

See accompanying notes to financial statements.

INNOVATIVE STUDENT FACILITIES, INC.

STATEMENTS OF ACTIVITIES

FOR THE YEARS ENDED JUNE 30, 2007 AND 2006

	2007		
	Unrestricted	Temporarily Restricted	Total
Revenue:			
Rent income	1,146,089	229,610	1,375,699
Investment income	94,431	-	94,431
Total revenue	1,240,520	229,610	1,470,130
Net assets released from restrictions	183,359	(183,359)	-
Expenses:			
Amortization of bond discount-Note 6	14,546	-	14,546
Depreciation expense	518,958	-	518,958
Interest expense	913,537	-	913,537
Maintenance expense	183,359	-	183,359
Bank fees	2,668	-	2,668
Total expenses	1,633,068	-	1,633,068
Change in net assets	(209,189)	46,251	(162,938)
Net assets (deficit) at beginning of year	(601,026)	206,585	(394,441)
Net assets (deficit) at end of year	(810,215)	252,836	(557,379)

See accompanying notes to financial statements.

2006		
Unrestricted	Temporarily Restricted	Total
1,121,649	224,345	1,345,994
61,324	-	61,324
1,182,973	224,345	1,407,318
17,760	(17,760)	-
14,546	-	14,546
518,958	-	518,958
918,438	-	918,438
17,760	-	17,760
1,873	-	1,873
1,471,575	-	1,471,575
(270,842)	206,585	(64,257)
(330,184)	-	(330,184)
(601,026)	206,585	(394,441)

INNOVATIVE STUDENT FACILITIES, INC.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 2007 AND 2006

	2007	2006
Cash flows from operating activities:		
Rent income	1,375,699	1,345,994
Investment income	94,431	61,324
Interest paid on bonds	(915,987)	(918,438)
Maintenance expense	(183,359)	(17,760)
Bank fees	(2,668)	(1,873)
Payment of construction cost and retainage	-	(412,090)
Net cash provided by operating activities	368,116	57,157
Cash flows from investing activities:		
Capital expenditures	-	(5,436)
Net sale (purchase) of investments	-	402,373
Net cash provided by investing activities	-	396,937
Cash flows from financing activities:		
Proceeds from bond issuance	-	-
Repayment of bonds payable	(245,000)	-
Net cash (used) by financing activities	(245,000)	-
Net increase in cash and cash equivalents	123,116	454,094
Cash and cash equivalents-beginning of year	2,431,635	1,977,541
Cash and cash equivalents-end of year	2,554,751	2,431,635
Reconciliation of change in net assets to net cash provided by operating activities:		
Change in net assets	(162,938)	(64,257)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Amortization of bond discount	14,546	14,546
Depreciation of property, plant, and equipment	518,958	518,958
(Decrease) in accounts payable	-	(412,090)
(Decrease) in accrued interest payable	(2,450)	-
Net cash provided by operating activities	368,116	57,157

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.

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 $2,554,752 at June 30, 2007 and $2,431,635 at June 30, 2006. 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, 2007 and 2006 is $-0-.

4. **<u>Construction in Progress</u>**
Construction in progress consisted 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.

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 for the years ended June 30, 2007 and 2006, 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 was $913,537 and $918,438 for the years ending June 30, 2007 and 2006. There were no further commitments on construction contracts as of June 30, 2007.

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, 2007 and 2006, property, plant and equipment is comprised of the following:

	2007	2006
Land	951,774	951,774
Land improvements	117,700	117,700
Buildings	18,264,216	18,264,216
Furniture, fixtures, and equipment	564,673	564,673
Total	19,898,363	19,898,363
Less-accumulated depreciation	(1,336,927)	(817,969)
Net property, plant, and equipment	18,561,436	19,080,394

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, 2007 and 2006:

	2007	2006
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.	2,535,000	2,780,000
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
	21,595,000	21,840,000
Less-original issue discount	(378,203)	(392,749)
Total bonds payable	21,216,797	21,447,251

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, 2007 and 2006.

The annual debt service requirements to maturity, including principal and interest, for bonds payable as of June 30, 2007 are as follows:

6. **Bonds Payable** **(Continued)**

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
	37,733,099
Less-interest	(16,138,099)
Outstanding principal	21,595,000

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.

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August 7, 2007

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, 2007 and 2006 and have issued our report thereon dated August 7, 2007. 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 the Innovative Student Facilities, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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Compliance and Other Matters
As part of obtaining reasonable assurance about whether the financial statements 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

INNOVATIVE STUDENT FACILITIES, INC.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

FOR THE YEAR ENDED JUNE 30, 2007

A. Summary of Audit Results

1. The auditor's report expresses an unqualified opinion on the basic financial statements of Innovative Student Facilities, Inc.

2. No reportable conditions relating to the audit of the basic financial statements are reported.

3. No instances of noncompliance material to the basic financial statements of Innovative Student Facilities, Inc. were disclosed during the audit.

4. Innovative Student Facilities, Inc. was not subject to a Federal Single Audit for the year ended June 30, 2007.

B. Findings - Financial Statement Audit

None

C. Findings and Questioned Costs - Major Federal Award Programs

Not applicable.

See accompanying notes to financial statements.

INNOVATIVE STUDENT FACILITIES, INC.

SCHEDULE OF PRIOR YEAR FINDINGS

FOR THE YEAR ENDED JUNE 30, 2007

No prior year findings or questioned costs were reported.

See accompanying notes to financial statements.