

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

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Report of Independent Auditors

The Audit Committee of the Board of Directors
University of Georgia Research
Foundation, Inc.
Athens, Georgia

We have audited the accompanying statement of net assets of University of Georgia Research Foundation, Inc., (the "Research Foundation"), a discretely presented component unit of the University of Georgia, as of June 30, 2010 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the management of the University of Georgia Research Foundation, Inc.

Cheryl B. Helle

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Management's Discussion and Analysis

June 30, 2010

The *Statement of Cash Flows* presents information in the form of cash inflows and outflows summarized by operating, capital and noncapital financing, and investing activities.

Condensed financial statements are presented for the year ended June 30, 2010 and one prior. In the following discussion, Fiscal 2010 and Fiscal 2009 refer to the years ended June 30, 2010 and June 30, 2009, respectively.

Financial Highlights

The condensed statements of net assets are shown below:

**University of Georgia Research Foundation
Condensed Statements of Net Assets
June 30, 2010 and 2009**

	<u>2010</u>	<u>2009</u>	<u>Change</u>	<u>% Change</u>
Assets:				
Current assets	\$ 50,688,040	\$ 60,882,656	\$ (10,194,616)	(17%)
Capital assets, net	376,748	422,830	(46,082)	(11%)
Other noncurrent assets	<u>40,041,128</u>	<u>54,428,172</u>	<u>(14,387,044)</u>	(26%)
Total assets	<u>\$ 91,105,916</u>	<u>\$ 115,733,658</u>	<u>\$ (24,627,742)</u>	(21%)
Liabilities:				
Current liabilities	\$ <u>49,521,232</u>	\$ <u>66,972,359</u>	<u>\$ (17,451,127)</u>	(26%)
Total liabilities	<u>49,521,232</u>	<u>66,972,359</u>	<u>(17,451,127)</u>	(26%)
Net assets:				
Invested in capital assets	376,748	422,830	(46,082)	(11%)
Unrestricted	<u>41,207,936</u>	<u>48,338,469</u>	<u>(7,130,533)</u>	(15%)
Total net assets	<u>41,584,684</u>	<u>48,761,299</u>	<u>(7,176,615)</u>	(15%)
Total liabilities and net assets	<u>\$ 91,105,916</u>	<u>\$ 115,733,658</u>	<u>\$ (24,627,742)</u>	(21%)

Current assets decreased by \$10,194,616 or 17% from Fiscal 2009 to Fiscal 2010 due to decreases in cash and cash equivalents and accounts receivable related to sponsored research and licensing and royalties revenue. Capital assets include land and buildings net of accumulated depreciation. The decrease between years is due to annual depreciation on the Library Repository building. Other noncurrent assets primarily include investments held by investment managers and other investments. The \$14,387,044 (26%) decrease in noncurrent assets is attributable to decreases in funds invested.

Current liabilities decreased by \$17,451,127 or 26% due to the current year payment of significant prior year accounts payable.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Management's Discussion and Analysis

June 30, 2010

Net assets represent the difference between the Research Foundation's assets and liabilities. Total net assets at June 30, 2010 and 2009 were \$41,584,684 and \$48,761,299, respectively, which represents a decrease of 15% or \$7,176,615. This decrease is attributable primarily to decreases in cash and cash equivalents and sponsored research, licensing and royalties receivables and investments.

The condensed statements of revenues, expenses, and changes in net assets are as follows:

University of Georgia Research Foundation

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Statement of Net Assets

June 30, 2010

	Research Foundation	UMH	Real Estate Foundation
ASSETS			
Current Assets			
Cash and Cash Equivalents	\$ 11,154,560	\$ 108,614	\$ 18,701,332
Sponsored Research, Licensing, and Royalties Receivable	20,760,035	-	-
Accounts Receivable from University of Georgia	648,460	-	206,889
Trade and Other Receivables, net	-	86,371	28,666
Funds of Georgia	648,460	-	-

	Research Foundation	Component Units	
		UMH	Real Estate Foundation
LIABILITIES AND NET ASSETS			
Current Liabilities			
Accounts Payable - University of Georgia	\$ 28,698,491	\$ 84,325	\$ 5,606
Funds Received for Sponsored Research	18,120,768	-	-
Accounts Payable - Other	2,695,698	7,701	17,797
Deferred Revenue	6,275	24,582	-
Accrued Liabilities	-	24,374	765,271
Accrued Project Costs	-	-	4,656,717
Advance Rent Receipts	-	-	391,334
Advance Lease Payment Receipts	-	-	1,531,443
Revolving Credit Agreement	-	-	10,351,189
Bonds Payable	-	-	6,200,000
Total Current Liabilities	\$ 49,521,232	\$ 140,982	\$ 23,919,357
Noncurrent Liabilities			
Lease Rent Liability	\$ -	\$ -	\$ 1,813,124
Bonds Payable	-	-	301,143,868
Total Noncurrent Liabilities	\$ -	\$ -	\$ 302,956,992
TOTAL LIABILITIES	\$ 49,521,232	\$ 140,982	\$ 326,876,349
NET ASSETS			
Invested in Capital Assets, Net of Related Debt	\$ 376,748	\$ 1,367,852	\$ 8,219,691
Restricted	-	-	2,623,064
Unrestricted	41,207,936	402,818	16,533,038
Total Net Assets	\$ 41,584,684	\$ 1,770,670	\$ 27,375,793
TOTAL NET ASSETS AND LIABILITIES	\$ 91,105,916	\$ 1,911,652	\$ 354,252,142

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Statement of Revenue, Expenses, and Changes in Net Assets

Year Ended June 30, 2010

	Research Foundation	UMH	Real Estate Foundation
Operating Revenues			
Sponsored Research	\$ 130,625,369	\$ -	\$ -
Licensing and Royalties	6,672,555	-	-
Other	527,440	-	-
Advertising	-	1,131,611	-
Rental Income	-	-	3,760,106
Capital Lease Interest Income	-	-	17,222,061
Reimbursed Expenses	-	-	604,168
Total Operating Revenues	\$ 137,825,364	\$ 1,131,611	\$ 21,586,335
Operating Expenses			
Research Subcontracted to UGA (including facilities & administrative cost reimbursements)	\$ 127,350,423	\$ -	\$ -

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements

Year Ended June 30, 2010

RESEARCH FOUNDATION

Note 1 – Organization

The University of Georgia Research Foundation, Inc. (the “Research Foundation”) was established in November 1978 to contribute to the educational, research, and service functions of the University of Georgia (the “University”) in securing gifts, contributions, and grants from individuals, private organizations, and public agencies and in obtaining contracts with such individuals or entities for the performance of sponsored research, development, education, or other programs by the various colleges, schools, departments, or other units of the University.

All research grants awarded to the Research Foundation are subcontracted to the University, which is responsible for the fiscal administration of the grants on behalf of the Research Foundation and the University.

Effective July 1, 2007, the Research Foundation became the sole member of the UGA Real Estate Foundation, Inc. (the “Real Estate Foundation”).

In June 2008, the Research Foundation created UGARF Media Holdings, LLC (“UMH”), a limited liability company, for the purposes of acquiring and facilitating the operation of an FCC licensed television broadcast station.

Note 2 – Summary of significant accounting policies

Basis of presentation – The Research Foundation’s financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (“GASB”).

The GASB has issued Statements of Governmental Accounting Standards (“SGAS”) No. 35, *Basic Financial Statements—and Management’s Discussion and Analysis—for Public Colleges and Universities* and SGAS No. 38, *Certain Financial Statement Note Disclosures*. The financial statement presentation required by these statements provides a comprehensive, entity-wide perspective of the Research Foundation’s assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows and replaces the fund-group perspective previously required. In addition, these statements require the Research Foundation to present a Management’s Discussion and Analysis (“MD&A”). The MD&A is considered to be required supplemental information and precedes the financial statements.

Reporting entity – In accordance with the criteria in SGAS No. 39, *Determining Whether Certain Organizations Are Component Units*, the Research Foundation qualifies for treatment as a component unit of the University; therefore, the Research Foundation’s financial statements are included in the University’s combined financial statements as a discretely presented component unit.

The Real Estate Foundation and UMH qualify as component units of the Research Foundation. The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets of the Real Estate Foundation and UMH are reported discretely in the Research Foundation’s financial statements for fiscal year 2010 as required by government accounting standards.

These statements are the primary financial statements of UGARF and UMH. Complete financial statements for the Real Estate Foundation may be obtained at the following address: UGA Real Estate Foundation, Inc., c/o Controller’s Office, 324 Business Services Building, 456 E. Broad Street, Athens, GA 30602.

Notes related to the financial statements of component units follow the notes for the Research Foundation.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 2 – Summary of significant accounting policies (Continued)

Revenue recognition (Continued) - The unrecognized portion of such advance payments is classified as deferred revenues in the statement of net assets. The Research Foundation is obligated to distribute a portion of the licensing revenues and royalties pursuant to the University of Georgia Intellectual Property Policy. Such distributions are recorded as expenses when the related revenues are recognized.

Operating and nonoperating revenues - The financial statements distinguish between operating and nonoperating

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 3 – Deposits and investments (Continued)

B. Investments

The Research Foundation maintains both short-term and long-term investment policies. Both establish primary and secondary objectives, specify allowable investments, set target investment mix, and provide investment guidelines.

The Research Foundation's investments at June 30, 2010 are presented below. All investments are presented by investment type and debt securities are presented by maturity.

<u>Investment type</u>	<u>Fair Value</u>	<u>Investment Maturity</u>			
		<u>Less Than 1 Year</u>	<u>1-5 Years</u>	<u>6-10 Years</u>	<u>More Than 10 Years</u>
<u>Debt Securities</u>					
U.S. Treasuries	\$ 11,118,238	\$ 3,914,269	\$ 6,817,977	\$ 287,012	\$ 98,980
U.S. Agencies					
Implicitly Guaranteed	4,999,008	622,664	4,376,344	-	-
Corporate Debt	<u>8,255,892</u>	<u>619,049</u>	<u>6,845,343</u>	<u>668,846</u>	<u>122,654</u>
	<u>\$ 24,373,138</u>	<u>5,155,982</u>	<u>\$ 18,039,664</u>	<u>\$ 955,858</u>	<u>\$ 221,634</u>
<u>Other Investments</u>					
Equity Mutual Funds - Domestic	\$ 3,818,377				
Equity Mutual Funds - International	1,772,724				
Equity Mutual Funds - Global	1,813,409				
Equity Securities - Domestic	2,778,481				
Equity Securities - International	858,132				
Managed Futures/Hedge Funds	<u>3,727,319</u>				
Total investments	<u>\$ 39,141,580</u>				

Interest rate risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Research Foundation's policy for managing interest rate risk is divided between short-term and long-term investments. Short-term investments will have a maximum maturity of eighteen months to five years depending on the type of investment. Long-term investments are managed using a planning timeline of five years or more and overall risk measurements rather than specific maturity limits.

Custodial credit risk

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the Research Foundation will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The Research Foundation does not have a formal policy for managing custodial credit risk for investments.

At June 30, 2010, \$28,009,751 of the Research Foundation's applicable investments were uninsured and held by the

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 3 – Deposits and investments (Continued)

B. Investments (Continued)

Credit quality risk

Credit quality risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Research Foundation's investment policies specify that fixed income securities be of investment grade. The short-term investment policy specifies that corporate bonds be rated BBB (Standard & Poor's) or Baa (Moody's) or higher; the long-term policy requires a BBB (Standard & Poor's) or Baa3 (Moody's) rating or higher. The investment policy also requires that securities that drop below investment grade should be sold at the manager's discretion; in the event that a rating falls below investment grade, the manager will contact the financial advisor and advise them of the proposed strategy for disposition of the security.

The Research Foundation's investments at June 30, 2010 are presented below. All investments are presented by investment type and fixed income securities are presented by credit quality ratings.

Quality Ratings	Rated Debt Investments			
	Fair Value	U.S. Agencies	Corporate Debt	Mutual Funds
Moody's				
Aaa	\$ 6,899,813	\$ 4,999,008	\$ 1,900,805	\$ -
Aa2	377,575	-	377,575	-
Aa3	518,070	-	518,070	-
A1	1,867,131	-	1,867,131	-
A2	2,296,407	-	2,296,407	-
A3	1,113,023	-	1,113,023	-
Baa1	39,027	-	39,027	-
Baa2	143,854	-	143,854	-
Morningstar				
5-Star	5,276,494	-	-	5,276,494
4-Star	1,633,580	-	-	1,633,580
3-Star	494,436	-	-	494,436
	\$ 20,659,410	\$ 4,999,008	\$ 8,255,892	\$ 7,404,510
Exempt investments				
U. S. Treasuries	\$ 11,118,238			
Equity Securities - Domestic	2,778,481			
Equity Securities - International	858,132			
Managed Futures/Hedge Funds	3,727,319			
	\$ 39,141,580			

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 3 – Deposits and investments (Continued)

B. Investments (Continued)

Concentration of credit risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. The Research Foundation's policy for managing concentration of credit risk is divided between short-term and long-term investments. For short-term investments, maximum percentages are set for cash and cash equivalents at 15%, asset backed securities at 50% and corporate bonds at 90%, while U. S. Treasuries, U. S. Agencies debt, and certificates of deposit may comprise 100% for the short-term investments. For long-term investments, equities comprise 40-80%, bonds 20-60% and alternative investments can range 0-20%.

As of June 30, 2010, investments in a single issuer where those investments exceed 5% of total investments were as follows:

United States Treasuries	28%
Federal Home Loan Mortgage Corporation	6%

Foreign currency risk

Foreign currency risk is the risk that cha

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Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 4 – Investments (Continued)

C. Investments – Cost Method

During 2009, the Research Foundation made a commitment to invest \$1,000,000 in GRA Venture Fund (T. E.), LLC, (the “Fund”). The Fund was created by Georgia legislature whereby State funds and funds from profit and not-for-profit entities will be combined to provide seed and early stage venture financing for businesses formed around intellectual property resulting from Georgia Research Alliance universities. During fiscal year 2010, the Fund requested contributions of \$107,822 from the Research Foundation.

A fair value is not estimated for the investment in the Fund but is evaluated for any impairment or permanent decline in value. At June 30, 2010, the Fund had not experienced any operating losses or changes to indicate a decline in the value of its investments, therefore, the contributions by the Research Foundation are shown at cost.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 5 – Fair value measurement of assets and liabilities (continued)

Category C – Multi-Strategy Hedge Funds. This category includes investments of the same type as Category B but consists of investments currently in the process of being liquidated. Redemption payments are made as liquidation of the underlying funds and investments allow. Therefore, no specific redemption date is available.

Note 6 – Facilities and administrative cost revenue

The Research Foundation receives reimbursement from research sponsors for facilities and administrative (F&A) cost incurred. Of the total received, 78% is remitted to the University for reimbursement of (F&A) cost incurred by the University. Additionally, the Research Foundation remitted \$2,790,898 for the year ended June 30, 2010 to various departments of the University for (F&A) cost they incurred in the support of research.

Note 7 – Summary of sponsored research activity

The activity for sponsored research awarded to the Research Foundation is summarized for the year ended June 30, 2010 as follows:

Sponsored research awarded but not recognized – beginning of year	\$ 208,879,993
Sponsored research awarded during the year (including facilities and administrative cost reimbursements)	158,271,925
Sponsored research recognized during the year (including facilities and administrative cost reimbursements)	(130,625,369)
	<hr/>
	\$ 236,526,549

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 11 – Commitments and contingencies (Continued)

As the sole member of the Real Estate Foundation, the Research Foundation is guarantor on up to \$50 million on a revolving credit agreement maintained by the Real Estate Foundation. As of June 30, 2010, current borrowings are all under rental agreements with the University so the Research Foundation's guarantee is not applicable. The Real Estate Foundation's revolving line of credit expires on November 30, 2010. In September 2010, the Real Estate Foundation received proposals from banks for a replacement line of credit that would go into effect upon the expiration of the current line of credit. After reviewing the proposals, the Board voted to renew the revolving line of credit with the current provider in the amount of \$50,000,000 for a five year period beginning December 1, 2010.

The Research Foundation is currently engaged in litigation related to ownership of certain patents. Parties adverse to the Research Foundation have asserted claims for money damages and other legal and equitable relief. This litigation is ongoing and it is not currently possible to estimate what effect, if any, the litigation may have on the Research Foundation's financial position or results of operations.

In the normal course of business, there are legal actions pending against the Research Foundation. Management does not believe that any of these legal actions, with the possible exception of the litigation discussed in the preceding paragraph, are expected to have a material effect on the Research Foundation's financial condition, results of operations, or liquidity.

Note 12 – Subsequent events

The Research Foundation has evaluated subsequent events through September 22, 2010, which was the date the financial statements were available to be issued. As of this date, there were no material subsequent events requiring adjustment to or disclosure in the financial statements for the year ended June 30, 2010.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements – Continued

Year Ended June 30, 2010

UGARF MEDIA HOLDINGS, LLC

Note 1 – Organization

UGARF Media Holdings, LLC (“UMH”), a limited liability company, was established in June 2008. The University of Georgia Research Foundation (the “Research Foundation”) is the sole member of this disregarded entity. UMH was organized under the laws of the State of Georgia.

In October, 2008, UMH acquired and began operating an FCC licensed television broadcast station, WNEG-TV. The station is licensed, transmits from Toccoa, GA, and serves northeast Georgia. In January 2010, the WNEG-TV broadcasting studio relocated to the Grady College of Journalism and Mass Communication at the University of Georgia without affecting the license, transmission or area served.

UMH operates as a business-type activity and provides the opportunity for students, faculty and staff to work in research, development and teaching in media.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation – UMH’s financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (“GASB”).

Reporting Entity – In accordance with the criteria in SGAS No. 39, *Determining Whether Certain Organizations Are Component Units*, UMH qualifies as a component unit of the Research Foundation. The statements of UMH are reported discretely in the Research Foundation’s financial statements for fiscal year 2010.

Cash and Cash Equivalents – UMH considers all short-term investments with an original maturity of three months or less to be cash equivalents.

Other Assets – Other assets at June 30, 2010 consist of intangible assets that have indefinite useful lives and are not amortized but rather are tested at least annually or when events and circumstances occur that may indicate impairment.

Capital Assets - Capital assets are recorded at cost, less accumulated

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 3 – Accounts Receivable

UMH recorded trade accounts receivable of \$89,568 at June 30, 2010 and an allowance for doubtful accounts of \$3,197.

Note 4 – Capital Assets

Capital assets consisted of the following:

	<u>Balance at June 30, 2009</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance at June 30, 2010</u>
Capital assets not being depreciated				
Land	\$ 162,750	\$ -	\$ -	\$ 162,750
Capital assets being depreciated				
Furniture and equipment	1,374,443	221,182	(307,520)	1,288,105
Less: accumulated depreciation	(148,094)	(210,027)	75,023	(283,098)
Building and improvements	209,250	-	-	209,250
Less: accumulated depreciation	(3,923)	(5,232)	-	(9,155)
Total capital assets being				

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 6 – Commitments and Contingencies

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UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 2 – Summary of significant accounting policies (Continued)

Capital leases receivable —The Real Estate Foundation enters into lease contracts of real property as a lessor. The terms and conditions of these contracts are assessed and the leases are classified as operating leases or capital leases according to their economic substance. When making such an assessment, the Real Estate Foundation focuses on the following aspects: a) transfer of ownership of the asset to the lessee at the end of the lease term; b) existence of a bargain purchase option held by the lessee; c) whether the lease term is for the major part of the economic life of the asset; d) whether the present value of the minimum lease payments is substantially equal to the fair value of the leased asset at inception of the lease term; and e) whether the asset is of a specialized nature that only the lessee can use without major modifications being made. If one or more of the conditions are met, the lease is generally classified as a capital lease. The initial recording of the capital lease receivable is made on the day the real property is placed in service, with a corresponding entry to remove the capital asset using the lesser of the net present value of the lease payments or the fair value of the leased property. Capital leases are amortized over the term of the lease using the effective interest rate – the implicit rate that exactly discounts estimated future cash receipts through the expected life of the lease. Lease payments are allocated between the principal component and the interest expense. Capital leases receivable consist of capital lease payments due for real property owned by the University. Collectability of these lease payments is reasonably assured and no allowance for uncollectible amounts has been established.

Capital assets – Expenditures for maintenance and repairs are charged to operations as incurred, while renewals and betterments are capitalized.

Furniture and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets of seven years.

Real property includes buildings and improvements stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the lesser of the estimated useful life of the related asset of 10 to 30 years or the remaining term on the related ground or air rights leases.

Land is stated at cost and is not depreciated.

Construction in progress — Construction in progress is stated at cost and includes planning, development, and construction costs, as well as capitalized interest. When construction is complete and the asset is placed in use, assets are transferred at cost to real property or transferred to a lessee as part of a capital lease agreement.

Cost of bond issuance – Cost of bond issuance is stated at cost, less accumulated amortization and includes direct, incremental costs associated with the issuance of the bonds. Issuance costs are amortized to interest expense, capitalized during construction, using the effective interest method.

Capitalized interest — Interest incurred during construction of real estate projects is capitalized until the underlying assets are ready for their intended use. Interest related to projects financed by tax-exempt borrowings is capitalized after reduction for interest earned on temporary investment of the proceeds of those borrowings from the date of borrowing until the specified qualifying assets acquired with those borrowings are ready for their intended use. Interest related to projects financed by taxable borrowings does not include a reduction for interest earned on the temporary investment of the proceeds of those borrowings. At the time the qualifying assets are placed in service, amortization of the capitalized interest begins, straight-line, over the estimated useful lives of the related assets.

If a project is determined to be placed in service under a capital lease agreement, the asset, including capitalized interest, is transferred to a lessee under a capital lease agreement. For the year ended June 30, 2010, capitalized interest, net of interest earned on tax-exempt borrowings, amounted to \$2,332,437. None of this capitalized interest is being amortized as of the year ended June 30, 2010.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 2 – Summary of significant accounting policies (Continued)

Derivative financial instruments – In accordance with SGAS No. 53, *Accounting and Financial Reporting for Derivative Instruments*, the Real Estate Foundation is required to present certain information addressing the recognition, measurement, and disclosure regarding derivative instruments entered into in order to hedge a portion of its current and future borrowings for the purpose of managing interest rate risk. In accordance with accounting principles generally accepted in the United States of America, these derivative financial instruments are recorded at fair value in the Statement of Net Assets. Changes in the fair value of the derivative financial instruments are recorded in the Statement of Revenues, Expenses, and Changes in Net Assets.

Bonds payable – The Real Estate Foundation records the net proceeds of tax-exempt and taxable bond financing as a liability upon issuance. Bond proceeds consist of the par value of the bonds issued plus premiums or minus discounts. Bond premiums and discounts are amortized to interest expense using the effective interest method.

Deferred gains and losses on bond refunding are treated as an offset to the related bond liability and are amortized to interest expense using the straight-line method.

Net assets – As of June 30, 2010, the Real Estate Foundation's net assets are comprised of \$16,533,038 in unrestricted net assets, \$2,623,064 in restricted net assets, and \$8,219,691 in net assets invested in capital assets, net of related debt.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 2 – Summary of significant accounting policies (Continued)

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 and disclosure of contingent 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.

Note 3 – Deposits and investments

A. Deposits

At June 30, 2010, the bank value of the Real Estate Foundation's deposits, consisting of cash held in interest bearing checking accounts at financial institutions, cash and cash equivalents held by trustees, short-term money market funds invested in corporate money market securities, and repurchase agreements backed by short-term United States Treasuries was \$42,586,757.

Custodial Credit Risk

The custodial credit risk for deposits is the risk that in

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 3 – Deposits and investments (Continued)

B. Investments

The Real Estate Foundation follows the Real Estate Foundation’s investment policy which establishes objectives, specifies allowable investments, sets target investment mixes, and provides investment guidelines.

The Real Estate Foundation’s investments as of June 30, 2010 are presented below. All investments are presented by investment type and debt securities are presented by maturity.

Investment Type	Fair Value	Investment Maturity			
		Less Than 1 Year	1 – 5 Years	6 – 10 Years	More Than 10 years
Debt Securities					
U.S. Treasuries					
Held by Trustees	\$ 206,820	\$ 206,820	\$ -	\$ -	\$ -
Total investments	\$ 206,820	\$ 206,820	\$ -	\$ -	\$ -

Interest rate risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Real Estate Foundation’s policy for managing interest rate risk for debt service reserve funds is to invest only in short-term United State treasury obligations with a maximum maturity of one year.

Credit quality risk

Credit quality risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Since all of the Real Estate Foundation’s investments are invested in U. S. Treasuries, they are considered to be exempt from investment grade credit quality rating requirements.

Concentration of credit risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an entity’s investment in a single issuer. The Real Estate Foundation’s policy for managing concentration of credit risk for debt service reserve funds is to invest only in short-term investments of U. S. Treasuries.

Foreign currency risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. During the year ended June 30, 2010, the Real Estate Foundation’s investments decreased by \$8,364 due to foreign currency fluctuations between the Euro and the dollar on cash balances held in banks. Amounts held in foreign currency denominations are valued at \$266,689 as of June 30, 2010.

Investments at fair market value

Investments held by trustee at quoted market prices	\$ <u>206,820</u>
Total investments at fair market value	\$ <u><u>206,820</u></u>

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 4 – Investments

Changes in investments for the year ended June 30, 2010 consisted of:

Fair value – Beginning of year	\$	840,990
Purchase of investments		7,516,202
Sales and maturities of investments		(8,175,978)
Realized gain (investment income)		44,283
Change in fair value		<u>(18,677)</u>
Fair value – End of year	\$	<u>206,820</u>

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 5 – Derivative financial instruments (Continued)

All of the Real Estate Foundation's derivatives are treated as investment derivatives since they do not substantially offset changes in cash flows or fair values for the year ended June 30, 2010. There are no cumulative deferred inflows or outflows related to these derivative instruments.

Credit risk

Credit risk is the risk that a counterparty to a derivative instrument will not fulfill its obligations. The Real Estate Foundation does not have a formal policy for managing credit risk for derivatives.

Interest rate risk

Interest rate risk is the risk that changes in interest rates could reduce the value of the derivative instrument. The Real Estate Foundation is exposed to interest rate risk on its interest rate caps. As rates decrease, the value of the derivative decreases.

Termination risk

During the year ended June 30, 2010, the Real Estate Foundation terminated its interest rate cap scheduled to mature in December 2012. A gain of \$21,900 was realized upon termination. The Real Estate Foundation is not exposed to termination risk on its derivative instruments.

Rollover risk

The Real Estate Foundation is exposed to rollover risk on hedging derivative instruments that are hedges of debt that mature or may be terminated prior to the maturity of the hedged debt. When these hedging derivative instruments terminate, or in the case of a termination option, if the counterparty exercises its option, the Real Estate Foundation will be re-exposed to the risks being hedged by the hedging derivative instrument. After the derivative matures, the Real Estate Foundation would no longer be protected against rising interest rates and may not be able to enter into a new derivative with similar terms.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 7 – Capital assets

Capital assets consisted of the following at June 30, 2010:

	<u>Balance at July 1, 2009</u>	<u>Additions</u>	<u>Disposals and Reclasses</u>	<u>Balances at June 30, 2010</u>
Capital assets not being depreciated				
Land	\$ 20,424,224	\$ -	\$ (4,700,000)	\$ 15,724,224
Construction in progress	34,047,860	52,257,173	(43,175,731)	43,129,302

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 8 – Long-term debt (Continued)

\$7,960,000 Bond Issue — In 2009, the Development Authority issued Educational Facilities Revenue Refunding Bonds (UGAREF Carlton Street Parking Deck, LLC Project), Series 2009 (the “Carlton Street Bonds”) and entered into an agreement (the “Carlton Street Loan Agreement”) to loan \$7,960,000 to UGAREF Carlton Street Parking Deck, LLC (a single-member limited liability company owned by the Real Estate Foundation) (the “Carlton Street Entity”). Payment of principal and interest under the Carlton Street Bonds is insured by a financial guaranty insurance policy and secured by certain real property.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 8 – Long-term debt (Continued)

\$34,090,000 Bond Issue — On March 1, 2010, the Housing Authority issued \$34,090,000 in Student Housing Lease Revenue Bonds (UGAREF East Campus Housing, LLC Project), Series 2010 (the "2010 Housing Bonds") with interest rates ranging from 2.5% to 5.0% and entered into an agreement (the "2010 Housing Loan Agreement") with the Housing Entity to advance refund \$32,265,000 of outstanding 2002 Housing Bonds with interest rates ranging from 4.0% to 5.25%.

The net proceeds of \$35,626,248, including \$125,000 segregated for future debt service reserves (after payment of \$476,550 in underwriting fees and other issuance costs), plus an additional \$413,000 of 2002 Series debt service reserve funds were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded portion of the 2002 Housing Bonds. As a result, \$32,265,000 of outstanding 2002 Housing Bonds are considered to be defeased and the liability for those bonds has been removed from the Statement of Net Assets for the year ended June 30, 2010.

The advance refunding resulted in a loss which consisted of the difference between the reacquisition price and the net carrying amount of the old debt of \$3,430,768. This difference, reported in

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 8 – Long-term debt (Continued)

Following is a summary as of June 30, 2010 of principal and interest payments for the face value of the bonds payable during each of the next five years ending June 30 and every five years thereafter:

	<u>Principal</u>	<u>Interest</u>
2011	\$ 6,200,000	\$ 13,147,778

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 9 – Disclosures about fair value of financial instruments

The Real Estate Foundation adopted the provisions of accounting principles generally accepted in the United States of America as they relate to fair value measurements, for financial assets and liabilities measured at fair value. These principles require fair value measurements be classified and disclosed in one of the following three categories ("Fair Value Hierarchy"):

Level 1: Financial instruments with unadjusted, quoted prices listed on active market exchanges.

Level 2: Financial instruments valued using inputs that include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3: Financial instruments that are not actively traded on a market exchange and require using significant unobservable inputs in determining fair value.

Assets measured at fair value on a recurring basis:

Description	June 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
U.S. Treasury Securities	\$ 206,820	\$ 206,820	\$ -
Derivative financial instruments	<u>-</u>	<u>-</u>	<u>-</u>
Totals	<u>\$ 206,820</u>	<u>\$ 206,820</u>	<u>\$ -</u>

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents – The carrying amount approximates fair value because of the short-term maturity of these instruments.

Derivatives – Interest rate caps are carried at fair value. SunTrust Bank calculates “Mark-To-Market Estimates” by constructing mid-market forward curves with available market data from external and internal sources. Once constructed, the mid-market forward curves generate a nominal amount for each of a transaction’s expected future payments. SunTrust Bank discounts those expected future payments at the respective zero rate, and the sum of all discounted payments equals the Mark-To-Market Estimate.

Operating funds held by trustee – Funds held by the trustee are carried at fair value based on quoted market prices for those or similar investments.

Bond proceeds restricted for construction, debt service and reserves – Funds held by the trustee are carried at fair value based on quoted market prices for those or similar investments.

Bonds payable – Based on the borrowing rates currently available to the Real Estate Foundation for bonds payable with similar terms and maturities, the fair value of bonds payable was approximately \$329,788,274 as of June 30, 2010, compared to the recorded balance of \$307,343,868 for the same periods.

Revolving credit agreement — The carrying amount approximates fair value because the interest rate approximates the current rates at which similar loans could be obtained from lenders for the same remaining maturities.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 9 – Disclosures about fair value of financial instruments (Continued)

Other receivables and payables – The carrying amount approximates fair value because of the short-term maturity of these instruments.

Note 10 – Operating leases

The Real Estate Foundation is a lessee under an amended multiyear operating lease for University education facilities that expires on January 31, 2015, with escalating rents. For the year ended June 30, 2010 rent expense has been recognized on a straight-line basis in the amount of \$709,442, and a straight-line lease liability of \$631,599 is included in accrued liabilities as of June 30, 2010.

The Real Estate Foundation is a lessee under an amended multiyear operating lease for University office space that expires on June 30, 2014, with escalating rents. For the year ended June 30, 2010, rent expense has been recognized on a straight-line basis in the amount of \$413,008, and a straight-line lease liability of \$72,409 is included in accrued liabilities as of June 30, 2010.

The Real Estate Foundation is a lessee under a multiyear operating lease for University education facilities that expires on December 31, 2019, with escalating rents. For the year ended June 30, 2010, rent expense has been recognized on a straight-line basis in the amount of \$1,278,389, and a straight-line lease liability of \$1,109,116 is included in accrued liabilities as of June 30, 2010.

The following is a schedule by years of future minimum rental payments under operating leases as of June 30, 2010 that have initial or remaining noncancelable lease terms in excess of one year:

Years ending June 30,	
2011	\$ 2,496,546
2012	2,578,920
2013	2,642,916
2014	2,709,265
2015	1,933,744
2016 – 2019	<u>5,155,192</u>
Total	\$ <u>17,516,583</u>

Note 11 – Related party transactions

The Real Estate Foundation has leased real property to the Board of Regents under both operating and capital leases. The Real Estate Foundation has also subleased space under operating leases to the Board of Regents. Rental income and the receipt of capital lease interest and principal from the Board of Regents totaled \$3,760,106, \$17,222,061, and \$4,543,422, respectively, for the year ended June 30, 2010. As of June 30, 2010, balances receivable under capital leases are \$242,934,781, of which \$3,416,327 is the current portion. The lease agreements with the Board of Regents are the primary source of revenue for the Real Estate Foundation, which constitutes a concentration of credit risk.

The lease agreements provide for certain expenses to be reimbursed to the Real Estate Foundation. During the year ended June 30, 2010, the Real Estate Foundation requested reimbursement from the Board of Regents for expenses of \$604,168. As of June 30, 2010, accounts receivable from related party included reimbursable expenses of \$206,889.

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 11 – Related party transactions (Continued)

The Real Estate Foundation has one-year licensing agreements with the Board of Regents to allow the Board of Regents to operate parking lots on the Real Estate Foundation's land in exchange for a fee adjusted at the end of the term to reflect actual costs incurred. Under these licensing agreements, rental income of \$232,129 was recorded for the years ended June 30, 2010. As of June 30, 2010, the Real Estate Foundation has accrued an amount payable to the University of \$0, to reflect revenues in excess of expenses.

The Real Estate Foundation leases the use of land from the Board of Regents where it has constructed property on Board of Regents' land. These ground leases are for a period of up to 3 years during construction and continue for 30 years after construction is complete for a base rental of \$10 per year. Under the ground leases, the ownership of any building or structure constructed on the land passes to the Board of Regents at the end of the ground lease.

The Real Estate Foundation leases air rights from the Board of Regents where it has constructed property above the lower floors on the Board of Regents' land. The air rights lease is for a period of up to three years during construction and continues for 30 years after construction is complete for a base rental of \$10 per year. Under the air rights lease, the ownership of any building or structure constructed above the lower floors of the building passes to the Board of Regents at the end of the air rights lease.

The Real Estate Foundation has entered into an administrative services agreement with the University whereby the University provides project management, accounting, and other administrative services. During the year ended June 30, 2010, the Real Estate Foundation paid \$245,000 to the University under the terms of that agreement. The administrative services agreement is renewable on an annual basis. Effective July 1, 2010, the amount of the annual payment under the administrative services agreement was modified to include provisions for office space, maintenance, utilities and parking to be provided by the University to the Real Estate Foundation.

Note 12 – Commitments and contingencies

In 2009, the Board committed to utilize \$1,068,333 of the repair and replacement reserves to fund dormitory repairs and replacements. As of June 30, 2010, \$592,663 of this amount has been expended.

In May 2010, the Real Estate Foundation and the University agreed to transfer ownership of the parking deck at East Campus Village to the University upon payment of an amount sufficient to defease the outstanding bond debt associated with the parking deck (pro rata portions of the 2002 Housing Bonds and 2010 Housing Bonds). The Real Estate Foundation will deposit this amount with an escrow agent to defease the debt. On August 31, 2010, the Real Estate Foundation received \$8,758

UNIVERSITY OF GEORGIA RESEARCH FOUNDATION, INC.

Notes to Financial Statements - Continued

Year Ended June 30, 2010

Note 13 – Defined contribution plans

Starting in 2003, the Real Estate Foundation offers a 403(b) defined contribution plan to any of its employees who elect to participate. The Real Estate Foundation matches employee contributions to the plan by 200%, up to a maximum of 10% of the employee's compensation, subject to Internal Revenue Service annual maximum limitations. The plan is administered by Fidelity Investments. Plan provisions are established and amended by Board resolution based on the plan documents. For the year ended June 30, 2010, the employees of the Real Estate Foundation contributed \$19,080 to the plan and the Real Estate Foundation incurred employer contributions to the plan for two employees in the amount of \$21,974 for same time period.

Note 14 – Subsequent events

Construction of a \$50.7 million residence hall was complete in July 2010 and is under lease with the Board of Regents effective July 26, 2010.

The Real Estate Foundation has evaluated subsequent events through September 22, 2010, which was the date the financial statements were available to be issued. As of this date, there were no additional material subsequent events requiring adjustment to or disclosure in the financial statements for the year ended June 30, 2010.

