HARRIS COUNTY HEALTH FACILITIES DEVELOPMENT CORPORATION
MEDICAL FACILITIES REVENUE BONDS
(BAYLOR COLLEGE OF MEDICINE)
Series 1999A , $50,000,000 Dated: March 15, 1999
41415MAG9, 41415MAH7, 41415MAJ3, 41415MAK0, 41415MAL8, 41415MAM6, 41415MAN4, 41415MAP9, 41415MAQ7, 41415MAT1, 41415MAV6

HARRIS COUNTY HEALTH FACILITIES DEVELOPMENT CORPORATION
HOSPITAL REVENUE BONDS
(BAYLOR COLLEGE OF MEDICINE)
Series 2007A, $245,000,000 consisting of subseries 2007A-1, $34,550,000 Conversion Date: November 12, 2008 and Subseries 2007A-1, $105,450,000 Conversion Date: November 13, 2008 and Subseries 2007A-2, $105,000,000, Conversion Date: November 18, 2008 Original Date: November 15, 2007
414152RL4, 414152RM2, 414152RN0, 414152RK6, 414152RJ9, 414152SH2, 414152SS8, 414152SJ8

HARRIS COUNTY HEALTH FACILITIES DEVELOPMENT CORPORATION
HOSPITAL REVENUE BONDS
(BAYLOR COLLEGE OF MEDICINE)
Series 2007B, $200,000,000, Dated: November 15, 2007
414152RQ3

HARRIS COUNTY HEALTH FACILITIES DEVELOPMENT CORPORATION
HOSPITAL REVENUE REFUNDING BONDS
(BAYLOR COLLEGE OF MEDICINE)
Series 2008, $157,730,000 consisting of $85,000,000 Series 2008A, $34,550,000 Series 2008B and $38,180,000 Series 2008C, Dated June 18, 2008
414152SA7, 414152SB5, 414152SC3

HARRIS COUNTY CULTURAL EDUCATION FACILITIES FINANCE CORPORATION
MEDICAL FACILITIES REVENUE REFUNDING BONDS
(BAYLOR COLLEGE OF MEDICINE)
Series 2008D, $200,000,000, Dated September 4, 2008
414008AC6, 414008AD4, 414008AE2, 414008AF9, 414008AG7, 414008AH5, 414008AK8, 414008AJ1, 414008AL6, 414008AM4, 414008AN2, 414008AP7, 414008AQ5, 414008AR3, 414008AS1

HARRIS COUNTY CULTURAL EDUCATION FACILITIES FINANCE CORPORATION
MEDICAL FACILITIES REVENUE REFUNDING BONDS
(BAYLOR COLLEGE OF MEDICINE)
Series 2008E, $55,000,000, Dated: August 20, 2008
414008AA0

APPENDIX A

BAYLOR COLLEGE OF MEDICINE

APPENDIX A

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APPENDIX A

BAYLOR COLLEGE OF MEDICINE

General

Baylor College of Medicine (the "***College***") is one of the leading medical schools and biomedical research institutions in the United States. The College is a Texas non-profit corporation exempt from federal income taxation under Section 501(a) of the Internal Revenue Code of 1986, as amended (the "***Code***"), by reason of being an organization described in Section 501(c)(3) of the Code. The College is located in the Texas Medical Center, a 700 acre complex of 47 independent institutions, in Houston, Texas, and is the only private medical school in the Southwestern United States.

In addition to physician education, the College offers programs and postgraduate degrees in graduate biomedical sciences and the allied health fields and offers graduate medical education in 21 specialties. Further, the College is among the nation's leading biomedical research institutions. The College consistently ranks among the top of the country's 126 medical schools. For 2010, U.S. News & World Report has ranked the College 17th overall among the nation's top medical schools for research and 7th for primary care. The College also is listed 13th among all U.S. medical schools for National Institutes of Health funding, ranked 1st among all Texas colleges, universitites, and medical schools in federal funding for research and development, and No. 2 for research expenditures in biological science by the National Science Foundation. The College has total annual research support of $374 million, and has 25 departments and more than 90 research and patient-care centers and units. See "**RESEARCH**." Currently, the College trains more than 3,000 medical, graduate, nurse anesthesia, and physician assistant students, as well as residents and post-doctoral fellows. See "**EDUCATION**." Finally, the College provides extensive patient care services. The College's affiliated hospitals serve 130,000 inpatients and almost 1.5 million outpatients annually. See "**PATIENT CARE**."

History

In 1900, a small group of dedicated physicians and community leaders started a medical school in Dallas to improve the practice of medicine in North Texas. The fledgling school was called the University of Dallas Medical Department, although no such university existed. The school opened its doors Oct. 30, 1900, with 81 students. The young medical school needed a true affiliation with an established university to survive; an alliance was formed with Baylor University in Waco in 1903. At that time, the name changed to Baylor University College of Medicine.

In 1943, the M.D. Anderson Foundation invited Baylor University College of Medicine to join the newly formed Texas Medical Center. The College relocated to Houston in July, 1943, in a converted Sears, Roebuck & Co. building, with 131 students. Four years later, the College moved into its present site in The Roy and Lillie Cullen Building, the first building completed in the new Texas Medical Center.

In 1948, Michael E. DeBakey, M.D. joined the faculty as chair of the Department of Surgery. The Graduate School of Biomedical Sciences was established the following year. During the next several years, the College began its affiliation with a number of hospitals, which created superior training facilities for students and residents.

The College's rise in prominence began in the 1950s when Dr. DeBakey's innovative surgical techniques garnered international attention. The 1960s brought the first major expansion of College facilities, along with a major turning point for the institution. In 1969, by mutual agreement, the College separated from Baylor University to become an independent institution. This encouraged broader, nonsectarian support and provided access to federal research funding. The institution's name changed to Baylor College of Medicine.

In 1971, the State of Texas enacted legislation pursuant to which the state began appropriating funds to offset a portion of the costs of the College of the medical education of Texas residents. See "**EDUCATION**." The College has since doubled its enrollment and expanded its affiliation with medical and educational institutions in Houston and throughout Texas. Today the College enjoys an international reputation as one of the premier medical colleges in the United States.

Baylor Clinic & Hospital

In January, 2007, the Board of Trustees of the College passed a resolution to develop an integrated Baylor Clinic and Hospital. Baylor Clinic and Hospital will be located on 35 acres of College-owned land in the Texas Medical Center area. Construction commenced in May, 2007. In February 2009 the College decided because of changes in the US economy to pause construction once the building's core and shell is completed, which is expected to happen in late fiscal year 2010. During the pause the College is considering all options including partnering with another institution.

BEST MINDS BEST MEDICINE CAMPAIGN

General. The College has embarked on a capital campaign, known as "Best Minds Best Medicine." The planned initiatives of the campaign focus on several areas, including:

- Assisting in the funding of the Baylor Clinic and Hospital;
- Investment in multidisciplinary strategic initiatives in:
    - Neuroscience and mental health,
    - Cardiovascular disease,
    - Regenerative medicine, and
    - Cancer research and treatment;
- Faculty recruitment and development, including endowed positions and research funds, junior faculty and support staff, start-up equipment and supplies for new laboratories, seed funding for novel research, and resources for conferences and community outreach; and
- Educational excellence in its student body, such as premedical summer programs, scholarships, research stipends, additional classrooms and laboratories, its combination M.D./Ph.D. and M.D./J.D. programs, the DeBakey Library and Museum, and a state-of-the-art simulation center for the U.S. Medical Licensing Exam.

Fund raising. As part of Best Minds Best Medicine, the College expects to raise $1 billion in contributions by 2013. The campaign began July 1, 2003, in a silent phase, with the approval of the College's strategic plan by the Board. It was announced to the public in May, 2007 and has raised more than $723 million in pledges. A portion of the funds received from these contributions may be used to prepay and redeem a portion of the principal of the Series 2007 Bonds and Series 2008 Bonds.

MANAGEMENT OF THE COLLEGE

Board of Trustees

The College is governed by a 47 member Board of Trustees (the "***Board***"). Members of the Board are divided into two groups. Group One Trustees comprise a minimum of one-fourth of the Trustees. Group Two Trustees, which comprise the remainder of the Trustees, are divided into three approximately equal classes to create staggered three-year terms of office for each class. Group One Trustees are elected by the Board of Trustees of Baylor University. Group Two Trustees are elected by the Board of the College. Terms end at the annual meeting each May three years following election. Unless the Board's Executive Committee requests an individual Trustee to continue serving, a Group Two Trustee who reaches age 72 is deemed to have resigned at the first annual meeting of the Board that follows the date that such Group Two Trustee reaches that age. The Bylaws permit Trustees Emeritus, Retired Trustees and Advisory Trustees to be designated from time to time. Such persons do not have the power to vote. The Bylaws require the Board to meet at least quarterly; currently, the Board meets bimonthly.

The current members of the Board, their offices (if any), their principal outside activity and their years of service are as follows:

Mrs. Barbara B. Allbritton	Executive Vice President and Director, Allbritton Communications	18
Robert H. Allen, Chair	Private Investor	29
Laura E. Munoz Arnold	President, Arnold Family Foundation	1
John H. Baker, III	Baker Managers, L.L.C.	32
John F. Bookout, III	First Reserve	9
Robert T. Brockman	Chairman & CEO, Universal Computer Systems, Inc.	3
Philip Burguieres	Chairman & CEO EMC Holdings	2
Pastor Kirbyjon Caldwell	Senior Pastor of the Windsor Village United Methodist Church	8
W. Fred Cameron	Retired Partner, Fulbright & Jaworski L.L.P.	9
Richard N. Carrell, Secretary	Partner, Fulbright & Jaworski L.L.P.	11
James Y. Chao	Chairman, Westlake Chemical Corp.	3
Dan L. Duncan	Chairman, Enterprise Products Partners, L.P.	7
James C. Flores	Chairman & CEO, Plains Exploration & Production	6
James T. Hackett	President & CEO, Anadarko Petroleum Corp.	5
Paul W. Hobby	Chairman, Hobby Media Services, Inc.	9
Ned S. Holmes	Chairman & CEO, Parkway Investments	7
Harold S. Hook	Retired Chairman & CEO, American General Corp.	32
Jack Hunt	President & CEO, King Ranch, Inc.	13
Jodie Lee Jiles	Managing Director, RBC Capital Markets	7
Carolyn Dineen King	Judge, US Court of Appeals, Fifth Circuit	2
C. Berdon Lawrence	Chairman, Kirby Corporation	6
Dr. John M. Lilley	President and CEO, Baylor University	3
Jack E. Little, Ph.D.	Retired President & CEO, Shell Oil Company and JEL Interests	10
Fred R. Lummis, Vice Chair	Managing Director, The CapStreet Group, L.L.C.	13
Drayton McLane, Jr.	Chairman, McLane Group, Chairman & CEO, Houston Astros Baseball Club	2
Robert C. McNair	Chairman & CEO, Houston Texans	15
Trinidad Mendenhall Sosa	Mendenhall Foundation	7
John L. Nau, III	President & CEO, Silver Eagle Distributors L.P.	7
Lyndon L. Olson, Jr.	Senior Advisor, Citigroup, Inc.	5
R. Randall Onstead, Jr.	Onstead Interests	11
Laree E. Perez	The Medallion Companies, L.L.C.	2
Thomas R. Powers	President, Tom and Pat Powers Foundation	2
Harry M. Reasoner	Senior Partner, Vinson & Elkins L.L.P.	17
Frank H. Richardson	Retired President & CEO, Shell Oil Company	20
Corbin Robertson, Jr.	President, Quintana Minerals Corporation	26
J. Hugh Roff, Jr.	Chairman, Roff Resources, L.L.C.	26
Ali A. Saberioon	President & CEO, Sabco Oil and Gas Corp.	3
Marc J. Shapiro, Vice Chair	Consultant, JPMorgan Chase Bank	19
Lester H. Smith	The Smith Foundation	5
H. Ben Taub	Taub Foundation	9
Peter G. Traber, M.D.	President & CEO, Baylor College of Medicine	6
J. Adan Trevino	President & CEO, Amex Investments, Inc.	15
Louis A. Waters	SimDesk Technologies	34
Chuck Watson	Chairman of the Board, Eagle Energy Partners	8
Marvin L. West	President/Consultant, Risk Management Consultants	32
Charles A. Williams	President, Chaswil, Inc.	14
Wallace S. Wilson	Private Investor	9

Committees

The Board performs many of its functions through a series of committees made up of members of the Board. In addition to the Executive Committee, which has the full authority of the Board, the following Board committees exist: Audit; Buildings and Interiors; Compensation and Employee Benefits; Endowment, Development and Fine Arts; Finance; Governance and Nominating; Government Affairs; Investment; and Risk Management and Insurance.

Conflict of Interest Policy

The Board of the College has adopted a formal conflict of interest policy to facilitate the identification and resolution of conflicts of interest. Some of the members of the Board of the College are associated with, or are investors in, businesses or firms with which the College has, from time to time, entered into transactions to provide goods or services. An affiliate of Citigroup is a counterparty to certain interest rate swap transactions with the College. JPMorgan Chase Bank serves the College in a traditional banking capacity as depository and custodian, and also serves as a lender to the College under the $50 million loan facility dated December 21, 2007, and as provider of an irrevocable letter of credit securing the payment of the Series 2008 E Bonds. Fulbright & Jaworski L.L.P. serves as Counsel to the College and bond counsel in connection with the Series 2008 Bonds and as counsel in connection with other ongoing matters. In the opinion of management of the College ("College Management"), the transactions between businesses or firms with which members of the Board are associated and the College are conducted on an "arm's length" basis.

Executive Leadership

Interim President and Chancellor Emeritus William T. Butler, M.D., and his staff conduct the day-to-day operations of the College. Descriptions of Dr. Butler and his staff are as follows:

William T. Butler, M.D., Interim President Chancellor Emeritus. Dr. Butler served as President and Chief Executive Officer of the College from 1979 until 1996. Dr. Butler has held several other administrative positions at the College, including Executive Vice President and Dean. Dr. Butler is a Professor of Internal Medicine and Microbiology & Immunology and a Distinguished Service Professor. A medical graduate of Western Reserve University in Cleveland, Dr. Butler worked with the National Institutes of Health before joining the College faculty in 1966. Dr. Butler served as Chairman of the Association of American Medical Colleges ("***AAMC***") from 1990 to 1991 and was previously Chairman of the AAMC Council of Deans. Dr. Butler chaired the congressionally chartered Special Medical Advisory Group of the Department of Veterans Affairs and, for eight years, he was Chairman of the Health Professions Education Advisory Committee of the Texas Higher Education Coordinating Board. In 1990, Dr. Butler was elected to membership in the Institute of Medicine of the National Academy of Sciences.

Bobby R. Alford, M.D., Chancellor. Dr. Alford is the Distinguished Service Professor and Chairman of the Department of Otolaryngology & Communicative Sciences. Prior to becoming Chancellor, Dr. Alford served as Executive Vice President and Dean of Medicine. Dr. Alford serves on the staff of several hospitals and medical centers in the Houston area. A medical alumnus of the College, he has been elected to the prestigious National Academy of Sciences' Institute of Medicine and has received a Presidential Citation from the American Academy of Otolaryngology-Head and Neck Surgery. Dr. Alford also received the National Aeronautics and Space Administrations Distinguished Public Service Award. In 1981, he received the Outstanding Service Award from the American Council of Otolaryngology and was appointed to NASA's National Advisory Council in 1992. He is a past President of both the American Academy of Otolaryngology-Head and Neck Surgery and the American Board of Otolaryngology.

Cyndi M. Baily, J.D., M.P.H., Senior Vice President and General Counsel. Ms. Baily received a bachelor's degree in Microbiology from Allegheny College, a Master's of Public Health from The University of Texas Public Health, and a law degree from the University of Houston Law Center. She has practiced law in Texas since 1994, specializing in health care law, including corporate, transactional, and regulatory work as well as litigation focusing on medical malpractice and employment law.

William R. Brinkley, Ph.D., Senior Vice President and Dean of The Graduate School of Biomedical Sciences. Dr. Brinkley is Professor and Vice Chairman of Cell Biology. A Distinguished Service Professor, Dr. Brinkley also serves as Co-Director of the W.M. Keck Center of Computational Biology, a joint project of the College, Rice University and the University of Houston. A graduate of Iowa State University with a Ph.D. in Cell Biology, he is a member of the Association of American Medical Colleges' Advisory Board on Biomedical Research and is a past president of both the American Society of Cell Biology and the International Federation of Cell Biology.

Stephen B. Greenberg, M.D., Senior Vice President and Dean of Medical Education at Baylor College of Medicine. Dr. Greenberg was appointed to this position in July 2006. Since 1990, he had been the Herman Brown Teaching Professor and Chief of the Medicine Service at the Ben Taub General Hospital. From 2002 to 2006, he was Acting Chair and permanent Chair of the Baylor Department of Medicine. From 2001 to 2004, he was Assistant Dean of Graduate Medical Education. Dr. Greenberg's Honors include Alpha Omega Alpha Honor Society membership, John McGovern Award for Teaching in the Clinical Sciences, Distinguished Service Professorship at BCM, and Master of the American College of Physicians.

David Holcomb, Ed.D., Senior Vice President and Dean for Allied Health Sciences. Dr. Holcomb received a bachelor of science and a Master's of Education degree from Stephen F. Austin University and a Doctor of Education from the University of Houston. He completed his postdoctoral work at the University of Southern California. Dr. Holcomb has served on the College faculty for over 35 years.

Lisa Kennedy, Senior Vice President of Development and Executive Administration. Ms. Kennedy joined the College in 1996 as Senior Director of Development. In that position, she played a key role in the successful completion of the College's Investment in Discovery Campaign. She was named Assistant Vice President and Interim Vice President in 2002 and Vice President in July 2003. Prior to joining the College, she spent four years as the Director of Corporate and Foundation Relations at Rice University and two years as the Director of Corporate Relations at Southern Methodist University. Ms. Kennedy also spent 14 years in sales, marketing, and management in the contract furniture market. She holds an undergraduate degree from Texas Tech University and an MLA from Southern Methodist University.

Claire M. Bassett, Vice President for Public Affairs and Federal Government Relations. Ms Bassett, has been with the College for more than 26 years, having also served as Senior Director of Communications and Acting Chief Public Affairs Officer. She is a volunteer for the National American Heart Association and served as President of the Board of Directors of the Texas Society of Biomedical Research. In her current role, she oversees all areas of the College's Office of Public Affairs, including Media Relations and Communications, Publications and

Creative Services, Institutional Web Management, and Federal Government Relations, and coordinates all international activities for the College.

Rachel Caillouet, Ph.D., Vice President for Human Resources. Dr. Caillouet joined the College in 1999 after 10 years with Our Lady of the Lake Regional Medical Center ("***OLOL***"), in Baton Rouge, Louisiana, a part of the Franciscan Missionaries of Our Lady Health Care System. As Director of Human Resources for OLOL, Dr. Caillouet had responsibility for 4,000 employees. Dr. Caillouet holds a Ph.D. and M.A. in organizational communication, with specialties in crisis communication, change management, and organizational culture. Dr. Caillouet is a member of the Society of Human Resource Management and the American Society for Training and Development.

Kimberly C. David, C.P.A., M.B.A., Senior Vice President for Finance Chief Financial Officer, has been with the College for more than nine years. Prior to joining the College in 1998, Ms. David worked at Arthur Anderson LLP for ten years in a variety of accounting and management positions. Trained as an accountant with her CPA, Ms. David graduated from Oklahoma State University with a Bachelor of Science degree in Accounting. Ms. David recently graduated from Rice University with a Masters in Business Administration.

Jennifer C. Dudley, Vice President of Advancement. Ms. Dudley began leading the College's marketing effort in July 2007 as Interim Executive Director and was made Vice President of Marketing in July 2008. Ms. Dudley led the development of the Best Minds Best Medicine advertising campaign, the first institutional advertising campaign in the College's history. Her previous role was as a member of the College's development team, where she served as a major gift officer, senior director of development, and executive director of development resources. Prior to joining the College, Ms. Dudley held positions at Rice University as Foundation Director and Director of Development, and at The University of Texas Medical Branch at Galveston as a research administrator and grant writer. Ms. Dudley has a degree in English and Philosophy from the University of New Mexico in Albuquerque.

Jenifer Jarriel, ***M.B.A.,*** Vice President of Information Technology and Chief Information Officer. Ms. Jarriel has been with the College since May 1995. Before joining the College, she served as Vice President of Information Services for Texas Children's Hospital for four years. Prior to her work at Texas Children's, she served as Director of Information Services at Hermann Hospital, where she worked for eleven and one-half years. She is a member of the Board of Directors for LEARN (Lonestar Education and Research Network), a founding member of CHIME (College of Healthcare Information Management Executives), and a long-standing member of HIMSS (Health Information and Management Systems Society). Ms. Jarriel holds an undergraduate degree from the University of Houston Central Campus and an M.B.A. from Houston Baptist University.

Tom Kleinworth, **Vice President for State Relations**. Mr. Kleinworth joined the College in 1986. He oversees BCM's interactions with all areas of state government, including the Texas Legislature, statewide elected officials and state agencies such as the Higher Education Coordinating Board. A graduate of The University of Texas at Austin, Mr. Kleinworth worked as a newspaper reporter and editor in Memphis, Tennessee, then served five years as a legislative aide to a Texas state senator. Prior to joining the College, Mr. Kleinworth served as director of communications for the Texas Pharmacy Association.

Robert G. McCleskey, A.I.A., is the Vice President for Strategic Capital Projects of the College. Mr. McCleskey has held this position since December 2006. Prior to joining Baylor, Mr. McCleskey served as a program manager with Fluor, a large international engineering and construction company responsible for the management of design and construction projects, primarily in the research and life sciences industries, for over 26 years. Mr. McCleskey has a total of 35 years of experience in design and construction. He is a graduate of Clemson University with Bachelor of Arts in Pre-Architecture and Master of Architecture degrees. Mr. McCleskey is also a registered architect and a member of the American Institute of Architects.

Rock Morille, M.B.A Vice President for facilities. Rock is a 1981 graduate of Texas A&M University with a degree in Mechanical Engineering and holds a MBA from St. Edward's University in Austin. He joined Baylor in 1988 as manager of technical operations and engineering and was named senior director of facility services in 2005.

Thomas J. Riley, M.B.A., Vice President of Clinical and Hospital Operations. Mr. Riley joined the College as a Senior Director in August 2004 as a member of the team developing the facility and operational model for the Baylor Clinic. Before joining the College, Mr. Riley was Project Manager of the Gulf Coast Division for HCA. Prior to his work at HCA, he served as Senior Manager in Healthcare Consulting for Ernst & Young LLP and was charged with project direction and achieving improved financial and operational performance for his clients. Mr. Riley holds an undergraduate degree in Economics from Northwestern University in Evanston, Illinois, and an MBA and HAS from Duke University's Fuqua School of Business in Durham, North Carolina.

Carlos Rodriguez, M.B.A., Vice President for Business Operations. Mr. Rodriguez received a Bachelor of Science degree in Engineering from Texas A&M in 1986 and a Masters in Business Administration in 1991 from the University of Dallas. He has been employed by Texas Instruments, General Instrument (a division of Motorola) and Oak Industries as an Industrial Engineer, Engineering Manager, Vice President of Operations, and Business Unit President. He joined the College in 2003 as Administrator for the Michael E. DeBakey Department of Surgery. He has been serving as the College's Vice President of Business Operations since August of 2004.

William D. Walker, M.B.A., J.D., Vice President and Chief Investment Officer. Mr. Walker joined the College in 2000 after 19 years with JPMorgan Investment Management, Inc. where he served as Managing Director and Group Head - Petroleum Funds. Mr. Walker is a 1975 graduate of the University of Virginia with a B.A. in Economics with High Distinction. Mr. Walker also holds M.B.A. and law degrees from that institution and is a retired member of the New York State Bar Association. Mr. Walker is responsible for investment of the College's endowment. Mr. Walker works closely with the Board of Trustees' Investment Committee managing the endowment's spending policy, asset allocation, portfolio construction, external manager selection, performance reporting, and custodian and consultant relationships. Mr. Walker is also responsible for the endowment's $20 million investment in start-up companies through BCM Technologies, Inc. Mr. Walker also serves as a Director of BCM Technologies, Inc. and as a member of its Investment and Finance and Audit Committees.

CORPORATE STRUCTURE

General

The following entities are affiliated with the College:

Affiliated Medical Services ("***AMS***") is a Texas non-profit corporation that is exempt from federal income taxation under Section 501(a) of the Code by virtue of being an entity described in Section 501(c)(3) of the Code (a "tax exempt entity"). AMS is certified by the Texas Medical Board under Section 162.001 of the Texas Occupations Code. The College and The University of Texas System are the sole members of AMS. AMS was formed in 1988 to jointly negotiate for physician services with the Harris County Hospital District. Through AMS, the College and The University of Texas System supply the majority of residents and physicians to the hospitals and other health care facilities owned by the Harris County Hospital District. See "**PATIENT CARE**" and "**FINANCIAL INFORMATION**."

Baylor College of Medicine Healthcare, d/b/a BaylorMedcare ("***Medcare***") is a Texas non-profit corporation and tax exempt entity. The College is the sole member of Medcare. Medcare was formed in 1994 by the College for the purpose of centralizing the professional practices of the physicians within the academic departments of the College or physicians in the community in order to contract with third parties to provide health care services within the community. Medcare currently has contracts on behalf of College physicians with health care providers, self-insured employers, health maintenance organizations, health insurers, and other managed care entities.

Baylor College of Medicine International Pediatric AIDS Initiative ("***Initiative***") is a Texas non-profit corporation and tax exempt entity. The College is the sole member of Initiative. Initiative was formed to provide health care support for underserved children with AIDS. Initiative currently operates clinics and programs in the following countries: Romania, Botswana, Lesotho, Swaziland, Malawi, Uganda, Burkina Faso, Kenya, and Libya.

Baylor College of Medicine Radiology Associates ("Radiology") is a Texas non-profit corporation which is in the process of applying for federal tax-exempt status. The College is Radiology's sole member. Radiology is certified by the Texas Medical Board under Section 162.001 of the Texas Occupations Code and is organized to facilitate the delivery of professional radiological services. Radiology currently has no operations.

Baylor College of Medicine Shoulder to Shoulder Foundation ("***Shoulder***") is a Texas non-profit corporation and tax exempt entity. Baylor College of Medicine is the sole corporate member. Shoulder is an alliance with the Health Committee of Santa Ana, Honduras, and aims to improve health and the provision of health services for underserved people in the area of Santa Ana and Intibucá in Honduras.

BCM Technologies, Inc. ("***Technologies***") is a Delaware business corporation. The College directly and indirectly owns all shares of Technologies. Technologies was formed in 1983 for the purpose of commercializing technology and intellectual property developed by employees of the College, including investment in start-up technology companies.

BCM Technologies I, L.P. is a Delaware limited partnership formed to make venture capital investments in start up and emerging companies in medical / biomedical and healthcare.

BCM Ventures Management I, L.P. is the general partner of BCM Technologies, I L.P.

BCM Pathology Associates ("Pathology") is a Texas non-profit corporation. The College is Pathology's sole member. Pathology is certified by the Texas Medical Board under Section 162.001 of the Texas Occupations Code and is organized to facilitate the delivery of professional pathology services. Pathology currently has no operations.

Community Pathology PLLC, ***("CPPLLC")*** a Texas professional limited liability company wholly owned by Pathology, was formed to facilitate the acquisition of a professional pathology practice. CPPLLC currently has no operations.

The Menninger Clinic ("Menninger Clinic") is a Texas non-profit corporation and tax exempt entity. The Menninger Clinic is dedicated to making a positive difference in the health and lives of adolescents and adults with severe psychiatric and dual disorders. Since its founding in 1925, the Menninger Clinic has provided treatment for more than 250,000 patients from the United States and around the world. Originally located in Topeka, Kan., the Menninger Clinic partnered with the College and The Methodist Hospital in 2002 and moved to Houston in June 2003. Residents from The Menninger Department of Psychiarty and Behavioral Sciences at the College complete portions of their advanced training at the Menninger Clinic. The Menninger Clinic hosts trainees from the college from the following programs: General Psychiatry Residency, Childs Psychiatry Residency, Psychology Internship Program, Social Work Internship Program, and Postgraduate Fellowship in Clinical Social Work.

National Space Biomedical Research Institute ("***NSBRI***") is a Texas non-profit corporation that is exempt from federal income taxation under Section 501(a) of the Code by reason of being an entity described in Section 501(c)(3) of the Code. The College is the sole member of NSBRI. NSBRI was formed in 1997 to perform biomedical and related research and to conduct educational programs at the request of the National Aeronautics and Space Administration. See "**RESEARCH**."

In addition to the foregoing entities, the College has several unincorporated operating divisions, such as The DeBakey Heart Center, the Children's Nutrition Research Center, the Shell Center for Gene Therapy, and the Influenza Research Center. The results of operations of these centers, along with the College's other research centers and operating divisions, are included in the Summary of Unrestricted Operating Activities of the College. See "**FINANCIAL INFORMATION**."

In addition, the College receives support from Baylor Medical Foundation (the "***Foundation***"). The Foundation was organized in 1962 exclusively to aid, support and maintain the College. The Foundation is a Texas non-profit corporation and tax exempt entity. Income from endowment funds held by the Foundation is dedicated to the College and, historically, each year the Foundation transfers to the College all investment income of the

Foundation. A separate Board governs the Foundation. In the event of the Foundation's dissolution, the Foundation is required to transfer to the College any funds or property that it then owns. The College's interest in the net assets of the Foundation of approximately $22..0 million as of June 30, 2009, is included in the Balance Sheet contained in the financial statements set forth in **APPENDIX B**.

EDUCATION

Medical School Education

More than 17,000 physicians and allied health professionals have received all or part of their training, either as students or residents, at the College. These alumni are in private practice, serve on the faculty of medical schools, or conduct research throughout the 50 states and 37 foreign countries.

In 1969, the Texas Legislature enacted legislation (the "***Appropriation Legislation***") which authorizes the Texas Higher Education Coordinating Board (the "***HECB***") to contract with the College for the administration, direction, and performance of services and the provision, maintenance, operation, and repair of buildings, facilities, structures, equipment, and materials necessary to the education, training, preparation or instruction of Texas resident undergraduate medical students. Pursuant to the Appropriation Legislation, each year the College and HECB enter into a contract pursuant to which the College is paid, if such amounts are appropriated by the Texas Legislature biannually, an amount per Texas resident undergraduate medical student enrolled at the College that is computed by reference to the amount of money appropriated to certain state-supported medical schools. Pursuant to the Appropriation Legislation and the contract in effect between the College and HECB for the two-year period commencing September 1, 2009, the College is to be paid approximately $40.2 million in fiscal year 2010 and $43.1 million in fiscal year 2011 based on the number of Texas resident undergraduate medical students enrolled at the College. The legislature appropriated $40.2 million in fiscal year 2010 and $43.1 million in fiscal year 2011 to fund the two contract years beginning September, 2009. See "**FINANCIAL INFORMATION**."

The College's excellent reputation and quality teaching facilities consistently attract the best medical students from throughout the United States. In fiscal 2009, the College received 4,879 applications for 176 positions in the entering medical class. The average grade point average for the fall 2009 entering class was 3.8. The 678 medical students currently enrolled represent more than 70 undergraduate schools.

Graduate Medical Education

Top medical school graduates from the United States and many foreign countries also are attracted to the College for advanced training in the Graduate Medical Education ("***GME***") program. With 922 resident physicians, the College's GME program is one of the largest in the country and offers training in 81 Accreditation Council for Graduate Medical Education programs.

With an enrollment of 556, the College's Graduate School for Biomedical Sciences also attracts outstanding students who are seeking advanced degrees in the biomedical sciences. The Graduate School's nine Ph.D. programs and five interdepartmental programs focus on training and research in the basic sciences for students pursuing careers in research and as medical school and university teachers. A joint M.D./Ph.D. program is also available to selected students pursuing academic careers. Currently, 81 students are enrolled in this program.

The College has 524 students enrolled in its postdoctoral research and training program and 394 clinical fellows (M.D.). This program offers postdoctoral fellowships to outstanding students who have received advanced degrees and want to pursue research and clinical activities at an even higher level.

The College also offers joint M.D./M.B.A. and Ph.D./M.B.A. programs with the Jesse H. Jones Graduate School of Management at Rice University.

Other Educational Programs

The College sponsors continuing medical education courses. These courses provide physicians with the latest information in their medical specialties. In 2008, over 3,500 practicing physicians attended formal continuing medical education courses sponsored by the College.

The College offers Masters of Science degrees in both Nurse Anesthesia and Physician Assistant Studies. Enrollment in these degree programs for the allied health professions has been stable and highly competitive.

The Medical Scholars Program, established jointly by the College and Rice University, accepts 15 outstanding high school graduates entering Rice each year. After satisfactorily completing broad-based undergraduate degree requirements at Rice, these students are automatically accepted as medical students at the College. Similar programs exist with Baylor University, the University of Houston and The University of Texas-Pan American.

The College maintains a partnership with the school districts in Houston, Mercedes, Corpus Christi and Laredo, Texas to sponsor high schools for students with career interests in medicine and science.

Student Enrollment

The College receives many more applications than there are allowable places and is thus able to be highly selective in the admissions process. With certain exceptions, the allowable places annually include: 176 medical students and 50 allied health (36 physicians assistants and 14 nurse anesthetists). The College is ranked 10th in the nation for student selectivity.

Medical Students	2007	2008	2009
Number of Applicants	4,326	4,922	4,879
Number Accepted	275	297	300
Number Admitted	168	172	176
Mean MCAT Score(1)	11.3	11.6	11.5

Graduate Students	2007	2008	2009
Number of Applicants	931	1,075	1,178
Number Accepted	182	201	220
Number Admitted	109	98	103
Allied Health	**2007**	**2008**	**2009**
Number of Applicants	660	831	844
Number Accepted	63	69	74
Number Enrolled	50	50	55

(1)The Mean MCAT Score is for students admitted. The MCAT is given in three parts. The maximum score for each part is 15 points. Scores are given as an average of the three parts. For the 2008 MCAT exams, the national Mean for Matriculants was 10.3.

Source: College Management

Faculty

As of June 30, 2008, the College employed 1,963 full-time faculty members and 338 part-time faculty members. The following table depicts the number of faculty members in each position for June 30, 2008 and June 30, 2009:

	June 30, 2008	June 30, 2009	Change
Professor-Tenured	307	355	48
Professor-Non-Tenured	37	46	9
Associate Professor-Tenured	165	183	18
Associate Professor-Non-Tenured	229	237	8
Assistant Professor-Tenured-Track	482	447	(35)
Assistant Professor-Non-Tenured-Track	637	688	51
Instructors	389	345	(44)
TOTAL	2,246	2,301	55

Source: College Management

Accreditation

The College is accredited by:

- The Liaison Committee on Medical Education, joint committee representing American Medical Association and Association of American Medical Colleges,
- The Commission on Colleges of the Southern Association of Colleges and Schools to award masters and doctorate degrees (M.D., Ph.D., M.S.),
- The Accreditation Review Committee on Education for the Physician Assistant, Inc.,
- The American College of Nurse Midwives,
- The Council on Accreditation of Nurse Anesthesia Educational Programs,
- The Accreditation Council for Continuing Medical Education, and
- The Accreditation Council for Graduate Medical Education.

RESEARCH

For more than 30 years, the College has been recognized as a national leader in biomedical research. The College's total research expenditures have grown from $17 million in 1971 to more than $357 million in 2008. The College consistently ranks in the top 10% of the 126 U.S. medical schools in competitive research grants to faculty and it was ranked 13th in 2008 by the National Institutes of Health ("***NIH***"). The College ranks first among medical schools in Texas in research expenditures.

Much of the research is performed in the College's national research centers, the privately-funded Howard Hughes Medical Institute and the College's more than 70 specialty centers:

- The Influenza Research Center, located at the College since 1974, conducts studies on the ever-changing flu and respiratory viruses that affect people throughout the world.
- The Children's Nutrition Research Center is the only federally-funded nutrition center devoted to studying the nutritional needs of children. Its annual funding exceeds $11 million.

- The DeBakey Heart Center, established in 1985 and supported in part by private endowment, is the site of some of the country's most intensive research on cardiovascular disease.

- The Shell Center for Gene Therapy, established in 1993 and supported in part by private endowment, combines basic research on gene therapy with clinical applications.

The Howard Hughes Medical Institute (the "***Institute***") conducts research activities in Institute laboratories at over 60 medical centers, teaching hospitals and university campuses, including the College. Currently, the Institute employs four faculty members at the College. Pursuant to a collaborative research agreement with the College, research is conducted by Institute investigators at the College primarily in the fields of genetics and structural biology and, more recently, in immunology and neuroscience.

The College is also the site of major ongoing national research projects funded by the federal government.

The College is:

- One of only three U.S. institutions to house two NIH Heart, Lung and Blood Special Centers of Research;

- One of two NIH-funded Specialized Programs of Research Excellence to study prostate cancer through the Matsunaga-Conte Prostate Cancer Research Center; and

- One of 40 centers chosen by the NIH to participate in the Women's Health Institute-the first comprehensive study of women's health undertaken in the United States.

The Dan L. Duncan Cancer Center at Baylor College of Medicine (the "***Duncan Cancer Center***") is organized around eight major programs of excellence, including cell and gene therapy, cancer prevention and population sciences, molecular carcinogenesis, nuclear receptor biology, breast cancer, pediatric oncology, cancer biology and prostate cancer. Faculty members represent 28 departments or centers from across the College. The College has been developing its cancer center since 1997, building programs in research and patient care. In early 2006, Dan L. Duncan, businessman and philanthropist, contributed $100 million to the center. More than 100,000 square feet is currently dedicated to cancer research and additional space has been established in the new Margaret M. Alkek Building for Biomedical Research. The College receives approximately $100 million per year in cancer-related research funding with about $37.8 million from the National Cancer Institute ("***NCI***"). The Duncan Cancer Center has been named a designated cancer center by the NCI. The NCI designation is a milestone for cancer programs across the country and recognizes the College's scientific and clinical excellence. Only 63 cancer centers have achieved such status in the United States, and only three are in Texas. The Duncan Cancer Center joins M.D. Anderson Cancer Center in Houston as the only two designated cancer centers in Houston. As part of the designation, the Duncan Cancer Center will receive up to $3 million over the next three years. Cancer treatment will be one of the major patient services at the new Baylor Clinic and Hospital, which will open in 2011.

The College is the lead institution and home of the National Space Biomedical Research Institute, a consortium of academic institutions charged with enhancing the nation's expertise in the space life sciences through understanding the basic mechanisms that produce the biological and physiological effects of microgravity; and producing countermeasures to mitigate these effects and ensure safe, long duration human space flight.

College Management believes the College's relationships with entities providing research funding are positive and does not anticipate a decrease in such funding.

PATIENT CARE

Affiliated Hospitals

The College's undergraduate medical students and resident physicians in the Graduate Medical Education training program learn and work primarily in eight teaching hospitals with which the College has contracts to provide residents and physicians. These eight affiliated teaching hospitals have a combined total of approximately

4,600 licensed beds. These state-of-the-art facilities provide the College's students and residents unsurpassed educational surroundings for clinical and research training.

The College's physicians, students, and residents see inpatients and outpatients each year in these affiliated teaching hospitals and their clinics. Set forth below is a list of the affiliated teaching hospitals with which the College has contractual agreements to supply physicians and services. Information in the following descriptions is derived from the websites of the respective institutions and other public information.

Ben Taub General Hospital ("***Ben Taub***"), part of the Harris County Hospital District, is a 650-bed medical and surgical hospital that is nationally recognized for its Level I trauma center. The acute care facilities have psychiatric and pediatric emergency centers, and 12 operating rooms. Nearly 40 percent of the College's resident physicians are trained at Ben Taub and 11 community centers, which are also part of the Harris County Hospital District.

Memorial Hermann - The Institute for Rehabilitation and Research ("***TIRR***") is a 116-bed rehabilitation hospital located in the Texas Medical Center, with associated outpatient services in the community. One of the top five rehabilitation facilities in the country, TIRR focuses on providing care to individuals who have experienced catastrophic injuries or illnesses.

*St. Luke's Episcopal Hospital ("**St. Luke's**"),* founded by the Episcopal Diocese of Texas in 1954, delivers primary and tertiary health care to patients throughout the Houston metropolitan area and from around the world. St. Luke's is licensed for 912 beds with 718 beds in service; the nonprofit hospital cares for more than 30,000 inpatients and 220,000 outpatients each year. St. Luke's is a teaching hospital with a medical staff of nearly 600 physicians.

Texas Children's Hospital, licensed for 639 beds, is one of the nation's largest pediatric hospitals. Its physicians treat infants, children, and adolescents, and its units specialize in the diagnosis and treatment of rare disorders. Almost all of the geographically based physicians at Texas Children's Hospital are members of the College's full-time faculty. More than 40 medical and surgical outpatient services are available to children. On April 10, 2008 Ralph Feigin announced that he has approached the leadership of Texas Children's Hospital and Baylor College of Medicine about seeking his successor as Physician-in-Chief of Texas Children's Hospital and Chair of the Department of Pediatrics at Baylor College of Medicine. Dr. Feigin will continue to serve as Physician-in-Chief and Chair of Pediatrics until a successor is named. Following the naming of a successor, he will continue to serve as a professor in the Department of Pediatrics at Baylor and as a pediatrician at Texas Children's Hospital.

The Methodist Hospital ("***Methodist***") is one of the nation's largest private, non-profit hospitals with 1,269 beds. The hospital records approximately 40,500 inpatients each year, and another 327,000 outpatients receive care annually.

The Michael E. DeBakey Veterans Affairs Medical Center ("***MEDVAMC***") has been affiliated with the College since 1949. Today, with 319 acute care, medical, intermediate medicine, and surgical beds and a 120-bed nursing home, it is one of the Veteran's Administration's largest hospitals, serving Harris County and 27 surrounding counties.

Baylor department chairmen and top administrators from the Veteran's Administration serve on the Deans Committee at MEDVAMC to set medical care standards and advise on education and research programs at MEDVAMC. The committee recommends measures to assure that the highest quality of medical care is delivered to the veteran patients. Members of the College's faculty serve as medical service chiefs at the hospital.

M. D. Anderson Cancer Center is one of the world's most respected centers devoted exclusively to cancer patient care, research, education, and prevention. It has ranked among the nation's top two cancer hospitals in U.S. News & World Report's "America's Best Hospitals" survey since the survey's inception 17 years ago.

The College and its affiliated teaching hospitals have entered into formal contracts that govern the payments to be made to the College and other matters. These contracts are negotiated and renewed on a periodic basis. In fiscal year 2008, payments made to the College pursuant to these agreements accounted for 27% of the College's operating revenues, with no more than 33% of these payments coming from any one entity. In addition, certain members of the College's Executive Leadership have medical staff or management appointments at the affiliated teaching hospitals. The following information for the College's affiliated teaching hospitals includes patients who are not treated by the College's physicians and students. The most recent admissions and visit information available from the College's affiliated hospitals is summarized in the table below:

Hospital Name	Total Admissions	Outpatient Visits
St. Luke's Episcopal Hospital	30,000	200,000
The Methodist Hospital	39,000	308,000
Texas Children's Hospital	22,000	330,000
M.D. Anderson Cancer Center	22,194	965,248
Ben Taub General Hospital(1)	24,600	195,000
MEDVAMC	14,057	900,000
Memorial Hermann-TIRR	1,000	35,000

Source: Teaching Hospitals' Records for each Hospital's most current fiscal year

(1)Although the College provides services to multiple facilities of the Harris County Hospital District, information shown above is solely for Ben Taub General Hospital and does not include the other Harris County District facilities at which the College provides services.

Other Cooperating Patient Care Institutions

In addition to the affiliated teaching hospitals described above, the College's students, residents and physicians also provide health care services to other hospitals, private hospitals, and sub-acute facilities, including the following:

Community Health Centers	Park Plaza Hospital
Cullen Bayou Place	Quentin Mease Hospital
DePelchin Children's Center	Seven Acres Jewish Geriatric Center
Houston Child Guidance Center	Shriners Hospital for Children
Jewish Family Service	Thomas Street AIDS Clinic
Kelsey-Seybold Clinic	The Women's Hospital of Texas

HISTORICAL ACHIEVEMENTS AT THE COLLEGE

The following list summarizes what College Management believes are historical achievements in education, research and patient care at the College:

1949 • Dr. Michael E. DeBakey begins a program of innovative cardiovascular surgery.

1953 • Dr. DeBakey invents the Dacron graft.

1955 • The College's affiliated hospital residency program is created.

1961 • The World Health Organization Collaborating Center for Virus Reference and Research is established at the College.

1964 • Dr. DeBakey performs the first successful coronary artery bypass operation.

• The Jesse H. Jones Hall, M.D. Anderson Hall, and the Jewish Institute for Medical Research are added to the College's East Campus.

1971 • The College begins a Physician Assistant Program to train students focused on a career in the allied health profession.

1972 • The College and the Houston ISD create the nation's first High School for Health Professions.

1974 • The College is designated the National Influenza Research Center and the National Heart and Blood Vessel Research and Demonstration Center.

1977 • The College begins the M.D./PhD. program for students interested in medicine and research.

• Dr. Roger Guillemin receives the Nobel Prize in Medicine for research conducted during his tenure as a College faculty member.

1978 • The College researchers achieve a first in recombinant DNA research: extraction, purification and cloning of Escherichia coli bacteria.

• The nation's first Children's Nutrition Research Center is opened in collaboration with the U.S. Department of Agriculture and Texas Children's Hospital.

1982 • The Michael E. DeBakey Center for Biomedical Education and Research building opens.

1983 • BCM Technologies, Inc., is established to take faculty research developments to the marketplace.

1986 • The Ben Taub Research Center opens to provide additional research space for the College faculty.

1988 • The Vivian and Bob Smith Medical Research Building opens.

• A Federally funded Children's Nutrition Research Center building opens.

1990 • The College and Rice University establish a Medical Scholars Program to simultaneously accept students to both institutions for a seamless 8-year program for students interested in becoming physicians.

1991 • The College is designated as a national Human Genome Sequencing Center to complete the mapping of the human genome.
• The Center for Gene Therapy is created.

• The AIDS Research Center is established.

1992 • The Science Academy of South Texas is formed by the College, Rice University and the South Texas ISD.

1993 • The gene for Severe Combined Immune Deficiency disease, which resulted in the death of David, the Bubble Boy, is discovered by consortium of scientists at the College and NIH.

1994 • The College is designated as a site for the national Women's Health Initiative, the first large scale study of women's health issues.

1997 • The National Space Biomedical Research Institute is established with the College serving as the lead of the consortium of 12 institutions.

1998 • Surgeons in Germany implant the first MicroMed Ventricular Assist Device developed by Dr. DeBakey.

- The Center for Cell and Gene Therapy is established.

1999 • The gene that causes Rett Syndrome, a disease that robs healthy girls of language and mental function, is discovered at the College.

2001 • The Vannie Cook Children's Cancer Center, a joint project of the College and Texas Children's Hospital, opens in McAllen to provide care to children with cancer in South Texas.

- Baylor International Pediatric AIDS Initiative begins to provide care to children in third world countries.

2002 • The Menninger Clinic announces it will move to Houston and partner with the College and The Methodist Hospital to provide mental health services.

- The College physicians perform islet cell transplant to "cure" patient of diabetes.

2003 • Dr. Lawrence Chan develops the first successful gene therapy for diabetes in mice.

- Human Neuroimaging Lab opens to study brain function.

2004 • Alliance for NanoHealth is created with consortium of the College, Rice University, University of Houston, M.D. Anderson, University of Texas Medical Branch at Galveston, and The University of Texas Health Science Center.

- The College and the University of Houston create a joint program to offer a combined M.D./J.D. degree.

2005 • Blood pressure drug that may prevent osteoporosis is identified at the College.

- Research at the College shows for the first time when and where "trust" is formed in the brain.

2006 • Establishment of Baylor Pediatric AIDS Corps to care for the HIV-positive children in Africa.

- Genetic cause of cardiomyopathy and sudden death in young adults identified at the College.

- The College is awarded four-year $114 million grant for gene sequencing.
- The College is awarded first and only NIH quantum grant for stroke research.

2007 • Rhesus macaque genome is mapped at the College.

2008 • Dr. DeBakey is awarded the Congressional Gold Medal, the nation's highest civilian honor.

PHYSICAL PLANT

The College's campus began in 1947 with the construction of The Roy and Lillie Cullen Building (the "***Cullen Building***"). The Cullen Building served as the center for education, research and many outpatient clinics for almost 20 years. Today, the Cullen Building serves as the primary location for the College's administrative offices and also houses departmental offices and research facilities. Basic research laboratories and departmental offices are also housed in Anderson Hall, Jones Hall and the Jewish Institute. In 1982, a new Cullen Building main entry, including the Alkek Fountain and circular drive, was constructed.

The Jesse H. Jones Hall, M.D. Anderson Hall and the Jewish Institute for Medical Research were added to the Cullen Building in 1964. The adjoining Michael E. DeBakey Center for Biomedical Education and Research was occupied in 1980. The DeBakey Center is divided between basic science teaching facilities for medical students and research laboratories. Teaching facilities include modern anatomy laboratories, two 300-seat auditoriums, multi-disciplinary teaching labs, classrooms and a learning resources center.

The Ben Taub Research Center, completed in 1986, and the Vivian and Bob Smith Medical Research Building, dedicated in 1989, are twin nine-story research towers joined to the Cullen Building complex. The Ben Taub Research Center and the Vivian and Bob Smith Medical Research Building house facilities primarily dedicated to biomedical research. The Smith Building houses one of the nation's Human Genome Centers.

Apart from the main complex, the College has facilities located throughout the Texas Medical Center. More than 4 million gross square feet (GSF) is located on the Main campus (1.7 million GSF) and satellite facilities (2.3 million GSF). The Neurosensory Center and the Alkek Tower are joint projects of the College and The Methodist Hospital. Dedicated in 1977, the Neurosensory Center is an eleven-story research, teaching and patient-care facility that serves the Departments of Ophthalmology, Neurology, and Otolaryngology and Communicative Sciences. The Alkek Tower, completed in 1978, is a four-story addition to Methodist's Brown Cardiovascular Research and Training Center.

The nation's only Children's Nutrition Research Center ("***CNRC***"), established in 1979, is operated by the College in cooperation with Texas Children's Hospital for the United States Department of Agriculture. The CNRC establishes the nutritional requirements of children from infancy through adolescence, as well as those of pregnant and nursing women. An 11-story facility at the corner of Fannin and Holcombe was completed in 1988 to house all CNRC research. The facility was funded by the United States Department of Agriculture.

Construction of the 16-story Albert B. Alkek Graduate School building was substantially completed in 1997 and includes the Graduate School of Biomedical Sciences, Office of Admissions, the Office of Scholarships & Student Financial Planning, numerous research laboratories, lecture rooms, and a 176-seat auditorium. Completion of such building was paid, in part, out of the proceeds of the Series 1999 Bonds. During the years 1997 through 2003 eleven floors of the building were built out for basic science laboratory use.

The Margaret M. Alkek Building for Biomedical Research was completed and occupied in January 2008. The research tower is eight stories high with 170,000 square feet for research and research support facilities.

College faculty members currently serve patients at the Baylor Clinic located at 6620 Main. The facilities at that location are leased from St. Luke's Episcopal Hospital.

College ophthalmology physicians serve patients at a building at the northeast corner of the McNair Campus. The new building opened in the fall of 2008.

FINANCIAL INFORMATION

Sources of Revenue

The mission of the College involves education, research, patient care and community services. The following table shows the approximate percentages, as derived from the audited financial statements, of unrestricted operating revenues from these activities for the three fiscal years ended June 30, 2009.

	Fiscal Years Ended June 30,		
	2007	**2008**	**2009**
Education	9%	9%	8%
Research	35%	34%	32%
Medical Services	26%	28%	22%
Affiliated Hospitals	19%	18%	27%
Other	11%	11%	11%
TOTAL	**100%**	**100%**	**100%**

Revenues derived from education represent, tuition, fees, and state appropriations through a contract with the Texas Higher Education Coordinating Board (see "**EDUCATION**"). Revenues derived from research are from unrestricted grants and awards from federal, state and private sources (see "**RESEARCH**"). Revenues derived from medical services are fees paid to the College by patients or third party payers for medical services provided by physician employees of the College to such patients. Revenues derived from affiliated hospitals are revenues received as contractual payments by affiliated institutions for the provision of doctors and residents in those institutions (see "**PATIENT CARE**"). Revenues derived from other sources include gifts and investment and endowment income (see "**INVESTMENT CONSIDERATIONS**") for a discussion of how these sources of revenue could change in the future.

Cash and Investments

The following table (dollars in thousands) sets forth the cash and investment holdings of the College, as of the ends of the fiscal years ended June 30, 2007, 2008 and 2009.

	June 30,		
	2007	**2008**	**2009**
Cash and Cash Equivalents	$ 42,881	$ 61,609	$ 51,762
Investments (at fair market value)	1,328,939	1,132,799	757,229
TOTAL	**$ 1,371,820**	**$ 1,194,408**	**$ 813,841**

Investments as shown in the table above are the endowment funds of the College. The decline in the market value of such investments between June 30, 2008 and June 30, 2009 was driven by a decline in the stock market and the resulting unrealized losses in the College's investment portfolio.

The College's portfolio of investments is managed by professional portfolio managers under the guidance of the Investment Committee of the Board (the "***Investment Committee***"). The Investment Committee determines the asset allocation of the College's portfolio of investments based upon the current income needs of the College's various departments, overall domestic economic conditions, investment preferences, and risk tolerance. As of June 30, 2009 approximately 49% of the College's investment portfolio was allocated to U.S. Equity Securities, 7% to Fixed Income Securities, 13% to International Equities, 6% to Emerging Markets, 19% to Private Equities and 6% to High Yield Securities. Currently, the investment policy of the College does not allow for investment in Derivative Securities.

Endowment

The following table (dollars in thousands) sets forth the endowment of the College as of the end of the fiscal years ended June 30, 2007, 2008 and 2009, including the historical cost and market value of the endowment as of such dates. See "**FINANCIAL INFORMATION – Cash and Investments**."

	June 30,		
	2007	**2008**	**2009**
Market	$ 1,328,939	$ 1,132,799	$ 757,229
Cost	880,043	845,906	706,942

Contributions to the College

The following table (dollars in thousands) sets forth the restricted and unrestricted contributions received by the College for the fiscal years ended June 30, 2006, 2007 and 2008.

2007		2008		2009	
$	77,249	$	83,173	$	77,642

Since its formation, the College has sponsored a series of fundraising campaigns to raise money for the College's various departments, programs, and services. On May 23, 2007, the College formally announced its $1 billion Best Minds Best Medicine Campaign. The campaign started with a silent phase in July 2003, and has now raised more than $723 million in pledges. On September 2, 2007, the College announced that Robert McNair, a member of the Board of Trustees, and his wife will give $100 million to the College.

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Summary of Revenue and Expenses (Fiscal Year)

The following table (dollars in thousands) sets forth a comparative summary of revenues and expenses for the two fiscal years ended June 30, 2008 through 2009, derived from the audited consolidated financial statements of the College, followed by Management's Discussion and Analysis. These summaries should be considered in conjunction with the complete audited consolidated financial statements for the fiscal years ended June 30, 2009 and 2008, set Forth in **APPENDIX B.**

	Fiscal Year Ended June 30,	
	2008	**2009**
Operating Revenues		
Tuition and fees	$ 21,689	$ 20,482
Less: Institutional scholarships	(12,388)	(12,044)
Net tuition and fees	9,301	8,438
State appropriations	42,087	41,727
Government and private grants and contracts:		
Direct recoveries	294,204	308,807
Indirect recoveries	62,682	65,043
Medical services	296,748	247,878
Affiliated hospital contracts	197,500	306,496
Investment income distribution and other	58,840	58,430
Equipment acquired through grants, contracts, and gifts	7,552	8,568
Contributions	19,521	28,524
Net assets released from restrictions	35,579	37,358
Other sources	48,298	43,481
Total Operating Revenues	1,072,312	1,154,750
Operating Expenses		
Salaries, wages and benefits	743,017	797,609
Services, supplies and other	328,100	345,385
Depreciation	59,119	65,806
Interest	9,958	18,675
Total Operating Expenses	1,140,194	1,227,475
Revenues Under Expenses	(67,882)	(72,725)
Non-Operating Activities		
Contributions	2,619	2,927
Investment (loss) income, net of distribution	(58,716)	(163,284)
Unrealized loss on bond swaps	(43,591)	(52,878)
Non-equipment assets acquired through grants, contracts and gifts	252	(254)
Losses on disposals and write-downs of property and equipment	(5,628)	(1,989)
Net assets released from restrictions	2,577	1,562
Retirement of bond original issue costs	(5,312)	(3,579)
Impairment losses on capital projects		(57,000)
Net asset reclassification based on change in law	(277,566)	
(Decrease)Increase in Unrestricted Net Assets from Non-Operating Activities	(385,365)	(274,495)
Increase (Decrease) in Unrestricted Net Assets	(453,247)	(347,220)
Temporarily Restricted Net Assets		
Contributions	49,420	30,185
Net assets released from restrictions	(38,156)	(38,920)
Investment Income (Loss)	(60,844)	(120,649)
Net asset reclassification based on change in law	277,566	
Increase (Decrease) in Temporarily Restricted Net Assets	227,986	(129,384)
Permanently Restricted in Net Assets		
Contributions (Loss)	11,613	16,006
Investment Income Net of distributions	2,602	(5,537)
Increase in Permanently Restricted Net Assets	14,215	10,469
Increase (Decrease) in Net Assets	(211,046)	(466,135)
Net Assets, beginning of year	1,642,041	1,430,995
Net Assets, end of year	$1,430,995	$964,860

Management's Discussion and Analysis

Fiscal Years ended June 30, 2008 and 2009. The College's revenues under expenses for the year ended June 30, 2009 were $72.2 million compared to revenues under expenses in fiscal year 2008 of $67.9 million. For the year ended June 30, 2009 to the year ended June 30, 2008 operating revenues increased $82.4 million or 7.7%, while operating expenses increased $87.3 million or 7.7%.

Direct recoveries increased $14.6 million or 5.0% for fiscal year 2009 compared to the same period for fiscal year 2008, while indirect recoveries increased $2.4 million or 3.8%. Medical Services Revenue decreased $49 million or 16.5%. Affiliated hospital contracts increased $109 million or 55.2%. Investment Income distributed from endowment decreased $.4 million or 1.0%. Net assets released from restrictions increased $1.8 million or 5.0%. Operating contributions for fiscal year 2009 increased $9 million or 46.1% compared to fiscal year 2008. Temporarily restricted contributions were down $9.2 million or 38.9% for the comparable periods; permanently restricted contributions increased $4.4 million or 37.8%.

Operating expenses increased $87.2 million in fiscal year 2009 compared to fiscal year 2008 and consisted principally of increases of $54.6 million in salary and benefits and, $17.3 million in services, supplies and other. These increases are the result of normal growth at the College. The remaining operating expense increases for fiscal year 2009 compared to fiscal year 2008 were the result of increased depreciation expense related to the capitalization of assets and increased interest expenses related to increasing interest rates on the College's variable rate debt.

The decrease in unrestricted net assets for the year ended June 30, 2009 was $274.5 million compared to a $385.4 million decrease for fiscal year 2008.

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INTEREST RATE SWAPS

General

The College follows a board-approved policy for its use of interest rate swaps, caps, options, basis swaps, rate locks, total return swaps, and other similar derivative products. The policy authorizes such derivative products to be used only with board authority and only to achieve a specific objective consistent with the College's overall debt and investment management policy and not for speculation. Under the policy, the College's total variable rate exposure, net of derivatives transactions which have the economic effect of reducing (or increasing) variable rate exposure, may not exceed an amount to be determined by the Board from time to time (currently 40-70%). The policy requires that the College enter into derivatives transactions only with counterparties that are rated in the "A" category or above or that provide collateral or additional guarantees. In addition, the policy provides that the College is to include terms in derivatives transactions to mitigate and offset its exposure to counterparty risk, including ratings-based termination events. The chief financial officer prepares periodic reports on the status of the College's derivatives transactions, including a summary of transaction terms, the credit ratings of the counterparties, the value of posted collateral, the market value of the transactions, and cumulative and periodic cash flows.

Interest Rate Swap Transactions

The College entered into a 30-year interest rate swap transaction (the "***2005 Swap Transaction***") with Citibank, N.A., New York (the "***Swap Provider***"), on May 13, 2005, to substantially hedge the College's interest expense associated with the subsequently issued Series 2005A Bonds. Under the 2005 Swap Transaction, the College pays amounts computed at a fixed rate of 3.395% per annum, and the Swap Provider pays amounts computed at a floating rate equal to 67% of one-month LIBOR, in each case times the notional amount of the transaction, and the two parties' payments are netted. The initial notional amount of the swap was $125,000,000 and was to be reduced proportionately each year, beginning in November of 2009, at the rate at which the Series 2005A Bonds were to be retired through mandatory sinking fund redemption. The College's scheduled net payment obligations under the 2005 Swap Transaction were insured by a financial guaranty insurance policy issued by Ambac Assurance Corporation ("***Ambac***").

In anticipation of the issuance of the Series 2007A Bonds, the College entered into interest rate swap transactions (the "***2007 Swap Transactions***") with the Swap Provider in order to substantially fix the College's expected net interest expenses associated with the Series 2007A Bonds. After redeeming a portion of the Series 2007A Bonds, the College maintained the 2007A Swap Transactions as a hedge of its interest expense for the Series 2007A Bonds that were not being redeemed and the variable rate demand bonds issued to partially refund the Series 2007A Bonds. The aggregate notional amount of the 2007 Swap Transactions is equal to the aggregate amount of the unredeemed Series 2007A Bonds and such refunding bonds scheduled to remain outstanding in each period (currently $400,000,000). The College's net payment obligations under the 2007 Swap Transactions are insured by Ambac. In connection with such redemptions, the Ambac insurance will be limited to the portion of the 2007 Swap Transaction allocable to the unredeemed Series 2007A Bonds, and the College's collateral posting agreement will be extended to the balance of the 2007 Swap Transaction.

With respect to a notional amount of $300,000,000, the 2007 Swap Transactions provide that, subject to the terns thereof, the College is obligated to make payments to the Swap Provider at a fixed rate of 4.125% per annum, and the Swap Provider is obligated to make reciprocal floating rate payments calculated on the same notional amount at a rate equal to 70% of a taxable short-term interest rate index - the U S dollar one-month LIBOR rate reset weekly. With respect to a notional amount of $100,000,000, the 2007 Swap Transactions provide that, subject to the terms thereof, the College is obligated to make payments to the Swap Provider at a fixed rate of 3.833% per annum, and the Swap Provider is obligated to make reciprocal floating rate payments calculated on the same notional amount at a rate equal to 70% of 'a taxable short-term interest rate index -- the U.S. dollar one-month LIBOR rate reset weekly.

Under both the 2005 Swap Transaction and the 2007 Swap Transaction (the "***Swap Transactions***") net payments by the College or the Swap Provider as applicable, are payable monthly. The floating rate which the College receives pursuant to the Swap Transactions may be greater or less than the interest rate on the bonds that they are intended to hedge.

The Swap Transactions may be terminated prior to the maturity of the hedged bonds under certain circumstances. If a Swap Transaction is terminated under certain market conditions, the College may owe a termination payment to the Swap Provider or the Swap Provider may owe a termination payment to the College. Such a termination payment would be based upon the market value of the applicable Swap Transaction on the date of termination, and could be substantial. In addition, each party is obligated to post cash or securities with the other party equal to all or a portion of its settlement obligation from time to time, depending on its credit rating at the time.

The College's obligations under the Swap Transactions are evidenced by Notes issued by the College to the Swap Provider. The Notes are secured under the Master Indenture (i) on a parity with all outstanding Notes secured under the Master Indenture and any future Notes that may be secured by the Master Indenture to the extent that the College's obligations under the Swap Transactions are insured and (ii) on a subordinate basis, to the extent that such obligations are not insured.

LITIGATION, MEDICAL MALPRACTICE AND OTHER INSURANCE

The College is a defendant in various lawsuits and has identified certain events that can be expected to result in claims for damages. Based upon the claims history of the College, actuarial computations, the current status of pending claims and other information known to College Management, the College Management is of the opinion that no medical malpractice or other claim of which the College is now aware, whether or not filed as of the date hereof, will have a material adverse effect on the financial condition or operations of the College. College Management also believes that the self-insurance fund and commercial insurance coverage can reasonably be expected to pay for any insured liability of the College, although no assurance can be made that this will be the case.

From FY 1978 to FY 2003, the College was partially self-insured for Medical malpractice claims and purchased commercial excess insurance policies. Thereafter, the College became completely self-insured for this exposure. The College's self-insured retention is funded based upon actuarial reports that determine the amount needed for payment of medical malpractice losses, related legal expenses and the cost of administering the fund. The assets of the fund, as well as the actuarially determined liabilities, are reported in the combined balance sheets as of June 30, 2009 and 2008, which are included in **APPENDIX B**. Income from the fund assets, professional liability losses and administrative costs are reported in the combined statements of activities for the years ended June 30, 2009 and 2008, which are included in **APPENDIX B**.

The College maintains coverage with respect to general liability and other insurance that is similar to other medical schools.

EMPLOYEES

As of June 30, 2008 the College had approximately 5,467 full-time faculty and staff, 959 part-time employees and 922 residents. The College provides a competitive compensation and benefits program that includes a 401(a) savings plan, group life, medical, disability and dental insurance plans as well as paid vacation, holidays, and sick leave programs.

The College currently has no labor unions or collective bargaining agreements. There have been no stoppages of work due to strikes or labor problems. Employee problem resolution is provided by the Department of Human Resources through workplace mediation, an open-door policy with management and a formal grievance procedure. College Management considers its relationship with College employees to be excellent.

BAYLOR COLLEGE OF MEDICINE

FINANCIAL STATEMENTS

2009

Together with Auditor's Report

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Baylor College of Medicine
Houston, Texas

We have audited the accompanying balance sheets of Baylor College of Medicine (the "College") 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 the College'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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the College's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, such financial statements present fairly, in all material respects, the financial position of the College at June 30, 2009 and 2008, 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.

As discussed in Note 6 to the financial statements, the College adopted the provisions of the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*. As discussed in Note 2 to the financial statements, the College retroactively adopted the provisions of FASB Staff Position No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*.

Also, as discussed in Note 14 to the financial statements, the 2008 financial statements were restated to properly present cash and cash equivalents in the statement of cash flows and to properly classify the net assets and changes in the net assets of Baylor Medical Foundation on the College's balance sheet and statement of activities for the year ended June 30, 2008.

November 24, 2009

Deloitte & Touche LLP

Baylor College of Medicine
Balance Sheets

As of June 30, 2009 and 2008 (in thousands)

	2009	2008 (As restated, see Notes 2 & 14)
Assets		
Cash and cash equivalents	$ 51,762	$ 61,609
Cash held by bond trustee	348,411	503,183
Accounts receivable, net	98,644	92,593
Patient receivables, net	35,180	36,788
Contributions receivable, net	164,667	166,525
Notes receivable	18,593	18,708
Investments	754,397	1,100,924
Investments loaned under security lending agreements	2,832	31,875
Security lending collateral	2,952	32,962
Property and equipment, net	712,917	641,135
Other assets	27,756	32,400
Total Assets	$ 2,218,111	$ 2,718,702
Liabilities		
Accounts payable and other liabilities	$ 197,458	$ 201,894
Short term line of credit	25,000	50,000
Bond swap liability, net	14,099	36,893
Self-insurance reserves	42,845	46,843
Unexpended current awards	73,466	66,933
Bonds payable	897,431	852,182
Payable under security lending agreements	2,952	32,962
Total Liabilities	1,253,251	1,287,707
Net Assets		
Unrestricted	310,892	649,349
Temporarily restricted	327,376	465,523
Permanently restricted	326,592	316,123
Total Net Assets	964,860	1,430,995
Total Liabilities and Net Assets	$ 2,218,111	$ 2,718,702

See accompanying notes to financial statements.

Baylor College of Medicine
Statements of Activities

For the Years Ended June 30, 2009 and 2008 (in thousands)

	2009	2008 (As restated, see Notes 2 & 14)
Operating Revenues		
Tuition and fees	$ 20,482	$ 21,689
Less: Institutional scholarships	(12,044)	(12,388)
Net tuition and fees	8,438	9,301
State appropriations	41,727	42,087
Government and private grants and contracts:		
Direct recoveries	308,807	294,204
Indirect recoveries	65,043	62,682
Medical services	247,878	296,748
Affiliated hospital contracts	306,496	197,500
Investment income distribution and other	58,430	58,840
Equipment acquired through grants and contracts	8,568	7,552
Contributions	28,524	19,521
Net assets released from restrictions	37,358	35,579
Other sources	43,481	48,298
Total Operating Revenues	1,154,750	1,072,312
Operating Expenses		
Salaries, wages and benefits	797,609	743,017
Services, supplies and other	345,385	328,100
Depreciation	65,806	59,119
Interest	18,675	9,958
Total Operating Expenses	1,227,475	1,140,194
Expenses in Excess of Revenue	(72,725)	(67,882)
Non-Operating Activities		
Contributions	2,927	2,619
Investment loss, net of distribution	(154,521)	(85,352)
Unrealized loss on bond swaps	(52,878)	(43,591)
Non-equipment assets acquired through grants, contracts and gifts and other	(254)	252
Losses on disposals and write-downs of property and equipment	(1,989)	(5,628)
Net assets released from restrictions	1,562	2,577
Write-off of original bond issue costs	(3,579)	(5,312)
Impairment losses on capital projects	(57,000)	-
Net asset reclassification based on change in law	-	(277,566)
Decrease in Unrestricted Net Assets from Non-Operating Activities	(265,732)	(412,001)
Decrease in Unrestricted Net Assets	$ (338,457)	$ (479,883)

(Continued)

See accompanying notes to financial statements.

Baylor College of Medicine
Statements of Activities

For the Years Ended June 30, 2009 and 2008 (in thousands)

	2009	2008 (As restated, see Notes 2 & 14)
Decrease in Unrestricted Net Assets	$ (338,457)	$ (479,883)
Temporarily Restricted Net Assets		
Contributions	30,185	49,420
Net assets released from restrictions	(38,920)	(38,156)
Investment loss	(129,412)	(34,208)
Net asset reclassification based on change in law	-	277,566
(Decrease) Increase in Temporarily Restricted Net Assets	(138,147)	254,622
Permanently Restricted Net Assets		
Contributions	16,006	11,613
Investment (loss) income	(5,537)	2,602
Increase in Permanently Restricted Net Assets	10,469	14,215
Decrease in Net Assets	(466,135)	(211,046)
Net Assets, beginning of year, as restated (Notes 2 & 14)	1,430,995	1,642,041
Net Assets, end of year	$ 964,860	$ 1,430,995

(Concluded)

See accompanying notes to financial statements.

Baylor College of Medicine
Statements of Cash Flows

For the Years Ended June 30, 2009 and 2008 (in thousands)

	2009	2008 (As restated, see Note 14)
Cash Flows from Operating Activities		
Decrease in Net Assets	$ (466,135)	$ (211,046)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:		
Depreciation and loss on disposals and write-downs of property and equipment and other	70,904	79,123
Impairment losses on capital projects	57,000	-
Equipment acquired through grants and contracts	(8,376)	(8,064)
Investment income	(5,469)	(7,535)
Change in net unrealized losses on investments	236,904	164,375
Net realized losses (gains) on sale of investments	13,165	(78,915)
Increase in accounts receivable	(6,051)	(21,473)
Decrease (increase) in patient receivables	1,607	(1,562)
Decrease (increase) in contributions receivable	1,859	(9,575)
Permanently restricted contributions and investment income	(10,469)	(21,182)
Decrease (increase) in other assets	4,644	(7,822)
Increase in accounts payable and other liabilities	11,644	25,816
Increase in bond swap liability	52,878	36,893
Decrease in deferred insurance proceeds	(6,202)	(3,147)
Net Cash Used In Operating Activities	(52,097)	(64,114)
Cash Flows from Investing Activities		
Purchases of investments	(172,732)	(282,509)
Proceeds from sales of investments	298,232	393,190
Purchases of property and equipment	(198,572)	(173,661)
Decrease (increase) in restricted cash held by bond trustee	154,772	(503,183)
Investment income	5,469	7,535
Issuances of notes receivable	(2,157)	(3,429)
Repayments of notes receivable	2,272	1,963
Net Cash Provided by (Used In) Investing Activities	87,284	(560,094)
Cash Flows from Financing Activities		
Proceeds of line of credit	-	50,000
Repayment of line of credit	(25,000)	-
Proceeds from bonds payable	251,893	742,081
Payments to bond swap collateral	(75,671)	-
Payments of bond issuance costs	-	15,649
Repayment of bonds payable	(243,150)	(157,975)
Purchases of bonds payable	36,425	(36,425)
Permanently restricted contributions and investment income	10,469	21,182
Net Cash (Used In) Provided by Financing Activities	(45,034)	634,512
Net Increase (Decrease) in Cash and Cash Equivalents	(9,847)	10,304
Cash and Cash Equivalents, beginning of year, as restated (Note 14)	61,609	51,305
Cash and Cash Equivalents, end of year	$ 51,762	$ 61,609
Supplemental disclosures		
Net interest paid on bonds (excluding capitalized interest)	$ 17,644	$ 9,594
Non-cash investing activities:		
Property and equipment acquisitions in accounts payable and other liabilities	$ (7,263)	$ 12,300
Decrease in security lending collateral	$ (30,010)	$ (21,885)

See accompanying notes to financial statements.

Baylor College of Medicine
Notes to Financial Statements
For the Years Ended June 30, 2009 and 2008

(1) DESCRIPTION OF ORGANIZATION

Baylor College of Medicine (the College) is a Texas not-for-profit corporation and is exempt from Federal income taxes under Section 501(a) of the Internal Revenue Code (IRC) of 1986, as amended, by reason of being an organization described in Section 501(c)(3) of the Code. The College is located in the Texas Medical Center in Houston, Texas and is the only private medical school in the southwestern United States.

In addition to physician education, the College offers programs and postgraduate degrees in biomedical sciences, the allied health fields and graduate medical education. Further, the College is one of the nation's leading biomedical research institutions and provides extensive patient care services.

In January, 2007, the Board of Trustees of the College passed a resolution to develop an integrated Baylor Clinic and Hospital (BCH Project). The BCH Project is located on 33 acres of College-owned land in the Texas Medical Center area. Construction commenced in May, 2007, and is being financed in part with the proceeds of the bonds issued in November, 2007. The remainder of the costs will be funded by the College from a combination of College resources, community support, philanthropy or a potential joint venture partner. In February 2009, the College decided, based on changes in the U.S. economy and higher than expected costs to complete the BCH Project, to pause the construction of the BCH Project once the building's core and shell is completed, which is expected to occur in late fiscal year 2010. The College is considering using the remaining bond proceeds, after the shell and core is completed, to repurchase some of the College's outstanding bonds (see Note 8). See Note 2 for the College's consideration and recognition of impairment on these long-lived assets. See Note 3 for management's plan.

On March 27, 2009 the College entered into a Memorandum of Understanding with William Marsh Rice University (Rice University), to discuss a significant and permanent affiliation. Discussions are ongoing and have not yet progressed far enough to assess what form of affiliation, if any, may ultimately be structured between the two parties.

Baylor College of Medicine International Pediatric AIDS Initiative (BIPAI) is a Texas not-for-profit corporation organized to foster international HIV/AIDS prevention, care and treatment, health professional education, and clinical research. BIPAI's activities, which are primarily located in the Sub-Saharan region of Africa, are included in the College's financial statements.

Baylor Medical Foundation (the Foundation) is a Texas not-for-profit corporation organized exclusively to aid, support and maintain the College. The Foundation is governed by a separate Board. In the event of dissolution of the Foundation, any funds or property then owned by the Foundation are to be transferred to the College. In accordance with Statement of Financial Accounting Standards (SFAS) No. 136, *"Transfer of Assets to a Not-for-Profit Organization or Charitable Trust that Raises or Holds Contributions for Others,"* the College's interest in the net assets of the Foundation is included in the accompanying balance sheets (see Notes 5 and 14).

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Change in basis of presentation

The fiscal year 2008 financial information has been restated so that the basis of presentation is consistent with that of fiscal year 2009 financial information. This restatement reflects the adoption of Financial Accounting Standards Board (FASB) Staff Position 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (FSP FAS 117-1) in fiscal year 2009 (see below and Note 5).

Use of Estimates

The accompanying financial statements of the College have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Preparation of the financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, including contingencies, at the date of the financial statements and the reported revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash Equivalents

The College considers all unrestricted demand deposits and short-term managed pooled investments, with maturities of 90 days or less, to be cash equivalents.

Accounts Receivable, net

Accounts receivable, net consists primarily of unreimbursed grant and contract expenditures and amounts owed by various affiliated hospitals to which the College provides residents and faculty. These amounts are reduced by approximately $1.2 million at both June 30, 2009 and 2008, respectively, related to allowances for uncollectible accounts. Unreimbursed grant and contract expenditures consist of receivables from the Federal Government, specifically, the National Institutes of Health, and other non-federal sources for payment for research provided by the College.

Patient Receivables, net

Patient receivables are recorded net of an allowance for contractual adjustments and doubtful accounts to report the receivables at their estimated net realizable value. At both June 30, 2009 and 2008, the patient receivables were reduced by approximately $1.6 million related to the allowance for doubtful accounts.

Investments

The College's investments in marketable equity and fixed income securities are recorded at fair value. Non-marketable securities are securities for which no public market exists; substantially all of these securities are accounted for under the equity method, which approximates fair value. These non-marketable securities include investments in private equity limited liability corporations or partnerships.

Other investments are stated at cost or fair value at the date of the acquisition or donation. Realized gains and losses arising from the sale or other disposition of investments have been accounted for as changes in unrestricted net assets unless restrictions have been imposed by the donor. Certain investments are pooled with each fund subscribing to or disposing of units on the basis of the market value per unit, which is computed monthly. Realized gains and losses arising from the sale of securities are determined on an average cost basis.

The U.S. and international financial markets have experienced significant volatility that has resulted in substantial fluctuations in equity markets, in which the College invests. Market volatility can affect the value the College receives for its investments in future periods.

Securities Lending

The College participates in securities lending transactions whereby a portion of its investments are loaned, through its agent, to various parties in return for cash and securities from the parties as collateral for the securities loaned, usually on a short-term basis. Collateral provided by parties is maintained at levels of at least 100% of the fair value of the securities on loan and is adjusted for market fluctuations (see Note 6). The fees received for these transactions are recorded as investment income.

Property and Equipment

Property and equipment acquisitions are recorded at cost or fair value on the date of acquisition. Depreciation is calculated on the straight-line method based on the estimated useful lives of the assets, which range from 17 to 50 years for buildings, the shorter of the lease term or 5 to 15 years for leasehold improvements, and 3 to 10 years for furniture, equipment and computer software.

Impairment of Long-Lived Assets

In accordance with SFAS 144 "Accounting for the Impairment or Disposal of Long-Lived Assets", when events or changes in circumstances indicate the carrying amount of property and equipment, and intangible or other long-lived assets related to specifically acquired assets may not be recoverable, an evaluation of the recoverability of currently recorded costs is performed. When an evaluation is performed, the estimated value of undiscounted future net cash flows associated with the asset is compared to the asset's carrying value to determine if a write down to fair value is required. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. The College recognized an impairment write down of $57 million on the BCH Project as of June 30, 2009. The fair value estimate for the BCH Project was derived from internal estimates of future net cash flows expected to be received from the ultimate disposition of the assets. The estimates of future cash flows are based on assumptions the College believes to be reasonable and supportable. Fair value estimates can change by material amounts in subsequent periods as many factors and assumptions can impact an estimate. The impairment amount is included in non-operating "Impairment losses on capital projects" in the June 30, 2009 statement of activities.

Other Assets

Other assets primarily include inventory, prepaid expenses, unbilled costs and accrued revenues. At June 30, 2009, there were no amounts relating to unbilled costs and accrued revenues on grants and contracts, and affiliated hospital contracts. At June 30, 2008, amounts relating to unbilled costs and accrued revenues on grants and contracts, and affiliated hospital contracts, were $3.1 million and $2.3 million, respectively.

Unexpended Current Awards

Unexpended current awards represent amounts received from sponsors for which the College has not yet fulfilled its obligations. These amounts will be recognized in future periods once the obligations are satisfied.

Unrestricted, Temporarily Restricted and Permanently Restricted Net Assets

Unrestricted net assets generally result from operating and non-operating revenues and gains generated by the College in fulfilling its mission that are neither temporarily nor permanently restricted by donor-imposed stipulations. Revenues and gains with explicit donor stipulations are reported as either temporarily restricted or permanently restricted net assets as determined by the nature of the stipulations. Unrestricted net assets also reflect all expenditures of the College.

Temporarily restricted net assets include contributions, investment income, and gains for which donor-imposed purpose and/or time restrictions have not been satisfied. Donor restricted contributions, for which restrictions are satisfied in the current reporting period, are reported as unrestricted revenue by the College. The amount of temporarily restricted net assets reported at June 30, 2009 and 2008, for which the College has satisfied the restrictions or the donor has released the College from the restrictions during 2009 and 2008, respectively, are reported as net assets released from restrictions in the statements of activities. Income and appreciation on permanently restricted net assets that exceed appropriations for expenditures (therefore the restrictions have not been satisfied) are included in temporarily restricted net assets. Temporarily restricted net assets at June 30, 2009 and 2008 are principally restricted for research and education.

Permanently restricted net assets result from donor-imposed stipulations on contributions and other assets, which neither expire by the passage of time, nor can be fulfilled or otherwise removed by actions of the College. Permanently restricted net assets at June 30, 2009 and 2008, include amounts that are required by donor restrictions to be invested in perpetuity. The income and appreciation on permanently restricted net assets for which restrictions have not been satisfied are included in temporarily or permanently restricted net assets depending on the nature of the donor-imposed restriction.

On July 1, 2008 the College implemented FASB Staff Position 117-1. FSP FAS 117-1 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). The state of Texas enacted UPMIFA in September 2007. The cumulative effect of the implementation resulted in a $277.6 million reclassification as of June 30, 2007 of unrestricted net assets to temporarily restricted net assets representing the net amount of income and appreciation on permanently restricted net assets which had not been appropriated for expenditure. The effects of the restatement on June 30, 2008 financial statements are included in the following table (in thousands):

	June 30, 2008 As Originally Presented		June 30, 2008 As Restated (1)	
	Unrestricted	Temporarily Restricted	Unrestricted	Temporarily Restricted
Statement of Activities				
Non-Operating - Investment loss, net of distribution	$ (118,978)	$ -	$ (58,716)	$ -
Investment loss		$ (582)		$ (60,844)
Net asset reclassification based on change in accounting principle	$ -	$ -	$(277,566)	$ 277,566
Increase (Decrease) in Net Assets	$ (235,943)	$ 10,682	$(453,247)	$ 227,986
Balance Sheet				
Net Assets at June 30, 2007	$ 1,129,232	$ 210,901	$ 851,666	$ 488,467
Net Assets at June 30, 2008	$ 893,289	$ 221,583	$ 675,985	$ 438,887

(1) See Note 14 for other restatements related to correction of errors.

Operating and Non-Operating Activities

Operating activities include revenues provided by and expenses and equipment associated with the College's medical education, research and patient care programs. Non-operating activities include endowment investment losses in excess of the College's spending policy, changes in unrealized gains and losses related to investments, unrealized losses on bond interest rate swaps, losses on disposals and write-downs of property and equipment, net assets released from restrictions for capital, restricted contributions and transfers, and other. Additionally, any unusual or non-recurring gains and retirement of bond original issue costs are included in non-operating activities.

State Appropriations

The College receives funding in the form of appropriations from the state of Texas. State appropriations received during fiscal years 2009 and 2008 were $41.7 million and $42.1 million, respectively.

Included in appropriations are amounts received from the state of Texas related to earnings on the Permanent Health Fund for Higher Education established in fiscal year 2000. This appropriation is based in part on instruction, research and charity care expenditures of the College. Instruction expenditures used in determining the Permanent Health Fund for Higher Education appropriation include instruction expenditures (see Note 10) and certain amounts related to the instruction of resident physicians included in affiliated hospital programs expenditures. The College's instruction expenditures related to the Permanent Health Fund for Higher Education appropriation for fiscal years 2009 and 2008 were $174.0 million and $178.1 million, respectively.

Medical Services Revenue

Medical services revenue is reported at the anticipated realizable amounts from patients, third-party payors, and others for services rendered before any allowance for bad debt. Bad debt expense related to medical services in fiscal years 2009 and 2008 was $19.5 million and $17.4 million, respectively. Changes in the Medicare and Medicaid programs could have an adverse or positive impact on prospective medical services revenues.

The College has entered into payment agreements with certain commercial insurance carriers, health care maintenance organizations, and preferred provider organizations. The basis for payment to the College under these agreements is primarily prospectively determined rates. The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, governmental health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse.

Endowment Investments and Income Distribution

The College recognizes the goals of endowment management are preserving the purchasing power of the assets and providing stable support for current programs. The primary focus of the College's endowment investment policy is structuring both the endowment's investment portfolio and its annual spending in order to balance the needs of current and future generations of scholars, scientists, patients and teachers. Current annual spending from the endowment plus inflation combines to create a minimum target total return for the portfolio. The College employs strategies of investing in equity assets and some illiquid assets, broadly diversifying and investing in assets that are out of favor. The College believes these strategies will help achieve the total return target over the long-term.

The College's board approved endowment earnings distribution policy, as permitted by the Texas Uniform Prudent Management of Institutional Funds Act of 2006 is based on a 5% distribution applied to a trailing twelve-quarter average market value of the endowment assets. Funds for the earnings distribution are provided from endowment investment income and realized capital gains and are reflected as investment income distribution in the accompanying financial statements. Amounts distributed under this policy are considered appropriated for purposes of FASB Staff Position 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (FSP FAS 117-1) (see Note 5).

Affiliated Hospital Contracts

The College has affiliation agreements with area hospitals, including, but not limited to, St. Luke's Episcopal Hospital, The Methodist Hospital, Texas Children's Hospital, The Institute for Rehabilitation and Research, Menninger Clinic, Michael E. DeBakey Veterans Affairs Medical Center, and the Harris County Hospital District. Under the terms of these agreements, the College conducts administrative, research and educational activities on behalf of these hospitals. In addition, the College provides residents to the affiliated institutions who in turn provide patient care services as part of their medical training. Mutual commitments include sharing of operational and research costs, including physicians' salaries. Amounts due to the College from affiliated hospitals included in accounts receivable, net in the accompanying balance sheets as of June 30, 2009 and 2008 were $39.3 million and $37.8 million, respectively.

Charity Care

The College is committed to providing assistance to financially indigent patients in the community who require care and services at reduced or no cost. Additionally, the College provides care to a number of Medicaid and Medicare eligible patients that require continued care after benefits are exhausted.

Records are maintained to identify and monitor the level of charity care the College provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The level of charity care provided during fiscal years 2009 and 2008, based on established charges, was $192.0 million and $246.7 million, respectively.

Uncertainty in Income Taxes

In July 2006, Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* (FIN 48), was issued. FIN 48 creates a single model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Under the requirements of FIN 48, tax-exempt organizations could now be required to record an obligation as the result of a tax position they have historically taken on various tax exposure items. Prior to FIN 48, tax liabilities were recorded as incurred. The College adopted FIN 48 in fiscal year 2008 and the adoption had no impact on the consolidated financial statements. There are no material unrecorded tax liabilities as of June 30, 2009.

New Accounting Standards

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an Amendment of FASB Statement No. 133*. This Statement requires enhanced disclosures regarding how derivative and hedging activities affect an entity's financial position, financial performance, and cash flows for an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2008, with early application encouraged. The College has not yet determined the timing or impact, if any, on the consolidated financial statements from the adoption of SFAS No.161.

In April of 2009, the FASB issued SFAS No. 164, *Not-for-profit Entities: Mergers and Acquisitions – Including an Amendment to FASB Statement No. 142*. This Statement establishes principles and requirements for how a not-for-profit entity:

a. Determines whether a combination is a merger or an acquisition
b. Applies the carryover method in accounting for a merger
c. Applies the acquisition method in accounting for an acquisition, including determining which of the combining entities the acquirer is
d. Determines what information to disclose to enable users of financial statements to evaluate the nature and financial effects of a merger or an acquisition.

This Statement also improves the relevance, representational faithfulness, and comparability of the information a not-for-profit entity provides about goodwill and other intangible assets after an acquisition by amending FASB Statement No. 142, Goodwill and Other Intangible Assets, to make it fully applicable to not-for-profit entities. This Statement is effective for mergers and acquisitions with reporting periods beginning on or after December 15, 2009. The College has not yet determined the timing or impact, if any, on the consolidated financial statements from the adoption of SFAS No.164.

(3) MANAGEMENT PLAN

The accompanying consolidated financial statements have been prepared assuming the College will continue as a going concern. The College has incurred significant operating deficits (i.e., expenses in excess of revenue), has several technical defaults on its bond covenants (see Note 8) and is planning to pause construction of the BCH Project in late fiscal 2010 (see Notes 1 and 2). The College has experienced deficits from operations from fiscal years 2004 to 2008, ranging from $17 million to $68 million and a deficit from operations for the year ended June 30, 2009 of $72 million. Factors that contributed to these operating deficits included increased investment in faculty, bond reissuance costs incurred when the College converted auction rate debt to variable-rate bonds during fiscal years 2007 and 2008, BCH Project start-up and shut down costs and increased fees incurred related to waivers due to debt covenant defaults during 2009. To address these operating deficits, the College has taken certain actions, including instituting a salary freeze, reducing benefits and identifying other cost savings to reduce the operating deficits over the next two fiscal years. The College will also be pausing construction of the BCH Project in late fiscal 2010 (see Notes 1 and 2) and has delayed other capital projects. Management is projecting a budgeted operating deficit for fiscal year 2010 of $24.8 million, and the College is committed to implementing additional cost reductions, if needed, to achieve these budgeted results.

The College was in technical default on three bond covenants at June 30, 2009. The College was not in compliance with its debt covenants to maintain a minimum debt service coverage ratio of 1.0, maintain a maximum capitalization ratio of no more than 0.70 and maintain a minimum ratio of unrestricted cash and equivalents (as defined) to long-term debt of not less than 0.65 as of June 30, 2009. Investment losses in fiscal 2009, which losses primarily occurred as a result of significant declines in the U.S. and international financial markets, as well as reclassifications from unrestricted net assets to temporarily restricted net assets required by FSP FAS 117-1, had a significant impact on the College's inability to meet these debt covenants.

Subsequent to June 30, 2009, the College has received waivers of these technical defaults through July 1, 2010, from all required financial institutions unless certain revised covenants are not met during fiscal year 2010 (see below). Without these waivers, the bonds could have been called by any or all of the financial institutions, and the College would have been required to repurchase the bonds. The College has obtained a waiver of noncompliance and revised covenants that the College believes it can meet through July 1, 2010 and beyond. The revised covenants are to maintain days cash on hand of at least 65 days, maintain a maximum capitalization ratio of no more than 0.80, maintain a minimum ratio of unrestricted cash and equivalents (as defined) to long-term debt of not less than 0.30 and maintain unrestricted net assets (as defined) of at least $350 million, all of which will be measured as of December 31, 2009 and June 30, 2010, except the capitalization ratio which will be measured quarterly. In addition, cumulative operating deficits for fiscal year 2010 cannot exceed $23.5 million for the six-month period ending December 31, 2009; $35.3 million for the nine-month period ending March 31, 2010 and $47.0 million for the year ending June 30, 2010.

In addition, there are other non-financial covenants contained in the waivers from the financial institutions. The College is restricted from taking any action which would cause any party to accelerate, terminate, or take any action related to its debt. The College is also prohibited from entering into a management services agreement or similar agreement that would give substantial operational or management control of the College to a third party or changing the ownership, use, or parties using the BCH Project, except in the case of a merger with Rice University, in a form acceptable to the creditors. As a condition of the on-going effectiveness of the waivers, in the event the College and Rice University have not entered into an agreement regarding a merger prior to January 31, 2010, the College must hire a Chief Implementation Officer thirty days following the termination of the agreement with Rice University or February 28, 2010, whichever is earlier. The Chief Implementation Officer would oversee the financial and operational aspects of the College and carry out the proposed reorganization plan that is based on recommendations related to operational improvements received by the College from consultants engaged previously.

The College believes, absent another significant decline in the U.S. and international financial markets, that it will be able to meet these covenants by executing on its plans to reduce costs.

The College also decided, based on changes in the U.S. economy and higher than expected costs to complete, to pause the construction of the BCH Project once the building's core and shell are completed, which is expected to occur in late fiscal year 2010. The College also terminated the newly hired hospital management and staff in fiscal year 2009. The College is currently in discussions with several not-for-profit institutions to provide these institutions with a controlling interest in the BCH Project for an uncertain consideration. No agreement has been finalized with any of these institutions, and the ultimate outcome of these discussions is uncertain at this time. If the College has not reached an agreement with a third party regarding this matter by June 30, 2010, the revised covenants require the College to reduce its debt by $100 million; of this amount, approximately $57 million would be obtained from unspent bond proceeds and approximately $43 million would be obtained from the College's cash and cash equivalents.

The accompanying financial statements do not include any adjustments that might result from the resolution of these uncertainties.

(4) CONTRIBUTIONS

Contributions receivable as of June 30, 2009 and 2008 are expected to be realized as follows (in thousands):

	2009	2008
In one year or less	$ 33,155	$ 28,616
Between one year and five years	90,039	82,238
More than five years	74,789	94,840
Less: present value discount (2.55% to 5.09%)	(33,316)	(39,169)
Total	$ 164,667	$ 166,525

Included in contributions receivable at June 30, 2009 is $60.3 million for the BCH Project. As of June 30, 2009 and 2008, the College had received conditional promises to give and indications of intentions to give of approximately $209.9 million and $207.8 million, respectively, in addition to the amounts recorded as contributions receivable. These conditional promises to give are not reflected in the accompanying financial statements until such time as the conditions are substantially met.

(5) INVESTMENTS

Investments (including amounts for self-insurance) held by the College at June 30, 2009 and 2008, are as follows (in thousands):

	2009	2008
Pooled investments:		
Stocks (cost of $286,382 and $366,015)	$ 347,834	$ 557,250
Bonds (cost of $93,556 and $149,802)	87,747	146,683
Other short-term investments	8,958	42,386
International equities (cost of $169,618 and $157,635)	136,451	193,276
Private equity securities (cost of $139,233 and $119,586)	146,881	152,554
Assets held for state of Texas (cost of $31,385 and $32,834)	(23,013)	(30,019)
Total pooled investments	704,858	1,062,130
Net equity interest in Baylor Medical Foundation	21,951	30,714
Other stocks (cost of $8,532 and $9,390)	16,546	24,871
Real estate, at cost	2,152	2,152
Assets held in trust (cost of $8,681 and $9,048) and other	11,722	12,932
Total	$ 757,229	$ 1,132,799

The College's commitments outstanding for private equity investments are described in Commitments and Contingencies (see Note 12).

In fiscal year 2000, the College received $25.0 million to establish a fund for investing a portion of receipts paid to the state of Texas under a judgment rendered in the tobacco settlement (the "tobacco funds"). The College is responsible for the administration of the tobacco funds, which are invested along with the College's pooled investments; however, the College does not have title to the assets, and the tobacco funds are not recorded in the financial statements. As of June 30, 2009 and 2008, the value of the distributed funds is included in pooled investments and a corresponding reduction to the College's investments has been recorded to reflect that the College does not currently have an ownership interest.

The earnings of the tobacco funds are required to be remitted to the state of Texas which, in turn, appropriates the earnings to the College to benefit programs in medical research, health education and treatment. This distribution is included in state appropriations in the accompanying financial statements.

Investment performance, including equity earnings, for the years ended June 30, 2009 and 2008, is summarized as follows (in thousands):

2009	Operating	Non Operating	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total
Distribution of endowment earnings and other	$ 4,591	$ -	$ 114	$ -	$ 4,705
Other investment income	-	57	47	4	108
Net realized gains (losses)	-	25,395	(21,051)	(1,932)	2,412
Net unrealized losses	-	(126,134)	(108,522)	(3,609)	(238,265)
Total investment return (loss)	$ 4,591	$ (100,682)	$ (129,412)	$ (5,537)	$ (231,040)
Investment return, designated for current operations	53,839	(53,839)	-	-	-
Total investment return (loss), net of distributions to operations	$ 58,430	$ (154,521)	$ (129,412)	$ (5,537)	$ (231,040)

2008	Operating	Non Operating	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total
Distribution of endowment earnings and other	$ 4,404	$ -	$ 108	$ -	$ 58,948
Other investment income	-	266	157	152	575
Net realized gains	-	80,808	15,620	4,740	46,732
Net unrealized losses	-	(111,990)	(50,093)	(2,290)	(207,964)
Total investment return (loss)	$ 4,404	$ (30,916)	$ (34,208)	$ 2,602	$ (101,709)
Investment return, designated for current operations	54,436	(54,436)	-	-	-
Total investment return (loss), net of distributions to operations	$ 58,840	$ (85,352)	$ (34,208)	$ 2,602	$ (101,709)

Included within net unrealized gains above are approximately $(25.7) million and $4.9 million of the College's equity in (losses) earnings on private equity securities for the years ended June 30, 2009 and 2008, respectively.

Endowment earnings are recorded net of investment management fees, which amounted to approximately $5.0 million and $5.3 million for the years ended June 30, 2009 and 2008, respectively.

The College's endowment consists of the following net asset types at June 30, 2009 and 2008 (in thousands):

2009	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (34,306)	$ 99,756	$ 262,773	$ 328,223
Board designated endowment funds	379,762	11,364	-	391,126
Total endowments at June 30, 2009	$ 345,456	$ 111,120	$ 262,773	$ 719,349

2008				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted endowment funds	$ (840)	$ 219,068	$ 253,780	$ 472,008
Board designated endowment funds	606,879	13,114	-	619,993
Total endowments at June 30, 2008	$ 606,039	$ 232,182	$ 253,780	$ 1,092,001

The following endowment-related activities occurred during the year end June 30, 2009 and 2008 (in thousands):

2009				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at June 30, 2008	$ 606,039	$ 232,182	$ 253,780	$ 1,092,001
Investment income (loss)	(107,109)	(120,075)	(5,690)	(232,874)
Contributions	3,203	164	14,683	18,050
Appropriation of endowment assets for expenditure	(53,888)	-	-	(53,888)
Transfer from board designated endowments within unrestricted net assets	(102,789)	(1,151)	-	(103,940)
Endowment net assets at June 30, 2009	$ 345,456	$ 111,120	$ 262,773	$ 719,349

2008				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at June 30, 2007	$ 1,042,326	$ 17,188	$ 241,221	$ 1,300,735
Net asset reclassification based on change in law	(277,566)	277,566	-	-
Endowment net assets after restatement	764,760	294,754	241,221	1,300,735
Investment income (loss)	3,654	(60,859)	2,450	(54,755)
Contributions	5,481	325	10,109	15,915
Appropriation of endowment assets for expenditure	(54,363)	-	-	(54,363)
Transfer from board designated endowments within unrestricted net assets	(113,493)	(2,038)	-	(115,531)
Endowment net assets at June 30, 2008	$ 606,039	$ 232,182	$ 253,780	$ 1,092,001

(6) FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

On July 1, 2008, the College adopted SFAS No. 157, *Fair Value Measurements*. SFAS No.157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the reporting date. The statement establishes consistency and comparability by providing a fair value hierarchy that prioritizes the inputs to valuation techniques into three broad levels, which are described below:

Level 1 inputs are quoted market prices in active markets for identical assets or liabilities (these are observable market inputs).

Level 2 inputs are other than quoted prices included within Level 1 that are observable for the asset or liability (includes quoted market prices for similar assets or similar assets in markets in which there are few transactions and prices that are not current or vary substantially).

Level 3 inputs are unobservable market inputs that reflect the entity's own assumptions in pricing the asset or liability (used when little or no market data is available).

SFAS No.157 requires the use of observable market inputs (quoted market prices) when measuring fair value whenever possible and requires Level 1 quoted prices be used to measure fair value whenever possible.

Financial assets and liabilities included in the College's financial statements and measured at fair value as of June 30, 2009 are classified based on the applicable valuation technique level in the following table (in thousands):

	Total June 30, 2009	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. & international equities	$ 485,083	$ 473,860	$ -	$ 11,223
Fixed income	84,930	84,930	-	-
Private equity investments	140,114	-	-	140,114
Security lending collateral	2,952	-	2,952	-
	$ 713,079	$ 558,790	$ 2,952	$ 151,337
Liabilities:				
Payable under security lending agreements	$ 2,952	$ -	$ 2,952	$ -
Bond interest rate swap liability	89,771	-	89,771	-
	$ 92,723	$ -	$ 92,723	$ -

U.S. & international equities and fixed income investments included in Level 1 are measured using quoted market prices in active markets for the identical equities or fixed income investments. Non-marketable U.S. & international equities included in Level 3 are biotechnology start up companies generally based on technology derived from the College's clinical and research activities; as such, observable market prices are not available. These are valued using a combination of last outside transaction price and internal information on the progress of the technology.

Private equity investment valuation is determined by the private equity general partner using proprietary information that is unobservable to a market participant.

Bond interest rate swap liability (see Note 9) valuation is determined using market valuation techniques, including discounted cash flow analysis on the expected cash flow of each agreement. This analysis reflects the contractual terms of the agreement, including the period to maturity, and uses observable market-based inputs, including forward interest rate curves. These observable (Level 2) inputs are available to a market participant.

The following is a reconciliation of activity for the period ended June 30, 2009 for assets measured at fair value based on using significant unobservable inputs (Level 3) (in thousands):

	U.S. & International Equities	Private Equity Investments	Total
Balance at June 30, 2008	$ 23,787	$ 139,718	$ 163,505
Realized and unrealized gains/(losses) included in earnings (or changes in net assets), net	(8,251)	(23,255)	(31,506)
Purchases, issuances and settlements (capital calls, distributions), net	(4,313)	23,651	19,338
Balance at June 30, 2009	$ 11,223	$ 140,114	$ 151,337
Change in unrealized gains/(losses) included in other income/(expense) related to assets held as of June 30, 2009, net			$ (29,914)

(7) PROPERTY AND EQUIPMENT

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

	Useful Life (years)	2009	2008
Land	–	$ 27,583	$ 27,583
Buildings	17 – 50	536,959	472,256
Land improvements	15 – 20	15,078	14,099
Leasehold improvements	5 – 15	94,526	95,834
Furniture and equipment	5 – 10	251,118	250,332
Computer software	3 – 10	60,275	50,700
		985,539	910,804
Less: Accumulated depreciation		(457,093)	(421,157)
		528,446	489,647
Construction in progress		175,843	143,514
International operations, principally buildings, net	40	8,628	7,974
Property and equipment, net		$ 712,917	$ 641,135

Capitalized interest is inclusive of standby letter of credit and remarketing fees. Capitalized interest expense and income for the years ended June 30, 2009 and 2008 are as follows (in thousands):

	2009	2008
Interest cost:		
Capitalized		
Interest expense	$ 22,588	$ 23,305
Letter of credit fees	3,670	-
	26,258	23,305
Charged to operations		
Interest expense	16,995	9,807
Letter of credit fees	332	$ -
	17,327	9,807
Total	$ 43,585	$ 33,112
Interest income:		
Capitalized	$ 17,783	$ 13,984
Credited to operations	656	254
Total	$ 18,439	$ 14,238

The College has obligations involving various federal, state and local regulations to decontaminate certain portions of buildings at the College's principal location. Accordingly, the College's recorded asset retirement obligation is $0.6 million as of both June 30, 2009 and 2008.

(8) BONDS PAYABLE

A summary of bonds payable at June 30, 2009 and 2008 is as follows (in thousands):

Medical Facilities Revenue Bonds	2009	2008
Series 1999A	$ 43,195	$ 44,445
Series 1999B	-	66,900
Series 2005A	-	125,000
Series 2005B	-	50,000
Series 2007A-1 & A-2	245,000	245,000
Series 2007B	200,000	200,000
Series 2008A	85,000	85,000
Series 2008B	34,550	34,550
Series 2008C	38,180	38,180
Series 2008D	200,000	-
Series 2008E	55,000	-
Less: Original Issue discount 1999A	(446)	(468)
Less: Original Issue discount 2008D	(3,048)	-
Less: Repurchase of 2005B	-	(36,425)
	$ 897,431	$ 852,182

The aggregate annual maturities of long-term debt as of June 30, 2009, for the next five fiscal years and thereafter are as follows (in thousands):

2010	$ 9,320
2011	9,555
2012	9,855
2013	10,490
2014	10,915
Thereafter	850,790
	$ 900,925

Advance refunding of tax-exempt debt is subject to arbitrage rules under the IRC §103(c) and related regulations that, in general, prohibit the yield realized from the investment of the proceeds of the new debt from exceeding the yield on the debt itself. Compliance with those rules is necessary for the interest on the debt to be exempt from federal income tax, and the College believes that it is in compliance with those rules.

All bonds outstanding have been issued under terms of the Master Trust Indenture, dated March 1, 1999, between master trustee and the College, as amended by supplemental master trust indentures. The master trustee has a secured interest in all gross receipts and substantially all College land including all improvement, appurtenances, personal property and proceeds now or here after placed, acquired or arising from the land.

Series 1999A Bonds

On April 9, 1999, Medical Facilities Revenue Bonds in the amount of $50 million were issued with an original discount of $0.6 million by the Harris Country Health Facilities Development Corporation (the Issuer) under a loan agreement with the College. The Medical Facilities Revenue Bonds Series 1999A (Series 1999A Bonds) consist of the following at June 30, 2009 (in thousands):

(a) Serial bonds, in the amount of $19,170, due in annual installments between November 15, 2003 and November 15, 2016, with interest ranging between 4.0% and 5.375%, payable semiannually.

(b) Term bonds, in the amount of $6,095, due November 15, 2019, with interest at 5.125% payable semiannually. Mandatory annual redemption before maturity is required between 2017 and 2019.

(c) Term bonds, in the amount of $24,735, due November 15, 2028, with interest at 5.00% payable semiannually. Mandatory annual redemption before maturity is required between 2020 and 2028.

The College may redeem the Series 1999A Bonds commencing November 15, 2009, through November 14, 2010, at a 1% premium, declining to face value in 2010, and thereafter. Bond proceeds of the Series 1999A Bonds, together with funds of the College, were used to refund the Series 1997 Bonds and to pay the cost of issuance of the Series 1999A Bonds. Bond insurance is provided by Ambac Financial Group, Inc. (see Note 15).

Series 1999B Bonds

On June 11, 1999, Medical Facilities Revenue Bonds, Series 1999B (Series 1999B Bonds), in the amount of $75 million, were issued by the Issuer under a loan agreement with the College. The Series 1999B Bonds were refunded on October 8, 2008.

The Series 1999B Bonds bore interest at a variable rate determined in weekly Dutch auctions. The average interest rates on borrowed amounts until refunded on October 8, 2008 was 3.41% and for the year ended June 30, 2008 was 3.78%. The interest rate at June 30, 2008 was 3.55%. The proceeds of the Series 1999B Bonds were used for various construction and renovation projects.

Series 2005A and 2005B Bonds

On August 3, 2005, the Harris County Health Facilities Development Corporation issued for the College Series 2005A Bonds in the amount of $125 million and Series 2005B Bonds in the amount of $50 million. Series 2005A Bonds and the Series 2005B Bonds are referred to together as the Series 2005 Bonds and carried a variable rate of interest (see Note 8). The proceeds of the Series 2005 Bonds were used for various construction and renovation projects. The Series 2005A and 2005B Bonds were refunded on September 12, 2008.

The Series 2005A Bonds bore interest at a variable rate. The average interest rate on borrowed amounts for the 2005A Bonds until refunded on September 12, 2008 was 6.50% and for the year ended June 30, 2008 was 3.81%. The interest rate at June 30, 2008 was 6.66%.

The Series 2005B Bonds bore interest at a variable rate determined in weekly auctions. The average interest rate on borrowed amounts for the 2005B Bonds until refunded on September 12, 2008 was 2.40% and for the year ended June 30, 2008 was 4.61%. The interest rate at June 30, 2008 was 2.42%. The College had repurchased $36.4 million of the Series 2005B Bonds at June 30, 2008, which are included as a reduction of bonds payable.

Series 2007A-1, 2007A-2 and 2007B Bonds

On November 15, 2007, the Harris County Health Facilities Development Corporation issued for the College Series 2007A-1 and Series 2007A-2 Bonds (Series 2007A Bonds) in the amount of $400 million, $245 million of which are still outstanding at June 30, 2009 and 2008, and Series 2007B Bonds in the amount of $200 million. Both series are due November 15, 2047. The proceeds of the Series 2007A and Series 2007B Bonds are being used for construction of a medical office building and BCH Project.

The Series 2007A Bonds bear interest at a variable rate. In November 2008, the interest mode on these bonds was converted from auction rate to variable rate demand bonds with interest rate pricing changing from weekly to daily. Letters of credit were provided as credit enhancements by Bank of America Corporation and Wachovia Corporation and the existing bond insurance provided by Ambac Financial Group, Inc. (see Note 15) was continued. The average interest rate on borrowed amounts for Series 2007A Bonds for the years ended June 30, 2009 and 2008 were 0.45% and 5.98%, respectively. The interest rates at June 30, 2009 and 2008 were 0.31% and 3.94%, respectively.

The Series 2007B Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the Series 2007B Bonds for the years ended June 30, 2009 and 2008 were 0.62% and 2.43%, respectively. The interest rates at June 30, 2009 and 2008 were 0.18% and 1.54%, respectively.

Series 2008A, 2008B and 2008C Bonds

On June 15, 2008, the Harris County Health Facilities Development Corporation issued for the College Series 2008A Bonds in the amount of $85 million, Series 2008B Bonds in the amount of $34.6 million and Series 2008C Bonds in the amount of $38.2 million, which are due June 15, 2048. The proceeds were used to redeem $155 million of Series 2007A Bonds and to pay the cost of issuance of the Series 2008A, 2008B and 2008C Bonds. Credit is enhanced for the Series 2008A, 2008B and 2008C bond series with letters of credit provided by Compass Bancshares, Inc., Northern Trust Corporation and Commerzbank AG, respectively.

The Series 2008A Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the 2008A Bonds for the year ended June 30, 2009, and for the period from the date of issuance to June 30, 2008, were 1.36% and 1.58%, respectively. Interest rates at June 30, 2009 and 2008 were 0.28% and 1.50%, respectively.

The Series 2008B Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the 2008B Bonds for the year ended June 30, 2009, and for the period from the date of issuance to June 30, 2008, were 1.27% and 1.58%, respectively. Interest rates at June 30, 2009 and 2008 were 0.20% and 1.50%, respectively.

The Series 2008C Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the 2008C Bonds for the year ended June 30, 2009, and for the period from the date of issuance to June 30, 2008, were 1.30% and 1.63%, respectively. Interest rates at June 30, 2009 and 2008 were 0.32% and 1.55%, respectively.

Series 2008D Bonds

On September 4, 2008 the Harris County Cultural Education Facilities Finance Corporation issued for the College Series 2008D Bonds (Series 2008D Bonds) in the amount of $200 million with an original discount of $3.1 million. The proceeds, together with funds of the College, were used to refund $66.9 million of Series 1999B Bonds, $125 million of Series 2005A Bonds and to pay the cost of issuance of the Series 2008D Bonds The Cultural Education Facilities Revenue Bonds Series 2008D consist of the following (in thousands):

(a) Serial bonds, in the amount of $69,220, due in annual installments between November 15, 2009 and November 15, 2019, with interest ranging between 3.00% and 5.00%, payable semiannually.

(b) Term bonds, in the amount of $29,965, due November 15, 2023, with interest at 5.125% payable semiannually. Mandatory annual redemption before maturity is required between 2019 and 2023.

(c) Term bonds, in the amount of $44,905, due November 15, 2028, with interest at 5.375% payable semiannually. Mandatory annual redemption before maturity is required between 2024 and 2028.

(d) Term bonds in the amount of $55,910 due November 15, 2032 with interest at 5.625% payable semiannually. Mandatory annual redemption before maturity is required between 2029 and 2032.

The College may redeem the Series 2008D Bonds commencing November 15, 2020 through November 14, 2032 at a redemption price equal to 100% of the principal amount thereof, without premium.

The Loan Agreement on the Series 2008D Bonds provides for the initial establishment and maintenance by the College with the Bond Trustee of a reserve fund, as a debt service reserve, with a balance equal to the lesser of the maximum or 125% of the average annual debt service requirements on the Series 2008D Bonds. The balance of the reserve fund at June 30, 2009 is $18.0 million. The College is required to cure any deficiency in the balance of the reserve fund on any interest payment date for the Series 2008D Bonds in 12 monthly installments if caused by a transfer to cure a deficiency in the bond fund, and otherwise by four monthly installments. There were no deficiencies at June 30, 2009.

Series 2008E Bonds

On August 27, 2008 the Harris County Cultural Education Facilities Finance Corporation issued for the College Series 2008E Bonds in the amount of $55 million. Series 2008E Bonds are due November 15, 2035. The proceeds were used to refund Series 2005B bonds totaling $50 million and to pay the cost of issuance of the Series 2008E Bonds. Credit enhancement in the form of a letter of credit for the Series 2008E Bonds is provided by J.P. Morgan Chase & Co.

The Series 2008E Bonds bear interest at a variable rate. The average interest rate on borrowed amounts for the period from date of issuance to June 30, 2009 was 1.20% and the interest rate at June 30, 2009 was 0.22%.

Bond Compliance

The College was in technical default on three of its debt covenants at June 30, 2009. The College was not in compliance with its debt covenants to maintain a minimum debt service coverage ratio of 1.0, maintain a maximum capitalization ratio of no more than 0.70 and maintain a minimum ratio of unrestricted cash and equivalents to long-term debt of not less than 0.65 at June 30, 2009. Subsequent to year end, the College has received waivers of these technical defaults through July 1, 2010, from all required financial institutions providing credit enhancement for the bonds (see Note 3).

Revolving Credit Line

The College has a $50 million revolving credit line with a local bank of which $25 million and $50 million were outstanding at June 30, 2009 and 2008, respectively. The funds were used for operating purposes. The College was not in compliance with the revolving credit line covenant to maintain a minimum of $600 million in unrestricted net assets at June 30, 2009. Subsequent to year end, the College has received a waiver of this technical default through July 1, 2010, from the bank providing the revolving credit line (see Note 3).

(9) DERIVATIVE AND OTHER FINANCIAL INSTRUMENTS

The College has derivative financial instruments, as allowed by its Debt and Swap Policy's Guidelines, both of which specifically preclude their use for speculation. In the normal course of business during fiscal year 2005, the College entered into a long-term interest rate swap agreement having a notional amount of $125 million, which essentially fixed the interest rate on the variable rate Series 2005A Bonds at 3.395% through November 15, 2035. The fair value of the interest rate swap is the estimated amount that the College would receive or pay to terminate the agreements at the reporting date, taking into account current interest rates and the current credit-worthiness of the swap counter party.

During fiscal year 2008, the College entered into two additional long-term interest rate swap agreements having notional amounts of $300 million and $100 million. These swap agreements essentially fixed the interest rate on the variable rate Series 2007A Bonds. The $300 million swap fixed the interest rate at 4.125% through November 15,

2047. The $100 million swap fixed the interest rate at 3.833% through November 15, 2047.

The fair value of the College's $525 million of interest rate swaps at June 30, 2009 and 2008 were liabilities of $89.8 million and $36.9 million. The change in the fair value of all interest rate swaps was $(52.9) million and $(43.6) million for the years ended June 30, 2009 and 2008, respectively, and are recorded in non-operating unrealized loss on bond swaps. The swap liability, net of collateral posted (see below), is presented as a separate line in the accompanying balance sheets.

In accordance with the terms of the College's long term interest rate swap agreements, as amended on September 4, 2008, the College is required to post collateral equal to the amount that the fair value of any swap liability exceeds $25 million. The College has posted at June 30, 2009, $75.7 million of cash as collateral in accordance with these agreements. Subsequent to June 30, 2009, the collateral posting threshold has been reduced and the College is required to post collateral equal to the fair value of the swap liability. At November 24, 2009 the College has posted $92.6 million of collateral.

(10) FUNCTIONAL EXPENSES

The College's expenses relate principally to providing education, research and clinical services. The functional expenses for these services are recorded directly or allocated. Operation and maintenance of plant expense, depreciation expense and interest expense are allocated to the various functional areas of the College based on the square footage of space occupied by each program and supporting service. For the years ended June 30, 2009 and 2008, expenses related to providing these services are as follows (in thousands):

	2009			
		Allocations		
	Expenses by Functional Area	Operation and Maintenance of Plant	Depreciation and Interest	Allocated Expenses by Functional Area
Instruction	$ 117,901	$ 8,978	$ 8,829	$ 135,708
Research	352,744	38,003	53,036	443,783
Medical services	242,009	446	7,047	249,502
Affiliated hospital programs	301,333	-	174	301,507
Institutional support	81,580	-	15,395	96,975
Total	$ 1,095,567	$ 47,427	$ 84,481	$ 1,227,475

	2008			
		Allocations		
	Expenses by Functional Area	Operation and Maintenance of Plant	Depreciation and Interest	Allocated Expenses by Functional Area
Instruction	$ 121,128	$ 8,071	$ 5,844	$ 135,043
Research	351,190	36,640	42,119	429,949
Medical services	299,661	529	3,850	304,040
Affiliated hospital programs	193,865	-	105	193,970
Institutional support	60,033	-	17,159	77,192
Total	$ 1,025,877	$ 45,240	$ 69,077	$ 1,140,194

(11) EMPLOYEE BENEFITS

Retirement Plan

Substantially all faculty and staff participate in the College's defined contribution retirement plan (the Plan). The Plan is a core benefit, and contributions are made by the College based on a formula using the employee's base annual salary. The College's contributions to the Plan in the years ended June 30, 2009 and 2008 were $42.1 million and $38.0 million, respectively. The assets of the Plan are administered by third parties.

Post Retirement Life Insurance

The College sponsors a life insurance plan (the Plan) covering substantially all employees. Employees are eligible for the benefits if upon retirement they have at least 10 years of service and are at least age 55. Benefits under the Plan are based upon the employee's final annual salary. The plan's eligibility requirements were changed during fiscal year 2009 to make only employees who retire on or before June 30, 2009 eligible to receive benefits. This negative plan amendment resulted in an $8.7 million reduction of the post retirement benefit obligation.

The College's post retirement benefit obligation at June 30, 2009 and 2008 is $5.4 million and $13.0 million, respectively, and is recorded in accounts payable and other liabilities. The post retirement obligation is measured at year end and is funded by general assets of the College on a pay-as-you-go approach. The weighted average discount rate for net periodic benefit costs for June 30, 2009 and 2008 is 6.25% for both years. The weighted average discount rate for the benefit obligation at June 30, 2009 and 2008 is 6.25% for both years. The net periodic post retirement costs for the years ended June 30, 2009 and 2008, including the following components is as follows (in thousands):

	2009	2008
Service cost	$ 376	$ 438
Interest cost	781	746
Amortization of transition obligation	108	146
Net periodic post retirement costs	$ 1,265	$ 1,330

Future benefit payments expected to be paid in each of the next five fiscal years and in the aggregate for the following five years as of June 30, 2009, are as follows (in thousands):

2010	$ 435
2011	438
2012	440
2013	440
2014	439
2015 - 2019	2,134

(12) COMMITMENTS AND CONTINGENCIES

Operating Leases

The College leases various facilities under non-cancelable operating leases expiring at various dates through 2017. Total rental expense in fiscal years 2009 and 2008 for all operating leases was $17.4 million and $17.6 million respectively.

Future minimum lease payments under operating leases as of June 30, 2009, which have initial or remaining lease terms in excess of one year, are as follows (in thousands):

2010	$ 15,793
2011	15,373
2012	14,455
2013	9,948
2014	8,432
Thereafter	8,499
	$ 72,500

Private Equity Investments

The College has committed to invest in certain private equity investments over a period of time. The remaining private equity commitment as of June 30, 2009 and 2008 is $119.4 million and $123.6 million, respectively.

Self-Insurance Program for Professional Liability

Medical malpractice and other actions alleging wrongful conduct and seeking punitive damages are sometimes filed against physicians and the College's affiliated institutions. Since 1977, the College has maintained a medical malpractice self-insurance program (the Program) that until July 1, 2003 had been supplemented by reinsurance or excess insurance agreements with private insurance companies. Due to sharply increased costs, the College's favorable loss experience, and the positive effects of tort reform legislation, the College, effective July 1, 2003, elected not to purchase excess insurance coverage.

The Program's dedicated account is funded on an occurrence basis, meaning it is designed to cover the health care provider for an incident that happened while he or she was a participant no matter when the claim or lawsuit was filed. Participants have access to a pool of a self-insured retention and, if the claim was made before July 1, 2003, or if the patient care was rendered after July 1, 1977 but before July 1, 1986, several layers of excess coverage to respond to claims made against them. Once the College stopped purchasing excess coverage, funding for the Program has been actuarially determined to the level of $35 million per occurrence, $70 million aggregate for payment of medical malpractice losses and related expenses. After July 1, 2003, all risk of loss is borne by the College.

The College has been named as a defendant in various claims for damages resulting from alleged medical malpractice. The malpractice reserve, which includes reserves for incurred but not reported claims as of June 30, 2009 and 2008, is $42.8 million and $46.8 million, respectively. The discount rate used in calculating the actuarial present value was 5.00% for both years.

General Liabilities

The College also has been named in other actions filed by individuals alleging discrimination in the terms, conditions and privileges of employment. Based on information received to date, the College's administration believes that uninsured losses resulting from these matters, if any, will not be material to the College's financial statements.

Construction Contracts

At June 30, 2009 and 2008, the remaining commitments on existing construction and information technology contracts for the BCH Project and other information technology projects are approximately $109.6 million and $253.2 million, respectively.

The Menninger Clinic

The College anticipates becoming the sole member of The Menninger Clinic, a Texas non-profit corporation and tax exempt entity. In addition, The Menninger Clinic Foundation (formerly MBM Foundation) became an affiliate of and will operate to support, The Menninger Clinic and the College's Menninger Department of Psychiatry.

(13) TRANSACTIONS WITH AFFILIATES

Included among the College's Board of Trustees are members from the banking, insurance and legal communities, who provide assistance in the development of policies and programs for the College. Also, certain trustees, faculty and staff of the College participate in the management of affiliated hospitals with which the College has contracts to provide services. During fiscal years 2009 and 2008, the College paid legal and related professional fees of approximately $8.5 million and $4.0 million, respectively, to law firms with which several board members are affiliated. Also, the College has received, from time to time, significant contributions from various board members and corporations with which board members are affiliated. These transactions have been entered into in the normal course of business.

(14) RESTATEMENTS OF FINANCIAL STATEMENTS

The College had inappropriately included cash held by bond trustee, which is restricted cash, in cash and cash equivalents on the statements of cash flows originally presented for the year ended June 30, 2008. Because the cash held by trustee is restricted for construction activities, the College has restated its statements of cash flows for the year ended June 30, 2008. This restatement had no impact on the balance sheet or statement of activities. The effects of this restatement on June 30, 2008 statements of cash flows are included in the following table (in thousands):

	June 30, 2008 As Originally Presented	June 30, 2008 As Restated
Statements of Cash Flows		
Cash Flows from Investing Activities		
Decrease (increase) in restricted cash held by bond trustee	$ -	$ (503,183)
Net Cash Used in Investing Activities	$ (56,911)	$ (560,094)
Net Increase in Cash and Cash Equivalents	$ 513,487	$ 10,304
Cash and Cash Equivalents, at June 30, 2008	$ 564,792	$ 61,609

In addition, the College had classified the unrestricted net assets and changes in the unrestricted net assets of Baylor Medical Foundation as unrestricted net assets on the College's balance sheet and statement of activities for the year ended June 30, 2008. Under the provisions of Statement of Financial Accounting Standards (SFAS) No. 136, *"Transfer of Assets to a Not-for-Profit Organization or Charitable Trust that Raises or Holds Contributions for Others,"* these net assets and changes in net assets are time restricted and, therefore, should be classified as temporarily restricted net assets. As a result, the College has restated its balance sheet and statement of activities for the year ended June 30, 2008. This restatement had no impact on the statement of cash flows. The effects of this restatement on the June 30, 2008, balance sheet and statement of activities are included in the following table (in thousands):

	June 30, 2008 As Restated for FAS 117-1		June 30, 2008 As Restated	
	Unrestricted	Temporarily Restricted	Unrestricted	Temporarily Restricted
Statement of Activities				
Non-Operating- Investment loss, net of distribution	$ (58,716)	$ -	$ (85,352)	$ -
Investment loss	$ -	$ (60,844)	$ -	$ (34,208)
Increase (Decrease) in Net Assets	$ (453,247)	$ 227,986	$ (479,883)	$ 254,622
Balance Sheet				
Net Assets at June 30, 2007	$ 851,666	$ 488,467	$ 851,666	$ 488,467
Net Assets at June 30, 2008	$ 675,985	$ 438,887	$ 649,349	$ 465,523

(15) SUBSEQUENT EVENTS

During May 2009, the FASB issued SFAS No. 165, Subsequent Events (SFAS 165). SFAS 165 establishes evaluation principles and disclosure requirements for subsequent events. In accordance with this Statement, an entity should apply the requirements to annual financial periods ended after June 15, 2009. Therefore, the College adopted this pronouncement for the year ended June 30, 2009. Upon implementation of SFAS 165, the College recognized in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Additionally, the College did not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before financial statements are issued or are available to be issued. Some non-recognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading and any events that meet these criteria are disclosed below. The College has evaluated events occurring between the end of its most recent fiscal year, June 30, 2009, and the date the financial statements were issued, November 24, 2009.

Bond Insurance

On October 26, 2009 the College released Ambac Financial Group, Inc. from its obligation to provide bond insurance for the Series 2007A Bonds, which are outstanding at June 30, 2009 (see Note 8). This resulted in a $6.6 million write off of prepaid bond insurance premiums during fiscal 2010.

Contributions Receivable

In November 2009 the College received notice that the collectability of a pledge valued at $19.3 million at June 30, 2009 was in question. The College will record an allowance for this amount during fiscal year 2010, which will reduce temporarily restricted contribution income and contributions receivable.

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