

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.
(A NON-PROFIT ORGANIZATION)

INDEPENDENT AUDITORS' REPORT

June 30, 2012 and 2011

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

June 30, 2012 and 2011

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Balsler Horowitz Frank & Wakeling
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Habitat for Humanity of Orange County, Inc.
Santa Ana, California

We have audited the accompanying statements of financial position of Habitat for Humanity of Orange County, Inc. (the Organization) as of June 30, 2012 and 2011, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Habitat for Humanity of Orange County, Inc. as of June 30, 2012 and 2011, 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.

Balsler, Horowitz, Frank & Wakeling

BALSER, HOROWITZ, FRANK & WAKELING
Santa Ana, California
November 6, 2012

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF FINANCIAL POSITION

June 30, 2012 and 2011

	2012	2011
Assets		
Cash and cash equivalents	\$ 1,464,084	\$ 2,089,894
Restricted cash	616,374	650,020
Promises to give	128,434	377,000
Other receivable	146,704	85,462
Inventory - Homes for sale	1,208,210	870,379
Inventory - ReStores	174,374	208,551
Prepaid expenses and deposits	329,870	97,949
Housing assets, at net realizable value	3,570,171	781,614
Investment in joint venture - HFHI-SA Leverage VI, LLC (Note 4)	5,929,634	5,990,216
Mortgages receivable, net of unamortized discount	4,975,813	5,359,042
Property and equipment, net	98,090	82,142
Loan costs - joint venture, net	151,414	173,942
	<u>18,793,172</u>	<u>16,766,211</u>
Total assets	<u>\$ 18,793,172</u>	<u>\$ 16,766,211</u>
Liabilities		
Accounts payable and accrued expenses	\$ 656,903	\$ 526,753
Property tax and insurance impounds	121,194	160,729
Deferred mortgage receipts	51,902	32,849
Security deposits	34,398	20,118
Notes payable	3,085,289	906,194
Long-term debt - Clearinghouse NMTC (Sub 21), LLC (Note 9)	7,883,619	7,883,619
	<u>11,833,305</u>	<u>9,530,262</u>
Total liabilities	<u>11,833,305</u>	<u>9,530,262</u>
Net assets		
Unrestricted	5,623,207	5,274,345
Temporarily restricted	1,336,660	1,961,604
	<u>6,959,867</u>	<u>7,235,949</u>
Total net assets	<u>6,959,867</u>	<u>7,235,949</u>
Total liabilities and net assets	<u>\$ 18,793,172</u>	<u>\$ 16,766,211</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF ACTIVITIES
For the Years Ended June 30, 2012 and 2011

	2012	2011
Unrestricted net assets		
Support and revenue		
Contributions	\$ 1,319,779	\$ 1,282,405
Donated materials and services	198,355	174,788
Interest income	268,921	314,251
Rental income	57,105	92,411
ReStore revenues	1,888,320	2,459,966
Special events revenues	100,123	183,405
Other income	18,866	33,043
	<u>3,851,469</u>	<u>4,540,269</u>
Total unrestricted support revenues	3,851,469	4,540,269
Net assets released from restrictions	<u>2,498,592</u>	<u>5,567,650</u>
Total unrestricted support and reclassifications	<u>6,350,061</u>	<u>10,107,919</u>
Expenses		
Program services:		
Construction costs	3,971,583	3,369,135
ReStore expenses	2,058,922	2,353,118
Special events	48,596	118,198
Public relations	281,932	356,376
Faith relations	99,004	91,968
Family relations	305,701	286,673
Rental expenses	43,887	52,813
Contributions to Habitat for Humanity International	46,222	41,846
Costs in excess of estimated sales price	1,066,503	3,977,193
Less costs capitalized as housing assets	<u>(3,144,921)</u>	<u>(2,787,940)</u>
Total program services	<u>4,777,429</u>	<u>7,859,380</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF ACTIVITIES (continued)
For the Years Ended June 30, 2012 and 2011

	2012	2011
Unrestricted net assets (continued)		
Supporting services:		
General and administrative	593,611	505,382
General and administrative - joint venture	214,035	154,346
Fundraising	416,124	409,995
	<u>1,223,770</u>	<u>1,069,723</u>
Total supporting services		
	<u>6,001,199</u>	<u>8,929,103</u>
Total expenses		
	<u>348,862</u>	<u>1,178,816</u>
Change in unrestricted net assets		
Temporarily restricted net assets		
Contributions	1,391,088	2,049,149
Donated materials and services	247,560	581,803
Donated land	235,000	-
Net assets released from restrictions	(2,498,592)	(5,567,650)
	<u>(624,944)</u>	<u>(2,936,698)</u>
Change in temporarily restricted net assets		
	<u>(276,082)</u>	<u>(1,757,882)</u>
Change in net assets		
Net assets, beginning of year	<u>7,235,949</u>	<u>8,993,831</u>
Net assets, end of year	<u>\$ 6,959,867</u>	<u>\$ 7,235,949</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities		
Change in net assets	\$ (276,082)	\$ (1,757,882)
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Depreciation and amortization	45,285	49,249
Changes in:		
Cash held for investment in joint venture	-	867,681
Promises to give	248,566	(155,617)
Other receivable	(61,242)	(33,274)
Inventory - Homes for sale	(337,831)	464,125
Inventory - ReStores	34,177	(35,415)
Prepaid expenses and deposits	(231,921)	41,598
Housing assets	(2,788,557)	4,445,710
Acquisition of mortgages receivable	-	(5,298,334)
Payments on mortgages receivable	812,585	432,189
Discounts on mortgage receivable	(268,785)	2,476,019
Buybacks of mortgages	(160,571)	835,484
Accounts payable and accrued expenses	130,150	2,489
Property tax and insurance impounds	(39,535)	37,858
Deferred mortgage receipts	19,053	(31,332)
Security deposits	14,280	6,781
	<u>(2,860,428)</u>	<u>2,347,329</u>
Net cash from operating activities		
Cash flows from investing activities		
Investment in joint venture - HFHI-SA Leverage VI, LLC	-	(6,040,887)
Distributions from joint venture	60,582	50,671
Purchase of property and equipment	(38,705)	(13,589)
Acquisition of loan costs	-	(194,593)
	<u>21,877</u>	<u>(6,198,398)</u>
Net cash from investing activities		

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF CASH FLOWS (continued)
For the Years Ended June 30, 2012 and 2011

	2012	2011
Cash flows from financing activities		
Loan proceeds	2,706,020	8,563,279
Loan principal payments	<u>(526,925)</u>	<u>(3,269,448)</u>
Net cash from financing activities	<u>2,179,095</u>	<u>5,293,831</u>
Net change in cash and cash equivalents	(659,456)	1,442,762
Cash and cash equivalents, beginning of year	<u>2,739,914</u>	<u>1,297,152</u>
Cash and cash equivalents, end of year	<u>\$ 2,080,458</u>	<u>\$ 2,739,914</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 1 – Summary of significant accounting policies

This summary of significant accounting policies is presented to assist in understanding the accompanying financial statements. The financial statements and notes are the representations of Habitat for Humanity of Orange County, Inc.'s management, which is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting policies and have been consistently applied in the preparation of the financial statements.

Nature of activities

Habitat for Humanity of Orange County, Inc. (the Organization) is a non-profit corporation under Section 501(c)(3) of the Internal Revenue Code and was incorporated on January 26, 1988, under the laws of the State of California. The Organization is an ecumenical grass-roots Christian ministry whose purpose is to encourage, promote, and assist in the building and redevelopment of housing for low income families in Orange County, California. The Organization aims to accomplish its purpose through privately operated and financed programs to sell such housing to low-income families at cost, utilizing non-interest bearing instruments. Debt was incurred to meet construction commitments, but only to the extent these could be repaid via mortgages from the sales of homes. Homes sold during the year ended June 30, 2012, and homes sold since inception, were 3 and 172, respectively.

The Organization also operates two ReStore retail outlets that sell predominantly donated materials to the public. ReStore revenue comprises approximately 31% and 34% of total revenue for the years ended June 30, 2012 and 2011, respectively. Purchased product represents approximately 14% and 15% of total retail sales for the years ended June 30, 2012 and 2011, respectively. In 2012, one ReStore facility was closed and the Organization incurred approximately \$96,000 of costs to re-open in a larger retail facility.

Basis of accounting

The financial statements of the Organization have been prepared on the accrual basis of accounting and, accordingly, reflect all significant receivables, payables and other liabilities.

Basis of presentation

The Organization reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. At June 30, 2012 and 2011, there were no net assets or activities classified as permanently restricted net assets.

Use of estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from these estimates.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 1 – Summary of significant accounting policies (continued)

Cash and cash equivalents

For the purposes of the statements of cash flows, the Organization considers all temporary cash investments purchased with a maturity of three months or less to be cash equivalents.

Concentration of credit risk

The Organization maintains its cash deposit accounts at various commercial banks located in Southern California. Cash accounts at banks are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. The balances in these accounts may, at times, exceed federally insured limits. Management believes the Organization is not exposed to any significant risk in connection with cash accounts.

Promises to give

Unconditional promises to give are recognized as support and revenues or gains in the period promised and as assets, decreases of liabilities, or expenses depending on the form of the benefits to be received.

Other receivable

Other receivable consists of miscellaneous items related to properties.

Inventory - ReStores

The Organization operates two ReStore retail outlets that sell predominantly donated materials to the public. Donated inventories on hand at year end are valued at estimated fair market value. Purchased inventories are valued at the lower of cost or market.

Mortgages receivable

Mortgages receivable are non-interest bearing and exchanged for homes to low-income families, fulfilling the Organization's exempt purposes. The notes are recorded at their present value based on the prevailing market rate of interest at the time the mortgage was originated. Prevailing market rates are determined annually and provided by Habitat for Humanity International. The difference between the face amount of the note and its present value is accounted for as a discount and recorded as a reduction in the receivable. The resulting discount is amortized over the life of the mortgage using the interest method. Amortization of the discount is recognized as interest income in the statements of activities. Also see Note 5.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 1 – Summary of significant accounting policies (continued)

Housing assets

Housing assets represent amounts expended for the construction of new or refurbished homes and include costs of construction, donated materials and donated land. Housing assets are recorded at cost if materials are purchased, and at estimated fair market value if donated.

The Organization constructs housing for sale to low income families. In furtherance of this purpose a substantial amount of the cost of housing assets is not passed on to the homeowners but absorbed by the Organization. When the sales price of homes can be reasonably estimated, housing assets are reduced to their net realizable value. The reduction in these housing assets is recorded as "costs in excess of estimated sales price" in the statements of activities.

Property and equipment

All acquisitions of property and equipment in excess of \$2,000 and all expenditures in excess of \$2,000 for repairs, maintenance, and renewals that materially prolong the useful lives of assets are capitalized. Property and equipment is carried at cost, or, if donated, at the approximate market value at the date of donation. Depreciation is computed over the estimated useful lives of the assets on a straight-line basis. Depreciation expense for the years ended June 30, 2012 and 2011, was \$22,757 and \$28,598, respectively.

Loan costs

Amortization is computed over the life of the loan on a straight-line basis. Amortization expense for the years ended June 30, 2012 and 2011, was \$22,528 and \$20,651, respectively

Deferred mortgage receipts / rental income

At various times approved homeowners reside in homes which have not closed escrow. From the rental payments received from these homeowners, the Organization designates a portion of these rents to be applied to the homeowners' mortgages once escrow closes.

Revenue recognition

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted net assets depending on the existence or nature of any donor restrictions. All donor-restricted net assets are reported as an increase in temporarily restricted or permanently restricted net assets depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions. During the years ended June 30, 2012 and 2011, there were no contributions received that were classified as permanently restricted.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 1 – Summary of significant accounting policies (continued)

Donated services

Donated services are recognized as contributions if the services (a) create or enhance nonfinancial assets or (b) require specialized skills, are performed by people with those skills, and would otherwise be purchased by the Organization. Numerous volunteers provided many services throughout the year that are not recognized as contributions in the financial statements since the criteria for recognition are not met. Donated services are recognized as revenues in the period received and as assets or expenses depending on the services performed.

Donated materials

Donated materials and other non-monetary items are reflected as contributions in the accompanying statements at their estimated fair market values as of the date of receipt.

Functional allocation of expenses

The costs of providing various programs and other activities have been summarized on a functional basis in the statements of activities. Accordingly, certain costs have been allocated among the program and supporting services benefited.

An additional program service is costs in excess of estimated sales price. This includes the cost of offering a zero percent interest loan to families, actual costs incurred in excess of the sales price, donated land, and donated services.

Income taxes

The Organization is exempt from Federal and California income tax under Internal Revenue Code Section 501(c)(3). The Organization is subject, however, to Federal and California income tax on unrelated business income as stipulated in Internal Revenue Code Section 511 and Regulation Section 1.511. During the years ended June 30, 2012 and 2011, the Organization had revenue from an activity that constitutes unrelated business income. However, since applicable expenses of the activity exceeded the income from the activity, the Organization did not have unrelated business taxable income, and therefore incurred no tax liability due to unrelated business income.

The Organization follows the provisions of Accounting Standards Codification (ASC) 740-10-50, *Accounting for Uncertainty in Income Taxes*. The statement requires that a tax position be recognized or derecognized based on a 'more-likely-than-not' threshold. This applies to positions taken or expected to be taken in a tax return. The statement had no impact on the Organization's statements of financial position or statements of activities. The Organization does not believe its financial statements include (or reflect) any uncertain tax positions.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 2 – Restricted cash

Restricted cash consists of amounts held for legal or contract compliance and amounts reserved for homeowner impounds and delinquencies.

Note 3 – Promises to give

Promises to give are substantially restricted to payment for the costs of construction for several projects. The promises to give as of June 30, 2012 and 2011, were unconditional and all were due within one year.

Note 4 – Investment in joint venture - HFHI-SA Leverage VI, LLC

In July 2010, the Organization participated in a New Markets Tax Credit (NMTC) program. This Federal program provides funds to eligible organizations for investment in "qualified low-income community investment." Program compliance requirements included creation of a promissory note and investment in a qualified community development entity (sub-CDE). Tax credit recapture is required if compliance requirements are not met over a seven-year period.

This NMTC program included a consortium of California Habitat affiliates. In July 2010 the Organization recorded its 32.178% investment in HFHI-SA Leverage VI, LLC at the initial cost of \$6,040,887, of which all funds were ultimately invested in the sub-CDE. A promissory note is payable to Clearinghouse NMTC (Sub 21), LLC (the sub-CDE) for funds loaned back to the Organization. See Note 9.

The resulting benefit of the Organization's participation in the NMTC program was \$1,100,000 in cash proceeds used to build homes: \$750,000 to build 26 homes and \$350,000 to build 4 homes in San Juan Capistrano and Fullerton, respectively.

In July, 2017, Habitat California Investment Fund LLC (the Fund), the effective upstream owner of Clearinghouse NMTC (Sub 21), LLC (the sub-CDE), holder of the promissory note due from the Organization, is expected to exercise its put option. Under the terms of the put option agreement, HFHI-SA Leverage VI, LLC is expected to purchase the ownership interest of the Fund. Exercise of the option will effectively allow the Organization to extinguish its outstanding debt owed to the Fund. See Note 9.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 5 – Mortgages receivable

In general, mortgages receivable carry imputed interest rates between 5% and 8% and are presented in the accompanying statements of financial position net of unamortized discount. The face amount and unamortized discount of mortgages receivable as of June 30, 2012 and 2011, were \$10,732,326 and \$11,544,911, respectively. Imputed interest rates for June 30, 2012 and 2011, ranged from 5% to 7%. Interest income resulting from the amortization of discounted notes for the years ended June 30, 2012 and 2011 totaled \$268,785 and \$314,251, respectively.

Certain mortgages have been pledged as collateral under financing agreements with Residential Funding Corporation, Habitat for Humanity International, and California Bank and Trust (See Note 8). As of June 30, 2012 and 2011, the amount of receivables pledged (at face value) in connection with specific loan agreements are shown in the table below. On the statements of financial position, these same non-interest bearing mortgages are included net of discounts. In the table below, the payment streams represent cash paid out by the Organization to the specified lenders and cash received by the Organization from mortgage payments from homeowners related to the collateralized Habitat mortgages.

<u>Lender</u>	<u>Loan name</u>	<u>Payment streams</u>		<u>Balance of mortgages receivable pledged</u>	
		<u>Paid out</u>	<u>Receipts</u>	<u>2012</u>	<u>2011</u>
Habitat for	AAR 2006	\$ 106,455	\$ 116,020	\$ 1,271,274	\$ 1,377,729
Humanity	AAR 2007	30,086	30,086	653,943	684,029
International	FlexCap 2009	23,840	23,840	<u>792,966</u>	<u>816,806</u>
	Subtotal			2,718,183	2,878,564
Residential					
Funding					
Corporation	-	30,432	30,432	-	30,432
California Bank &					
Trust	-	61,316	61,743	<u>2,119,030</u>	<u>-</u>
	Total mortgages receivable pledged			<u>\$ 4,837,213</u>	<u>\$ 2,908,996</u>

These agreements are also subject to certain guarantees and may contain substitution requirements or options. See Note 13.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 6 – Property and equipment

A summary of property and equipment follows:	2012	2011
Equipment	\$ 282,420	\$ 243,715
Automobiles	110,159	110,159
Improvements	<u>49,353</u>	<u>49,353</u>
Total property and equipment	441,932	403,227
Less: accumulated depreciation	<u>(343,842)</u>	<u>(321,085)</u>
Property and equipment, net	<u>\$ 98,090</u>	<u>\$ 82,142</u>

Note 7 – Loan costs – joint venture

A summary of loan costs follows:	2012	2011
Closing costs	\$ 69,178	\$ 69,178
Guarantor fee	<u>125,415</u>	<u>125,415</u>
Total loan costs	194,593	194,593
Less: accumulated amortization	<u>(43,179)</u>	<u>(20,651)</u>
Loan costs, net	<u>\$ 151,414</u>	<u>\$ 173,942</u>

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 8 – Notes payable

Notes payable at June 30, 2012 and 2011, was comprised of the following:	2012	2011
Loan payable at an annual interest rate of 4%, dated August 6, 1993, to Residential Funding Corporation, collateralized by a combination of the Organization’s mortgage loans receivable, personal property rights, title and interest in all escrow accounts, and other related assets. The loan is payable in quarterly installments of \$11,730, including interest, through July 2011. The loan was paid in full in July 2011.	\$ -	\$ 14,460
Loan payable dated April 30, 2006, to Habitat for Humanity International, collateralized by mortgages receivable, with principal and interest at an annual rate of 3.89% payable in monthly installments of \$8,321 through March 31, 2013.	73,455	168,135
Loan payable dated November 9, 2007, to Habitat for Humanity International, collateralized by mortgages receivable, with principal and interest at an annual rate of 4.0% payable in quarterly installments of \$6,555 through December 31, 2014.	62,087	85,242
Loan payable dated April 30, 2009, to Habitat for Humanity International, collateralized by mortgages receivable, with principal and interest at an annual rate of 5.3% payable in quarterly installments of \$6,366 through June 30, 2016.	91,235	111,197
Loan payable dated December 1, 2011, to California Bank and Trust, collateralized by mortgages receivable, with principal and interest at an annual rate of 4.75% payable in monthly installments of \$5,145 through December 20, 2026.	645,638	-

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 8 – Notes payable (continued)

	2012	2011
<p>Loan payable dated February 15, 2012, to the City of Huntington Beach. The loan term is for twelve months from the date of the loan. The loan is payable in full upon the sale of the identified property to an eligible purchaser or February 15, 2013, whichever is sooner. The note does not accrue interest, however, in the event of default, the note will begin to accrue interest at the lesser of 10% or the highest rate permitted by law.</p>	261,604	-
<p>Loan payable dated September 23, 2011, to Cypress Redevelopment Agency, collateralized by a deed of trust. The loan is reconveyed in full upon sale of the last condominium in the project to a qualified homebuyer. The note does not accrue interest, however, in the event of default, the note will begin to accrue interest at the lesser of 10% or the highest rate permitted by law.</p>	1,437,389	-
<p>Loan payable dated February 16, 2012, to Housing Authority of the City of Santa Ana, collateralized by deed of trust, with principal due upon sale to a qualified homebuyer. The note does not accrue interest.</p>	345,541	-
<p>Loan payable dated December 20, 2010, to Neighborhood Housing Services of Orange County. The loan term is for twelve months from the date of the loan, subject to extension until August 11, 2012. The loan is payable in full upon the sale of the identified property to an eligible purchaser, or August 11, 2012, whichever is sooner. The note does not accrue interest, however, in the event of default, the note will begin to accrue interest at the lesser of 10% or the highest rate permitted by law.</p>	168,340	168,340

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 8 – Notes payable (continued)

	2012	2011
<p>Loan payable dated February 9, 2011, to Neighborhood Housing Services of Orange County. The loan term is for twelve months from the date of the loan, subject to extension until August 11, 2012. The loan is payable in full upon the sale of the identified property to an eligible purchaser, or August 11, 2012, whichever is sooner. The note does not accrue interest, however, in the event of default, the note will begin to accrue interest at the lesser of 10% or the highest rate permitted by law. The loan was paid in full in June 2012.</p>	-	182,836
<p>Loan payable dated February 24, 2011, to Neighborhood Housing Services of Orange County. The loan term is for twelve months from the date of the loan, subject to extension until August 11, 2012. The loan is payable in full upon the sale of the identified property to an eligible purchaser, or August 11, 2012, whichever is sooner. The note does not accrue interest, however, in the event of default, the note will begin to accrue interest at the lesser of 10% or the highest rate permitted by law. The loan was paid in full in August 2011.</p>	-	<u>175,984</u>
Total notes payable	<u>\$ 3,085,289</u>	<u>\$ 906,194</u>

Maturities of notes payable for the years ended June 30, are as follows:

2013	\$ 2,385,657
2014	85,324
2015	75,920
2016	65,870
2017	42,916

Interest expense related to notes payable for the years ended June 30, 2012 and 2011, totaled \$90,411 and \$80,167, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 9 – Long-term debt – Clearinghouse NMTC (Sub 21), LLC

Long-term debt consists of the following:

Clearinghouse NMTC (Sub 21), LLC	<u>\$7,883,619</u>
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Debt requires interest only payments until December 5, 2017 at 0.76633%. The loan matures on July 28, 2025. The loan is secured by substantially all the assets acquired by the Organization from the project loan proceeds. Debt has a put option feature that is exercisable in July 2017. Management expects that the put option will be exercised. Exercise of the option will effectively allow the Organization to extinguish its outstanding debt owed to the Fund. See Note 4.

Note 10 – Temporarily restricted net assets

Temporarily restricted net assets were comprised of the following at June 30:

	2012	2011
Land	\$ 520,000	\$ 285,000
Proceeds from sale of donated home	209,264	1,026,418
Capital campaign	86,000	-
Huntington Beach IV	-	62,811
Cypress II	-	38,180
Neighborhood Revitalization Initiative	146,256	-
Santa Ana VI	92,456	-
Special events	86,521	8,750
Future projects	136,810	128,175
Other	59,353	32,330
Net investment in joint venture	<u>-</u>	<u>379,940</u>
Total temporarily restricted net assets	<u>\$ 1,336,660</u>	<u>\$ 1,961,604</u>

Note 11 – Reclassifications

Certain reclassifications have been made to prior year balances in order to conform to the current year presentation.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 12 – Operating leases

The Organization leases office space, ReStore warehouse/retail space, and various office equipment under operating leases totaling \$53,578 per month for terms from April 2012 through September 2017. Rental expenses related to these leases totaled \$791,386 and \$636,081 for the years ended June 30, 2012 and 2011, respectively.

Future minimum lease payments for operating leases for the years ended June 30, are as follows:

2013	\$ 794,110
2014	529,256
2015	150,210
2016	147,634
2017	61,712

Note 13 – Guarantees

The Organization uses cash leveraging programs to generate cash today from years of future monthly mortgage payments by Habitat homeowners.

Habitat for Humanity International (See Note 14)

The Organization has guaranteed payment streams in connection with some of its debt instruments. These include the notes payable to Habitat for Humanity International (HFHI) under the AAR and FlexCap programs. On a monthly basis, the amount specified in the respective agreements is remitted to the appropriate party to the agreement. The term of these agreements is seven years. The Organization continues to service these mortgages, monitors payments, and is responsible for collections.

Under the agreements, if a mortgage has significant reported delinquencies, despite on-time remittance of the quarterly payments, the Organization could be required to substitute the loan with a loan that is consistently current. The Organization also retains the right to substitute a mortgage of equal or greater value in the event of the homeowner requesting a buyback of their property or in the event that the Organization plans to renegotiate the terms of the mortgage with the homeowner.

Residential Funding Corporation

The Organization also has guaranteed payment streams in connection with the Residential Funding Corporation (RFC) note payable. The Organization continues to service these mortgages, monitors payments, and is responsible for collections. On a quarterly basis, a specified amount, equal to the payments collected by the Organization during the three month period, are remitted to RFC. The term of this agreement is twenty years with a termination date of July 2011.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 13 – Guarantees (continued)

Vertical US Recovery Fund, LLC

The Organization entered into agreements with an unrelated investor, Vertical US Recovery Fund LLC (Vertical) which purchased certain of the Organization's mortgages. In conjunction with the purchase agreements, The Organization will continue to service these mortgages, monitor payments, and be responsible for collections. Under the terms of the agreement the Organization will remit to Vertical on a monthly basis for a period up to 40 years, an amount equal to the monthly payments due from the homeowners. This amount will vary as homeowners pay off their mortgages.

Under the agreements, the Organization retains the right to substitute a mortgage of equal or greater value in the event of the homeowner requesting a buyback of their property or in the event that the Organization plans to renegotiate the terms of the mortgage with the family. The Organization has guaranteed the full and prompt payment of all obligations in conjunction with the mortgages. The Organization's obligation to Vertical will not change irrespective of the payments collected on the mortgages.

First Republic Bank

First Republic Bank has made loans direct to Habitat homeowners. First Republic services these loans. The Organization retains the right to cure the loan for up to 180 days of consecutive late payments by the homeowner or up to 12 months of non-consecutive late payments by the homeowner. After the 180 days or 12 months passes, the loan balance outstanding would be purchased by the Organization. The Organization would then renegotiate a Habitat loan with the homeowner. The Organization has guaranteed mortgages made by First Republic Bank in the outstanding principal amount of \$1,606,598 and \$1,605,003 as of June 30, 2012 and 2011, respectively.

California Bank and Trust

The Organization has also guaranteed payment streams in connection with the California Bank and Trust note payable. The Organization continues to service these mortgages, monitors payments, and is responsible for collections, and will remit to California Bank and Trust \$5,145 on a monthly basis for the 15 year term of the agreement.

The Organization retains the right to substitute a mortgage of equal or greater value in the event of the homeowner requesting a buyback of their property or in the event that the Organization plans to renegotiate the terms of the mortgage with the family. The Organization has encumbered five loans, of which their total present value equates to approximately forty percent of the note payable to California Bank and Trust, as possible substitution loans. See Notes 5 and 8.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 14 – Related party transactions

Habitat for Humanity International

The Organization is affiliated, by agreement, with Habitat for Humanity International, a tax-exempt organization incorporated under the laws of the state of Georgia. The Organization has been added to the roster of exempt subordinates by the Internal Revenue Service within a group exemption granted to Habitat for Humanity International under Section 501(c)(3) of the Internal Revenue Code.

Under its affiliate agreement the Organization is expected to contribute a certain portion of its unrestricted cash donations to Habitat for Humanity International to continue its international programs. These contributions are accounted for as program services and are recorded when due.

The Organization has entered into three loans through HFHI, and these loans are collateralized by pledged mortgages receivables. See Notes 5 and 8.

Note 15 – Agreement with Humanity Housing, Inc.

The Organization has an Agreement of Purchase and Sale and Joint Escrow Instructions (the "Purchase Agreement") with an unrelated entity, Humanity Housing, Inc., a California non-profit corporation. Humanity Housing, Inc. is working in cooperation with the Organization pursuant to the HOME program regulations requiring Humanity Housing, Inc. to convey the properties and assign all rights and obligations to the Organization which has qualified to rehabilitate the properties, complete the housing construction, and offer for sale and sell the completed units to eligible homebuyers. During the years ended June 30, 2012 and 2011, no properties were transferred between the entities.

Note 16 – Supplemental disclosures of cash flow information

	2012	2011
Cash paid during the year for:		
Interest	<u>\$ 90,411</u>	<u>\$ 80,167</u>
Noncash investing activities:		
Contributed housing assets	<u>\$ 3,144,921</u>	<u>\$ 2,787,940</u>

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2012 and 2011

Note 17 – Subsequent events

Management's review

Management has evaluated subsequent events through November 6, 2012, the date on which the financial statements were available to be issued.

Loans payable

In July 2012 the Organization received a \$400,000 loan from Sunwest Bank for construction of two homes in Santa Ana.

In October 2012 the Organization received a \$600,000 loan from Sunwest Bank for construction of three homes in Santa Ana.

Sale of homes

On August 10, 2012, the Organization sold a home to an unrelated party, which included a third-party loan and a mortgage receivable. The Organization does guarantee the third party loan. The home sale fulfills annual compliance requirements for the New Markets Tax Credit transaction of July 2010.

Sale of mortgages

On August 31, 2012, two mortgages were sold to Vertical US Recovery Fund II, LLC and three mortgages were sold to Vertical Capital Income Fund.