

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

INDEPENDENT AUDITORS' REPORT

June 30, 2013 and 2012

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

June 30, 2013 and 2012

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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 financial statements of Habitat for Humanity of Orange County, Inc. (the Organization), which comprise the statements of financial position as of June 30, 2013 and 2012, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the financial statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*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, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Balser, Horowitz, Frank & Wakeling*

BALSER, HOROWITZ, FRANK & WAKELING  
Santa Ana, California  
December 11, 2013

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF FINANCIAL POSITION

June 30, 2013 and 2012

	2013	2012
<b>Assets</b>		
Cash and cash equivalents	\$ 1,092,408	\$ 1,464,084
Cash and cash equivalents - restricted	1,569,359	616,374
Promises to give	256,422	128,434
Other receivable	38,443	146,704
Inventory - Homes for sale	1,048,909	1,208,210
Inventory - ReStores	223,597	174,374
Prepaid expenses and deposits	239,389	329,870
Housing assets, at net realizable value	5,217,314	3,570,171
Investment in joint venture - HFHI-SA Leverage VI, LLC (Note 4)	5,869,225	5,929,634
Mortgages receivable, net of unamortized discount	4,391,955	4,975,813
Property and equipment, net	105,103	98,090
Loan costs - joint venture, net	128,885	151,414
	<u>                    </u>	<u>                    </u>
Total assets	<u>\$ 20,181,009</u>	<u>\$ 18,793,172</u>
<b>Liabilities</b>		
Accounts payable and accrued expenses	\$ 682,891	\$ 656,903
Property tax and insurance impounds	104,766	121,194
Deferred mortgage receipts	112,172	51,902
Security deposits	33,122	34,398
Notes payable	3,663,184	3,085,289
Long-term debt - Clearinghouse NMTC (Sub 21), LLC (Note 9)	7,883,619	7,883,619
	<u>                    </u>	<u>                    </u>
Total liabilities	<u>12,479,754</u>	<u>11,833,305</u>
<b>Net assets</b>		
Unrestricted	6,464,067	5,623,207
Temporarily restricted	1,237,188	1,336,660
	<u>                    </u>	<u>                    </u>
Total net assets	<u>7,701,255</u>	<u>6,959,867</u>
	<u>                    </u>	<u>                    </u>
Total liabilities and net assets	<u>\$ 20,181,009</u>	<u>\$ 18,793,172</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF ACTIVITIES  
For the Years Ended June 30, 2013 and 2012

	2013	2012
<b>Unrestricted net assets</b>		
Support and revenue		
Contributions	\$ 1,488,098	\$ 1,319,779
Donated materials and services	224,465	198,355
Interest income	232,354	268,921
Rental income	42,515	57,105
ReStore revenues	1,957,641	1,888,320
Special events revenues	472,688	100,123
Other income	122,278	18,866
	<hr/>	<hr/>
Total unrestricted support revenues	4,540,039	3,851,469
Net assets released from restrictions	1,677,978	2,498,592
	<hr/>	<hr/>
Total unrestricted support and reclassifications	6,218,017	6,350,061
	<hr/>	<hr/>
<b>Expenses</b>		
Program services:		
Construction costs	4,073,358	3,971,583
Construction costs - joint venture	211,218	214,035
ReStore expenses	2,088,911	2,058,922
Special events	56,745	48,596
Public relations	271,953	281,932
Faith relations	56,468	99,004
Family relations	286,926	305,701
Rental expenses	48,904	43,887
Contributions to Habitat for Humanity International	54,408	46,222
Costs in excess of estimated sales price	720,238	1,066,503
Less costs capitalized as housing assets	(3,440,691)	(3,144,921)
	<hr/>	<hr/>
Total program services	4,428,438	4,991,464
	<hr/>	<hr/>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF ACTIVITIES (continued)  
For the Years Ended June 30, 2013 and 2012

	2013	2012
<b>Unrestricted net assets (continued)</b>		
Supporting services:		
General and administrative	491,545	593,611
Fundraising	457,174	416,124
	<u>948,719</u>	<u>1,009,735</u>
Total supporting services		
	<u>5,377,157</u>	<u>6,001,199</u>
Total expenses		
	<u>840,860</u>	<u>348,862</u>
Change in unrestricted net assets		
<b>Temporarily restricted net assets</b>		
Contributions	1,400,734	1,391,088
Donated materials and services	177,772	247,560
Donated land	-	235,000
Net assets released from restrictions	(1,677,978)	(2,498,592)
	<u>(99,472)</u>	<u>(624,944)</u>
Change in temporarily restricted net assets		
	<u>741,388</u>	<u>(276,082)</u>
Change in net assets		
<b>Net assets, beginning of year</b>	<u>6,959,867</u>	<u>7,235,949</u>
<b>Net assets, end of year</b>	<u>\$ 7,701,255</u>	<u>\$ 6,959,867</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, 2013 and 2012

	2013	2012
<b>Cash flows from operating activities</b>		
Change in net assets	\$ 741,388	\$ (276,082)
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Depreciation and amortization	55,742	45,285
Changes in:		
Promises to give	(127,988)	248,566
Other receivable	108,261	(61,242)
Inventory - Homes for sale	159,301	(337,831)
Inventory - ReStores	(49,223)	34,177
Prepaid expenses and deposits	90,481	(231,921)
Housing assets	(1,647,143)	(2,788,557)
Acquisition of mortgages receivable	(340,544)	-
Payments on mortgages receivable	1,523,551	812,585
Discounts on mortgage receivable	(26,620)	(268,785)
Buybacks of mortgages	(572,528)	(160,571)
Accounts payable and accrued expenses	25,987	130,150
Property tax and insurance impounds	(16,428)	(39,535)
Deferred mortgage receipts	60,270	19,053
Security deposits	(1,276)	14,280
	<u>(16,769)</u>	<u>(2,860,428)</u>
Net cash from operating activities		
<b>Cash flows from investing activities</b>		
Distributions from joint venture	60,409	60,582
Purchase of property and equipment	(40,226)	(38,705)
	<u>20,183</u>	<u>21,877</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, 2013 and 2012

	2013	2012
<b>Cash flows from financing activities</b>		
Loan proceeds	1,241,700	2,706,020
Loan principal payments	<u>(663,805)</u>	<u>(526,925)</u>
Net cash from financing activities	<u>577,895</u>	<u>2,179,095</u>
Net change in cash and cash equivalents	581,309	(659,456)
<b>Cash and cash equivalents, beginning of year</b>	<u>2,080,458</u>	<u>2,739,914</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 2,661,767</u>	<u>\$ 2,080,458</u>

See accompanying notes and independent auditors' report

## HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

### NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

#### **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. New homes sold during the year ended June 30, 2013, and homes sold since inception, were 2 and 174, respectively.

The Organization also operates two ReStore retail outlets that sell predominantly donated materials to the public. ReStore revenue comprises approximately 29% and 31% of total revenue for the years ended June 30, 2013 and 2012, respectively. Purchased product represents approximately 22% and 14% of total retail sales for the years ended June 30, 2013 and 2012, 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, 2013 and 2012, 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, 2013 and 2012

**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, 2013 and 2012

#### 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, 2013 and 2012, was \$33,213 and \$22,757, 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, 2013 and 2012, was \$22,529 and \$22,528, 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, 2013 and 2012, there were no contributions received that were classified as permanently restricted.

## HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

### NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

#### 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, 2013 and 2012, 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, 2013 and 2012

#### **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 may include restricted and unrestricted pledges. Restricted pledges are generally restricted to payment for the costs of construction for several projects.

In March 2012 and in May 2013, the organization initiated a five year unrestricted pledge program. These unrestricted and unconditional promises to give had no collection history as of the end of June 2012, so a pledge receivable was not recorded for 2012. In 2013, the pledges from the previous year are being collected as are the 2013 pledges. The unrestricted promises to give as of June 30, 2013 and 2012 include current portions of \$84,112 and \$128,434, respectively and long-term portions of \$172,310 and \$0, respectively.

#### **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, 2013 and 2012

**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, 2013 and 2012, were \$9,549,318 and \$10,732,326, respectively. Imputed interest rates for June 30, 2013 and 2012, ranged from 5% to 7%. Interest income resulting from the amortization of discounted notes for the years ended June 30, 2013 and 2012 totaled \$232,340 and \$268,785, respectively.

Certain mortgages have been pledged as collateral under financing agreements with Habitat for Humanity International and California Bank and Trust (See Note 8). As of June 30, 2013 and 2012, 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>2013</u>	<u>2012</u>
Habitat for	AAR 2006	\$ 49,925	\$ 58,010	\$ -	\$ 1,271,274
Humanity	AAR 2007	26,221	30,087	623,856	653,943
International	FlexCap 2009	25,462	24,485	<u>767,522</u>	<u>792,966</u>
	Subtotal			1,391,378	2,718,183
California Bank & Trust	-	61,743	61,743	<u>2,057,236</u>	<u>2,119,030</u>
	Total mortgages receivable pledged			<u>\$ 3,448,614</u>	<u>\$ 4,837,213</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, 2013 and 2012

**Note 6 – Property and equipment**

A summary of property and equipment follows:	2013	2012
Equipment	\$ 291,061	\$ 282,420
Automobiles	141,744	110,159
Improvements	<u>49,353</u>	<u>49,353</u>
Total property and equipment	482,158	441,932
Less: accumulated depreciation	<u>(377,055)</u>	<u>(343,842)</u>
Property and equipment, net	<u>\$ 105,103</u>	<u>\$ 98,090</u>

**Note 7 – Loan costs – joint venture**

A summary of loan costs follows:	2013	2012
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>(65,708)</u>	<u>(43,179)</u>
Loan costs, net	<u>\$ 128,885</u>	<u>\$ 151,414</u>

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

**Note 8 – Notes payable**

Notes payable at June 30, 2013 and 2012, was comprised of the following:	2013	2012
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. This note was paid in full in March 2013.	-	73,455
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.	37,991	62,087
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.	70,195	91,235
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.	614,305	645,638
Loan payable dated February 15, 2012, to the City of Huntington Beach. The loan term is for 12 months from the date of the loan. The loan is payable in full upon the sale of the identified property to an eligible purchaser.	261,604	261,604

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

Note 8 – Notes payable (continued)

	2013	2012
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.	1,437,389	1,437,389
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. This note was fully reconveyed in August 2012.	-	345,541
Loan payable dated September 12, 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.	363,070	-
Loan payable dated July 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.	165,933	-
Loan payable dated September 12, 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.	124,937	-

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

Note 8 – Notes payable (continued)

	2013	2012
Loan payable dated September 12, 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.	181,535	-
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. This note was fully reconveyed in July 2012.	-	168,340
Loan payable dated March 22, 2013, to Orange County Housing Trust. The loan term is for 24 months from the date of the loan. The note is collateralized by a deed of trust, with principal and interest at an annual rate of 5.00%.	155,967	-
Loan payable dated July 10, 2012, to Sunwest Bank, collateralized by the property under construction and donations. The loan term is for twelve months from the date of the loan, with principal and interest at an annual rate of 5.00%.	178,461	-

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

Note 8 – Notes payable (continued)

	2013	2012
Loan payable dated October 17, 2012, to Sunwest Bank, collateralized by the property under construction and donations. The loan term is for 18 months from the date of the loan, with principal and interest at an annual rate of 5.00%.	<u>71,797</u>	<u>-</u>
Total notes payable	<u>\$ 3,663,184</u>	<u>\$ 3,085,289</u>

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

2014	\$ 2,927,642
2015	174,294
2016	65,872
2017	42,916
2018 and thereafter	452,460

Interest expense related to notes payable for the years ended June 30, 2013 and 2012, totaled \$100,195 and \$90,411, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

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

Long-term debt consists of the following:

Clearinghouse NMTC (Sub 21), LLC \$7,883,619

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:

	2013	2012
Land	\$ 520,000	\$ 520,000
Proceeds from sale of donated home	209,672	209,264
Capital campaign	51,000	86,000
Neighborhood Revitalization Initiative	-	146,256
Home Depot Critical Repair	291,448	-
Santa Ana VI	-	92,456
Special events	-	86,521
Future projects	88,767	136,810
Other	<u>76,301</u>	<u>59,353</u>
Total temporarily restricted net assets	<u>\$ 1,237,188</u>	<u>\$ 1,336,660</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, 2013 and 2012

#### Note 12 – Operating leases

The Organization leases office space, ReStore warehouse/retail space, and various office equipment under operating leases totaling \$74,384 per month for terms through September 2017. Rental expenses related to these leases totaled \$855,880 and \$791,386 for the years ended June 30, 2013 and 2012, respectively.

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

2014	\$	723,163
2015		385,001
2016		274,893
2017		203,007
2018		32,648

#### 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.

## HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

### NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

#### Note 13 – Guarantees (continued)

##### Vertical US Recovery Fund, LLC

The Organization entered into agreements with unrelated investors, Vertical US Recovery Fund LLC, Vertical US Recovery Fund II LLC, and Vertical Capital Income Fund (collectively 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 \$1,779,552 and \$1,606,598 as of June 30, 2013 and 2012, 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, 2013 and 2012

#### **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, one of which has been repaid, 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, 2013 and 2012, no properties were transferred between the entities.

The Organization has an accommodation agreement with Humanity Housing, Inc. whereby the Organization pays Humanity Housing, Inc. a sum of \$400 upon the close of escrow for each Affordable Housing Agreement (AHA) in which Humanity Housing, Inc. serves as the counterparty in the role of beneficiary of the AHA.

#### **Note 16 – Reclassification of construction costs - joint venture**

During the year ended June 30, 2013, management determined to reclassify certain on-going expenses associated with the July 2010 New Markets Tax Credit (NMTC) transaction described in Note 4. Construction costs – joint venture in the amounts of \$211,218 and \$214,035 for the years ended June 30, 2013 and 2012, respectively, were shown in prior years as General and administrative expenses – joint venture. This reclassification more accurately presents the on-going expenses associated with the construction of 30 homes under the NMTC program.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

**Note 17 – Supplemental disclosures of cash flow information**

	2013	2012
Cash paid during the year for:		
Interest	<u>\$ 100,195</u>	<u>\$ 90,411</u>
Noncash investing activities:		
Contributed housing assets	<u>\$ 3,440,691</u>	<u>\$ 3,144,921</u>

**Note 18 – Subsequent events**

Management's review

Management has evaluated subsequent events through December 11, 2013, the date on which the financial statements were available to be issued.

Loans payable

In July 2013, the Organization received four loans totaling \$766,000 from the City of Santa Ana Housing Authority for land acquisition of four properties in Santa Ana. These loans, which are non-interest-bearing and require no payments will be fully reconveyed upon sale of the respective completed home to a qualifying family.

In July 2013 the Organization received an \$800,000 loan at 5% interest with an eighteen month term from Sunwest Bank for construction of four new homes on the four properties in Santa Ana.

In July 2013, the Organization's construction loan from Sunwest Bank in the amount of \$178,461 was fully repaid.

In September 2013, the Organization's loan from the Housing Authority of the City of Santa Ana in the amount of \$165,933 was fully reconveyed as the home was completed and sold to a qualifying family.

Reimbursement agreement

The Organization has agreed to reimburse the City of La Habra \$60,000 for costs related to storm drain improvements. Payment will be made prior to the close of escrow, expected to occur in December 2013.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2013 and 2012

**Note 18 – Subsequent events (continued)**

La Habra Development

Escrow has opened for the Organization to acquire land from the City of La Habra to build seven affordable homes. Sunwest Bank has committed to a \$1.1 million construction loan for the development.

New ReStore lease

On November 27, 2013, the Organization entered into a seven and one-half year lease for a new retail site in Anaheim. The "seven year" term effectively begins July 1, 2014. The Organization currently operates two retail stores (ReStores) in Garden Grove and Santa Ana. The Garden Grove lease expires in February 2014. ReStore operations in Garden Grove will move to the new location in Anaheim.

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

2014	\$	26,364
2015		280,678
2016		283,087
2017		285,567
2018		288,123