

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

INDEPENDENT AUDITORS' REPORT

June 30, 2014 and 2013

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

June 30, 2014 and 2013

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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, 2014 and 2013, 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, 2014 and 2013, 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.

*Ronald Blue & Co.
CPAs and Consultants, LLP*

RONALD BLUE & CO. CPAS AND CONSULTANTS, LLP
(formerly Balser, Horowitz, Frank & Wakeling)
Santa Ana, California
October 22, 2014

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF ACTIVITIES
For the Years Ended June 30, 2014 and 2013

	2014	2013
Unrestricted net assets		
Support and revenue		
Contributions	\$ 1,570,809	\$ 1,488,098
Donated materials and services	194,992	224,465
Interest income	252,041	232,354
Rental income	79,710	42,515
ReStore revenues	1,867,169	1,957,641
Special events revenues	522,998	472,688
Other income	33,571	122,278
	<hr/>	<hr/>
Total unrestricted support revenues	4,521,290	4,540,039
Net assets released from restrictions	<hr/>	<hr/>
Total unrestricted support and reclassifications	<hr/>	<hr/>
Expenses		
Program services:		
Construction costs	6,487,239	4,073,358
Construction costs - joint venture	211,556	211,218
ReStore expenses	1,982,951	2,088,911
Special events	70,919	56,745
Public relations	234,568	271,953
Faith relations	31,938	56,468
Family relations	370,887	286,926
Rental expenses	37,404	48,904
Contributions to Habitat for Humanity International	61,640	54,408
Costs in excess of estimated sales price	1,378,685	720,238
Less costs capitalized as housing assets	(5,862,361)	(3,440,691)
	<hr/>	<hr/>
Total program services	5,005,426	4,428,438

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF ACTIVITIES (continued)
For the Years Ended June 30, 2014 and 2013

	2014	2013
Unrestricted net assets (continued)		
Supporting services:		
General and administrative	557,564	491,545
Fundraising	<u>594,874</u>	<u>457,174</u>
Total supporting services	<u>1,152,438</u>	<u>948,719</u>
Total expenses	<u>6,157,864</u>	<u>5,377,157</u>
Change in unrestricted net assets	<u>606,414</u>	<u>840,860</u>
Temporarily restricted net assets		
Contributions	1,632,125	1,400,734
Donated materials and services	183,945	177,772
Donated land	955,940	-
Net assets released from restrictions	<u>(2,242,988)</u>	<u>(1,677,978)</u>
Change in temporarily restricted net assets	<u>529,022</u>	<u>(99,472)</u>
Change in net assets	<u>1,135,436</u>	<u>741,388</u>
Net assets, beginning of year	<u>7,701,255</u>	<u>6,959,867</u>
Net assets, end of year	<u><u>\$ 8,836,691</u></u>	<u><u>\$ 7,701,255</u></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, 2014 and 2013

	2014	2013
Cash flows from operating activities		
Change in net assets	\$ 1,135,436	\$ 741,388
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Depreciation and amortization	51,220	55,742
Changes in:		
Promises to give	10,588	(127,988)
Other receivable	(243,830)	108,261
Inventory - Homes for sale	(295,949)	159,301
Inventory - ReStores	23,608	(49,223)
Prepaid expenses and deposits	73,717	90,481
Housing assets	(2,439,266)	(1,647,143)
Acquisition of mortgages receivable	(338,744)	(340,544)
Payments on mortgages receivable	369,358	1,523,551
Discounts on mortgage receivable	(76,818)	(26,620)
Buybacks of mortgages	180,186	(572,528)
Accounts payable and accrued expenses	315,516	25,987
Property tax and insurance impounds	10,633	(16,428)
Deferred mortgage receipts	34,269	60,270
Security deposits	1,989	(1,276)
	<u>(1,188,087)</u>	<u>(16,769)</u>
Net cash from operating activities		
Cash flows from investing activities		
Distributions from joint venture	60,409	60,409
Purchase of property and equipment	(51,908)	(40,226)
	<u>8,501</u>	<u>20,183</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, 2014 and 2013

	2014	2013
Cash flows from financing activities		
Loan proceeds	2,447,234	1,241,700
Loan principal payments	<u>(1,449,802)</u>	<u>(663,805)</u>
Net cash from financing activities	<u>997,432</u>	<u>577,895</u>
Net change in cash and cash equivalents	(182,154)	581,309
Cash and cash equivalents, beginning of year	<u>2,661,767</u>	<u>2,080,458</u>
Cash and cash equivalents, end of year	<u>\$ 2,479,613</u>	<u>\$ 2,661,767</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

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 transform lives and communities by helping families in need build and purchase or renovate their own homes. 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.

The Organization builds new homes and rehabilitates properties repurchased by the Organization to ready them for resale, homes owned by qualifying families, and buildings owned by other non-profits to help them accomplish their mission in a more cost effective manner.

Prior to the dissolution of the Redevelopment Agencies in California in 2012, public land was donated to the Organization. Generally land is secured by debt payable to the purveyor of the land. In many cases, this debt is non-interest bearing and no principal payments are required. The debt is then reconveyed to the Organization upon the successful sale of the home to a qualified buyer as defined in the Disposition and Development Agreement with the purveyor. June 2014 is the first time the Organization has had to purchase land.

Debt is also incurred to meet construction commitments, but only to the extent these can be repaid via mortgages from the sales of homes.

Twenty-one (21) homes are under construction as of the year ended June 30, 2014. During the year ended June 30, 2014, the Organization sold 4 homes, and has sold 177 homes since inception. By serving families, the Organization has changed 867 lives since inception. Homes rehabilitated in the year ended June 30, 2014 include twenty-five in a Veteran home repair program. The Organization has also funded the building of 405 homes worldwide as of June 30, 2014 and it currently tithes to the Habitat affiliates in Nicaragua.

The Organization also operates two ReStore retail outlets that sell predominantly donated materials to the public. ReStore revenue comprises approximately 30% and 29% of total revenue for the years ended June 30, 2014 and 2013, respectively. Purchased product represents approximately 7% and 22% of total retail sales for the years ended June 30, 2014 and 2013, respectively. In 2014, the Organization incurred approximately \$15,000 of costs to close one ReStore facility, and approximately \$99,000 of costs to re-open in a comparably sized retail facility.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 1 – Summary of significant accounting policies (continued)

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, 2014 and 2013, 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.

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. As of June 30, 2014, this includes a grant receivable of \$243,499.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 1 – Summary of significant accounting policies (continued)

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.

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, 2014 and 2013, was \$28,692 and \$33,213, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 1 – Summary of significant accounting policies (continued)

Loan costs

Amortization is computed over the life of the loan on a straight-line basis. Amortization expense for the years ended June 30, 2014 and 2013, was \$22,528 and \$22,529, 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, 2014 and 2013, there were no contributions received that were classified as permanently restricted.

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.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 1 – Summary of significant accounting policies (continued)

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, 2014 and 2013, 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 does not believe its financial statements include (or reflect) any uncertain tax positions.

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.

Since March 2012, the organization held an annual five year unrestricted pledge program. These unrestricted and unconditional promises to give have had over two years of collection history. The unrestricted promises to give as of June 30, 2014 and 2013 include current portions of \$106,036 and \$84,112, respectively and long-term portions of \$139,798 and \$172,310, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

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.

Note 5 – Mortgages receivable

In general, mortgages receivable carry imputed interest rates between 4.5% and 8.0% 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, 2014 and 2013, were \$9,470,748 and \$9,549,318, respectively. Imputed interest rates for June 30, 2014 and 2013, ranged from 4.5% to 5.0%. Interest income resulting from the amortization of discounted notes for the years ended June 30, 2014 and 2013 totaled \$251,913 and \$232,340, 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, 2014 and 2013, 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.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 5 – Mortgages receivable (continued)

<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>2014</u>	<u>2013</u>
Humanity	AAR 2007	\$ 26,221	\$ 30,087	\$ 593,769	\$ 623,856
International	FlexCap 2009	25,462	24,485	<u>741,881</u>	<u>767,522</u>
	Subtotal			1,335,650	1,391,378
California Bank & Trust	-	61,743	61,743	<u>1,995,347</u>	<u>2,057,236</u>
Total mortgages receivable pledged				<u>\$ 3,330,997</u>	<u>\$ 3,448,614</u>

These agreements are also subject to certain guarantees and may contain substitution requirements or options. See Note 12.

Note 6 – Property and equipment

A summary of property and equipment follows:

	<u>2014</u>	<u>2013</u>
Equipment	\$ 308,099	\$ 291,061
Automobiles	145,224	141,744
Improvements	<u>80,743</u>	<u>49,353</u>
Total property and equipment	534,066	482,158
Less: accumulated depreciation	<u>(405,747)</u>	<u>(377,055)</u>
Property and equipment, net	<u>\$ 128,319</u>	<u>\$ 105,103</u>

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 7 – Loan costs – joint venture

A summary of loan costs follows:

	2014	2013
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>(88,236)</u>	<u>(65,708)</u>
Loan costs, net	<u>\$ 106,357</u>	<u>\$ 128,885</u>

Note 8 – Notes payable

Notes payable at June 30, 2014 and 2013, was comprised of the following:

	2014	2013
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.	\$ 12,916	\$ 37,991
Loan payable dated April 30, 2009, to Habitat for Humanity International, collateralized by Deeds of Trust for mortgages receivable, with principal and interest at an annual rate of 5.3% payable in quarterly installments of \$6,366 through June 30, 2016.	48,017	70,195
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.	581,439	614,305

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 8 – Notes payable (continued)

	2014	2013
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
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 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. This note was fully reconveyed in December 2013.	-	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. This note was fully reconveyed in September 2013.	-	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. This note was fully reconveyed in February 2014.	-	124,937

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 8 – Notes payable (continued)

	2014	2013
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. This note was fully reconveyed in December 2013.	-	181,535
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.	174,937	-
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.	174,937	-
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.	174,937	-
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.	240,933	-
Loan payable dated March 22, 2013, to Neighborworks (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%.	717,856	155,967

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 8 – Notes payable (continued)

	2014	2013
Loan payable dated July 10, 2012, to Sunwest Bank, collateralized by the property under construction in Santa Ana, CA 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%. This note was paid in full in July 2013.	-	178,461
Loan payable dated October 17, 2012, to Sunwest Bank, collateralized by the property under construction in Santa Ana, CA 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%. The note was paid in full in January 2014.	-	71,797
Loan payable dated June 30, 2014, to Sunwest Bank, collateralized by the property in Santa Ana, CA. The loan term is for 6 months from the date of the loan, with principal and interest at an annual rate of 5.00%.	160,000	-
Loan payable dated July 5 ,2013, to Sunwest Bank, collateralized by the property under construction in Santa Ana, CA 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%.	396,366	-
Loan payable dated December 3, 2013, to Sunwest Bank, collateralized by the land and property under construction in La Habra, CA 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>279,285</u>	<u>-</u>
Total notes payable	<u>\$ 4,660,616</u>	<u>\$ 3,663,184</u>

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 8 – Notes payable (continued)

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

2015	\$ 3,597,102
2016	553,551
2017	38,361
2018	40,223
2019 and thereafter	<u>431,379</u>
	<u>\$ 4,660,616</u>

Interest expense related to notes payable for the years ended June 30, 2014 and 2013, totaled \$94,831 and \$100,195, respectively.

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.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 10 – Temporarily restricted net assets

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

	2014	2013
Land	\$ 302,000	\$ -
Proceeds from sale of donated home	-	209,672
Capital campaign	50,000	51,000
Home Depot Critical Repair	18,317	291,448
Santa Ana VI	150,000	-
La Habra	243,500	-
Cypress II	350,000	-
Future projects	122,186	88,767
Other	<u>607</u>	<u>66,701</u>
Total temporarily restricted net assets	<u>\$ 1,236,610</u>	<u>\$ 707,588</u>

Note 11 – Operating leases

The Organization leases office space, ReStore warehouse/retail space, and various office equipment under operating leases totaling \$55,377 per month for terms through November 2020. Rental expenses related to these leases totaled \$740,182 and \$855,880 for the years ended June 30, 2014 and 2013, respectively.

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

2015	\$ 659,021
2016	543,162
2017	465,633
2018	320,595
2019	276,264

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 12 – 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 13)

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.

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.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 12 – Guarantees (continued)

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 \$1,925,560 and \$1,779,552 as of June 30, 2014 and 2013, 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, through December 2026.

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.

Note 13 – 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 currently has two loans through HFHI, and these loans are collateralized by pledged mortgages receivables. See Notes 5 and 8.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 14 – 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, 2014 and 2013, 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 15 – Supplemental disclosures of cash flow information

	2014	2013
Cash paid during the year for:		
Interest	<u>\$ 94,831</u>	<u>\$ 100,195</u>
Noncash investing activities:		
Contributed housing assets	<u>\$ 5,862,361</u>	<u>\$ 3,440,691</u>

Contributed housing assets represents program costs which have been capitalized until the homes are sold.

Note 16 – Prior period adjustment

During the year ended June 30, 2014, management discovered that, as a result of a misclassification in a prior year, certain temporarily net assets should have been reported as unrestricted net assets. To correct this misclassification, 2013 beginning unrestricted net assets has been increased and beginning temporarily restricted net assets has been decreased by \$529,600. This reclassification has no effect on the beginning net assets, in total, or the change in net assets for the years ended June 30, 2014 and 2013.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2014 and 2013

Note 17 – Subsequent events

Loans payable

In August 2014, the Organization acquired debt with California Bank and Trust. Collateral is the Deeds of Trust for specified mortgages. The Organization has also guaranteed payment streams in connection with the California Bank and Trust notes payable. The Organization continues to service these mortgages, monitors payments, and is responsible for collections, and will remit to California Bank and Trust on a monthly basis as follows: \$3,021 for the 15 year term of the agreement through August 2029, and \$3,500 for the 7 year term of the agreement through August 2021.

In October 2014, the Organization acquired two properties and related debt with The Housing Authority of the City of Santa Ana for land value of \$360,870 and corresponding debt of \$360,870. The loan payable is collateralized by two deeds of trust, with principal due upon sale to a qualified homebuyer. The note does not accrue interest.

As part of the same transaction, the Organization acquired debt up to \$400,000 for a construction loan for the two properties. The loan payable to Sunwest Bank, is collateralized by the property under construction in Santa Ana, California 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%.

Management's review

Management has evaluated subsequent events through October 22, 2014, the date on which the financial statements were available to be issued.