

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

FINANCIAL STATEMENTS WITH
INDEPENDENT AUDITORS' REPORT

June 30, 2016 and 2015

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

June 30, 2016 and 2015

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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, 2016 and 2015, 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.

Auditors' 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 auditors' 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 organization'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 organization'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, 2016 and 2015, 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*

Santa Ana, California
October 19, 2016

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF FINANCIAL POSITION

June 30, 2016 and 2015

	2016	2015
Assets		
Cash and cash equivalents	\$ 2,373,675	\$ 995,959
Cash and cash equivalents - restricted	1,398,171	928,344
Promises to give	633,922	474,128
Other receivables	63,910	176,536
Inventory - Homes for sale	1,106,242	4,674,859
Inventory - ReStores	176,686	162,787
Prepaid expenses and deposits	171,518	122,573
Housing assets, at net realizable value	6,595,539	6,348,498
Investment in joint venture - HFHI-SA Leverage VI, LLC (Note 4)	5,687,998	5,748,407
Mortgages receivable, net of unamortized discount	6,171,144	4,468,371
Property and equipment, net	<u>87,620</u>	<u>104,302</u>
 Total assets	 <u>\$ 24,466,425</u>	 <u>\$ 24,204,764</u>
Liabilities		
Accounts payable and accrued expenses	\$ 753,049	\$ 804,372
Property tax and insurance impounds	147,991	124,392
Deferred mortgage receipts	142,094	201,372
Security deposits	246,023	45,771
Line of credit	130,000	-
Notes payable	4,518,649	5,637,254
Long-term debt - Clearinghouse NMTC (Sub 21), LLC, net (Note 9)	<u>7,822,318</u>	<u>7,799,791</u>
 Total liabilities	 <u>13,760,124</u>	 <u>14,612,952</u>
Net assets		
Unrestricted	9,401,905	8,797,820
Temporarily restricted	<u>1,304,396</u>	<u>793,992</u>
 Total net assets	 <u>10,706,301</u>	 <u>9,591,812</u>
 Total liabilities and net assets	 <u>\$ 24,466,425</u>	 <u>\$ 24,204,764</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF ACTIVITIES

For the Years Ended June 30, 2016 and 2015

	2016	2015
Unrestricted net assets		
Support and revenue		
Contributions	\$ 696,734	\$ 739,776
Donated materials and services	147,956	150,427
Interest income	359,251	423,049
Rehab income	60,197	39,500
Rental income	128,091	93,505
ReStore revenues	2,306,141	2,050,033
Sale of homes	7,217,346	1,203,800
Special events revenues	851,412	867,035
Other income	30,902	19,567
	<u>11,798,030</u>	<u>5,586,692</u>
Total unrestricted support and revenues	11,798,030	5,586,692
Net assets released from restrictions	<u>2,179,343</u>	<u>1,702,149</u>
Total unrestricted support, revenues and reclassifications	<u>13,977,373</u>	<u>7,288,841</u>
Expenses		
Program services:		
Construction costs	4,358,921	8,297,590
Construction costs - joint venture	251,288	171,317
ReStore expenses	1,928,494	1,843,551
Special events	576,627	78,974
Public relations	251,267	217,780
Faith relations	30,124	22,074
Family relations	194,318	280,111
Rental expenses	63,552	57,733
Contributions to Habitat for Humanity International	55,325	41,462
Cost of home sales and rehabs	7,480,625	1,600,126
Discount of home sales	929,906	184,180
Less costs capitalized as housing assets	<u>(3,601,769)</u>	<u>(7,662,336)</u>
Total program services	<u>12,518,678</u>	<u>5,132,562</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, 2016 and 2015

	2016	2015
Unrestricted net assets (continued)		
Supporting services:		
General and administrative	471,592	462,891
Fundraising	383,018	495,649
	<u>854,610</u>	<u>958,540</u>
Total supporting services		
	<u>13,373,288</u>	<u>6,091,102</u>
Total expenses		
	<u>604,085</u>	<u>1,197,739</u>
Change in unrestricted net assets		
Temporarily restricted net assets		
Contributions	2,589,056	1,060,380
Donated materials and services	100,691	199,151
Net assets released from restrictions	(2,179,343)	(1,702,149)
	<u>510,404</u>	<u>(442,618)</u>
Change in temporarily restricted net assets		
	<u>1,114,489</u>	<u>755,121</u>
Change in net assets		
Net assets, beginning of year	<u>9,591,812</u>	<u>8,836,691</u>
Net assets, end of year	<u>\$ 10,706,301</u>	<u>\$ 9,591,812</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, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Change in net assets	\$ 1,114,489	\$ 755,121
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Depreciation expense	16,682	24,017
Interest expense - loan costs	22,528	22,529
Changes in:		
Promises to give	(159,794)	(228,294)
Other receivables	112,626	105,737
Inventory - Homes for sale	3,568,617	(3,330,001)
Inventory - ReStores	(13,899)	37,202
Prepaid expenses and deposits	(48,945)	43,099
Housing assets	(247,041)	1,308,082
Acquisition of mortgages receivable	(3,463,808)	(271,710)
Payments on mortgages receivable	1,338,764	380,436
Discounts on mortgage receivable	601,100	(264,094)
Buybacks of mortgages	(178,829)	(55,030)
Accounts payable and accrued expenses	(51,325)	(194,034)
Property tax and insurance impounds	23,599	8,993
Deferred mortgage receipts	(59,278)	54,931
Security deposits	200,252	10,660
	<u>2,775,738</u>	<u>(1,592,356)</u>
Net cash from operating activities		
Cash flows from investing activities		
Distributions from joint venture	<u>60,409</u>	<u>60,409</u>
Net cash from investing activities	<u>60,409</u>	<u>60,409</u>

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, 2016 and 2015

	2016	2015
Cash flows from financing activities		
Loan proceeds	2,490,285	1,674,144
Line of credit proceeds	130,000	-
Loan principal payments	<u>(3,608,889)</u>	<u>(697,507)</u>
Net cash from financing activities	<u>(988,604)</u>	<u>976,637</u>
Net change in cash and cash equivalents	1,847,543	(555,310)
Cash and cash equivalents, beginning of year	<u>1,924,303</u>	<u>2,479,613</u>
Cash and cash equivalents, end of year	<u>\$ 3,771,846</u>	<u>\$ 1,924,303</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

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- and moderate-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 was the first time the Organization 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.

Eight (8) homes are under construction as of the year ended June 30, 2016. Five (5) more were completed and being readied for sale. During the year ended June 30, 2016, the Organization sold fourteen (14) homes (ten new construction and four resales of homes purchased from the prior Habitat family), and has sold 200 newly constructed homes since inception. Additionally, one home was repurchased and has been prepared for resale to another qualifying family. By serving families, the Organization has changed 3,601 lives since inception. Fifteen homes (15) were repaired in the year ended June 30, 2016. Five (5) of these were for Veterans as part of a Veteran Home Repair Program. The Organization has also funded the building of 425 homes worldwide as of June 30, 2016 and it currently tithes to the Habitat affiliates in Nicaragua and Macedonia.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 1 – Summary of significant accounting policies (continued)

The Organization also operates two ReStore retail outlets that sell predominantly donated materials to the public. ReStore revenue comprises approximately 34% and 34% of total revenue for the years ended June 30, 2016 and 2015, respectively. Purchased product represents approximately 9% and 9% of total retail sales for the years ended June 30, 2016 and 2015, respectively.

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, 2016 and 2015, 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.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 1 – Summary of significant accounting policies (continued)

Other receivables

Other receivables consists of miscellaneous items related to properties. As of June 30, 2016 and 2015, this includes a grant receivable of \$0 and \$153,500, respectively.

Inventory – Homes for sale

The Organization constructs housing for sale to low- and moderate-income families. Homes for sale inventories are valued at net realizable value.

Inventory - ReStores

The Organization operates two ReStore retail outlets, which are located in Santa Ana and Anaheim, 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- and moderate-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 based on current mortgage interest rates offered by our banking partners. 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- and moderate-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. Completed new construction homes are stated at the lower of cost or market using the specific identification method and reserving for a loss when appropriate. As of June 30, 2016 and 2015, the reserve for loss was \$361,632 and \$838,842, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 1 – Summary of significant accounting policies (continued)

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, 2016 and 2015, was \$16,682 and \$24,017, 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, 2016 and 2015, 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.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

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, 2016 and 2015, the Organization had revenue from the sale of purchased goods in the ReStores, which constitutes unrelated business income. However, since purchased product represents approximately 9% and 9% of total retail sales for the years ended June 30, 2016 and 2015, respectively, and the 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 four years of collection history. The unrestricted promises to give as of June 30, 2016 and 2015 include current portions of \$230,140 and \$166,756, respectively and long-term portions of \$403,782 and \$307,372, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

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.

The balance of the investment in HFHI-SA Leverage VI, LLC as of June 30, is as follows:

	2016	2015
Beginning balance	\$ 5,748,407	\$ 5,808,816
Distributions	<u>(60,409)</u>	<u>(60,409)</u>
Ending balance	<u>\$ 5,687,998</u>	<u>\$ 5,748,407</u>

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

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, 2016 and 2015, were \$11,713,448 and \$9,409,576, respectively. Imputed interest rates for June 30, 2016 and 2015, ranged from 4.5% to 5.0%. Interest income resulting from the amortization of discounted notes for the years ended June 30, 2016 and 2015 totaled \$359,209 and \$423,024, respectively.

Certain mortgages have been pledged as collateral under financing agreements with Habitat for Humanity International and California Bank and Trust (See Note 7). As of June 30, 2016 and 2015, 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>2016</u>	<u>2015</u>
Habitat for Humanity International	FlexCap 2009	\$ 25,462	\$ 33,440	\$ 698,131	\$ 720,034
	Subtotal			698,131	720,034
California Bank & Trust	2011 - 15 yr	61,743	56,723	1,871,863	1,928,682
California Bank & Trust	2014 - 7 yr	42,010	38,688	408,771	346,446
California Bank & Trust	2014 - 15 yr	36,258	37,024	587,099	632,578
	Total mortgages receivable pledged			<u>\$ 3,565,864</u>	<u>\$ 3,627,740</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, 2016 and 2015

Note 6 – Property and equipment

A summary of property and equipment follows:	2016	2015
Equipment	\$ 308,099	308,099
Automobiles	145,224	145,224
Improvements	<u>80,743</u>	<u>80,743</u>
Total property and equipment	534,066	534,066
Less: accumulated depreciation	<u>(446,446)</u>	<u>(429,764)</u>
Property and equipment, net	<u>\$ 87,620</u>	<u>\$ 104,302</u>

Note 7 – Notes payable

Notes payable at June 30, 2016 and 2015, was comprised of the following:	2016	2015
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 5.30% payable in quarterly installments of \$6,366 through June 30, 2016.	\$ -	\$ 24,641
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.	510,855	546,959
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

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 7 – Notes payable (continued)

	2016	2015
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.	-	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%.	-	896,066
Loan payable dated June 30, 2014, to Sunwest Bank, collateralized by the property in Santa Ana, CA. The loan term is extended to October 24, 2015, with principal and interest at an annual rate of 5.00%. The loan will be replaced by a construction loan.	-	160,000
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 extended until December 3, 2015, with principal and interest at an annual rate of 5.00%.	-	671,979

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 7 – Notes payable (continued)

	2016	2015
Loan payable dated October 17, 2014 to Sunwest Bank, collateralized by the property under construction in Santa Ana, 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%	-	111,329
Loan payable dated August 11, 2014 to California Bank & Trust, collateralized by mortgages receivable with principal and interest at an annual rate of 4.00% payable in monthly installments of \$3,501 through August 20, 2021.	197,159	230,401
Loan payable dated August 11, 2014 to California Bank & Trust, collateralized by mortgages receivable with principal and interest at an annual rate of 5.00% payable in monthly installments of \$3,021 through August 20, 2029.	351,806	369,675
Loan payable dated October 22, 2014, 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.	-	180,435
Loan payable dated October 22, 2014, 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.	-	180,435
Loan payable dated December 29, 2014 to Sunwest Bank, collateralized by the property under construction in Cypress, and donations. The loan term is extended to December 29, 2016, with principal and interest at an annual rate of 5.00%.	419,573	150,471

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 7 – Notes payable (continued)

	2016	2015
Loan payable dated May 19, 2016, to the City of Santa Ana. The loan is transferred to a new owner upon the sale of the identified property to an eligible purchaser. The note does not accrue interest.	1,015,285	-
Loan payable dated September 8, 2015, to the City of Fullerton. The loan is transferred to a new owner upon the sale of the identified property to an eligible purchaser. The note does not accrue interest.	315,000	-
Loan payable dated November 15, 2015 to Sunwest Bank, collateralized by the property under construction in Santa Ana, 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>271,582</u>	<u>-</u>
Total notes payable	<u>\$ 4,518,649</u>	<u>\$ 5,637,254</u>
2017		\$ 3,598,837
2018		140,008
2019		140,008
2020		140,008
2021		140,008
2022 and thereafter		<u>359,780</u>
		<u>\$ 4,518,649</u>

Interest expense related to notes payable for the years ended June 30, 2016 and 2015, totaled \$115,643 and \$141,850, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 8 – Line of credit

The Organization secured a line of credit of up to \$1,000,000 dated March 9, 2016 from First Bank. The line is unsecured and matures September 9, 2017 with a variable interest rate at 0.50% over the index (Wall Street Journal Prime Rate), which was 3.50% at June 30, 2016. At June 30, 2016, the outstanding balance was \$130,000.

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

Long-term debt consists of the following:	2016	2015
Clearinghouse NMTC (Sub 21), LLC	\$ 7,883,619	\$ 7,883,619
Less: loan costs	<u>(61,301)</u>	<u>(83,828)</u>
Clearinghouse NMTC (Sub 21), LLC, net	<u>\$ 7,822,318</u>	<u>\$ 7,799,791</u>

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.

Interest expense related to loan costs for the years ended June 30, 2016 and 2015 totaled \$22,528 and \$22,529, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 10 – Temporarily restricted net assets

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

	2016	2015
Land	\$ 302,000	\$ 302,000
Cal Home Grant	428,867	-
Civilian repair	38,413	-
Fullerton II	155,621	177,851
Lowe's Woodcrest	46,407	-
Neighborhood Revitalization Initiative	18,313	33,718
NR Veterans	277,189	101,716
La Habra	-	153,500
Future projects	<u>37,586</u>	<u>25,207</u>
Total temporarily restricted net assets	<u>\$ 1,304,396</u>	<u>\$ 793,992</u>

Note 11 – Operating leases

The Organization leases office space, ReStore warehouse/retail space, and various office equipment under operating leases totaling \$58,233 per month for terms through August 2021. Rental expenses related to these leases totaled \$613,905 and \$645,368 for the years ended June 30, 2016 and 2015, respectively.

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

2017	\$ 659,743
2018	500,240
2019	451,019
2020	476,838
2021	367,422

Note 12 – Retirement Plan

The Organization offers a retirement plan to eligible employees. The Organization does not provide any employer contributions.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

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.

Vertical US Recovery Fund, LLC / Statebridge Company, 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. During the year ended June 30, 2016, Vertical sold all their interests to Statebridge Company, LLC. In conjunction with the 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 / Statebridge 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 /Statebridge will not change irrespective of the payments collected on the mortgages.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 13 – 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 \$2,852,460 and \$1,884,019 as of June 30, 2016 and 2015, respectively.

California Bank and Trust

The Organization has also guaranteed payment streams in connection with three 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 per the term of each agreement as follows: \$5,145 for 15 years through December 2026; \$3,501 for 7 years through August 2021, \$3,021 for 15 years through August 2029.

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 eleven loans, of which their total present value equates to approximately forty percent of the notes payable to California Bank and Trust, as possible substitution loans. See Notes 5 and 7.

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.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 14 – Related party transactions (continued)

The Organization has entered into three loans through HFHI, two of which have been paid in full, and one remains. The remaining loan is collateralized by pledged mortgages receivables. See Notes 5 and 7.

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 year ended June 30, 2015, one property was transferred from the Organization to Humanity Housing, Inc. through a Quit Claim Deed transfer for \$1.00. The property will be returned to the Organization through a Quit Claim Deed for \$1.00 in the fiscal year ended June 30, 2016. No other properties were transferred between the entities in the fiscal year ended June 30, 2016.

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 – Supplemental disclosures of cash flow information

	2016	2015
Cash paid during the year for:		
Interest	<u>\$ 115,643</u>	<u>\$ 141,850</u>
Noncash investing activities:		
Costs capitalized as housing assets	<u>\$ 3,601,769</u>	<u>\$ 7,662,336</u>

Interest expense for the years ended June 30, 2016 and 2015 was \$138,171 and \$164,379, of which \$22,528 and \$22,529 was related to loan fees, respectively.

Contributed housing assets represents program costs which have been capitalized until the homes are sold. These costs include land, construction in progress, donated materials and services, and incurred losses prior to sale of the homes.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2016 and 2015

Note 17 – Change in accounting principle

During the year ended June 30, 2016, management elected to adopt *ASC 835-30 Imputation of Interest*. With the adoption of this change, net loan fees of \$61,301 were combined with long-term debt. This change decreased assets by \$61,301 and decreased liabilities by \$61,301 creating a zero net effect. June 30, 2015 loan fees were also reclassified to reflect this policy change.

Note 18 – Subsequent events

Construction site incident

On August 3, 2016, trenching was occurring at one of the construction sites, and a telephone pole had to be secured to prevent it from falling. The utility company is requesting the Organization to pay for the additional costs incurred to further secure the telephone pole. The Organization has contacted their liability insurance company to determine next steps. It is not practicable to determine a possible amount of loss to the Organization, therefore no loss contingency has been recorded in the financial statements.

Management's review

Management has evaluated subsequent events through October 19, 2016, the date on which the financial statements were available to be issued.