# HABITAT FOR HUMANITY EAST BAY/SILICON VALLEY AND SUBSIDIARIES

*(A California Nonprofit Public Benefit Corporation)*

**CONSOLIDATED FINANCIAL STATEMENTS**

**AND**

**INDEPENDENT AUDITOR'S REPORT**

**YEARS ENDED JUNE 30, 2014 AND 2013**

HABITAT FOR HUMANITY EAST BAY/SILICON VALLEY AND SUBSIDIARIES

*(A California Nonprofit Public Benefit Corporation)*

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2014 AND 2013

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LINDQUIST
VON HUSEN
& JOYCE LLP



Board of Directors
Habitat for Humanity East Bay/Silicon Valley
Oakland, California

## INDEPENDENT AUDITOR'S REPORT

*Report on the Financial Statements*

We have audited the accompanying consolidated financial statements of Habitat for Humanity East Bay/Silicon Valley, a California nonprofit public benefit corporation, and Subsidiaries, which comprise the consolidated statements of financial position as of June 30, 2014 and 2013, and the related consolidated statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated financial statements based on our audit. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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



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*Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Habitat for Humanity East Bay/Silicon Valley and Subsidiaries 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.

*Report on Other Legal and Regulatory Requirements*

In accordance with *Government Auditing Standards*, we have also issued a report dated November 26, 2014 on our consideration of Habitat for Humanity East Bay/Silicon Valley and Subsidiaries' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Habitat for Humanity East Bay/Silicon Valley and Subsidiaries' internal control over financial reporting and compliance.

Lindquist, von Husen and Joyce LLP

November 26, 2014

HABITAT FOR HUMANITY EAST BAY/SILICON VALLEY AND SUBSIDIARIES

*(A California Nonprofit Public Benefit Corporation)*

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2014 AND 2013

| | 2014 | 2013 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 4,760,769 | $ 5,402,886 |
| Restricted cash – current (Note 3) | 447,442 | 414,204 |
| Receivables, net: | | |
| Grants and contributions – current (Note 4) | 1,389,042 | 1,086,266 |
| Mortgages and notes – current (Note 5) | 616,618 | 609,355 |
| Other | 322,040 | 257,473 |
| Inventory: | | |
| Property held for sale (Note 6) | 10,637,493 | 5,212,130 |
| Cost of homes in progress – current (Note 6) | 917,413 | 1,292,463 |
| Inventory of ReStore | 177,588 | 187,353 |
| Prepaid expenses and deposits – current | 163,907 | 127,912 |
| Total current assets | 19,432,312 | 14,590,042 |
| Restricted cash – net of current portion (Note 3) | 956,725 | 1,226,216 |
| Receivables, net: | | |
| Grants and contributions – net of current portion (Note 4) | 71,332 | 108,773 |
| Mortgages and notes – net of current portion (Note 5) | 14,561,172 | 14,284,512 |
| Cost of homes in progress – net of current portion (Note 6) | 5,190,243 | 7,862,928 |
| Prepaid expenses and deposits – net of current portion | 135,857 | 153,612 |
| Property and equipment, net (Note 7) | 157,581 | 99,158 |
| Total assets | $ 40,505,222 | $ 38,325,241 |

*The accompanying notes are an integral part of these consolidated financial statements.*

HABITAT FOR HUMANITY EAST BAY/SILICON VALLEY AND SUBSIDIARIES

*(A California Nonprofit Public Benefit Corporation)*

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2014 AND 2013

| | 2014 | 2013 |
|---|---|---|
| **LIABILITIES AND NET ASSETS** | | |
| Current liabilities: | | |
| Line of credit (Note 9) | $ 612,377 | $ 308,594 |
| Accounts payable and accrued expenses | 654,339 | 1,436,761 |
| Cash held for others (Note 3) | 126,149 | 81,686 |
| Interest payable (Note 11) | 60,251 | 63,713 |
| Notes payable – current portion (Note 10) | 1,306,887 | 1,618,046 |
| Reconveyable notes payable – current portion (Note 11) | 1,903,904 | 1,408,960 |
| Deferred revenue – current portion (Note 12) | 1,886,376 | 895,959 |
| Total current liabilities | 6,550,283 | 5,813,719 |
| Notes payable – net of current portion (Note 10) | 3,582,335 | 2,851,257 |
| Reconveyable notes payable – net of current portion (Note 11) | 3,991,440 | 2,528,052 |
| Deferred revenue – net of current portion (Note 12) | 1,978,760 | 2,789,719 |
| Total liabilities | 16,102,818 | 13,982,747 |
| Net assets: | | |
| Unrestricted: | | |
| Board designated (Note 13) | 34,289 | 29,265 |
| Undesignated | 23,371,275 | 23,377,477 |
| Total unrestricted | 23,405,564 | 23,406,742 |
| Temporarily restricted (Note 13) | 996,840 | 935,752 |
| Total net assets | 24,402,404 | 24,342,494 |
| Total liabilities and net assets | $ 40,505,222 | $ 38,325,241 |

*The accompanying notes are an integral part of these consolidated financial statements.*

HABITAT FOR HUMANITY EAST BAY/SILICON VALLEY AND SUBSIDIARIES

*(A California Nonprofit Public Benefit Corporation)*

CONSOLIDATED STATEMENTS OF ACTIVITIES

YEARS ENDED JUNE 30, 2014 AND 2013

| | 2014 | | |
|---|---|---|---|
| | *Unrestricted* | *Temporarily Restricted* | *Total* |
| Support and revenue: | | | |
| Grants and contributions | $ 4,334,952 | $ 1,144,279 | $ 5,479,231 |
| In-kind contributions (Note 14) | 1,965,348 | - | 1,965,348 |
| Forgiveness of debt | 1,325,708 | - | 1,325,708 |
| Fundraising event contributions | 1,028,223 | - | 1,028,223 |
| Less: fundraising event costs | (326,090) | - | (326,090) |
| Sales of homes | 4,332,107 | - | 4,332,107 |
| Other income | 179,742 | - | 179,742 |
| Net assets released from restrictions (Note 13) | 1,083,191 | (1,083,191) | - |
| Total support and revenue | 13,923,181 | 61,088 | 13,984,269 |
| Expenses: | | | |
| Program services: | | | |
| Housing | 10,177,743 | - | 10,177,743 |
| ReStore | 1,331,388 | - | 1,331,388 |
| Supporting services: | | | |
| Management and general | 1,870,405 | - | 1,870,405 |
| Fundraising | 1,027,748 | - | 1,027,748 |
| Total expenses | 14,407,284 | - | 14,407,284 |
| Change in net assets before other revenue and expenses: | (484,103) | 61,088 | (423,015) |
| Investment income – NMTC (Note 12) | 245,006 | - | 245,006 |
| Amortization of deferred revenue – NMTC (Note 12) | 810,959 | - | 810,959 |
| Mortgage discount amortization | 364,728 | - | 364,728 |
| Interest – New markets tax credits (Note 12) | (245,782) | - | (245,782) |
| Mortgage discount expenses | (691,986) | - | (691,986) |
| Loss on sale of mortgages receivable (Note 5) | - | - | - |
| Total other revenue and expenses | 482,925 | - | 482,925 |
| Change in net assets | (1,178) | 61,088 | 59,910 |
| Net assets, beginning of year (Note 16) | 23,406,742 | 935,752 | 24,342,494 |
| Net assets, end of year | $ 23,405,564 | $ 996,840 | $ 24,402,404 |

*The accompanying notes are an integral part of these consolidated financial statements.*

HABITAT FOR HUMANITY EAST BAY/SILICON VALLEY AND SUBSIDIARIES

*(A California Nonprofit Public Benefit Corporation)*

CONSOLIDATED STATEMENTS OF ACTIVITIES

YEARS ENDED JUNE 30, 2014 AND 2013

| | 2013 | | |
|---|---|---|---|
| | *Unrestricted* | *Temporarily Restricted* | *Total* |
| Support and revenue: | | | |
| Grants and contributions | $ 1,872,388 | $ 3,091,935 | 4,964,323 |
| In-kind contributions (Note 14) | 1,627,404 | - | 1,627,404 |
| Forgiveness of debt | 1,588,158 | - | 1,588,158 |
| Fundraising event contributions | 193,823 | - | 193,823 |
| Less: fundraising event costs | (94,465) | - | (94,465) |
| Sales of homes | 4,762,331 | - | 4,762,331 |
| Other income | 131,575 | - | 131,575 |
| Net assets released from restrictions (Note 13) | 3,763,361 | (3,763,361) | - |
| Total support and revenue | 13,844,575 | (671,426) | 13,173,149 |
| Expenses: | | | |
| Program services: | | | |
| Housing | 8,949,439 | - | 8,949,439 |
| ReStore | 1,052,991 | - | 1,052,991 |
| Supporting services: | | | |
| Management and general | 1,737,763 | - | 1,737,763 |
| Fundraising | 936,485 | - | 936,485 |
| Total expenses | 12,676,678 | - | 12,676,678 |
| Change in net assets before other revenue and expenses: | 1,167,897 | (671,426) | 496,471 |
| Investment income – NMTC (Note 12) | 245,006 | - | 245,006 |
| Amortization of deferred revenue – NMTC (Note 12) | 810,959 | - | 810,959 |
| Mortgage discount amortization | 353,312 | - | 353,312 |
| Interest – New markets tax credits (Note 12) | (245,781) | - | (245,781) |
| Mortgage discount expenses | (1,010,173) | - | (1,010,173) |
| Loss on sale of mortgages receivable (Note 5) | (49,841) | - | (49,841) |
| Total other revenue and expenses | 103,482 | - | 103,482 |
| Change in net assets | 1,271,379 | (671,426) | 599,953 |
| Net assets, beginning of year (Note 16) | 22,135,363 | 1,607,178 | 23,742,541 |
| Net assets, end of year | $ 23,406,742 | $ 935,752 | $ 24,342,494 |

*The accompanying notes are an integral part of these consolidated financial statements.*

HABITAT FOR HUMANITY EAST BAY/SILICON VALLEY AND SUBSIDIARIES

*(A California Nonprofit Public Benefit Corporation)*

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES

YEARS ENDED JUNE 30, 2014 AND 2013

| | 2014 | | | | | |
|---|---|---|---|---|---|---|
| | *Program Services* | | | *Supporting Services* [1] | | |
| | *Housing* | *ReStore* | *Program Services Total* | *Management and General* | *Fundraising* | *Total* |
| Cost of homes sold | $ 8,201,944 | $ - | $ 8,201,944 | $ - | $ - | $ 8,201,944 |
| Personnel | 2,948,999 | 766,252 | 3,715,251 | 1,167,471 | 463,500 | 5,346,222 |
| Homeowner relations | 20,535 | - | 20,535 | 1,006 | - | 21,541 |
| Office | 69,707 | 52,596 | 122,303 | 65,928 | 14,567 | 202,798 |
| Professional services | 231,082 | 27,455 | 258,537 | 164,896 | 82,108 | 505,541 |
| Travel | 36,673 | 9,289 | 45,962 | 19,924 | 6,007 | 71,893 |
| Tithe to international projects (Note 8) | 32,623 | - | 32,623 | - | - | 32,623 |
| Property management | 16,073 | - | 16,073 | - | - | 16,073 |
| Public relations | 1,612 | 74,878 | 76,490 | 567 | 110,703 | 187,760 |
| Rent (Note 15) | 129,305 | 150,528 | 279,833 | 61,456 | 33,523 | 374,812 |
| Warehouse lease (Note 15) | 12,162 | 8,802 | 20,964 | - | - | 20,964 |
| Equipment | 73,829 | 10,461 | 84,290 | 10,876 | 5,849 | 101,015 |
| Education | 4,211 | 1,097 | 5,308 | 7,672 | 97 | 13,077 |
| Insurance | 15,137 | 16,362 | 31,499 | 47,827 | - | 79,326 |
| Depreciation | - | 9,136 | 9,136 | 30,689 | - | 39,825 |
| Bad debt | - | - | - | - | 121,882 | 121,882 |
| Interest | - | - | - | 26,903 | - | 26,903 |
| Asset management, compliance and facilitation fees – NMTC (Note 11) | 127,191 | - | 127,191 | 142,161 | - | 269,352 |
| ReStore | 8,860 | 110,168 | 119,028 | - | - | 119,028 |
| Miscellaneous | 120,894 | 94,364 | 215,258 | 123,029 | 189,512 | 527,799 |
| Allocation to cost of homes in progress | (1,873,094) | - | (1,873,094) | - | - | (1,873,094) |
| Total expenses as shown in the consolidated statements of activities | 10,177,743 | 1,331,388 | 11,509,131 | 1,870,405 | 1,027,748 | 14,407,284 |
| Interest – NMTC (Note 11) | 245,782 | - | 245,782 | - | - | 245,782 |
| Mortgage discount expenses | 691,986 | - | 691,986 | - | - | 691,986 |
| Loss on sale of mortgages receivable | - | - | - | - | - | - |
| Fundraising event costs | 1,815 | - | 1,815 | - | 324,275 | 326,090 |
| Total expenses | $ 11,117,326 | $ 1,331,388 | $ 12,448,714 | $ 1,870,405 | $ 1,352,023 | $ 15,671,142 |

[1] For the last three fiscal periods ended 2012 through 2014, supporting services expenses have averaged 15.0% of total expenses. The supporting services expense percentage fluctuates by year depending on the number of homes sold. The fiscal period ended 2012 represents combined expenses for the merged entities for comparative purposes.

*The accompanying notes are an integral part of these consolidated financial statements.*

HABITAT FOR HUMANITY EAST BAY/SILICON VALLEY AND SUBSIDIARIES

*(A California Nonprofit Public Benefit Corporation)*

CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES

YEARS ENDED JUNE 30, 2014 AND 2013

| | 2013 | | | | | |
|---|---|---|---|---|---|---|
| | *Program Services* | | | *Supporting Services* [2] | | |
| | *Housing* | *ReStore* | *Program Services Total* | *Management and General* | *Fundraising* | *Total* |
| Cost of homes sold | $ 7,119,755 | $ - | $ 7,119,755 | $ - | $ - | $ 7,119,755 |
| Unrecoverable cost of homes | 173,134 | - | 173,134 | - | - | 173,134 |
| Personnel | 2,677,804 | 620,119 | 3,297,923 | 1,115,876 | 285,037 | 4,698,836 |
| Homeowner relations | 28,321 | - | 28,321 | 431 | - | 28,752 |
| Office | 74,305 | 38,326 | 112,631 | 44,277 | 12,656 | 169,564 |
| Professional services | 162,661 | 13,340 | 176,001 | 112,214 | 168,863 | 457,078 |
| Travel | 53,513 | 4,056 | 57,569 | 20,924 | 6,547 | 85,040 |
| Tithe to international projects (Note 8) | 122,877 | - | 122,877 | - | - | 122,877 |
| Property management | 18,587 | - | 18,587 | - | - | 18,587 |
| Public relations | 23,305 | 48,200 | 71,505 | 1,311 | 247,240 | 320,056 |
| Rent (Note 15) | 77,790 | 141,858 | 219,648 | 108,649 | 10,630 | 338,927 |
| Warehouse lease (Note 15) | 14,340 | 8,917 | 23,257 | 58 | 17 | 23,332 |
| Equipment | 50,996 | 16,061 | 67,057 | 23,061 | 5,563 | 95,681 |
| Education | 7,760 | 400 | 8,160 | 22,360 | 972 | 31,492 |
| Insurance | 14,592 | 1,904 | 16,496 | 80,111 | - | 96,607 |
| Depreciation | - | - | - | 54,717 | - | 54,717 |
| Interest | 7,848 | - | 7,848 | 19,390 | - | 27,238 |
| Asset management, compliance and facilitation fees – NMTC (Note 11) | 290,834 | - | 290,834 | - | - | 290,834 |
| ReStore | 33,412 | 92,202 | 125,614 | - | - | 125,614 |
| Miscellaneous | 34,121 | 67,608 | 101,729 | 134,384 | 198,960 | 435,073 |
| Allocation to cost of homes in progress | (2,036,516) | - | (2,036,516) | - | - | (2,036,516) |
| Total expenses as shown in the consolidated statements of activities | 8,949,439 | 1,052,991 | 10,002,430 | 1,737,763 | 936,485 | 12,676,678 |
| Interest – New markets tax credits (Note 11) | 245,781 | - | 245,781 | - | - | 245,781 |
| Mortgage discount expenses | 1,010,173 | - | 1,010,173 | - | - | 1,010,173 |
| Loss on sale of mortgages receivable | 49,841 | - | 49,841 | - | - | 49,841 |
| Fundraising event costs | 3,500 | - | 3,500 | - | 90,965 | 94,465 |
| Total expenses | $ 10,258,734 | $ 1,052,991 | $ 11,311,725 | $ 1,737,763 | $ 1,027,450 | $ 14,076,938 |

[2] For the last three fiscal periods ended 2011 through 2013, supporting services expenses have averaged 11.9% of total expenses. The supporting services expense percentage fluctuates by year depending on the number of homes sold. The previous two fiscal periods represent combined expenses for the merged entities for comparative purposes.

*The accompanying notes are an integral part of these consolidated financial statements.*

HABITAT FOR HUMANITY EAST BAY/SILICON VALLEY AND SUBSIDIARIES

*(A California Nonprofit Public Benefit Corporation)*

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2014 AND 2013

| | 2014 | 2013 |
|---|---|---|
| Cash flows from operating activities: | | |
| Change in net assets | $ 59,910 | $ 599,953 |
| Adjustments to reconcile change in net assets to net cash used in operating activities: | | |
| Forgiveness of debt | (1,325,708) | (1,588,158) |
| Amortization of deferred revenue | (810,959) | (810,959) |
| Mortgage discount amortization | (364,728) | (353,312) |
| Depreciation | 39,825 | 54,717 |
| Mortgage discount expenses | 691,986 | 1,010,173 |
| Loss on sale of mortgages | - | 49,841 |
| Notes payable discount amortization | 9,726 | 9,726 |
| (Gain) loss on disposal of property and equipment | (2,838) | 2,262 |
| (Increase) decrease in assets: | | |
| Grants and contributions receivable | (265,335) | (310,223) |
| Other receivables | (64,567) | 215,228 |
| Property held for sale | (5,425,363) | (797,816) |
| Cost of homes in progress | 3,047,735 | (2,018,748) |
| Inventory of ReStore | 9,765 | (29,471) |
| Prepaid expenses and deposits | (18,240) | 64,176 |
| Inventory of building materials | - | 26,921 |
| Increase (decrease) in liabilities: | | |
| Accounts payable and accrued expenses | (782,422) | 694,460 |
| Interest payable | 9,575 | 15,893 |
| Deferred revenue | 990,417 | 85,000 |
| Net cash used in operating activities | (4,201,221) | (3,080,337) |
| Cash flows from investing activities: | | |
| Net (increase) decrease in restricted cash | 280,716 | (28,514) |
| Issuance of mortgages receivable | (1,736,413) | (2,385,973) |
| Collection of mortgages receivable | 1,125,232 | 1,085,163 |
| Proceeds from sale of mortgages, net of selling costs | - | 2,750,498 |
| Purchase of property and equipment | (95,410) | (56,189) |
| Net cash provided by (used in) investing activities | (425,875) | 1,364,985 |
| Cash flows from financing activities: | | |
| Proceeds from line of credit | 1,701,201 | 790,038 |
| Payment of line of credit | (1,397,418) | (1,181,444) |
| Proceeds from notes payable | 5,605,132 | 5,516,470 |
| Payment of notes payable | (1,923,936) | (2,566,004) |
| Net cash provided by financing activities | 3,984,979 | 2,559,060 |
| Increase (decrease) in cash and cash equivalents | (642,117) | 843,708 |
| Cash and cash equivalents, beginning of year | 5,402,886 | 4,559,178 |
| Cash and cash equivalents, end of year | $ 4,760,769 | $ 5,402,886 |
| Supplementary information: | | |
| Cash paid for interest – net of capitalized portion | $ 268,922 | $ 253,703 |

*The accompanying notes are an integral part of these consolidated financial statements.*

## NOTE 1 – ORGANIZATION AND NATURE OF ACTIVITIES

Habitat for Humanity East Bay/Silicon Valley (HEBSV) is a California nonprofit public benefit corporation which is the surviving corporation from a merger, effective July 1, 2012, between Habitat for Humanity East Bay (HHEB) and Habitat for Humanity Silicon Valley (HHSV), California nonprofit public benefit corporations incorporated in 1987 and 1986, respectively. Seeking to put God's love into action, Habitat for Humanity brings people together to build home, communities, and hope. HEBSV pursues its mission of building affordable housing by utilizing volunteer labor and donated materials and funds.

The following programs are included in the accompanying financial statements:

*Building Affordable Homes*

Finished affordable homes are sold to qualified families who have been approved by the board of directors based upon the recommendation of the Family Selection Committee. The families are selected based upon income, current housing need, and a willingness to partner with HEBSV. HEBSV's policy is that each family is generally required to complete a minimum of 500 hours of "sweat equity" (voluntary labor). The mortgages for all homes are generally interest-free, have terms of no more than 30 years, and generally have monthly payments no greater than 30% of the family's monthly income. In recent years, HEBSV has been selling homes at a rate of approximately 25-35 homes per year. Due to the unpredictable nature of final home sales and the timing relative to the accounting fiscal year, revenue from home sales can fluctuate significantly from year to year.

*Home Repair Program*

HEBSV helps low-income homeowners restore and maintain their homes through its Home Repair Program. All repairs impact the safety of residents and/or the preservation of the home. Qualified and selected homeowners receive a variety of home repair services including but not limited to exterior painting, landscaping, ramps, exterior carpentry, roofing, window and door replacements. Homeowners participate in their repairs by contributing sweat equity volunteer hours if physically able. All home repairs are led by trained crew leaders and completed by volunteers.

*ReStores*

HEBSV operates retail stores (ReStore) for excess building materials.

HEBSV is the sole member of Habitat for Humanity East Bay Funding Company, LLC (HEBFC) and Habitat for Humanity East Bay Funding Company II, LLC (HEBFCII), California limited liability corporations formed in December 2009 and April 2011, respectively. HEBFC and HEBFCII were created for the sole purpose of acquiring and holding mortgage loans originated by HEBSV.

HEBSV is an affiliate of Habitat for Humanity International, Inc. (HFHI), a nondenominational Christian nonprofit organization whose purpose is to create decent, affordable housing for those in need, and to make decent shelter a matter of conscience with people everywhere. Although HFHI assists with information resources, training, publications, prayer support and other ways, HEBSV is directly responsible for its own operations.

HFHI has granted to HEBSV a limited right to use the Habitat for Humanity California (HFHCA) name, service mark and logo in connection with specific advocacy initiatives that HEBSV may engage in on behalf of, and as authorized by, Habitat for Humanity affiliates in the state of California. The term of the license is in effect indefinitely until terminated in accordance with the terms and conditions of the License Agreement. HFHI may terminate the agreement in its sole discretion.

HEBSV is especially vulnerable to the inherent risks associated with voluntary labor and with revenue that is substantially dependent on public support and contributions. The continued growth and well-being of HEBSV are contingent upon successful achievement of its long-term revenue-raising goals.

Various agreements dictate the maximum income level and other qualifications of eligible homebuyers for various extended periods.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Business Combination*

The merger between HHSV and HHEB was accounted for using the carryover method of accounting. Under the carryover method, a new organization was created combining the assets, liabilities, and net assets of the merged organizations.

*Principles of Consolidation*

The consolidated financial statements include the accounts of subsidiaries HEBFC and HEBFCII. All significant intercompany transactions and balances have been eliminated in the consolidation.

HEBSV accounts for the activities relating to HFHCA as fiscal agent transactions, which are not reflected in the consolidated statements of activities. The cash balance is presented as restricted cash and cash held for others liability on the consolidated statements of financial position.

*Accounting Methods*

HEBSV uses the accrual method of accounting, which recognizes income in the period earned and expenses when incurred, regardless of the timing of payments.

*Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the reserves for costs in excess of projected sales price, value of the donated material and facilities, and expenses allocated to cost of homes.

*Basis of Presentation*

HEBSV reports information regarding its financial position and activities according to three classes of net assets, as applicable: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. There were no permanently restricted net assets as of June 30, 2014 and 2013, respectively.

*Revenue Recognition*

Contributions are recognized as revenue when they are unconditionally communicated. Grants represent contributions if resource providers receive no value in exchange for the assets transferred. Contributions are recorded at their fair value as unrestricted support, temporarily restricted support, or permanently restricted support, depending on the absence or existence of donor-imposed restrictions as applicable. 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. If donors' restrictions are satisfied in the same period that the contribution is received, the contribution is reported as unrestricted support. Contributions restricted for the purchase of long-lived assets, are reported as unrestricted support when expended for that purpose.

Contributed services are stated at their estimated fair value, if they are ordinarily purchased and are of a specialized nature.

Income on sales of property acquired for improvements is recognized only upon the sale of the property. Rental income received during the rehabilitation period and prior to sale is recognized as deferred income, and such income is used to defray the costs of the improvement to the property.

Forgiveness of debt is comprised of forgivable loans that are recognized upon the sale of the home to which they relate.

*Cash and Cash Equivalents*

Cash is defined as cash in demand deposit accounts as well as cash on hand. Not included as cash are funds restricted as to their use, regardless of liquidity, such as the New Markets Tax Credit reserve and California Advocacy Fund. HEBSV occasionally maintains cash on deposit at a bank in excess of the Federal Deposit Insurance limit or Security Investor Protection Corporation Coverage. The uninsured cash balance, including restricted accounts, was approximately $3,995,000 as of June 30, 2014. HEBSV has not experienced any losses in such accounts.

Cash equivalents are highly liquid investments that are readily convertible to known amounts of cash. Generally, only investments with original maturities of three months or less qualify as cash equivalents.

*Mortgages and Notes Receivable*

Mortgages receivable bear no interest and are discounted to reflect imputed interest using the effective interest method over the lives of the mortgages. The discount rate used to impute interest of the first liens and second/third liens is 3% and 4%, respectively. Mortgages are reported net of amortized cost. No allowance for doubtful accounts is considered necessary as past experience and management's estimation indicates an adequate allowance for such accounts is immaterial.

Notes receivable are secured by the properties, bear no interest and are due upon sale of the home.

Management may sell a portion of the first-lien mortgages originated by HEBSV. Due to the uncertainty of the timing and amount of each sale of those mortgage receivables, any loss resulting from such transactions will be recorded when the transactions are settled or when amounts can be reasonably estimated.

*Inventory*

Inventory is stated at the lesser of cost, or net realizable value. Donated inventory is recorded at fair market value at the date of receipt, determined based on retail prices at ReStore. Inventory of ReStore is held for sale at HEBSV's retail outlet. For donated inventory, since the sales revenue equals the cost of goods sold, the balances are not presented in the consolidated financial statements.

The specific identification method is used to charge inventory to cost of homes sold. When a home is sold, the specific costs to build the home are charged to cost of homes sold. Any known amounts which are estimated to be non-recoverable from the ultimate sales price of the homes will be recorded, when known, in the consolidated financial statements.

Any funds expended on a project that do not pass beyond the pre-construction stage are recorded as expenses when further activity on the project ceases. Project costs of $-0- and $173,134 included in homes for sales and cost of homes in progress were charged to expenses for the years ended 2014 and 2013, respectively.

*Capitalized Interest*

HEBSV capitalizes interest incurred during construction as a component of costs of homes. During the years ended 2014 and 2013, HEBSV capitalized interest of $93,902 and $76,400, respectively.

*Property and Equipment*

Property and equipment are stated at cost of acquisition, or fair market value if donated. The costs of maintenance and repairs are charged to expense as incurred. Depreciation is computed based on the straight-line method over the estimated useful lives of the assets.

The useful lives of the assets are estimated as follows:

| | |
|---|---|
| Leasehold and improvements | 4 to 5 years |
| Furniture and Equipment | 3 to 5 years |

*Notes Payable*

Notes payable that bear no interest are discounted to reflect imputed interest using the effective interest method over the lives of the loan. Notes payable to governmental entities are exempt from imputed interest treatment.

*In-Kind Contributions*

In-kind contributions consist of donated land, building materials, labor, and use of facilities. Donated land, building materials, and use of facilities are valued at market values on the date of donation. Donated labor consisting of sweat equity (i.e., family homebuyer voluntary labor) and/or volunteer labor is not considered to be contribution revenue to HEBSV.

*Allocation to Cost of Homes in Progress*

Allocations to costs of homes in progress consist of various program service expenses that are capitalized and recorded as costs of homes in progress for the various projects, based on time incurred as estimated by management.

*Income Taxes*

HEBSV is exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code and the related California code sections. Contributions to HEBSV qualify for the charitable contribution deduction and HEBSV is not classified as a private foundation.

No income tax provision has been included in the consolidated financial statements for the single member limited liability companies (LLCs) which are generally considered disregarded entities. The income and loss of the LLCs is included in the tax returns of HEBSV. Only the annual California limited liability company minimum tax and the annual fee appear as expense in the consolidated financial statements.

HEBSV believes that it has appropriate support for any tax positions taken, and as such, do not have any uncertain tax positions that are material to the consolidated financial statements. HEBSV's federal and state information returns for the years 2010 through 2013 are subject to examination by regulatory agencies, generally for three years and four years after they were filed federal and state, respectively.

*Functional Expenses Allocation*

The costs of providing program services and supporting services are summarized on a functional basis in the statements of activities and statements of functional expenses. Accordingly, certain costs are allocated among program services and supporting services based on estimates of employees' time incurred and on usage of resources.

*Subsequent Events*

Management has evaluated subsequent events through November 26, 2014, the date on which the financial statements were available to be issued.

*Reclassification*

Certain amounts previously reported in the 2013 consolidated financial statements were reclassified to conform to the 2014 presentation for comparative purposes.

**NOTE 3 – RESTRICTED CASH**

Restricted cash consists of the following:

| | 2014 | 2013 |
|---|---|---|
| New Markets Tax Credits reserve | $ 1,249,975 | $ 1,519,299 |
| Habitat for Humanity California | 126,167 | 93,096 |
| Stormwater Reserve | 28,025 | 28,025 |
| | 1,404,167 | 1,640,420 |
| Less: current portion | (447,442) | (414,204) |
| Long-term portion | $ 956,725 | $ 1,226,216 |

*New Markets Tax Credits Reserve*

As a result of the New Markets Tax Credits transactions, HEBSV is required to maintain funds in separate accounts to fund guaranteed obligations and lender fees of the separate portion of business throughout the New Markets Tax Credits compliance period.

*Habitat for Humanity California*

HEBSV is a fiduciary agent for other Habitat for Humanity affiliates in the state of California that have banded together to educate policymakers and others about affordable housing issues, Habitat for Humanity's mission, and the potential impact of relevant policies. The fund, which is maintained in a separate bank account, consists of HEBSV funds and contributions from these affiliates to fund consulting expenses to help achieve those aims.

*Stormwater Reserve*

HEBSV is required to maintain a replacement fund for certain planters located in a housing project built by HEBSV. The requirement expires in 2018, which is 15 years after the homes are sold.

**NOTE 4 – GRANTS AND CONTRIBUTIONS RECEIVABLE**

Grants and contributions receivable consist of the following:

| | 2014 | 2013 |
|---|---|---|
| Private contributions | $ 1,338,333 | $ 721,453 |
| Government grants | - | 312,781 |
| Multi-year pledges | 246,121 | 323,651 |
| | 1,584,454 | 1,357,885 |
| Less: allowance for uncollectible pledges | (124,080) | (162,846) |
| Grants and contributions receivable, net | $ 1,460,374 | $ 1,195,039 |
| Amounts due in: | | |
| Less than one year | $ 1,389,042 | $ 1,086,266 |
| One to five years | $ 71,332 | $ 108,773 |

HEBSV receives multi-year pledges from donors ranging from one to five years. Since the pledged amounts generally range from $100 to $1,000, the face amounts instead of the present value of these unconditional promises to give are reflected in the consolidated financial statements.

**NOTE 5 – MORTGAGES AND NOTES RECEIVABLE**

All homes are sold to qualifying buyers under mortgage arrangements. A home is considered sold when a formal closing transaction has been finalized.

Mortgages and notes receivable is summarized as follows:

| | 2014 | 2013 |
|---|---|---|
| Mortgages and notes receivable, gross | $ 23,946,453 | $ 23,335,272 |
| Less: unamortized discount | (8,768,663) | (8,441,405) |
| | 15,177,790 | 14,893,867 |
| Less: current portion | (616,618) | (609,355) |
| Long-term portion | $ 14,561,172 | $ 14,284,512 |

HEBSV considers the homeowners' payment of the mortgage receivable due more than 30 days as delinquent. For the years ended June 30, 2014 and 2013, the aged mortgages receivable is summarized as follows:

| | *30-59 Days Past Due* | *60-89 Days Past Due* | *Greater Than 90 Days* | *Total Past Due* | *Current* | *Total Mortgage Receivable* |
|---|---|---|---|---|---|---|
| 2014 | $ 29,998 | $ 21,181 | $ 93,418 | $ 144,597 | $ 18,743,016 | $ 18,887,613 |
| 2013 | $ 25,873 | $ 19,279 | $ 68,671 | $ 164,750 | $ 18,565,932 | $ 18,730,682 |

HEBSV sold $-0- and $3,882,583 of the mortgages receivable, for gross proceeds of $-0- and $2,815,748 for the years ended June 30, 2014 and 2013, respectively. In accordance with the purchase agreements, HEBSV is required to either repurchase or substitute (or rectify by other means identified in the agreements) any mortgages included in the sale that become delinquent. After paying professional fees of $-0- and $65,250, recovering $-0- and $1,082,244 of mortgage discounts previously recognized, HEBSV recognized a loss of $-0- and $49,841 from these sales for the years ended June 30, 2014 and 2013, respectively.

In August 2013, HEBSV had entered into a loan origination agreement with Patelco Credit Union, whereas both parties wish Patelco Credit Union to commit to originate thirty (30) first lien mortgage loans at a fixed interest rate of 2.85%, and the Substitute Mortgage Loans, as defined in the agreement, may bear interest at 0%, pursuant to the terms of the agreement. HEBSV considers these mortgages as Zero Interest Equivalent Mortgage (ZEM), where the payments are the same as the traditional non-interest bearing mortgage. In the ZEM case, both interest and principle are amortized in the similar manner of the conventional amortized mortgage. HEBSV covenants and agrees that at HEBSV's option, HEBSV shall either purchase the defective mortgages loans or provide Substitute Mortgage Loans for such defective mortgage loans. As of June 30, 2014, Patelco Credit Union originated twelve (12) first lien mortgage loans for homes sold in the fiscal year ended June 30, 2014.

HEBSV evaluates notes receivable based on the following credit quality indicators: collateral and lien position. These credit quality indicators are updated at least annually. Details about the non-interest bearing mortgages and notes receivable, as of June 30, 2014 and 2013 as follows:

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | *Non-interest bearing* | *Discount* | *Total* | *Non-interest bearing* | *Discount* | *Total* |
| 1st liens | $ 18,887,613 | $ (5,654,060) | $ 13,233,553 | $ 18,730,682 | $ (5,528,173) | $ 13,202,509 |
| 2nd and 3rd liens | 5,054,765 | (3,114,603) | 1,940,162 | 4,599,415 | (2,913,232) | 1,686,183 |
| Other notes | 4,075 | - | 4,075 | 5,175 | - | 5,175 |
| Total | $ 23,946,453 | $ (8,768,663) | $ 15,177,790 | $ 23,335,272 | $ (8,441,405) | $ 14,893,867 |

## NOTE 6 – COSTS OF HOMES IN PROGRESS AND PROPERTY HELD FOR SALE

Costs of homes in progress and property held for sale are summarized as follows:

| | 2014 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | *Kinsell Commons Tassafronga Village Oakland* | *Fremont-4369 Central* | *Brookfield Court/9507 Edes* | *Pleasant Creek* | *Muir Ridge, Pacheco Blvd, CCC* | *NSP Projects* | *CDBG CCC & II* | *Rehab Programs* | *Other Projects* | *Total* |
| Costs since inception of project: | | | | | | | | | | |
| Land | $ 700,001 | $ 542,000 | $ 421,500 | $ 520,000 | $ 1,475,000 | $ 6,390,467 | $ 461,650 | $ 2,370,847 | $ 1,660,575 | $ 14,542,040 |
| Materials and subcontractors | 4,869,357 | 110,952 | 3,765,555 | 3,515,039 | 282,545 | 5,148,142 | 504,407 | 615,930 | 1,682,686 | 20,494,613 |
| Administration (including project manager and labor) | 863,906 | 83,477 | 748,198 | 693,737 | 92,848 | 1,323,492 | 142,160 | 394,912 | 1,064,976 | 5,407,706 |
| Costs of homes | 6,433,264 | 736,429 | 4,935,253 | 4,728,776 | 1,850,393 | 12,862,101 | 1,108,217 | 3,381,689 | 4,408,237 | 40,444,359 |
| Costs of finished homes not yet sold | - | - | (4,718,853) | (4,568,163) | - | - | (320,612) | (535,210) | (494,655) | (10,637,493) |
| Loss reserve on costs of homes | - | - | (216,400) | (160,613) | - | - | - | - | - | (377,013) |
| Cost of homes sold | (6,433,264) | - | - | - | - | (12,757,304) | (707,480) | (1,145,991) | (2,278,390) | (23,322,429) |
| Costs of homes in progress at June 30, 2014 | - | 736,429 | - | - | 1,850,393 | 104,797 | 80,125 | 1,700,488 | 1,635,192 | 6,107,424 |
| Less current portion | - | - | - | - | - | (104,797) | (80,125) | (552,233) | (180,258) | (917,413) |
| Long-term cost of home in progress | $ - | $ 736,429 | $ - | $ - | $ 1,850,393 | $ - | $ - | $ 1,148,255 | $ 1,454,934 | $ 5,190,011 |
| No. of finished homes | - | - | 12 | 10 | - | - | 1 | 1 | 2 | 26 |
| Unfinished homes planned or in progress | - | 30 | - | - | 20 | - | - | 15 | 56 | 121 |
| Number of homes sold in prior fiscal years | 14 | - | - | - | - | 35 | 2 | - | 4 | 55 |
| Number of homes sold in 2014 | 8 | - | - | - | - | 6 | 1 | 2 | 3 | 20 |
| Total number of homes | 22 | 30 | 12 | 10 | 20 | 41 | 4 | 18 | 65 | 222 |

| | 2013 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | *Kinsell Commons/ Tassafaronga* | *Byron Ave. Oakland* | *El Rincon/ Bay Point* | *Brookfield Court Oakland* | *Pleasant Creek (Walnut Creek)* | *Cleo* | *NSP Projects* | *CDBG Contra Costa County II* | *Rehab Programs* | *Other Projects* | *Total* |
| Costs since inception of project: | | | | | | | | | | | |
| Land | $ 700,001 | $ 386,550 | $ 443,066 | $ 421,500 | $ 270,000 | $ 615,000 | $ 6,390,467 | $ 281,696 | $ 802,450 | $ 763,808 | $ 11,074,538 |
| Materials and subcontractors | 4,857,051 | 27,601 | 3,594,711 | 2,423,338 | 1,831,412 | 1,072,714 | 5,072,653 | 254,993 | 18,330 | 1,104,336 | 20,257,139 |
| Administration (including project manager and labor) | 800,529 | 59,898 | 675,259 | 507,768 | 531,217 | 166,145 | 1,260,293 | 95,892 | 151,572 | 719,332 | 4,967,905 |
| Costs of homes since inception | 6,357,581 | 474,049 | 4,713,036 | 3,352,606 | 2,632,629 | 1,853,859 | 12,723,413 | 632,581 | 972,352 | 2,744,816 | 36,456,922 |
| Costs of finished homes not yet sold | (2,311,848) | - | (628,875) | - | - | - | (1,563,403) | - | - | (708,004) | (5,212,130) |
| Cost of homes sold since inception | (4,045,733) | - | (4,084,161) | - | - | (1,853,859) | (11,025,530) | (406,432) | - | (673,686) | (22,089,401) |
| Costs of homes in progress at June 30, 2013 | - | 474,049 | - | 3,352,606 | 2,632,629 | - | 134,480 | 226,149 | 972,352 | 1,363,126 | 9,155,391 |
| Less current portion | - | - | - | - | - | - | (126,542) | (220,299) | (945,622) | - | (1,292,463) |
| Long-term cost of home in progress | $ - | $ 474,049 | $ - | $ 3,352,606 | $ 2,632,629 | $ - | $ 7,938 | $ 5,850 | $ 26,730 | $ 1,363,126 | $ 7,862,928 |
| No. of finished homes | 8 | - | 1 | - | - | - | 6 | - | - | 3 | 18 |
| Unfinished homes planned or in progress | - | 7 | - | 12 | 10 | - | - | 2 | 14 | 48 | 93 |
| Number of homes sold in 2012 | 11 | - | 8 | - | - | - | 27 | - | - | 3 | 49 |
| Number of homes sold in 2013 | 3 | - | - | - | - | 4 | 8 | 2 | - | 2 | 19 |
| Total number of homes | 22 | 7 | 9 | 12 | 10 | 4 | 41 | 4 | 14 | 56 | 179 |

**NOTE 7 – PROPERTY AND EQUIPMENT**

Property and equipment is summarized as follows:

| | 2014 | 2013 |
|---|---|---|
| Office equipment | $ 242,839 | $ 197,067 |
| Site equipment | 111,067 | 115,968 |
| ReStore leasehold improvements | 108,266 | 92,185 |
| ReStore equipment | 143,391 | 133,887 |
| | 605,563 | 539,107 |
| Less accumulated depreciation | (447,982) | (439,949) |
| Total property and equipment | $ 157,581 | $ 99,158 |

**NOTE 8 – RELATED-PARTY TRANSACTIONS**

*Tithe to HFHI*

HEBSV contributes a portion of its annual unrestricted cash contribution income and net event income to the international work of HFHI. The costs of tithes to HFHI were $32,623 and $122,877 for the years ended June 30, 2014 and 2013, respectively. Payable to HFHI were $-0- and $42,877 as of June 30, 2014 and 2013, respectively.

*U.S. Stewardship and Organizational Sustainability Initiative (US-SOSI)*

Effective November 2013, to create a sustainable revenue stream to help finance a portion of the operational costs incurred by HFHI to support the work of U.S. affiliates, HEBSV is required to pay an annual US-SOSI fee. The amount of the annual fee is determined by the population within the approved geographic service area with a minimum payment of $1,500. The US-SOSI fee for the year ended June 30, 2014 was $8,300.

**NOTE 9 – LINE OF CREDIT**

HEBSV has a revolving line of credit of $2,750,000 with First Republic Bank, of which $612,377 and $308,594 was outstanding at June 30, 2014 and 2013, respectively. The line requires monthly interest only payments equal to the prime rate, subject to a floor of 3.25%. The effective interest rate at June 30, 2014 and 2013 was 3.25%. The bank advances on the credit line are payable in full by April 30, 2015. Certain financial covenants are required to be maintained, including a current ratio of 1.5 to 1.0, a debt/worth ratio not greater than 1.0 to 1.0, and a minimum tangible net worth of not less than $18,000,000, as defined in the agreement. The line is also secured by property as described in the Commercial Security Agreement. Interest expenses were $16,157 and $13,543 for the years ended June 30, 2014 and 2013, respectively.

**NOTE 10 – NOTES PAYABLE**

Notes payable are secured by the projects unless otherwise noted and consist of the following:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| ***HEBSV:*** | | | | |
| <u>*Humbolt & Vine*</u> | | | | |
| Summit Bank, in the maximum amount of $259,000, bore interest at 4.95%, paid in full in December 2013. Interest costs were $4,885 and $6,000 for the years ended June 30, 2014 and 2013, respectively. | $ - | $ - | $ - | $ 153,792 |
| <u>*NSP-Alameda County*</u> | | | | |
| Summit Bank, in the maximum principal amount of $235,800, bore interest at 4.95%, paid in full in December 2013. Interest costs were $5,211 and $3,593 for the years ended June 30, 2014 and 2013, respectively (27402 Capri). | - | - | - | 204,869 |
| Summit Bank, in the maximum principal amount of $184,800, bore interest at 4.95%, paid in full in March 2014. Interest costs were $1,296 and $642 for the years ended June 30, 2014 and 2013, respectively (27647 Pensacola). | - | - | - | 80,207 |
| Summit Bank, in the maximum principal amount of $175,000, bore interest at 4.95%, paid in full in March 2014. Interest costs were $6,104 and $4,088 for the years ended June 30, 2014 and 2013, respectively (27851 Pompano). | - | - | - | 163,820 |
| <u>*Rehab Program*</u> | | | | |
| Heritage Bank of Commerce, in the maximum amount of $318,500, bears variable interest at an initial rate of 3.75%, payable in full in January 2015. Interest costs were $684 and $-0- for the years ended June 30, 2014 and 2013, respectively (457 Andrews, City of Livermore). | - | 214,670 | - | - |

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| Heritage Bank of Commerce, in the maximum amount of $292,815, bears variable interest at an initial rate of 3.75%, payable in full in February 2015. Interest costs were $718 and $-0- for the years ended June 30, 2014 and 2013, respectively (538 Ruth Way, City of Livermore). | - | 230,580 | - | - |
| <u>*CDBG Contra Costa County II*</u> | | | | |
| Summit Bank, bore interest at 4.95%, paid in full in March 2014. Interest costs were $1,381 and $748 for the years ended June 30, 2014 and 2013, respectively (57 Inlet). | - | - | - | 52,300 |
| Heritage Bank of Commerce, in the maximum amount of $190,370, bears variable interest at an initial rate of 3.75%, payable in full in October 2014. The maturity date has been extended to January 2015. Interest costs were $398 and $-0- for the years ended June 30, 2014 and 2013, respectively (1827 Mason). | - | 131,634 | - | - |
| <u>*Recycles*</u> | | | | |
| Heritage Bank of Commerce, in the maximum amount of $143,500, bears variable interest at an initial rate of 3.75%, payable in full in January 2015. Interest costs were $431 and $-0- for the years ended June 30, 2014 and 2013, respectively (1784 Habitat Way). | - | 137,193 | - | - |
| <u>*Muir Ridge, Pacheco Blvd, CCC*</u> | | | | |
| Heritage Bank of Commerce, in the original amount of $775,000, bears variable interest at an initial rate of 4.25%. The effective interest rate at June 30, 2014 was 3.25%. The note matures in January 2015, and has been excluded from current liabilities since HEBSV refinanced the obligation on a long-term basis in October 2014 (4762 Pacheco). Interest costs were $15,371 and $-0- as of June 30, 2014 and 2013, respectively. | - | 775,000 | - | - |

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| <u>*NSP Contra Costa County II*</u> | | | | |
| Summit Bank, in the original amount of $94,500, bore interest at 4.95%, paid in full in December 2013. Interest costs were $2,690 and $3,924 for the years ended June 30, 2014 and 2013, respectively (136 Hill). | - | - | - | 94,500 |
| Summit Bank, in the original amount of $130,200, bore interest at 4.95%, paid in full in March 2014. Interest costs were $4,941 and $3,353 for the years ended June 30, 2014 and 2013, respectively (531 Harvey). | - | - | - | 130,200 |
| Summit Bank, in the original amount of $86,800, bore interest at 4.95%, paid in full in December 2013. Interest costs were $2,459 and $3,269 for the years ended June 30, 2014 and 2013, respectively (39 Lakeview). | - | - | - | 86,800 |
| <u>*San Jose Projects*</u> | | | | |
| Heritage Bank of Commerce, in the maximum amount of $303,800, bore variable interest at an initial rate of 3.75%, paid in full in March 2014. Interest costs were $9,248 and $-0- for the years ended June 30, 2014 and 2013, respectively (S. King). | - | - | - | 251,850 |
| Heritage Bank of Commerce, in the maximum amount of $287,700, bore variable interest at an initial rate of 3.75%, paid in full in June 2014. Interest costs were $7,028 and $-0- for the years ended June 30, 2014 and 2013, respectively (1705 Terilyn). | - | - | - | 244,850 |
| <u>*Spencer Court, Richmond*</u> | | | | |
| City of Richmond, in the maximum amount of $250,000, bears no interest, payable upon the sale of final home of Spencer Court Richmond in 300 monthly payments. | - | 244,302 | - | 244,302 |
| <u>*Pleasant Creek (Walnut Creek)*</u> | | | | |
| Presidio Bank, in the maximum amount of $562,500, bears interest at 4.25%, payable in full in January 2015. Interest costs were $11,975 and $-0- for the years ended June 30, 2014 and 2013, respectively. | - | 455,460 | - | 1,577 |

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| *Related-party Notes Payable* | | | | |
| HFHI, SHOP 2008 loan, in the original amount of $15,625, bears no interest, payable in monthly installments of $325 starting January 2013, due in full in January 2017. | - | 13,675 | - | 15,625 |
| HFHI, SHOP 2008 loan, in the original amount of $8,750, bears no interest, payable in monthly installments of $182 starting July 2014, due in full in July 2018. | - | 8,750 | - | 8,750 |
| HFHI, SHOP 2008 loan, in the original amount of $28,125, bears no interest, payable in monthly installments of $585 starting January 2012, due in full in January 2016. | - | 17,594 | - | 24,615 |
| HFHI, SHOP 2008 loan, in the original amount of $30,000, bears no interest, payable in monthly installments of $625 starting July 2014, payable in full in January 2018. | - | 30,000 | - | 30,000 |
| HFHI, SHOP 2009 loan, in the maximum principal amount of $30,000, bears no interest, payable in monthly installments of $625 starting January 2015, payable in full in January 2019. | - | 30,000 | - | 30,000 |
| HFHI, SHOP 2011 loan, in the original amount of $75,000, bears no interest, payable in monthly installments of $1,562 starting July 2015, payable in full in July 2019. | - | 75,000 | - | - |
| *Other notes payable* | | | | |
| Other various notes | - | 11,001 | - | 19,830 |
| ***HFHEB Funding Co. II:*** | | | | |
| Umpqua Bank, in the original amount of $2,181,455, bears no interest, with monthly installments of $7,995, payable in full in November 2035. (1) | - | 1,893,632 | - | 1,989,573 |

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| ***HFHEB Funding Co.:*** | | | | |
| Presidio Bank, in the original amount of $868,606, bears no interest, with monthly installments of $2,570, payable in full in January 2019. [(1)] | - | 729,832 | - | 760,671 |
| Total | - | 4,998,323 | - | 4,588,131 |
| Less discount on notes payable [(1)] | - | (109,101) | - | (118,828) |
| Net present value of notes payable | - | 4,889,222 | - | 4,469,303 |
| Less portion due in one year | - | (1,306,887) | - | (1,618,046) |
| Long-term portion | $ - | $ 3,582,335 | $ - | $ 2,851,257 |

Scheduled principal payments on the notes payable for the next five years are estimated as follows:

| | |
|---|---|
| 2015 | $ 1,306,887 |
| 2016 | 186,351 |
| 2017 | 957,674 |
| 2018 | 172,494 |
| 2019 | 765,547 |
| Thereafter | 1,609,370 |
| Total | $ 4,998,323 |

**NOTE 11 – RECONVEYABLE NOTES PAYABLE**

Reconveyable notes payable generally shall be reconveyed to an eligible purchaser of the property subject to terms outlined in the original loan documents. These notes payable are secured by the projects unless otherwise noted and consist of the following:

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| *4369 Central Freemont* | | | | |
| City of Fremont, CDBG loan, in the original amount of $530,000, bears no interest, payable in full in August 2020 upon sale of each unit to an eligible purchaser. | $ - | $ 530,000 | $ - | $ - |

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| <u>Barkley Avenue</u> | | | | |
| City of Walnut Creek, in the original amount of $370,000, bears no interest, payable at the earlier of March 2016 or the date on which the last home is sold. | - | 370,000 | - | 370,000 |
| <u>Brookfield Court, Oakland</u> | | | | |
| City of Oakland, in the maximum amount of $1,867,000, bears no interest, payable in full in the earlier of the sale of the project or August 2016. | - | 1,578,967 | - | 873,690 |
| State of California Department of Housing and Community Development (HCD), CalHome Program loan, in the maximum amount of $1,200,000 (together with the funding for Pleasant Creek project), bears interest at 6%, payable upon the completion and the sale to the lender eligible first time homebuyers. The loan will be proportionately converted to a grant upon sale of each unit to provide HCD-approved loans to the eligible homebuyers. Any balance should be payable to HCD. In addition, HCD may forgive accrued interest if certain conditions are met. Interest costs were $6,815 and $5,506 for the years ended June 30, 2014 and 2013, respectively. | 12,321 | 720,000 | 5,506 | 459,474 |
| <u>Bryon Avenue, Oakland</u> | | | | |
| City of Oakland, originally bore interest at 6%. The note was amended in December 2010, and all interest payable was forgiven. Interest rate was also reduced to 0%, with outstanding balance being payable in full by the earlier of March 2020 or the date the property is sold or refinanced. | - | 386,550 | - | 386,550 |
| City of Oakland, in the maximum amount of $29,200, bears interest at 6%, payable in full with accrued interest upon receiving construction or permanent financing sufficient to repay the loan. Interest costs were $297 for the years ended June 30, 2014 and 2013, respectively. | 1,768 | 4,938 | 1,471 | 4,938 |

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| *CDBG Contra Costa County II* | | | | |
| Contra Costa County, CDBG loan, in the maximum amount of $124,850, bore no interest, payable on the earlier of the date of sale of property to an eligible purchaser or in February 2014. $19,713 was forgiven in March 2014 when the property was sold to an eligible purchaser. The balance was repaid in full (57 Inlet). | - | - | - | 79,532 |
| Contra Costa County, CDBG loan, in the maximum amount of $75,000, bears no interest, payable on the earlier of the date of sale of property to an eligible purchaser or in November 2014 (1827 Mason). | - | 56,250 | - | - |
| *El Rincon, Bay Point* | | | | |
| Contra Costa County (successor agency of the Contra Costa County Redevelopment Agency), in the maximum amount of $300,000, bore no interest. The principal due was reconveyed to an eligible purchaser as a second mortgage upon sale of each unit. | - | - | - | 115,111 |
| State of California Department of Housing and Community Development (HCD), CalHome Program loan, in the maximum amount of $318,182, bore interest at 6%, payable upon the sale of nine single-family housing units. Interest costs were $169 and $2,121 for the years ended June 30, 2014 and 2013, respectively. At the discretion of HCD, the outstanding principal and interest were converted to a grant upon sale of each unit in the project to eligible purchasers. | - | - | 12,868 | 35,354 |
| *Jackson St. (Sunnyvale)* | | | | |
| City of Sunnyvale, in the maximum amount of $880,000, bears no interest, payable at the earlier of November 2016 or the date on which the last home is sold. A portion of the loan will be converted to a development grant upon completion of the project (239 and 279 Jackson St). | - | 875,699 | - | - |

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| <u>*Kinsell Commons/Tassafaronga*</u> | | | | |
| City of Oakland (successor agency to the Redevelopment Agency of the City of Oakland), in the original amount of $1,868,000, bore no interest, payable in full in October 2043. The outstanding balance was converted to a development grant as of June 30, 2014, when all units were sold to eligible purchasers to bridge the gap between the overall cost of the development and the sales proceeds. | - | - | - | 639,893 |
| <u>*Livermore*</u> | | | | |
| City of Livermore, assumed from the original borrower in the amount of $126,335, bears no interest, due upon transfer to a party other than an eligible purchaser as defined in the agreement (4139 Freeda Ct). | - | 126,335 | - | - |
| <u>*NSP-Alameda County*</u> | | | | |
| County of Alameda NSP loan, in the maximum amount of $180,230, bore no interest, payable on the earlier of the date of sale of property to an eligible purchaser or in October 2013. The outstanding balance was reconveyed to an eligible purchaser in December 2013 (27402 Capri). | - | - | - | 111,439 |
| County of Alameda NSP loan, in the maximum amount of $223,494, bore no interest, payable on the earlier of the date of sale of property to an eligible purchaser or in October 2013. $136,620 was reconveyed in March 2014 when the property was sold to an eligible purchaser. The balance was repaid in full (27647 Pensacola). | - | - | - | 158,126 |
| County of Alameda NSP loan, in the maximum principal amount of $213,941, bore no interest, payable on the earlier of the date of sale of property to eligible purchaser or in August 2013. $146,142 was reconveyed in March 2014 when the property was sold to an eligible purchaser. The balance was repaid in full (27851 Pompano). | - | - | - | 149,505 |

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| <u>*NSP Contra Costa County II*</u> | | | | |
| Contra Costa County, NSP loan, in the maximum amount of $50,000, bore no interest, payable in full on the earlier of the date of sale of property to an eligible purchaser or in December 2013. $26,500 was reconveyed in December 2013 when the property was sold to an eligible purchaser. The balance was repaid in full (136 Hill). | - | - | - | 40,000 |
| Contra Costa County, NSP loan, in the maximum amount of $50,000, bore no interest, payable in full on the earlier of the date of sale of property to an eligible purchaser or in October 2013. $24,500 was reconveyed in March 2014 when the property was sold to an eligible purchaser. The balance was repaid in full (531 Harvey). | - | - | - | 40,000 |
| Contra Costa County, NSP loan, in the maximum amount of $50,000, bore no interest, payable in full on the earlier of the date of sale of property to an eligible purchaser or in December 2013. $24,600 was reconveyed in December 2013 when the property was sold to an eligible purchaser. The balance was repaid in full (39 Lakeview). | - | - | - | 40,000 |
| <u>*Pleasant Creek (Walnut Creek)*</u> | | | | |
| State of California Department of Housing and Community Development (HCD), CalHome Program loan, in the maximum amount of $1,200,000 (together with the funding for Brookfield Court project), bears interest at 6%, payable upon the completion and the sale to the lender eligible first time homebuyers. The loan will be proportionately converted to a grant upon sale of each unit to provide HCD-approved loans to the eligible homebuyers. Any balance should be payable to HCD. In addition, HCD may forgive accrued interest if certain conditions are met. Interest costs were $10,334 and $133 for the years ended June 30, 2014 and 2013, respectively. | 10,467 | 480,000 | 133 | 270,067 |

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | *Interest Payable* | *Principal* | *Interest Payable* | *Principal* |
| Contra Costa County, HOME loan, in the original amount of $320,000, bears no interest, payable in full in the earlier of the sale of the last property to an eligible purchaser or December 2014. | - | 320,000 | - | - |
| *Redwood Hill, Oakland* | | | | |
| City of Oakland, bears interest at 6%, payable in full in February 2014. Interest costs were $2,100 for the years ended June 30, 2014 and 2013, respectively. | 8,998 | 35,000 | 6,898 | 35,000 |
| *Rehab Program* | | | | |
| City of Livermore, in the original amount of $173,716, bears no interest, payable upon the earlier of the sale of the property or January 2015. The maturity date has been extended to December 2014 (457 Andrews, City of Livermore). | - | 173,716 | - | - |
| City of Livermore, in the original amount of $114,000, bears no interest, payable upon the earlier of the sale of the property or February 2015 (538 Ruth Way, City of Livermore). | - | 114,000 | - | - |
| *Victor Avenue* | | | | |
| County of Santa Clara, CDBG loan, in the maximum amount of $400,000, bears no interest, payable in full in June 2032. | - | 123,889 | - | 128,333 |
| Total | 33,554 | 5,895,344 | 26,876 | 3,937,012 |
| Less portion due in one year | - | (1,903,904) | - | (1,408,960) |
| Long-term portion | $ - | $ 3,991,440 | $ 26,876 | $ 2,528,052 |

HEBSV also incurred additional interest costs in connection with the New Markets Tax Credit transactions (see Note 12).

Scheduled principal payments on the notes payable for the next five years are estimated as follows:

| | |
|---|---|
| 2015 | $ 1,903,904 |
| 2016 | 1,948,967 |
| 2017 | 875,699 |
| 2018 | - |
| 2019 | - |
| Thereafter | 1,166,774 |
| Total | $ 5,895,344 |

**NOTE 12 – DEFERRED REVENUE**

Deferred revenue is summarized as follows:

| | 2014 | 2013 |
|---|---|---|
| New Markets Tax credits: | | |
| Investments in leverage lenders | $ (24,575,253) | $ (24,575,253) |
| Notes payable from CDEs | 31,475,958 | 31,475,958 |
| Transaction costs | (1,223,990) | (1,223,990) |
| Net amortizable benefit | 5,676,715 | 5,676,715 |
| Less accumulated amortization | (2,886,996) | (2,076,036) |
| New Markets Tax credits, net | 2,789,719 | 3,600,678 |
| Offsite Affordable Housing Agreement | 1,075,000 | - |
| Other | 417 | 85,000 |
| | 3,865,136 | 3,685,678 |
| Less: current portion | (1,886,376) | (895,959) |
| Long-term portion | $ 1,978,760 | $ 2,789,719 |

*New Markets Tax Credits*

HEBSV entered into New Markets Tax Credit ("NMTC") transactions involving U.S. Bancorp Community Development Corporation ("USBCDC"), its related entities and agents. The NMTC program was established as part of the Community Renewal Tax Relief Act of 2000. The goal of the NMTC program is to spur revitalization efforts of low-income and impoverished communities across the United States and its Territories by providing tax credit incentives to investors in a certified community development entity. The tax credit for investors equals 39% of the investment, which is credited over a seven-year period. A community development entity is required to participate and has a primary mission of providing financing for revitalization projects in low-income communities.

NMTC financing allows organization such as affiliates of Habitat International to receive low-interest loans or investment capital from community development entities, primarily financial institutions, which allow their investors to receive tax credits to be applied against their federal tax liability.

The following is a summary of the NMTC Transactions:

*New Markets Tax Credit Transaction – Stonehenge*

HFHI-SA Leverage IV, L.L.C.:

In April 2010 HHEB acquired a 71.43% membership, interest in HFHI – SA Leverage IV, L.L.C. (the "LLC") in exchange for investing a combination of cash and construction in progress totaling $11,848,403. The LLC is owned 28.57% by another affiliate of Habitat for Humanity International, Inc. The LLC was formed by USBCDC to provide financing for the borrower's equity investment in a community development entity – Stonehenge Community Development XVIII, LLC ("CDE") and is solely managed by a third party. Accordingly, the LLC entered into a Loan Agreement to lend $16,587,764 to Habitat Stonehenge Investment Fund, LLC. ("Borrower"). The Borrower used the loan proceeds as its equity investment in the CDE which, in turn, used the proceeds of the Borrower's equity investment to fund the loans to the members of the LLC set forth below.

The loan receivable bears interest at a rate of 2.05%, with 1.00% being interest currently payable and 1.05% being accrual interest. The loan receivable matures on April 15, 2040 and requires semi-annual accrued interest payments until June 15, 2017 and semi-annual principal payments commencing on June 16, 2017 sufficient to fully amortize the loan. Simultaneous with these transactions, the LLC entered into an Option Agreement with USBCDC to put the ownership interest in the Fund for $1,000 commencing on April 30, 2017 and continuing for 3 months, or call the ownership interest for a 12-month period following the expiration of the Put Option at fair market value.

Loan payable – Stonehenge Community Development XVIII, LLC:

As a component of the NMTC transaction, HHEB and its affiliate (co-owner of the LLC) received loans of $15,000,000 and $6,000,000 from the CDE and entered into a Loan and Security Agreement ("Agreement") dated April 15, 2010. HHEB is obligated under the Agreement and related Promissory Note to pay interest on the borrowings at a rate of 0.79% per annum with a maturity date of April 15, 2040. Commencing on June 1, 2010 and semi-annually until June 1, 2017, HHEB is required to make payments of accrued interest. Commencing on June 1, 2017 and semi-annually thereafter, HHEB is required to make equal principal and interest payments in an amount to fully amortize the loan by its maturity date. Pursuant to the Agreement, HHEB is required to comply with the NMTC requirements as generally set forth in the Internal Revenue Code ("IRC") Section 45D, including that HHEB maintain a Separate Business such that the Separate Business will qualify as a qualified active low-income community business as defined in IRC Section 45D. Only the Separate Business assets of HHEB were pledged as security under the Agreement to the CDE.

*New Markets Tax Credit Transaction – Clearinghouse*

HFHI-SA Leverage VI, L.L.C.:

In July 2010 HHEB acquired a 28.07% membership, interest in HFHI – SA Leverage VI, L.L.C. (the "LLC") in exchange investing a combination of cash and construction in progress totaling $5,268,759. The LLC is owned 71.93% by three other affiliates of Habitat for Humanity International, Inc. The LLC was formed by USBCDC to provide financing for the borrower's equity investment in a community development entity – Clearinghouse NMTC (Sub 21), LLC ("Sub-CDE") and is solely managed by a third party. Accordingly, the LLC entered into a Loan Agreement to lend $18,773,324 to Habitat California Investment Fund, LLC. ("Borrower"). The Borrower used the loan proceeds as its equity investment in the Sub-CDE which, in turn, used the proceeds of the Borrower's equity investment to fund the loans to the members of the LLC set forth below.

The loan receivable bears interest at a rate of 2.86%, with 1.00% being interest currently payable and 1.86% being accrual interest. The loan receivable matures on June 28, 2025 and requires semi-annual accrued interest payments until June 15, 2017 and semi-annual principal payments commencing on June 16, 2017 sufficient to fully amortize the loan. Simultaneous with these transactions, the LLC entered into an Option Agreement with USBCDC to put the ownership interest in the Fund for $1,000 commencing on June 30, 2017 and continuing for 3 months, or call the ownership interest for a 12 month period following the expiration of the Put Option at fair market value.

Loan payable – Clearinghouse NMTC (Sub 21), LLC:

As a component of the NMTC transaction, HHEB and its affiliates (co-owners of the LLC) received loans of $6,875,958 and $6,000,000 from the Sub-CDE and entered into a Loan and Security Agreement ("Agreement") dated July 28, 2010. HHEB is obligated under the Agreement and related Promissory Note to pay interest on the borrowings at a rate of 0.77% per annum with a maturity date of July 28, 2025. Commencing on December 5, 2010 and semi-annually until December 5, 2017, HHEB is required to make payments of accrued interest. Commencing on December 5, 2017 and semi-annually thereafter, HHEB is required to make equal principal and interest payments in an amount to fully amortize the loan by its maturity date. Pursuant to the Agreement, HHEB is required to comply with the NMTC requirements as generally set forth in the Internal Revenue Code ("IRC") Section 45D, including that HHEB maintain a Separate Business such that the Separate Business will qualify as a qualified active low-income community business as defined in IRC Section 45D. Only the Separate Business assets of HHEB were pledged as security under the Agreement to the CDE.

*New Markets Tax Credit Transaction – LCD*

LCD NMF Leverage Lender XI, L.L.C.:

In January 2012 HHEB acquired a 99.00% membership, interest in LCD NMF Leverage Lender XI, LLC (the "LLC") in exchange investing a combination of cash and construction in progress totaling $7,458,091. The LLC was formed by USBCDC to provide financing for the borrower's equity investment in a community development entity – LCD New Markets Fund XI, LLC ("CDE") and is solely managed by a third party. Accordingly, the LLC entered into a Loan Agreement to lend $7,458,091 to LCD NMF XI Investment Fund, LLC. ("Borrower"). The Borrower used the loan proceeds as its equity investment in the CDE which, in turn, used the proceeds of the Borrower's equity investment to fund the loans to the members of the LLC set forth below.

The loan receivable bears interest at a rate of 2.70%, with 1.00% being interest currently payable and 1.70% being accrual interest. The loan receivable matures on January 23, 2027 and requires semi-annual accrued interest payments until January 23, 2019 and semi-annual principal payments commencing on January 24, 2019 sufficient to fully amortize the loan. Simultaneous with these transactions, the LLC entered into an Option Agreement with USBCDC to put the ownership interest in the Fund for $1,000 commencing on January 23, 2019 and continuing for 3 months, or call the ownership interest for a 12-month period following the expiration of the Put Option at fair market value.

Loan payable – LCD New Markets Fund XI, LLC:

As a component of the NMTC transaction, HHEB received loans of $7,680,000 and $1,920,000 from the CDE and entered into Loan and Security Agreements ("Agreements") dated January 24, 2012. HHEB is obligated under the Agreements and related Promissory Notes to pay interest on the borrowings at a rate of 0.78% per annum with a maturity date of January 23, 2027. Commencing on May 5, 2012 and semi-annually until November 5, 2018, HHEB is required to make payments of accrued interest. Commencing on May 5, 2019 and semi-annually thereafter, HHEB is required to make equal principal and interest payments in an amount to fully amortize the loan by its maturity date. Pursuant to the Agreement, HHEB is required to comply with the NMTC requirements as generally set forth in the Internal Revenue Code ("IRC") Section 45D, including that HHEB maintain a Separate Business such that the Separate Business will qualify as a qualified active low-income community business as defined in IRC Section 45D. Only the Separate Business assets of HHEB were pledged as security under the Agreement to the CDE.

*Financial Statement Presentation of New Markets Tax Credit Transactions:*

HEBSV's investments in the LLCs are accounted for on the cost basis since HEBSV is not able to influence the operating and financial policies of the LLCs. Accordingly, distributions received from the LLCs are reported as revenue on the statement of activities.

HEBSV has imputed a fair value rates of interest of 3.4% – 3.8% on the notes payable to the CDEs, resulting in discounts totaling $6,900,705 on the notes payable. This discount, net of the NMTC transaction costs of $1,223,990, results in a net amortizable benefit of $5,676,715, equal to approximately the cash flow received by HEBSV. As a result, HEBSV has recorded net deferred revenue of $5,676,715 to reflect the net revenue HEBSV will effectively receive from the NMTC transaction over their term. After fees and expenses, HEBSV received $3,619,143 in net cash proceeds to invest in its low-income housing projects.

The NMTC transactions, as set forth above, provide HEBSV, from an economic perspective, a right of offset of the loans payable to the CDE versus the investment in the Borrower. The right of offset arises in part due to the related party nature and flow of funds in the NMTC transactions, and in part, as a result of the Option Agreements effectively providing a legal right of offset. Exercise of these options will effectively extinguish HEBSV's outstanding debt owed to the CDEs. Upon execution, the investment and debt will then have a balance of zero. All entities related to the NMTC transactions will be dissolved, ending the NMTC structures. Accordingly, HEBSV's financial statements report only the net deferred benefit of the NMTC transaction, after offsetting the investments in LLCs, discounted notes payable CDEs, and transaction costs.

HEBSV is amortizing the net deferred revenue from the NMTC transaction over seven years. Amortization of the net deferred revenue totaled $810,959 for both the years ended June 30, 2014 and 2013. Interest expense on the notes payable to the CDE's totaled $245,782 for the years ended June 30, 2014 and 2013. The interest expense on the notes payable is effectively returned to HEBSV through distributions received from the investments in the LLC's totaling $245,006 for the years ended June 30, 2014 and 2013. HEBSV also paid and expensed $269,352 and $290,834 of annual new markets tax credit fees related to the asset management, compliance and facilitation fees for the years ended June 30, 2014 and 2013, respectively. These annual expenses are paid from the new markets tax credit restricted cash reserves (see Note 3).

*Offsite Affordable Housing Agreement*

In April 2013, HEBSV entered into an offsite affordable housing agreement with a for-profit housing developer (the Developer) to assist the Developer on satisfying their obligations under the certain city ordinance relating to affordable housing. The Developer will provide $1,075,000 for HEBSV to design, acquire, develop and construct at least 6 affordable units on a site specified by the city of Fremont. The entire funding has been received by HEBSV as of June 30, 2014, which can only be spent on the permitted uses approved by the city of Fremont. Any funds not spent for the permitted uses are required to be returned to the city. As of June 30, 2014, no qualified expenditures have incurred; therefore, the entire balance of $1,075,000 is reflected as deferred revenue.

**NOTE 13 – BOARD DESIGNATED AND TEMPORARILY RESTRICTED NET ASSETS**

*Board Designated Funds*

HEBSV established a charitable fund with the Lutheran Community Foundation to encourage and procure legacy gifts. It intends to use income from the fund as an operating source for future housing and other Habitat projects. Included in unrestricted net assets are designated net assets of $34,289 and $29,265 as of June 30, 2014 and 2013, respectively, relating to the cause.

*Temporarily Restricted Net Assets*

Temporarily restricted net assets are summarized as follows:

| | 2014 | | | |
|---|---|---|---|---|
| | *June 30, 2013* | *Contributions* | *Released from Restrictions* | *June 30, 2014* |
| Contributions restricted for specific programs: | | | | |
| El Rincon (Bay Point) | $ 46,875 | $ 161,212 | $ (208,087) | $ - |
| NRI (Bay Point and San Jose) | 462,410 | 45,000 | (84,104) | 423,306 |
| Sequoia Grove | 9,832 | 234,230 | (103,298) | 140,764 |
| Tri-Valley project | 35,565 | 8,876 | (44,441) | - |
| Jackson St. Sunnyvale | 277,091 | 230,990 | (508,081) | - |
| Golf Links | 10,000 | - | (10,000) | - |
| EIC Restore | - | 122,790 | (17,849) | 104,941 |
| Ivy Lane, Antioch | 80,320 | 5,441 | (85,761) | - |
| Rehab Program - City of Oakland | - | 68,500 | (2,473) | 66,027 |
| Delmas, San Jose | 10,891 | 267,239 | (16,328) | 261,802 |
| Others | 2,768 | - | (2,768) | - |
| | $ 935,752 | $ 1,144,279 | $ (1,083,191) | $ 996,840 |

| | 2013 | | | |
|---|---|---|---|---|
| | *June 30, 2012* | *Contributions* | *Released from Restrictions* | *June 30, 2013* |
| Contributions restricted for specific programs: | | | | |
| El Rincon (Bay Point) | $ 62,453 | $ - | $ (15,578) | $ 46,875 |
| NRI (Bay Point and San Jose) | 488,223 | 50,000 | (75,813) | 462,410 |
| Pleasant Creek | 108,951 | 699,290 | (808,241) | - |
| Sequoia Grove | - | 45,389 | (35,557) | 9,832 |
| Oakland Project – Brookfield Ct. | 526,653 | 1,069,145 | (1,595,798) | - |
| Tri-Valley project | 35,565 | - | - | 35,565 |
| Homeownership Counseling | 49,966 | 16,200 | (66,166) | - |
| Humboldt | 32,500 | 164,029 | (196,529) | - |
| Jackson St. Sunnyvale | - | 290,206 | (13,115) | 277,091 |
| CLEO | 138,696 | 667,231 | (805,927) | - |
| Golf Links | - | 10,000 | - | 10,000 |
| Ivy Lane, Antioch | - | 80,320 | - | 80,320 |
| Delmas, San Jose | 23,391 | - | (12,500) | 10,891 |
| Loan loss reserve | 25,000 | - | (25,000) | - |
| Others | 15,643 | 125 | (13,000) | 2,768 |
| Contributions restricted for future periods | 100,137 | - | (100,137) | - |
| | $ 1,607,178 | $ 3,091,935 | $ (3,763,361) | $ 935,752 |

**NOTE 14 – IN-KIND CONTRIBUTIONS**

In-kind contributions are summarized as follows:

| | 2014 | 2013 |
|---|---|---|
| Donated land and building | $ 250,000 | $ 323,700 |
| Donated use of facilities | 80,623 | 76,663 |
| Donated equipment and building materials | 1,609,194 | 1,161,043 |
| Donated professional services | 25,531 | 65,998 |
| Total in-kind donations | $ 1,965,348 | $ 1,627,404 |

Donated equipment and building materials include inventory received and sold at ReStore.

**NOTE 15 – EMPLOYEE BENEFIT PLAN**

HEBSV maintains a 403(b) retirement plan of which the employer contribution is 100% of the employee's contribution, up to 4% of gross salary. Eligible employees include full-time and part-time employees who have completed one year of service and who have worked at least 1,000 hours. Employee contributions are vested 100% after three years of service. HEBSV contributed $98,612 and $88,826 to the plan in 2014 and 2013, respectively.

**NOTE 16 – OPERATING LEASES**

HEBSV leases its Oakland ReStore site and a warehouse under operating lease agreements that expire in August 2015 and February 2015, respectively. The lease for the Oakland ReStore site has an option to extend for a period of three years. HEBSV leases its two San Jose ReStore sites under operating lease agreements that expire in March 2015 and April 2022. The lease expiring April 2022 includes an option to extend for a period of five years

HEBSV also has an operating lease for the use of office facilities in Oakland that expires in February 2018, with an option to extend for an additional five years. HEBSV also operates an office facility in Milpitas consisting of donated office space valued at $80,623 and $76,663 for the years ended June 30, 2014 and 2013, respectively. HEBSV is required to reimburse the lessors for common area maintenance and related charges for the use of both facilities.

In addition, HEBSV has several other operating leases for the use of office equipment and vehicles that expire through June 2017. Rental expenses, including common area maintenance charges and reimbursements for taxes, maintenance and utilities totaled $395,776 and $362,259 for the years ended June 30, 2014 and 2013, respectively.

The following represents the future minimum lease payments:

| *Year Ending June 30,* | |
|---|---|
| 2015 | $ 281,841 |
| 2016 | 142,944 |
| 2017 | 120,959 |
| 2018 | 90,291 |
| 2019 | 79,135 |
| Thereafter | 232,800 |
| | $ 947,970 |

**NOTE 17 – BUSINESS COMBINATION**

Effective July 1, 2012, HHEB and HHSV merged to form HEBSV. Both HHSV and HHEB shared the common mission of building affordable housing by utilizing volunteer labor and donated materials and funds. Through their merger, the entities seek to further their common mission by substantially improving their geographic reach, achieve economies of scale and other synergies through integrating their services.

Adjustments were made to the previously reported beginning net assets to conform the accounting policy of the merging entities of discounting mortgage receivables. The beginning mortgages receivable balance and nets assets were decreased by $6,578,144 to reflect the adjustment in mortgage receivable discount as of the merger date. In addition, beginning net assets were adjusted to remove HHSV imputed interest on government notes payable of $66,715, and a net adjustment of $39,595 to adjust the beginning NMTC investment balance to cost basis.

The amounts recognized as of the merger date for each major class of assets and liabilities and each class of net assets is as follows:

| | *July 1, 2012* | | | |
|---|---|---|---|---|
| | *HHEB* | *HHSV* | *Adjustments* | *Total HEBSV* |
| Assets: | | | | |
| Cash and cash equivalents | $ 4,527,123 | $ 58,855 | $ - | $ 4,585,978 |
| Restricted deposits and impound accounts | 1,445,944 | 192,063 | - | 1,638,007 |
| Contributions receivable | 770,863 | 113,953 | - | 884,816 |
| Other receivables | 451,431 | 21,270 | - | 472,701 |
| Mortgages and notes receivable | 22,199,053 | 1,429,348 | (6,578,144) | 17,050,257 |
| Cost of homes in progress | 5,718,755 | 1,417,888 | - | 7,136,643 |
| Property held for sale | 4,414,314 | - | - | 4,414,314 |
| Inventory of ReStore | 151,203 | - | - | 151,203 |
| Inventory of building materials | 33,600 | - | - | 33,600 |
| Property and equipment | 77,147 | 22,801 | - | 99,948 |
| Prepaid expenses and deposits | 390,819 | 30,534 | - | 421,353 |
| Total assets | $ 40,180,252 | $ 3,286,712 | $ (6,578,144) | $ 36,888,820 |
| Liabilities: | | | | |
| Line of credit | $ 700,000 | $ - | $ - | $ 700,000 |
| Accounts payable and accrued expenses | 682,935 | 88,151 | - | 771,086 |
| Homeowners impounds | - | 52,901 | - | 52,901 |
| Interest Payable | 47,818 | - | - | 47,818 |
| Deferred revenue | 4,372,044 | - | 39,595 | 4,411,639 |
| Notes and loans payable | 6,755,561 | 340,559 | 66,715 | 7,162,835 |
| | 12,558,358 | 481,611 | 106,310 | 13,146,279 |
| Net assets: | | | | |
| Unrestricted | 26,153,878 | 2,665,939 | (6,684,454) | 22,135,363 |
| Temporarily restricted | 1,468,016 | 139,162 | - | 1,607,178 |
| | 27,621,894 | 2,805,101 | (6,684,454) | 23,742,541 |
| Total liabilities and net assets | $ 40,180,252 | $ 3,286,712 | $ (6,578,144) | $ 36,888,820 |

## NOTE 18 – COMMITMENT AND CONTINGENCIES

During the normal course of business, HEBSV entered into various contracts relating to its ongoing construction projects.

HEBSV is named in certain claims and legal actions in the normal course of its activities. Based upon counsel and management’s opinion, the outcome of such matters is not expected to have a material adverse effect on HEBSV’s financial position or changes in net assets.

**NOTE 19 – SUBSEQUENT EVENTS**

In October 2014, in connection with the construction of a new affordable home project, HEBSV executed the following notes:

1) In the original amount of $1,500,000 in favor of the Contra Costa County (HOME loan). The note bears no interest, and $750,000 is due by June 30, 2016 and the remaining balance is to be repaid in full by August 31, 2017. Upon sale of each unit to an eligible purchase, the outstanding balance will be reconveyed proportionately.

2) In the original amount of $3,000,000 in favor of Heritage Bank of Commerce. The note bears variable interest at an initial rate of 4.25%, and is to be repaid in full in October 10, 2015.