

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

FINANCIAL STATEMENTS WITH
INDEPENDENT AUDITORS' REPORT

June 30, 2018 and 2017

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

June 30, 2018 and 2017

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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 statement of financial position as of June 30, 2018, and the related statements of activities, functional expenses, and cash flows for the year 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.

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

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, 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited Habitat for Humanity of Orange County, Inc.'s June 30, 2017 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated October 18, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2017 is consistent, in all material respects, with the audited financial statements from which it has been derived.

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

Santa Ana, California
October 17, 2018

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF FINANCIAL POSITION

June 30, 2018 and 2017

	2018	2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,444,424	\$ 2,226,942
Cash and cash equivalents - restricted	<u>1,066,794</u>	<u>2,001,800</u>
Total cash and cash equivalents	2,511,218	4,228,742
Promises to give - current	201,106	216,897
Other receivables	25,526	2,368
Inventory - Homes for sale	856,114	1,031,001
Inventory - ReStores	323,132	320,190
Prepaid expenses	6,084	21,474
Deposits	122,169	96,716
Housing assets, at net realizable value	5,207,904	4,815,737
Investment in joint venture - HFHI-SA Leverage VI, LLC (Note 4)	<u>-</u>	<u>5,627,589</u>
Total current assets	<u>9,253,253</u>	<u>16,360,714</u>
Noncurrent assets:		
Promises to give - noncurrent	340,685	404,410
Mortgages receivable, net of unamortized discount	5,927,152	6,058,943
Property and equipment, net	<u>54,152</u>	<u>64,516</u>
Total noncurrent assets	<u>6,321,989</u>	<u>6,527,869</u>
Total assets	<u>\$ 15,575,242</u>	<u>\$ 22,888,583</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF FINANCIAL POSITION (CONTINUED)

June 30, 2018 and 2017

	2018	2017
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable and accrued expenses	\$ 411,109	\$ 887,810
Property tax and insurance impounds	132,524	139,980
Deferred mortgage receipts	39,362	176,162
Security deposits	324,332	487,557
Line of credit	-	500
Notes payable - current portion	2,247,665	2,993,408
Clearinghouse NMTC (Sub 21), LLC, net (Note 9)	<u>-</u>	<u>7,844,846</u>
Total current liabilities	<u>3,154,992</u>	<u>12,530,263</u>
Noncurrent liabilities:		
Notes payable - noncurrent portion	<u>1,654,923</u>	<u>1,029,343</u>
Total noncurrent liabilities	<u>1,654,923</u>	<u>1,029,343</u>
Total liabilities	<u>4,809,915</u>	<u>13,559,606</u>
Net assets:		
Without donor restrictions	9,841,920	8,120,435
With donor restrictions	<u>923,407</u>	<u>1,208,542</u>
Total net assets	<u>10,765,327</u>	<u>9,328,977</u>
Total liabilities and net assets	<u>\$ 15,575,242</u>	<u>\$ 22,888,583</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF ACTIVITIES

For the Years Ended June 30, 2018 and 2017

	2018			2017		
	Without donor restrictions	With donor restrictions	Total	Without donor restrictions	With donor restrictions	Total
Support and revenue:						
Contributions	\$ 974,449	839,443	\$ 1,813,892	\$ 400,262	1,040,590	\$ 1,440,852
Donated materials and services	104,342	283,048	387,390	132,717	149,634	282,351
Interest income	163,433	-	163,433	145,936	-	145,936
Rehab income	131,007	-	131,007	37,687	-	37,687
Rental income	43,508	-	43,508	53,041	-	53,041
ReStore revenues	2,291,840	-	2,291,840	2,558,077	-	2,558,077
Sale of homes	1,465,500	-	1,465,500	2,904,900	-	2,904,900
Special events revenues	819,513	-	819,513	995,808	-	995,808
Other income	2,291,277	-	2,291,277	58,334	-	58,334
Net assets released from restrictions	<u>1,407,626</u>	<u>(1,407,626)</u>	<u>-</u>	<u>1,286,078</u>	<u>(1,286,078)</u>	<u>-</u>
Total support and revenue	9,692,495	(285,135)	9,407,360	8,572,840	(95,854)	8,476,986
Expenses:						
Program activities:						
Restore	2,083,597	-	2,083,597	2,064,669	-	2,064,669
Special events	168,492	-	168,492	311,420	-	311,420
Rental	26,160	-	26,160	24,220	-	24,220
Program	<u>5,016,888</u>	<u>-</u>	<u>5,016,888</u>	<u>6,508,535</u>	<u>-</u>	<u>6,508,535</u>
Total program activities	<u>7,295,137</u>	<u>-</u>	<u>7,295,137</u>	<u>8,908,844</u>	<u>-</u>	<u>8,908,844</u>
Supporting activities:						
Management and general	252,056	-	252,056	426,252	-	426,252
Fundraising	<u>423,817</u>	<u>-</u>	<u>423,817</u>	<u>519,214</u>	<u>-</u>	<u>519,214</u>
Total supporting activities	<u>675,873</u>	<u>-</u>	<u>675,873</u>	<u>945,466</u>	<u>-</u>	<u>945,466</u>
Total expenses	<u>7,971,010</u>	<u>-</u>	<u>7,971,010</u>	<u>9,854,310</u>	<u>-</u>	<u>9,854,310</u>
Change in net assets	1,721,485	(285,135)	1,436,350	(1,281,470)	(95,854)	(1,377,324)
Net assets, beginning of year	<u>8,120,435</u>	<u>1,208,542</u>	<u>9,328,977</u>	<u>9,401,905</u>	<u>1,304,396</u>	<u>10,706,301</u>
Net assets, end of year	<u>\$ 9,841,920</u>	<u>\$ 923,407</u>	<u>\$ 10,765,327</u>	<u>\$ 8,120,435</u>	<u>\$ 1,208,542</u>	<u>\$ 9,328,977</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

STATEMENTS OF FUNCTIONAL EXPENSES

For the Year Ended June 30, 2018

(with summarized information for the year ended June 30, 2017)

	Program services				Supporting services		2018 Total	2017 Total
	Restore	Special events	Rental	Program	Management and general	Fund development		
Expenses:								
Accounting	\$ -	\$ -	\$ -	\$ 44,089	-	-	\$ 44,089	\$ 41,004
Advertising and promotion	3,150	136,405	-	102,278	999	13,094	255,926	339,128
Conference	2,137	10,372	-	44,087	11,339	10,942	78,877	48,055
Cost of home sales	-	7,722	555	2,657,501	23,411	4,802	2,693,991	4,248,097
Cost of rehabs	-	-	25,605	525,900	-	-	551,505	320,577
Depreciation	-	-	-	-	10,364	-	10,364	23,104
Discount on sales	-	-	-	118,871	-	-	118,871	183,673
Grants	-	-	-	-	-	13,125	13,125	17,225
Information technology	5,686	-	-	111,541	61	480	117,768	101,345
Insurance	141,536	-	-	115,360	46,144	15,150	318,190	292,379
Interest	-	-	-	44,207	13,003	-	57,210	105,327
Interest - loan fees	-	-	-	-	8,048	-	8,048	22,525
NMTC costs	-	-	-	1,506	-	-	1,506	150,024
Occupancy	541,686	2,227	-	145,910	51,139	1,060	742,022	668,487
Office expense	61,225	2,718	-	19,734	25,867	15,921	125,465	200,240
Officer compensation	-	-	-	619,422	33,557	18,157	671,136	694,075
Other expenses	173,275	-	-	-	-	-	173,275	205,782
Other salaries and wages	993,809	9,048	-	335,763	12,410	296,420	1,647,450	1,862,510
Payroll taxes	77,303	-	-	130,719	15,714	34,666	258,402	243,483
Travel	83,790	-	-	-	-	-	83,790	87,270
Total expenses, net	<u>\$ 2,083,597</u>	<u>\$ 168,492</u>	<u>\$ 26,160</u>	<u>\$ 5,016,888</u>	<u>\$ 252,056</u>	<u>\$ 423,817</u>	<u>\$ 7,971,010</u>	<u>\$ 9,854,310</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, 2018 and 2017

	2018	2017
Cash flows from operating activities		
Change in net assets	\$ 1,436,350	\$ (1,377,324)
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Depreciation expense	10,364	23,104
Interest expense - loan costs	8,048	22,528
Cancellation of debt less related closing costs and fees	(2,225,305)	-
Changes in:		
Promises to give	79,516	12,615
Other receivables	(23,158)	61,542
Inventory - Homes for sale	174,887	75,241
Inventory - ReStores	(2,942)	(143,504)
Prepaid expenses and deposits	(10,063)	(46,210)
Housing assets	(392,167)	1,779,802
Acquisition of mortgages receivable	(478,573)	(338,980)
Payments on mortgages receivable	525,028	457,942
Discounts on mortgage receivable	85,336	41,749
Buybacks of mortgages	-	(48,510)
Accounts payable and accrued expenses	(476,701)	134,761
Property tax and insurance impounds	(7,456)	(8,011)
Deferred mortgage receipts	(136,800)	34,068
Security deposits	(163,225)	241,534
	<u>(1,596,861)</u>	<u>922,347</u>
Cash flows from investing activities		
Distributions from joint venture	<u>-</u>	<u>60,409</u>
	<u>-</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, 2018 and 2017

	2018	2017
Cash flows from financing activities		
Line of credit payments	(500)	(129,500)
Notes payable principal payments	<u>(120,163)</u>	<u>(495,898)</u>
Net cash from financing activities	<u>(120,663)</u>	<u>(625,398)</u>
Net change in cash and cash equivalents	(1,717,524)	357,358
Total cash and cash equivalents, beginning of year	<u>4,228,742</u>	<u>3,871,384</u>
Total cash and cash equivalents, end of year	<u>\$ 2,511,218</u>	<u>\$ 4,228,742</u>

See accompanying notes and independent auditors' report

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

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.

Eleven (11) homes are under construction as of the year ended June 30, 2018. Four (4) more were completed and being readied for sale. During the year ended June 30, 2018, the Organization sold six (6) homes (four new construction and two resales of homes purchased from the prior Habitat family), and has sold 212 newly constructed homes since inception. Additionally, two homes were repurchased and has been prepared for resale to another qualifying family. By serving families, the Organization has changed 3,815 lives since inception. Sixteen homes (16) were repaired in the year ended June 30, 2018. Nine (9) of these were for Veterans as part of a Veteran Home Repair Program. The Organization has also funded the building of 448 homes worldwide as of June 30, 2018 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, 2018 and 2017

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 24% and 30% of total revenue for the years ended June 30, 2018 and 2017, respectively. Purchased product represents approximately 7% and 12% of total retail sales for the years ended June 30, 2018 and 2017, 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.

Comparative financial information

The accompanying financial statements include certain 2017 comparative information. With respect to the accompanying statements of activities, information for 2017 is presented in the aggregate and not displayed by category. Accordingly, such information should be read in conjunction with the Organization's fiscal 2017 financial statements from which summarized information was derived.

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.

Cash and cash equivalents

All cash and highly liquid financial instruments with original maturities of three months or less, which are neither held for nor restricted by donors for long-term purposes, to be cash and cash equivalents. Cash and highly liquid financial instruments restricted to building projects, endowments that are perpetual in nature, or other long-term purposes are excluded from this definition.

Cash and cash equivalents - restricted

Restricted cash consists of amounts held for legal or contract compliance and amounts reserved for homeowner impounds and delinquencies. The Organization also routinely receives contributions that are subject to donor-imposed restrictions. Restricted cash consists of those amounts set aside to comply with such restrictions.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 1 – Summary of significant accounting policies (continued)

Promises to give

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

Other receivables

Other receivables consists of miscellaneous items related to properties. As of June 30, 2018 and 2017, other receivables totaled \$25,526 and \$2,368, 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.

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, 2018 and 2017, the reserve for loss was \$1,233,427 and \$527,797, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 1 – Summary of significant accounting policies (continued)

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.

Property and equipment

Capital expenditures over \$2,500 for property and equipment are capitalized, and presented at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, which range from three to thirty-nine years. Donated assets are capitalized at their approximate fair value at the date of the gift. Depreciation expense for the years ended June 30, 2018 and 2017, was \$10,364 and \$23,104, respectively.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows (undiscounted and without interest) expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. During 2018 and 2017, there were no events or changes in circumstances indicating that the carrying amount of long-lived assets may not be recoverable.

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.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 1 – Summary of significant accounting policies (continued)

Net assets

The Organization reports contributions restricted by donors as increases in net assets without donor restrictions if the restrictions expire (that is, when a stipulated time restriction ends or purpose restriction is accomplished) in the reporting period in which the revenue is recognized. All other donor-restricted contributions are reported as net assets with donor restrictions, depending on the nature of restrictions. When a restriction expires, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statements of activities as net assets released from restrictions. At June 30, 2018 and 2017, net assets with donor restrictions consisted of \$923,407 and \$1,208,542, respectively.

Revenue recognition

Contributions are recognized when cash, securities or other assets, an unconditional promise to give, or notification of a benefit interest is received. Conditional promises to give are not recognized until the conditions on which they depend have been substantially met. Revenue is recognized when earned.

Donated services

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

Donated materials

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

Functional allocation of expenses

The financial statements report certain categories of expenses that are attributed to more than one program or supporting function. Therefore, expenses require allocation on a reasonable basis that is consistently applied. Certain significant expenses are allocated on a basis of square footage, such as depreciation and interest; while others are allocated on a basis of time and effort estimates, such as salaries and payroll tax expense.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 1 – Summary of significant accounting policies (continued)

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, 2018 and 2017, the Organization had revenue from the sale of purchased goods in the ReStores, which constitutes unrelated business income. However, since purchased product represents approximately 7% and 12% of total retail sales for the years ended June 30, 2018 and 2017, 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.

Advertising expense

For the years ended June 30, 2018 and 2017, advertising expense totaled \$22,975 and \$40,118, respectively.

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.

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, 2018 and 2017

Note 2 – Liquidity and availability

As part of liquidity management, the Organization has put a policy in place to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. Financial assets available for general expenditure within one year consisted of the following at June 30, 2018:

Total cash and cash equivalents	\$ 2,511,218
Other receivables	<u>25,526</u>
Total financial assets	2,536,744
Contractual or donor-imposed restrictions:	
Cash restricted for legal or contractual compliance	143,387
Donor contributions with specific purpose restrictions	<u>923,407</u>
Total contractual or donor-imposed restrictions	<u>1,066,794</u>
Financial assets available to meet cash needs for general expenditures within one year	<u><u>\$ 1,469,950</u></u>

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. Based on six years of collection history, the unrestricted promises to give receivable has been discounted by 10%. The unrestricted promises to give as of June 30, 2018 and 2017 include current portions of \$201,106 and \$216,897, respectively and long-term portions of \$340,685 and \$404,410, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

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.

On August 3, 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, exercised its put option. Under the terms of the option agreement, HFHI-SA Leverage VI, LLC purchased the ownership interest of the Fund. Exercise of the option effectively allowed the Organization to extinguish its outstanding debt owed to the Fund. Therefore, as of August 3, 2017, the Investment in joint venture - HFHI-SA Leverage VI, LLC was retired, and the Long-term debt – Clearinghouse NMTC (Sub 21), LLC was extinguished. After closing costs, interest and amortization expense of roughly \$50,000, the transaction resulted in \$2,266,601 in cancellation of debt income, which was recorded as other income. This cancellation of debt was a non-cash transaction.

The balances of the investment in HFHI-SA Leverage VI, LLC consisted of the following at June 30:

	2018	2017
Beginning balance	\$ 5,627,589	\$ 5,627,589
Distributions	-	(60,409)
Completion of joint venture	<u>(5,627,589)</u>	<u>-</u>
Ending balance	<u>\$ -</u>	<u>\$ 5,627,589</u>

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 5 – Mortgages receivable

In general, mortgages receivable carry imputed interest rates between 4.50% and 8.00% 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, 2018 and 2017, were \$11,548,034 and \$11,594,490, respectively. Imputed interest rates for June 30, 2018 and 2017, ranged from 4.00% to 5.00%. Interest income resulting from the amortization of discounted notes for the years ended June 30, 2018 and 2017 totaled \$163,399 and \$145,920, 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, 2018 and 2017, 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.

Lender	Loan name	Payment streams		Balance of mortgages receivable pledged	
		Paid out	Receipts	2018	2017
California Bank & Trust	2011 - 15 yr	\$ 39,859	\$ 60,406	\$ 1,749,431	\$ 1,809,837
California Bank & Trust	2014 - 7 yr	36,100	46,284	319,174	365,458
California Bank & Trust	2014 - 15 yr	19,845	37,745	<u>571,048</u>	<u>608,794</u>
Total mortgages receivable pledged				<u>\$ 2,639,653</u>	<u>\$ 2,784,089</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, 2018 and 2017

Note 6 – Property and equipment

Property and equipment consisted of the following at June 30:

	2018	2017
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>(479,914)</u>	<u>(469,550)</u>
Property and equipment, net	<u>\$ 54,152</u>	<u>\$ 64,516</u>

Note 7 – Notes payable

Notes payable consisted of the following at June 30:

	2018	2017
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.	\$ 433,028	\$ 472,887
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 10.00% or the highest rate permitted by law. This loan was fully reconveyed during the year ended June 30, 2018.	-	1,455,000
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.	126,407	162,507

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 7 – Notes payable (continued)

	2018	2017
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.	313,105	332,950
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	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	315,000
Loan payable dated November 8, 2016 to California Bank & Trust, collateralized by the property under construction in Santa Ana, and donations. Additional borrowings were made during the year ended June 30, 2018. The loan term is for 24 months from the date of the loan with principal and interest at an annual variable rate of 0.50% over the index (Prime Rate) which was 5.50% at June 30, 2018.	777,363	269,122
Loan payable dated November 1, 2017 to NeighborWorks Orange County, collateralized by the property under construction in Placentia, and donations. The loan term is for 24 months from the date of the loan with principal and interest at an annual variable rate of 3.50%.	260,000	-

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 7 – Notes payable (continued)

	2018	2017
Loan payable dated November 1, 2017 to NeighborWorks Orange County, collateralized by the property under construction in Fullerton and donations. The loan term is for 24 months from the date of the loan with principal and interest at an annual variable rate of 3.50%.	260,000	-
Loan payable dated November 1, 2017 to NeighborWorks Orange County, collateralized by the property under construction in Tustin and donations. The loan term is for 24 months from the date of the loan with principal and interest at an annual variable rate of 3.50%.	<u>402,400</u>	<u>-</u>
Total notes payable	3,902,588	4,022,751
Less: current portion	<u>(2,247,665)</u>	<u>(2,993,408)</u>
Total notes payable, net	<u>\$ 1,654,923</u>	<u>\$ 1,029,343</u>

Future minimum payments consist of the following for the years ended June 30:

2019	\$ 2,247,665
2020	1,062,415
2021	140,387
2022	98,004
2023	98,004
2024 and thereafter	<u>256,113</u>
	<u>\$ 3,902,588</u>

Interest expense related to notes payable for the years ended June 30, 2018 and 2017, totaled \$57,210 and \$49,946, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 8 – Line of credit

The Organization secured a line of credit of up to \$500,000 dated November 1, 2017 from NeighborWorks Orange County. The line is unsecured and matures November 1, 2019 with a fixed interest rate of 3.50%. At June 30, 2018 and 2017, the outstanding balance was \$0 and \$0, respectively.

The Organization secured a line of credit of up to \$1,000,000 dated March 9, 2016 from First Bank. The line was unsecured and expired September 9, 2017 with a variable interest rate at 0.50% over the index (Wall Street Journal Prime Rate), which was 5.00% at June 30, 2018. At June 30, 2018 and 2017, the outstanding balance was \$0 and \$500, respectively.

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

Long-term debt consisted of the following at June 30:

	2018	2017
Clearinghouse NMTC (Sub 21), LLC	\$ -	\$ 7,883,619
Less: loan costs	<u>-</u>	<u>(38,773)</u>
Clearinghouse NMTC (Sub 21), LLC, net	<u>\$ -</u>	<u>\$ 7,844,846</u>

Debt required 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. The put option was exercised on August 3, 2017. Exercise of the option effectively allowed 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, 2018 and 2017 totaled \$8,048 and \$22,528, respectively.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 10 – Net assets with donor restrictions

Net assets with donor restrictions consisted of the following at June 30:

	2018	2017
Cal Home Grant	\$ 303,464	\$ 461,687
Tustin	-	57,921
Fullerton	108,829	146,605
Lowe's Woodcrest	-	46,407
Neighborhood Revitalization Initiative	150,947	70,126
Home repair	326,713	395,926
Future projects	<u>33,454</u>	<u>29,870</u>
Total net assets with donor restrictions	<u>\$ 923,407</u>	<u>\$ 1,208,542</u>

Note 11 – Operating leases

The Organization leases office space, ReStore warehouse/retail space, and various office equipment under operating leases totaling \$56,134 per month for terms through September 2022. Rental expenses related to these leases totaled \$653,831 and \$647,547 for the years ended June 30, 2018 and 2017, respectively.

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

2019	\$ 657,856
2020	637,838
2021	627,429
2022	345,964
2023	80,580

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, 2018 and 2017

Note 13 – Guarantees

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

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, 2017, 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 and has outstanding principal amount of \$2,376,345 and \$2,487,995 as of June 30, 2018 and 2017, respectively.

Guarantees to various banks

Various banks have made loans direct to Habitat homeowners. The banks service the loans. The Organization retains the right to cure the loans 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 balances 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 various banks in the outstanding principal amount of \$3,394,761 and \$3,101,652 as of June 30, 2018 and 2017, 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.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 13 – Guarantees (continued)

California Bank and Trust (continued)

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. The total amount contributed to Habitat for Humanity International for the years ended June 30, 2018 and 2017 were \$60,641 and \$50,900, respectively.

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. No properties were transferred between the entities in the fiscal years ended June 30, 2018 or 2017.

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.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 16 – Supplemental disclosures of cash flow information

	2018	2017
Cash paid during the year for:		
Interest	\$ 57,210	\$ 105,327
Noncash investing and financing activities:		
Completion of investment in joint venture - NMTC	\$ 5,627,589	\$ -
Extinguishment of debt - Clearinghouse NMTC	\$ (7,844,846)	\$ -
Costs capitalized as housing assets	\$ 3,581,126	\$ 2,837,575

Interest expense for the years ended June 30, 2018 and 2017 was \$65,258 and \$127,855, of which \$8,048 and \$22,528 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.

Note 17 – New accounting standards adopted

The Organization has elected to early adopt Accounting Standards Update 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which requires significant changes in the following areas: net asset classes, liquidity and availability of resources, classification and disclosure of underwater endowment funds, expense reporting, statement of cash flows, investment return, and release of restrictions on capital assets. There was no material impact on the presentation of the financial statements due to this implementation.

The Organization also elected to adopt the FASB issued Accounting Standards Update 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issue Task Force)*. The amendments in this update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash or restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown the statement of cash flows. The amendments in this ASU do not provide a definition of restricted cash or restricted cash equivalents. There was a no material impact on the Organization's financial statements upon adoption of the new standard.

HABITAT FOR HUMANITY OF ORANGE COUNTY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

Note 18 – Subsequent events

Escrows closed

During July, August, and September 2018, a total of seven escrows closed on Habitat Homes, thus increasing cash by approximately \$802,000.

New line of credit payable

On September 20, 2018, the Organization entered into a non-revolving line of credit with NeighborWorks Orange County in the amount of \$750,000. The new line of credit carries an interest rate of 4.75% and matures September 20, 2021.

Management's review

Management has evaluated subsequent events through October 17, 2018, the date on which the financial statements were available to be issued.