



Gorfine Schiller Gardyn

Certified Public Accountants and Consultants



**HABITAT FOR HUMANITY
OF THE CHESAPEAKE, INC.
AND AFFILIATES**

CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2017 AND 2016

HABITAT FOR HUMANITY OF THE CHESAPEAKE, INC. AND AFFILIATES
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors

**Habitat for Humanity of the Chesapeake, Inc. and Affiliates
Baltimore, Maryland**

We have audited the accompanying consolidated financial statements of Habitat for Humanity of the Chesapeake, Inc. and Affiliates, which comprise the consolidated statements of financial position as of June 30, 2017 and 2016, 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 Consolidated 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 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 auditors' 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.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Habitat for Humanity of the Chesapeake, Inc. and Affiliates as of June 30, 2017 and 2016, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Martins, Schiller & Hayden, P.A.

December 21, 2017
Owings Mills, Maryland

CONSOLIDATED FINANCIAL STATEMENTS

HABITAT FOR HUMANITY OF THE CHESAPEAKE, INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
June 30, 2017 and 2016

	2017	2016
<u>ASSETS</u>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 714,996	\$ 1,047,512
Contributions receivable - current portion	1,435,217	714,542
Mortgages receivable - current portion	965,515	980,969
Accounts receivable	262,253	281,240
Grants receivable	152,453	428,821
Inventory of homes	5,157,937	4,206,771
ReStore inventory	44,804	53,683
Prepaid expenses	64,588	110,654
Total current assets	8,797,763	7,824,192
PROPERTY AND EQUIPMENT		
Land and buildings	625,000	625,000
Furniture and fixtures and equipment	88,496	88,496
Leasehold improvements	285,574	266,911
Vehicles	345,603	367,746
Computers	232,351	227,779
	1,577,024	1,575,932
Less accumulated depreciation	(735,951)	(640,312)
Net property and equipment	841,073	935,620
OTHER ASSETS		
Long-term contributions receivable, net	326,184	623,187
Long-term mortgages receivable, net	6,146,034	6,860,706
Leveraged mortgages receivable, net	7,632,880	9,252,596
Capitalized interest on leveraged mortgages	3,492,957	3,539,152
Investments in limited liability companies	9,155,358	13,186,106
Prepaid interest	276,905	306,305
Deposits	48,329	49,329
Total other assets	27,078,647	33,817,381
TOTAL ASSETS	\$ 36,717,483	\$ 42,577,193

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

	<u>2017</u>	<u>2016</u>
<u>LIABILITIES AND NET ASSETS</u>		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 889,780	\$ 836,948
Lines of credit and notes payable - current portion	831,825	1,116,472
Deferred rent	<u>94,358</u>	<u>106,264</u>
Total current liabilities	<u>1,815,963</u>	<u>2,059,684</u>
LONG-TERM LIABILITIES		
Notes payable, related parties	10,391,645	14,846,758
Lines of credit and notes payable - net of current portion	5,054,789	4,963,830
Program debt	-	218,282
Leveraged mortgages receivable liability	<u>7,632,880</u>	<u>9,252,596</u>
Total long-term liabilities	<u>23,079,314</u>	<u>29,281,466</u>
Total liabilities	<u>24,895,277</u>	<u>31,341,150</u>
NET ASSETS		
Unrestricted	11,285,112	10,219,431
Temporarily restricted	<u>537,094</u>	<u>1,016,612</u>
Total net assets	<u>11,822,206</u>	<u>11,236,043</u>
 TOTAL LIABILITIES AND NET ASSETS	 <u>\$ 36,717,483</u>	 <u>\$ 42,577,193</u>

HABITAT FOR HUMANITY OF THE CHESAPEAKE, INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF ACTIVITIES
For the Years Ended June 30, 2017 and 2016

	2017			2016		
	Unrestricted	Temporarily Restricted	Total	Unrestricted	Temporarily Restricted	Total
REVENUES, GAINS AND SUPPORT						
Contributions	\$ 3,248,931	\$ 346,366	\$ 3,595,297	\$ 3,189,761	\$ 1,032,287	\$ 4,222,048
Donated goods and services	83,966	-	83,966	236,477	-	236,477
Donated property	55,000	-	55,000	44,500	-	44,500
Government grants	540,957	-	540,957	440,163	-	440,163
Real estate sales	523,002	-	523,002	1,984,344	-	1,984,344
ReStore income	3,461,902	-	3,461,902	3,251,451	-	3,251,451
Special events, net of expenses of \$26,333 and \$19,157, respectively	(11,806)	-	(11,806)	1,776	-	1,776
Rental income	23,750	-	23,750	21,010	-	21,010
Miscellaneous income	12,567	-	12,567	20,750	-	20,750
Debt forgiveness - program debt	204,676	-	204,676	269,864	-	269,864
Amortization of mortgage discounts	367,407	-	367,407	366,257	-	366,257
	<u>8,510,352</u>	<u>346,366</u>	<u>8,856,718</u>	<u>9,826,353</u>	<u>1,032,287</u>	<u>10,858,640</u>
NET ASSETS RELEASED FROM RESTRICTIONS						
Satisfaction of program restrictions	448,953	(448,953)	-	297,599	(297,599)	-
Satisfaction of time restrictions	376,931	(376,931)	-	69,000	(69,000)	-
	<u>825,884</u>	<u>(825,884)</u>	<u>-</u>	<u>366,599</u>	<u>(366,599)</u>	<u>-</u>
Total revenues, gains and support	<u>9,336,236</u>	<u>(479,518)</u>	<u>8,856,718</u>	<u>10,192,952</u>	<u>665,688</u>	<u>10,858,640</u>
EXPENSES						
Program services						
House construction	3,913,971	-	3,913,971	5,651,638	-	5,651,638
ReStore	3,062,887	-	3,062,887	2,907,703	-	2,907,703
Total program services	6,976,858	-	6,976,858	8,559,341	-	8,559,341
Supporting services						
Management and general	1,139,970	-	1,139,970	1,269,689	-	1,269,689
Fundraising	586,355	-	586,355	790,474	-	790,474
Total expenses	<u>8,703,183</u>	<u>-</u>	<u>8,703,183</u>	<u>10,619,504</u>	<u>-</u>	<u>10,619,504</u>
OPERATING INCOME (LOSS)	<u>633,053</u>	<u>(479,518)</u>	<u>153,535</u>	<u>(426,552)</u>	<u>665,688</u>	<u>239,136</u>
OTHER INCOME (EXPENSES)						
Investment income from limited liability companies	6,673	-	6,673	118,706	-	118,706
Debt forgiveness - notes payable, related parties, net	430,964	-	430,964	-	-	-
(Loss) gain on sale of property and equipment	(3,489)	-	(3,489)	6,942	-	6,942
(Loss) gain on sale of homes	(1,520)	-	(1,520)	5,524	-	5,524
Net other income (expenses)	<u>432,628</u>	<u>-</u>	<u>432,628</u>	<u>131,172</u>	<u>-</u>	<u>131,172</u>
CHANGES IN NET ASSETS	1,065,681	(479,518)	586,163	(295,380)	665,688	370,308
NET ASSETS - Beginning of year	<u>10,219,431</u>	<u>1,016,612</u>	<u>11,236,043</u>	<u>10,514,811</u>	<u>350,924</u>	<u>10,865,735</u>
NET ASSETS - End of year	<u>\$ 11,285,112</u>	<u>\$ 537,094</u>	<u>\$ 11,822,206</u>	<u>\$ 10,219,431</u>	<u>\$ 1,016,612</u>	<u>\$ 11,236,043</u>

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

HABITAT FOR HUMANITY OF THE CHESAPEAKE, INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES
For the Years Ended June 30, 2017 and 2016

	2017					
	<u>Program Services</u>			<u>Supporting Services</u>		
	<u>House Construction</u>	<u>ReStore</u>	<u>Total Program Services</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>Total</u>
Advertising	\$ 46,631	\$ 174,378	\$ 221,009	\$ -	\$ 101,776	\$ 322,785
Amortization of capitalized interest	118,804	-	118,804	-	-	118,804
Bad debt expense	146,332	-	146,332	551	5,691	152,574
Computer and software maintenance	15,630	21,936	37,566	9,434	37,053	84,053
Conference expenses	6,934	2,455	9,389	3,110	629	13,128
Construction and rehabilitation costs on houses sold and settled	1,359,964	-	1,359,964	-	-	1,359,964
Depreciation	36,898	58,262	95,160	15,032	4,100	114,292
Discounts of mortgages receivable	36,058	-	36,058	-	-	36,058
Dues and subscriptions	1,055	12,942	13,997	4,525	2,032	20,554
Employee benefits	142,035	163,400	305,435	52,003	15,319	372,757
Habitat for Humanity International tith	15,000	-	15,000	-	-	15,000
Homeownership	131,836	-	131,836	-	-	131,836
Insurance	6,104	19,828	25,932	2,486	678	29,096
Interest	76,036	13,188	89,224	3,915	-	93,139
Impairment on inventory of homes	711,716	-	711,716	-	-	711,716
Meals and entertainment	27,722	5,758	33,480	17,463	14,887	65,830
Miscellaneous expenses	60,749	5,325	66,074	-	3,315	69,389
Office administration and supplies	46,584	55,071	101,655	18,812	5,163	125,630
Postage	11,024	30	11,054	4,490	1,225	16,769
Printing and production	11,207	13,283	24,490	4,566	1,245	30,301
Professional fees	103,177	67,604	170,781	130,845	1,783	303,409
Purchased merchandise	-	218,359	218,359	-	-	218,359
Remediation of houses previously sold	4,333	-	4,333	-	-	4,333
Rent	85,653	719,749	805,402	34,896	9,517	849,815
Repair and renew	11,528	-	11,528	-	-	11,528
Repairs and maintenance	12,542	93,050	105,592	5,422	1,479	112,493
Salaries	643,565	1,107,540	1,751,105	746,140	343,913	2,841,158
Taxes - other	9,251	13,568	22,819	1,839	-	24,658
Taxes - payroll	83,539	77,896	161,435	57,255	26,313	245,003
Telephone	33,192	37,690	70,882	13,523	3,688	88,093
Travel	4,447	6,141	10,588	5,438	4,034	20,060
Truck expenses	(108,674)	115,425	6,751	-	-	6,751
Utilities	20,187	58,698	78,885	8,225	2,243	89,353
Volunteers	2,912	1,311	4,223	-	272	4,495
Total	<u>\$ 3,913,971</u>	<u>\$ 3,062,887</u>	<u>\$ 6,976,858</u>	<u>\$ 1,139,970</u>	<u>\$ 586,355</u>	<u>\$ 8,703,183</u>

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

HABITAT FOR HUMANITY OF THE CHESAPEAKE, INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES - CONTINUED
For the Years Ended June 30, 2017 and 2016

	2016					
	<u>Program Services</u>			<u>Supporting Services</u>		
	<u>House Construction</u>	<u>ReStore</u>	<u>Total Program Services</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>Total</u>
Advertising	\$ 18,747	\$ 125,942	\$ 144,689	\$ -	\$ 93,033	\$ 237,722
Amortization of capitalized interest	127,144	-	127,144	-	-	127,144
Bad debt expense	16,500	180	16,680	671	37,803	55,154
Computer and software maintenance	67,638	10,500	78,138	2,094	30,734	110,966
Conference expenses	3,174	1,930	5,104	4,700	425	10,229
Construction and rehabilitation costs on houses sold and settled	3,434,862	-	3,434,862	-	-	3,434,862
Depreciation	19,109	58,027	77,136	14,020	4,510	95,666
Discounts of mortgages receivable	142,649	-	142,649	-	-	142,649
Dues and subscriptions	935	14,756	15,691	6,218	2,598	24,507
Employee benefits	51,732	123,584	175,316	76,903	43,396	295,615
Habitat for Humanity International tithe	15,500	-	15,500	-	-	15,500
Homeownership	129,002	-	129,002	-	-	129,002
Insurance	7,280	12,539	19,819	4,449	1,618	25,886
Interest	70,835	21,354	92,189	29,275	-	121,464
Impairment on inventory of homes	583,049	-	583,049	-	-	583,049
Meals and entertainment	10,929	7,559	18,488	19,303	18,981	56,772
Miscellaneous expenses	559	9,610	10,169	2,194	373	12,736
Office administration and supplies	36,321	62,555	98,876	22,197	8,072	129,145
Postage	4,503	1,134	5,637	2,752	1,001	9,390
Printing and production	8,116	13,977	22,093	4,959	1,803	28,855
Professional fees	85,134	41,591	126,725	174,325	66,715	367,765
Purchased merchandise	-	212,537	212,537	-	-	212,537
Remediation of houses previously sold	3,484	-	3,484	-	-	3,484
Rent	133,433	502,335	635,768	81,543	29,652	746,963
Repair and renew	89,896	-	89,896	-	-	89,896
Repairs and maintenance	21,673	78,548	100,221	13,246	4,817	118,284
Restore start-up expenses	-	117,911	117,911	-	-	117,911
Salaries	472,264	1,128,208	1,600,472	702,059	396,170	2,698,701
Taxes - other	3,918	22,411	26,329	13,769	-	40,098
Taxes - payroll	42,276	100,997	143,273	62,848	35,465	241,586
Telephone	27,543	34,159	61,702	16,833	6,121	84,656
Travel	2,965	16,953	19,918	5,588	3,540	29,046
Truck expenses	-	144,857	144,857	-	-	144,857
Utilities	15,942	43,296	59,238	9,743	3,543	72,524
Volunteers	4,526	253	4,779	-	104	4,883
Total	<u>\$ 5,651,638</u>	<u>\$ 2,907,703</u>	<u>\$ 8,559,341</u>	<u>\$ 1,269,689</u>	<u>\$ 790,474</u>	<u>\$ 10,619,504</u>

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

HABITAT FOR HUMANITY OF THE CHESAPEAKE, INC. AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2017 and 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 586,163	\$ 370,308
Adjustments to reconcile changes in net assets to net cash (used in) provided by operating activities:		
Depreciation	114,292	95,666
Interest from deferred financing costs	3,463	3,463
Amortization of prepaid interest	29,400	36,885
Amortization of capitalized interest on leveraged mortgages	118,804	127,144
Capitalized interest from leveraging of mortgages receivable	(72,609)	(331,876)
Impairment on inventory of homes	711,716	583,049
Bad debt expense	152,574	55,154
Gain on sale of property and equipment	3,489	(6,942)
Forgiveness of program debt	(204,676)	(269,864)
Discounts of mortgages receivable	36,058	142,649
Amortization of mortgage discounts	(367,407)	(366,257)
Changes in operating assets and liabilities:		
Contributions receivable	(429,999)	(608,466)
Accounts receivable	18,987	(25,539)
Grants receivable	276,368	227,164
Inventory of homes	(1,406,313)	521,058
ReStore inventory	8,879	(9,705)
Prepaid expenses	46,066	(25,024)
Accounts payable and accrued expenses	52,832	(40,909)
Deferred rent	(11,906)	48,603
	(333,819)	526,561
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of property and equipment	(23,234)	(127,472)
Changes in equity in investments in limited liability companies	(424,365)	(118,611)
Origination and acquisition of mortgages receivable	(273,228)	(493,824)
Principal payments collected on mortgages receivable	730,025	895,848
Proceeds from sales of mortgages receivable	201,862	199,065
Decrease (increase) in deposits	1,000	(6,253)
	212,060	348,753
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from lines of credit and notes payable	1,016,685	1,028,360
Principal payments on lines of credit and notes payable	(1,213,836)	(1,502,298)
Proceeds from program debt	12,500	27,628
Principal payments on program debt	(26,106)	(182,671)
	(210,757)	(628,981)
NET CHANGES IN CASH AND CASH EQUIVALENTS	(332,516)	246,333
CASH AND CASH EQUIVALENTS - Beginning of year	1,047,512	801,179
CASH AND CASH EQUIVALENTS - End of year	\$ 714,996	\$ 1,047,512

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

HABITAT FOR HUMANITY OF THE CHESAPEAKE, INC. AND AFFILIATES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017 and 2016

NOTE A – NATURE OF ACTIVITIES

Habitat for Humanity of the Chesapeake, Inc. and Affiliates (the Organization) is composed of Habitat for Humanity of the Chesapeake, Inc. (Habitat), JLR Investments LLC (JLR), Habitat for Humanity of the Chesapeake CHDO, LLC (Chesapeake CHDO), Chesapeake Funding Company I, LLC (Chesapeake Funding) and BOTF, Inc. (BOTF).

Habitat was incorporated under the laws of the state of Maryland in 1982, and has been recognized by the Internal Revenue Service (IRS) as a not-for-profit, tax-exempt organization as defined by Section 501(c)(3) of the Internal Revenue Code (IRC) that is publicly supported, and therefore, not a private foundation.

JLR is a limited liability company created by Habitat that was incorporated in Maryland in 2005. Habitat is the sole member of JLR. JLR was formed to own, operate, lease and sell real property, including certain property located in Baltimore, Maryland together with all improvements thereon.

Chesapeake CHDO is a limited liability company formed for charitable purposes, including assisting community organizations in the planning and managing of housing and economic development projects and providing decent housing that is affordable to low and moderate income people, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under Section 501(c)(3) of the IRC. Habitat is the sole member of Chesapeake CHDO.

Chesapeake Funding is a limited liability company formed for the purpose of holding certain real estate investment portfolios, and to do any and all things necessary, convenient or incidental to that purpose. Habitat is the sole member of Chesapeake Funding.

BOTF was incorporated in Maryland in 2013 and has been recognized by the IRS as a not-for-profit, tax-exempt organization as defined by Section 501(c)(2) of the IRC. BOTF was formed to hold title to the building housing the Sandtown ReStore on behalf of and for the exclusive benefit of Sandtown Habitat for Humanity, Inc. (Sandtown) and is consolidated as a result of Habitat's merger with Sandtown.

The Organization is a Christian organization, unaffiliated with any denomination, that aims to demonstrate the Christian gospel by working to establish affordable housing and decent habitat through the acquisition and rehabilitation of homes for those that are in need in Anne Arundel County, Baltimore City, Baltimore County and Howard County. The Organization is supported primarily through contributions, home sponsorships, government grants, real estate sales, ReStore sales and donated goods and services.

The Organization is an affiliate of Habitat for Humanity International, Inc. (HFHI), a nondenominational Christian non-profit 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 in other ways, the Organization is primarily and directly responsible for its own operations.

The Organization operates six Habitat for Humanity ReStores (the ReStores). The ReStores are retail operations, where home furnishings, appliances, and other miscellaneous items are donated or purchased and then sold to the community at a greatly reduced price.

NOTE A – NATURE OF ACTIVITIES – Continued

Program Services

Program services encompass activities directly and indirectly related to establishing affordable and decent housing through acquisition, rehabilitation, sale of homes, and retail operations. Program service expenses are categorized as House construction or ReStore expenses.

Management and General

Management and general services are those related to operating and managing the Organization and its programs on a day to day basis. The Organization's management and general services consist of activities not directly related to the programs for which the Organization exists, including all activities related to the Organization's internal management and accounting for program services.

Fundraising

Fundraising consists of activities performed either directly or indirectly to induce contributions, which will be utilized to enhance the program service activities and related management and general activities.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Habitat, and those of its affiliates JLR, Chesapeake CHDO, Chesapeake Funding, and BOTF. Habitat is the sole member of its affiliates. All intercompany transactions and balances have been eliminated in consolidation.

2. Basis of Accounting

The Organization prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, which involves the application of accrual basis accounting. Accordingly, revenues and gains are recognized when earned, expenses and losses are recognized when incurred and all significant receivables, payables and other liabilities are reflected in the accompanying consolidated financial statements.

3. Cash and Cash Equivalents

For purposes of financial reporting, the Organization considers demand deposits and money market accounts and any certificates of deposit that do not contain material early withdrawal penalties, to be cash and cash equivalents. At various times during the year, bank balances may have exceeded the Federal Deposit Insurance Corporation (FDIC) insurance limitation for interest bearing accounts. The Organization does not believe it is exposed to any significant loss on such deposits.

4. Investments in Limited Liability Companies

The Organization has investments in limited liability companies (LLCs) in which it owns more than 20% of the entity. These investments are accounted for under the equity method. Under the equity method, the initial investment is recorded at cost and the Organization's share of the subsequent earnings or losses of the LLCs are recognized in the period reported by the LLCs.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

5. Contributions Receivable

Contributions receivable represents amounts due from contributors based on unconditional promises to give. The Organization provides an allowance for potentially uncollectible contributions based upon a review of their outstanding pledges receivable and their historical experience with individual accounts. As of June 30, 2017 and 2016, the Organization had unconditional promises to give, all of which management considered fully collectible of \$1,761,401 and \$1,337,729, respectively. Contributions receivable includes amounts receivable in more than one year in the amount of \$326,184 and \$623,187 as of June 30, 2017 and 2016, respectively, which are included in temporarily restricted net assets (see Note M). Contributions receivable are discounted for the time value of money using the IRS long term annual applicable federal rate at the date of the promise. Management considers the discount on the contributions receivable immaterial to record.

6. Mortgages Receivable

First Mortgages

Mortgages receivable consists of non-interest bearing mortgages, which are secured by real estate and payable in monthly installments, with original maturities ranging from 20 to 30 years. All of the mortgages are related to new construction and the rehabilitation of existing homes rehabilitated by the Organization. These mortgages are shown on the consolidated statements of financial position discounted at the prevailing interest rate, for the time value of money, between 2.11% and 3.20% for the years ended June 30, 2017 and 2016. Amortization revenue is recorded using the straight-line method over the lives of the mortgages.

The Organization is a secured creditor. Management therefore records a provision for loan losses at the time that it is determined that the mortgage balance exceeds the fair market value of the related home. Management has not provided a provision for loan losses because the fair market value of the homes exceeds the related mortgage balances.

The Organization has pledged some of the mortgage loans as collateral for lines of credit and notes payable (see Note I).

Second, Third and Fourth Mortgages Receivable

In addition to the mortgages receivable included in the consolidated statements of financial position, the Organization also holds non-interest bearing second, third and fourth mortgages. These mortgages originate at the same time as the first mortgage and reflect the difference between the sales price and the fair market value of the house. These mortgages are legal documents executed for protection against homeowners who may sell their house for a profit before the mortgage is repaid and to protect the homeowner by preventing predatory lenders from paying off the first mortgage and saddling the homeowners with an onerous new mortgage.

These mortgages are not included on the consolidated statements of financial position based on Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), *Contingencies*, which relates to the accounting concept of conservatism. Since these mortgages are contingent receivables, they are not recorded on the books because there is a significant uncertainty that they will be exercised and collected.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

7. Leveraged Mortgages Receivable

When a mortgage receivable is leveraged, the Organization receives a discounted cash amount in exchange for the transfer of the mortgage receivable to a bank. Under these agreements, the Organization is liable to repurchase or replace a mortgage transferred to the bank in the event that the homeowner does not make the required payments. In accordance with *ASC Broad Transactions*, the leveraging of the mortgage receivable with a conditional obligation to repurchase or replace the mortgage is not considered a sale.

The leveraged mortgage receivables are shown on the consolidated statements of financial position discounted at the prevailing interest rate for the time value of money. The difference between the cash received and the gross mortgage receivable transferred is recorded as capitalized interest on leveraged mortgages receivable in the consolidated statements of financial position. The capitalized interest on leveraged mortgages receivable is amortized over the term of the leveraged mortgage receivable. The liability in the event that the homeowner does not make the required payments is included in the consolidated statements of financial position as a leveraged mortgage receivable liability, carried at fair market value.

8. Inventory of Homes

Inventory of homes consists of houses and lots purchased by or donated to the Organization for rehabilitation and resale and the cost of homes that are under construction. Donated properties, materials, and services relating to the homes are recognized at fair market value as of the date of the donation. The houses and lots are valued at net realizable value. Impairment on the inventory of homes of \$711,716 and \$583,049 is included in the consolidated statements of activities for the years ending June 30, 2017 and 2016, respectively. When homes are sold the related costs and impairments are removed by recording construction and rehabilitation costs on houses sold and settled.

9. Property and Equipment

Property and equipment is stated at cost. The Organization capitalizes all costs that are in excess of \$1,000 and have a useful life of at least one year. Expenditures for maintenance, repairs and renewals are charged against income as incurred. Expenditures for additions, improvements and replacements are added to the property and equipment accounts and depreciated over their useful lives. When assets are retired or sold, the related costs and accumulated depreciation are removed from the accounts, and any gain or loss on disposition is recognized in income.

Depreciation is calculated under the straight-line method over the estimated useful lives of the respective assets, which range from 5 to 39 years. Depreciation expense amounted to \$114,292 and \$95,666 for the years ended June 30, 2017 and 2016, respectively.

10. Impairment of Long-Lived Assets

In accordance with *ASC Impairment and Disposal of Long-Lived Assets*, the Organization reviews its property and equipment and all other non-current assets for impairments whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the fair value is less than the carrying amount of an asset, an impairment loss is recognized for the difference. No impairment loss relating to long-lived assets has been recognized during the years ended June 30, 2017 and 2016.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

11. Warranties

The Organization provides homeowner warranties on the homes it rehabilitates and records an accrual for estimated future claims. Such accruals are based upon historical experience and management's estimate of the level of future claims. No accruals were considered necessary as of June 30, 2017 and 2016.

12. Deferred Financing Costs and Amortization

Deferred financing costs are presented as a contra-account to the mortgage liability and are amortized over the period the obligation is outstanding using the straight-line method. Interest from deferred financing costs charged to operations amounted to \$3,463 for 2016.

13. Restricted and Unrestricted Revenue

Contributions received by the Organization are presented at their fair market value on the date of such gifts. Contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support depending on the existence and/or nature of any donor imposed restrictions.

Unconditional promises to give are recognized as revenue when the underlying promises are received by the Organization. Conditional promises to give are recognized when the conditions on which they depend are substantially met.

The Organization reports contributions of cash and other assets as restricted support if they are received with donor stipulations that limit the time period or manner of use of the contribution. Donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. Support that is restricted by the donor is reported as an increase in unrestricted net assets if the restriction expires in the reporting period in which the support is recognized. When a donor restriction expires (that is, when a stipulated time restriction or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions.

14. Donated Services

Donated services meeting the requirements for recognition in the consolidated financial statements and donated materials are included in support and expense at their estimated fair values on the date they were contributed. The requirements for recognition of donated services in the consolidated financial statements are (a) the donated services create or enhance non-financial assets, or (b) the donated services require special skills, are provided by individuals who possess those special skills and donated services would typically be purchased by the Organization if they had not been provided by contribution.

15. Donated ReStore Items

Donations of ReStore items are not valued, nor is an inventory of such items used for financial reporting. This accounting treatment is based on ASC, *Contributions Received* where a major uncertainty about the existence of value may indicate that an item received or given should not be recognized. ASC, *Initial Measurement* also applies that fair value should be regarded as not determinable within reasonable limits if major uncertainties exist about the realizability of the value.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

16. ReStore Inventory

ReStore inventory consists of purchased merchandise to be sold in the ReStores and is valued at the lower of cost or market.

17. Allocation of Expenses

The costs of providing the Organization's various programs and other activities have been presented in the consolidated statements of functional expenses. Accordingly, estimates have been made to allocate certain costs among the program services, management and general and fundraising sources benefited.

18. Income Taxes

The Organization is exempt from Federal and State income taxes under Section 501(c)(3) of the IRC and is not considered a private foundation. Habitat's activities are not subject to the tax on unrelated business income. All of the ReStores' activities are classified as exempt activities since sales of purchased merchandise are less than 15% of the ReStores' total sales. JLR, Chesapeake CHDO and Chesapeake Funding are disregarded entities for tax purposes. Therefore, they do not generate taxable income. BOTF is exempt from Federal and State income taxes under Section 501(c)(2) of the IRC.

ASC, *Accounting for Income Taxes*, requires the Organization to recognize or disclose any tax positions that would result in unrecognized tax benefits. The Organization has no positions that would require disclosure or recognition under the topic. The Organization's tax returns for fiscal years ending June 30, 2014 and after are subject to examinations by the IRS and state taxing authorities.

19. Net Assets

The Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The Organization had no permanently restricted net assets at June 30, 2017 and 2016.

20. Use of 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

21. Reclassifications

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

22. Merger Accounting

Upon merger with another entity, the Organization recognizes all identifiable assets and liabilities acquired at their fair value at the date of acquisition. Any difference between the fair value of the assets and liabilities acquired is recognized in the consolidated statements of activities as contribution from merger.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

23. Recent Accounting Pronouncements

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-03, *Interest-Imputation of Interest (Subtopic 855-30)*, which changes the presentation and disclosure of debt issuance costs in the financial statements requiring these amounts to be presented as a direct deduction from the carrying amount of related debt. Previous accounting principles generally accepted in the United States required debt issuance costs to be reported as an asset. The new guidance does not change the subsequent accounting for debt issuance costs and these amounts will continue to be amortized over the term of the related debt. However, amortization of debt issuance costs will now be reported as a component of interest expense. As of July 1, 2015, the Organization reclassified debt issuance costs of \$45,596 as a contra-account to the mortgage liability.

In February 2016, FASB issued Accounting Standards Update 2016-02 *Accounting for Leases*, which requires that all leases greater than twelve months be presented on the statements of financial position. The new standard is effective for the year ended June 30, 2021.

In August 2016, the FASB issued Accounting Standards Updated 2016-14 *Not-for-Profit Entities*, which contains significant changes to the financial statements requirements under the *Not-for-Profit Entities* topic of the ASC. The new standard is effective for the year ending June 30, 2019.

The Organization will evaluate the effect that implementation of these new standards will have on its financial position, results of operations and cash flows.

24. Subsequent Events

In preparing these consolidated financial statements, the Organization has evaluated events and transactions for potential recognition or disclosure through December 21, 2017, the date the consolidated financial statements were available to be issued. During this period, the Organization had material recognizable subsequent events as discussed in Note J and Note P.

NOTE C – MORTGAGES RECEIVABLE

The Organization directly finances a number of the homes that it sells. Each mortgage is issued as a zero-interest mortgage to the buyer. The Organization discounts the mortgages using the current interest rates at the time the home is sold. The discounts are amortized using the straight-line method over the lives of the mortgages.

Mortgages receivable as of June 30, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Mortgages receivable	\$ 11,275,149	\$ 12,427,761
Less: discount on mortgages	<u>(4,163,600)</u>	<u>(4,586,086)</u>
	<u>\$ 7,111,549</u>	<u>\$ 7,841,675</u>

NOTE C – MORTGAGES RECEIVABLE – Continued

At June 30, 2017, the balances due on the mortgages, excluding those that have been leveraged, that are scheduled to be received for the next five years and thereafter are as follows:

Years ending June 30, 2018	\$	965,515
2019		939,919
2020		900,531
2021		854,429
2022		815,462
Thereafter		<u>6,799,293</u>
Total	\$	<u>11,275,149</u>

NOTE D – LEVERAGED MORTGAGES RECEIVABLE

The Organization leverages mortgages receivable to banks. Leveraged mortgages receivable as of June 30, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Leveraged mortgages receivable	\$ 11,954,296	\$ 15,699,136
Less: discount on leveraged mortgages	<u>(4,321,416)</u>	<u>(6,446,540)</u>
	<u>\$ 7,632,880</u>	<u>\$ 9,252,596</u>

NOTE E – FAIR VALUE MEASUREMENTS

ASC 820 *Fair Value Measurements and Disclosure* topic requires financial assets and liabilities to be valued and disclosed based on the following structure:

Level I - Investments included in this designation are valued based on quoted prices for identical investments in active markets as of the reporting date.

Level II - Investments included in this designation are valued based on observable market based inputs or unobservable inputs that are corroborated by market data.

Level III - Investments included in this designation are valued based on unobservable inputs that are significant to the valuation of a particular investment. The inputs into the determination of fair value in this level require significant management judgment or estimates.

In determining the appropriate levels for each investment, Management performs a detailed analysis of the assets and liabilities that are subject to the ASC *Fair Value Measurements and Disclosures* topic. In some instances, an investment may be valued using a combination of inputs. In such instances, the investment is to be classified based on the lowest significant level used in the valuation. Management's assessment of the significance of a particular input in the fair value measurement of an investment requires judgment and considers factors specific to the investment.

NOTE E – FAIR VALUE MEASUREMENTS – Continued

Following is a description of the valuation methodology used for assets and liabilities measured at fair value. There have been no changes in the methodology used at June 30, 2017 and 2016.

Leveraged mortgages receivable liability: Valued at the carrying amount of the related leveraged mortgage receivable asset which approximates the value of the replacement mortgage to be transferred to the bank in the event that the homeowner does not make the required payments.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Organization believes its valuation method is appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table is set forth by level, within the fair value hierarchy, the Organization's liabilities at fair value as of June 30, 2017 and 2016:

Assets and Liabilities at Fair Value as of June, 30 2017

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Leveraged mortgages receivable liability	\$ <u>-</u>	\$ <u>7,632,880</u>	\$ <u>-</u>	\$ <u>7,632,880</u>

Assets and Liabilities at Fair Value as of June, 30 2016

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Leveraged mortgages receivable liability	\$ <u>-</u>	\$ <u>9,252,596</u>	\$ <u>-</u>	\$ <u>9,252,596</u>

NOTE F – INVESTMENTS IN LIMITED LIABILITY COMPANIES

The Investments in Limited Liability Companies on the consolidated statements of financial position includes investments from participation in three New Market Tax Credit (NMTC) Programs. NMTC programs provide 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 (CDE). Tax credit recapture is required if compliance requirements are not met by the CDE over a seven-year period. Details of the transactions follow.

HFHI-SA Leverage III, LLC (Habitat Affiliate 1)

In 2010, the Organization invested, along with 5 other Habitat affiliates, in Habitat Affiliate 1 with 20.526% ownership, to take advantage of NMTC financing. The Organization invested \$3,716,144 with Habitat Affiliate 1 and was able to secure a 15-year loan in the amount of \$4,455,113 payable to City First Capital 21, LLC (CDE) (a subsidiary of Habitat Affiliate 1). The loan proceeds were used solely for the purpose of constructing and selling qualified housing properties to low income residents subject to certain conditions. See Note H for loan terms.

NOTE F – INVESTMENTS IN LIMITED LIABILITY COMPANIES – Continued

The following is a summary of the activity for Habitat Affiliate 1 for the years ending June 30:

	<u>2017</u>	<u>2016</u>
Beginning balance	\$ 4,100,124	\$ 4,050,882
Investment activity	<u>(4,100,124)</u>	<u>49,242</u>
Ending balance	<u>\$ -</u>	<u>\$ 4,100,124</u>

The following is the condensed financial information of Habitat Affiliate 1 as of and for the years ending June 30:

	<u>2017</u>	<u>2016</u>
Cash	\$ -	\$ 5
Interest receivable	-	1,985,084
Note receivable	<u>-</u>	<u>17,518,157</u>
Total assets	<u>\$ -</u>	<u>\$ 19,503,246</u>
Equity	<u>\$ -</u>	<u>\$ 19,503,246</u>
Revenue and net income	<u>\$ 2,144,832</u>	<u>\$ 473,688</u>

HFHI-SA Leverage VIII, LLC (Habitat Affiliate 2)

In 2011, the Organization invested, along with three other Habitat affiliates, in Habitat Affiliate 2 with 43.223% ownership to take advantage of NMTC financing. As a result, the Organization invested \$4,298,956 and was able to secure a 15-year loan in the amount of \$5,277,163 payable to HFHI-SA NMTC V, LLC (CDE) (a subsidiary of Habitat Affiliate 2). The loan proceeds were used solely for the purpose of constructing and selling qualified housing properties to low income residents. See Note H for loan terms.

The following is a summary of the activity for Habitat Affiliate 2 for the years ending June 30:

	<u>2017</u>	<u>2016</u>
Beginning balance	\$ 4,511,972	\$ 4,469,304
Investment activity	<u>42,675</u>	<u>42,668</u>
Ending balance	<u>\$ 4,554,647</u>	<u>\$ 4,511,972</u>

NOTE F – INVESTMENTS IN LIMITED LIABILITY COMPANIES – Continued

The following is the condensed financial information of Habitat Affiliate 2 as of and for the years ending June 30:

	<u>2017</u>	<u>2016</u>
Interest receivable	\$ 1,135,940	\$ 957,130
Note receivable	<u>9,322,862</u>	<u>9,322,862</u>
Total assets	<u>\$ 10,458,802</u>	<u>\$ 10,279,992</u>
Equity	<u>\$ 10,458,802</u>	<u>\$ 10,279,992</u>
Revenue and net income	<u>\$ 271,144</u>	<u>\$ 271,144</u>

Habitat Harbor Leverage, LLC (Habitat Affiliate 3)

In 2013, the Organization invested, along with 2 other nonprofit organizations, in Habitat Affiliate 3 with 50.915% ownership, to take advantage of NMTC financing. NMTC financing allows an entity to receive a loan or investment capital from outside investors, who will receive new market tax credits to be applied against their federal tax liability.

The Organization invested \$4,469,199 with Habitat Affiliate 3 and was able to secure a 15-year loan in the amount of \$5,114,482 payable to Harbor Community Fund VI LLC (CDE) (a subsidiary of Habitat Affiliate 3). The loan proceeds were used solely for the purpose of constructing and selling qualified housing properties to low income residents subject to certain conditions. See Note H for loan terms.

The following is a summary of the activity for Habitat Affiliate 3 for the years ending June 30:

	<u>2017</u>	<u>2016</u>
Beginning balance	\$ 4,574,010	\$ 4,547,309
Investment activity	<u>26,701</u>	<u>26,701</u>
Ending balance	<u>\$ 4,600,711</u>	<u>\$ 4,574,010</u>

The following is the condensed financial information of Habitat Affiliate 3 as of and for the years ending June 30:

	<u>2017</u>	<u>2016</u>
Interest receivable	\$ 795,646	\$ 630,078
Note receivable	<u>7,347,785</u>	<u>7,347,785</u>
Total assets	<u>\$ 8,143,431</u>	<u>\$ 7,977,863</u>
Equity	<u>\$ 8,143,431</u>	<u>\$ 7,977,863</u>
Revenue and net income	<u>\$ 239,046</u>	<u>\$ 239,046</u>

NOTE F – INVESTMENTS IN LIMITED LIABILITY COMPANIES – Continued

Additionally, in 2015, as part of a merger, the Organization acquired an additional 18.740% ownership in Habitat Affiliate 3. This investment is carried at fair market value and is netted against the related note payable, related party for financial statement purposes (see Note H). This results in a net fair market value of \$-0- since the cash inflows from the interest received from the investment and cash outflows from the interest paid on the note are approximately the same amount.

NOTE G – DEFERRED RENT

The Organization's lease agreements for its main office and for its Dundalk, Columbia, Glen Burnie, and Timonium ReStore buildings have provisions for rent payments with fixed annual increases (see Note O). In accordance with generally accepted accounting principles, the total rent commitment is recognized on a straight-line basis over the term of the lease. Accordingly, the difference between the actual monthly payments and the rent expense being recognized for consolidated financial statement purposes is recorded as deferred rent.

Future amortization of deferred rent over the remaining life of the leases is as follows:

Years ending June 30, 2018	\$	(27,406)
2019		(27,678)
2020		(31,048)
2021		(8,226)
	\$	<u>(94,358)</u>

NOTE H – NOTES PAYABLE, RELATED PARTIES

During 2010, in connection with the investment in Habitat Affiliate 1 (see Note F), the Organization received a \$4,455,113 note from City First Capital 21, LLC (a related party). The note required interest only payments at 0.8126%. The note was secured by substantially all the assets acquired by the Organization from the project loan proceeds. The note's put option feature was exercised on December 6, 2016 and the debt was forgiven in full. Debt forgiveness - notes payable, related parties, net of \$430,964 is shown in the consolidated statements of activities consisting of the debt forgiveness of \$4,455,113 net of the \$4,024,149 loss on the investment in Habitat Affiliate 1 that occurred at the time of the exercising of the put option.

During 2011, in connection with the investment in Habitat Affiliate 2 (see Note F), the Organization received a \$5,277,163 note from HFHI-SA NMTC V, LLC (a related party). The note requires interest only payments at 0.756432%. The note is secured by substantially all the assets acquired by the Organization from the project loan proceeds. The note has a put option feature that is exercisable on or before March 11, 2018. Management expects that the option will be exercised and the debt will thereby be forgiven. In the event that the option is not exercised principal and interest payments will be made through February 24, 2026.

During 2013, in connection with the investment in Habitat Affiliate 3 (see Note F), the Organization received a \$5,114,482 note from Harbor Community Fund VI, LLC (a related party). The note requires interest only payments at 0.7316%. The note is secured by substantially all the assets acquired by the Organization from the project loan proceeds. The note has a put option feature that is exercisable on or before September 10, 2019. Management expects that the option will be exercised and the debt will thereby be forgiven. In the event that the option is not exercised principal and interest payments will be made through September 10, 2027.

NOTE H – NOTES PAYABLE, RELATED PARTIES – Continued

Additionally, during 2015, the Organization acquired an additional note payable in the amount of \$1,882,483 due to Harbor Community Fund VI. LLC, subject to the same terms as the note from Harbor Community Fund VI. LLC, disclosed above. This note is carried at fair market value and is netted against the related investment for financial statement purposes (see Note F).

Interest expense on the notes payable, related parties included in investment income from limited liability companies on the consolidated statements of activities was \$109,310 and \$127,310 for the years ended June 30, 2017 and 2016, respectively.

NOTE I – LINES OF CREDIT AND NOTES PAYABLE

Lines of credit and notes payable consisted of the following as of June 30:

	<u>2017</u>	<u>2016</u>
M & T Revolving Note	\$ 200,000	\$ 200,000
MECU Revolving Note	50,000	-
Severn Savings Bank	2,179,286	2,289,286
Neighborhood Housing Services of Baltimore, Inc.	343,056	359,722
Self-help Homeownership Opportunity Program	77,905	114,049
Rosedale Federal Savings and Loan Association	686,141	-
BOKF, NA dba Bank of Texas	257,019	326,446
PNC Community Development Company, LLC	1,407,525	1,510,286
City of Annapolis - 55 Clay	31,250	125,000
City of Annapolis - 123 Clay	82,000	82,000
MECU	-	25,773
HABC	-	307,513
CDFC, net	196,548	309,690
M & T Notes	414,554	466,187
MECU Auto	<u>-</u>	<u>6,483</u>
Total principal balance	\$ 5,925,284	\$ 6,122,435
Unamortized deferred financing fees	(38,670)	(42,133)
Current portion	<u>(831,825)</u>	<u>(1,116,472)</u>
Long-term portion	<u>\$ 5,054,789</u>	<u>\$ 4,963,830</u>

M & T Bank – Credit Line

The Organization has a \$50,000 credit line with M & T, bearing interest at the bank's prime rate plus 1.5%, (5.00% and 5.00% as of June 30, 2017 and 2016, respectively) and due on demand. The credit line is secured by all business assets of the Organization. There were no outstanding borrowings as of June 30, 2017 and 2016.

NOTE I – LINES OF CREDIT AND NOTES PAYABLE – Continued

M & T Bank – Revolving Note

The Organization has a \$200,000 revolving demand note with M & T, bearing interest at the bank's prime rate, (3.50% and 3.50% as of June 30, 2017 and 2016, respectively) and due on demand. The revolving demand note is secured by all deposits or other sums credited by or due from M & T to the Organization, as well as any cash, securities, instruments or other property.

Municipal Employees Credit Union – Revolving Note

The Organization obtained a \$50,000 credit line with MECU on September 2, 2016 which matures on September 2, 2017. Borrowings under this line of credit bear interest at 4.50% and due on demand. The credit line is secured by real property owned by JLR. Borrowings outstanding as of June 30, 2017 were \$50,000. Subsequent to year end, the balance on the line was paid in full.

Severn Savings Bank

The Organization has a \$2,500,000 line of credit with Severn Savings Bank (Severn), bearing interest at 4.25%. The amended line of credit requires the Organization to make monthly principal payments of \$10,000 and matures on August 1, 2017. This line of credit is secured by mortgages receivable in the amount of \$3,364,822 and \$3,588,111 as of June 30, 2017 and 2016, respectively. This line of credit contains covenants with which the Organization must comply.

Neighborhood Housing Services of Baltimore

Note payable to Neighborhood Housing Services of Baltimore, Inc. (NHS), with 0% interest, with monthly principal payments of \$1,389 maturing January 31, 2038. This note is secured by 5 real estate properties.

Self-help Homeownership Opportunity Program

The Self-help Homeownership Opportunity Program (SHOP) notes payable to HFHI are noninterest-bearing and unsecured notes used for building homes. These notes represent a 25% portion of the SHOP grants received as of June 30, 2017 and 2016, respectively, payable through 2021.

BOKF, NA dba Bank of Texas

During 2013, the Organization obtained a note payable for \$150,000 from BOKF, NA dba Bank of Texas, with 4.03% interest. The note requires interest only payments for the first year followed by monthly payments of principal and interest in the amount of \$2,768, maturing November 30, 2018. This note contains covenants with which the Organization must comply.

During 2016, the Organization obtained two notes of \$125,000 each from BOKF, NA dba Bank of Texas, with 4.71% interest. The notes require monthly payments of principal and interest in the amount of \$2,346 each, maturing July 15, 2021. These notes contain covenants with which the Organization must comply.

PNC Community Development Company, LLC

During 2013, the Organization obtained a note payable for \$1,847,867 from PNC Community Development Company, LLC. Proceeds from the loan were \$1,401,012. The note includes \$416,855 of prepaid interest and \$30,000 of loan fees. The note is secured by approximately \$1,410,000 and \$1,510,000 of mortgages receivable as of June 30, 2017 and 2016, respectively, and requires monthly payments ranging from \$89 to \$8,800, based on a payment schedule that is based on the anticipated amounts to be received from those mortgages receivable. The note matures July 15, 2038.

NOTE I – LINES OF CREDIT AND NOTES PAYABLE – Continued

City of Annapolis – 55 Clay

During 2013, the Organization obtained a note payable for \$125,000 from the city of Annapolis, with 0% interest. During 2016, the note was extended to be repaid in full at the earlier of the sale of the home at 55 Clay Street or June 30, 2016. During 2017, the note was amended to require four equal installment payments of \$31,250 to be made from March 2017 through September 2017 with a maturity date of October 31, 2017. Subsequent to year end, the balance on the note was paid in full.

City of Annapolis – 123 Clay

During 2014, the Organization obtained a note payable for \$82,000 from the city of Annapolis, with 0% interest. During 2016, the note was extended to be repaid in full at the earlier of the sale of the home at 123 Clay Street or on December 31, 2016. During 2017, the note was extended to be repaid in full at the earlier of the sale of the home at 123 Clay Street or on December 31, 2017. Subsequent to year end, the balance on the note was paid in full.

MECU

During 2014, the Organization obtained a note payable for \$685,000 from the Municipal Employees Credit Union of Baltimore (MECU), with interest at 4.5%. The note was a construction loan that required interest only payments until the maturity date of April 1, 2017. This loan was paid in full as of June 30, 2017.

HABC

During 2015, the Organization obtained a bridge promissory note from the Housing Authority of Baltimore City (HABC) for \$307,513. The note is interest free and is due the earlier of July 15, 2015 or upon HABC receiving written approval from the United States Department of Housing and Urban Development that they intend to release the final five percent of the grant funds to HABC. During 2017, HABC agreed that in lieu of the Organization repaying the bridge promissory note, the Organization assigned to HABC all of its rights to receive the remaining \$307,513 in grant funds in consideration for the cancellation of the bridge promissory note.

CDFC, net

During 2015, as part of a merger the Organization acquired notes payable to Baltimore Community Development Financing Corporation (CDFC). The notes are secured by mortgages receivable, and are non-interest bearing with various maturity dates through 2021. The Organization imputed interest on these notes using a 4.25% interest rate at the date of the merger in order to approximate fair market value of the liability. The notes are carried net of a discount of \$14,451 and \$41,044 as of June 30, 2017 and 2016, respectively.

M & T Notes

During 2015, as part of a merger the Organization acquired notes payable to M&T Bank. The notes are secured by mortgages receivable, and bear interest at rates from 5.7% to 5.8% with various maturity dates through 2033.

MECU Auto

During 2015, as part of the merger the Organization acquired a note payable to MECU. The note was secured by a truck, bore interest at 3.74%, and was scheduled to mature in 2018. This loan was paid in full as of June 30, 2017.

NOTE I – LINES OF CREDIT AND NOTES PAYABLE – Continued

Rosedale Federal Savings and Loan Association

During 2017, the Organization obtained a \$1,150,000 construction loan for 9 townhouses in Baltimore City. The loan bears interest at prime plus .50% (4.75% as of June 30, 2017), but not less than 4.00%, and is secured by the properties being constructed. The loan requires interest only monthly payments until the maturity date of October 31, 2019, at which time all unpaid principal and interest is due.

The future minimum principal payments for the next five years and thereafter, based on maturity dates, including extensions obtained subsequent to year end, are as follows:

Years ending June 30, 2018	\$ 831,825
2019	441,341
2020	1,061,535
2021	347,557
2018	338,524
Thereafter	<u>2,904,502</u>
	<u>\$ 5,925,284</u>

Interest expense on the lines of credit and notes payable was \$68,405 and \$96,730 for the years ended June 30, 2017 and 2016, respectively. In addition, the Organization paid interest of \$65,391 and \$242,878 for the years ending June 30, 2017 and 2016, respectively, which has been capitalized as part of inventory of homes on the consolidated statements of financial position.

Subsequent to year end, the Organization obtained a \$1,000,000 revolving line of credit with Rosedale Federal Savings and Loan Association. The line bears interest at prime plus 1% and matures December 1, 2019.

NOTE J – PROGRAM DEBT

The Organization entered into a development agreement with Healthy Neighborhoods, Inc. (HNI). Under the development agreement, the Organization is required to expend no less than \$5,000,000 to acquire and rehabilitate 50 residential properties. This expenditure requirement has been fulfilled by the Organization. Loan proceeds are drawn by the Organization for purposes of acquiring and rehabilitating homes. Upon settlement of such homes, the Organization has the option of remitting the proceeds from the sale of the home as a prepayment to HNI. Under this option, the remaining liability relating to this home will be forgiven. This forgiving of the remaining liability is recognized in the consolidated statements of activities as debt forgiveness revenue. Any outstanding liabilities will become due two years after the date of the acquisition of the property. Interest will accrue on the loan at prime plus 3%. Interest does not accrue until after the payment of the final portion of the developer's fee associated with the property. As of June 30, 2017, all the properties under the agreement with HNI had been sold.

NOTE K – REAL ESTATE SALES

During the years ended June 30, 2017 and 2016, the Organization sold 5 and 16 homes, respectively. Income and related costs on the sale of each home are not recognized until the home goes to settlement and the deed is transferred to the purchaser.

NOTE L – DONATED MATERIALS AND SERVICES

Many individuals volunteer their time and perform a variety of tasks that assist the Organization with its program, fundraising and administrative activities. Due to the criteria regarding the recognition of donated goods and services, many of the Organization's donated services are not reflected in the accompanying consolidated financial statements.

The following amounts are included as donated property and donated goods or services in the accompanying consolidated statements of financial position and consolidated activities as of and for the year ended June 30:

	<u>2017</u>	<u>2016</u>
Donated property – capitalized in homes inventory	\$ 55,000	\$ 44,500
Materials and equipment – capitalized in homes inventory	20,150	40,164
Individual support meeting requirements for recognition	<u>63,816</u>	<u>196,313</u>
	<u>\$ 138,966</u>	<u>\$ 280,977</u>

NOTE M – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets were available for the following purposes and time restrictions as of June 30:

	<u>2017</u>	<u>2016</u>
Purpose restrictions		
Workforce development	\$ 90,562	\$ 201,147
Youth passenger bus	15,989	20,855
Team builds	15,000	-
House construction and rehabilitation		
Home sponsorships	-	170,918
Repair and renew	88,853	-
Chesapeake Matched Savings Account	<u>505</u>	<u>505</u>
Total purpose restrictions	210,909	393,425
Time restrictions		
Long-term contributions receivable, net	<u>326,184</u>	<u>623,187</u>
	<u>\$ 537,093</u>	<u>\$ 1,016,612</u>

NOTE N – LOSS ON SALE OF HOMES

During the year ended June 30, 2017, three homes were sold that were originally held as inventory to be sold within the House construction program. The proceeds were \$27,277 and the carrying value of the homes totaled \$28,797 resulting in a loss of \$1,520. During the year ended June 30, 2016, nine such homes were sold. The proceeds were \$54,960 and the carrying value of the homes totaled \$49,436 resulting in a gain of \$5,524.

NOTE O – LEASES

The Organization leases a building for its Dundalk ReStore location under a non-cancelable operating lease agreement. In 2015, the lease agreement was amended so that the lease term will end in February 2018. The lease provides for basic annual rent of \$115,308 for the first year with annual increases of 3% of the previous year's base rental.

Subsequent to year end, in August 2017 the lease agreement for the Dundalk Restore was amended to reflect base rent being abated from September 1, 2017 through January 31, 2018. For the month of February 2018 rent is \$10,194. From March 1, 2018 through February 28, 2019 the annual rent is \$116,250 with annual increases of 3%. The lease term will end June 30, 2023.

The Organization leases its office and warehouse space under a non-cancelable operating lease agreement. During 2015, the lease agreement was renewed for a five-year period from January 1, 2015 to December 31, 2019. The lease provides for annual rent of \$177,650 for the first year with annual increases.

In February 2013, the Organization leased a building for its Columbia ReStore location under a non-cancellable operating lease agreement. The lease agreement is for 66 months and through 2018. The lease provides for basic annual rent of \$82,886 with annual increases of 2% of the previous year's base rental.

In 2015, the Organization leased a building for its Glen Burnie ReStore location under a non-cancellable operating lease agreement. The lease agreement is for 63 months through July 2020. The lease provides for basic annual rent of \$128,700 with annual increases.

In 2016, the Organization leased a building for its Timonium ReStore location under a non-cancellable operating lease agreement. The lease is for 63 months through November 2020. The lease provides for basic annual rent of \$138,060 with annual increases.

Rent expense for the years ended June 30, 2017 and 2016 was \$849,815 and \$746,963, respectively.

The minimum annual lease payments under these leases as of June 30, 2017 are as follows:

Years ending June 30,	2018	\$	641,656
	2019		490,119
	2020		392,565
	2021		88,095
			<u>88,095</u>
		\$	<u>1,612,435</u>

NOTE P – EMPLOYEE BENEFITS

The Organization maintains a tax deferred annuity plan for its employees under IRC Section 403(b). Under the terms of the plan, the Organization will match 40% of the employee's deferral up to a maximum 8% of employee compensation. The Organization's contributions totaled \$26,318 and \$24,628 for the years ended June 30, 2017 and 2016, respectively.

NOTE Q – SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid for interest during the years ended June 30, 2017 and 2016 was \$99,526 and \$302,723, respectively.

During the years ended June 30, 2017 and 2016, HNI paid \$13,894 and \$58,197, respectively, of settlement costs, directly to banks on behalf of the Organization. These payments were recorded as increases in debt and decreases in debt forgiveness income on the consolidated statements of financial position and the consolidated statements of activities, respectively.

During the years ended June 30, 2017 and 2016, the Organization foreclosed or received the home back with a deed in lieu on homes for which the mortgagees were not making payments. These amounts were transferred from mortgages receivable to inventory of homes in the amounts of \$256,569 and \$230,449, respectively.

During the years ended June 30, 2017 and 2016, the Organization capitalized \$72,609 and \$331,876 of interest from leveraging of mortgages receivable. The differences between the gross value of the mortgage receivable and the cash received were recorded as decreases in mortgages receivable and increases of capitalized interest from leveraging of mortgages receivable in the consolidated statements of financial position.

During the year ended June 30, 2017, a \$4,445,113 note payable, related party was forgiven. This amount was recorded as a decrease in notes payable, related party and as debt forgiveness - notes payable, related parties, net on the consolidated statements of financial position and the consolidated statements of activities, respectively.

During the year ended June 30, 2016, the Organization directly remitted proceeds in the amount of \$504,216 from the sale of property to pay off a mortgage on the property in connection with the Pasadena ReStore.

NOTE R – TRANSACTIONS WITH HABITAT INTERNATIONAL

The Organization annually makes an election to remit to HFHI a tithe based on undesignated contributions. These funds are used to construct homes in economically depressed areas around the world. The Organization contributed \$15,000 and \$15,500 to HFHI for the years ended June 30, 2017 and 2016, respectively. Such amounts are included in program services expense in the consolidated statements of activities.