San Diego Habitat for Humanity, Inc.

Consolidated Financial Statements and Independent Auditor's Report

June 30, 2014

San Diego Habitat for Humanity, Inc.

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Independent Auditor's Report

To the Board of Directors
San Diego Habitat for Humanity, Inc.

We have audited the accompanying consolidated financial statements of San Diego Habitat for Humanity, Inc. ("SDHFH"), which comprise the consolidated statement of financial position as of June 30, 2014, and the related consolidated statements of activities and changes in net assets, functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of San Diego Habitat for Humanity, Inc. as of June 30, 2014, 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.

CohnReznick LLP

San Diego, California
November 10, 2014

San Diego Habitat for Humanity, Inc.

Consolidated Statement of Financial Position
June 30, 2014

Assets		
Cash and cash equivalents	$	1,339,402
Restricted cash		88,805
Accounts receivable, net of allowance for doubtful accounts of $54,631		100,489
Mortgage notes receivable, net of unamortized discount		5,675,761
Inventory - ReStore and other		255,857
Prepaid expenses and deferred charges		33,510
Construction-in-process		3,603,080
Finished homes held for sale		935,821
Property and equipment, net of accumulated depreciation		2,305,165
Beneficial interest in assets held by community foundation		358,285
Deposits and other assets		69,830
Total assets	$	14,766,005
Liabilities and Net Assets		
Accounts payable, accrued expenses, and other liabilities	$	686,317
Homeowner impounds		90,664
Deferred revenue		400,850
Notes payable - governmental agencies, net		606,903
Forgivable notes payable - governmental agencies		1,208,781
Refundable advances		824,917
Notes payable - J.P. Morgan Chase Bank		1,863,331
Notes payable - HFHI		918,276
Total liabilities		6,600,039
Commitments and contingencies		
Net assets:		
Unrestricted		7,358,692
Temporarily restricted		504,215
Permanently restricted		303,059
Total net assets		8,165,966
Total liabilities and net assets	$	14,766,005

See Notes to Consolidated Financial Statements.

San Diego Habitat for Humanity, Inc.

Consolidated Statement of Activities and Changes in Net Assets
Year Ended June 30, 2014

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Support and revenue:				
Support:				
Contributions	$ 370,958	$ 363,468	$ -	$ 734,426
In-kind contributions	-	594,320	-	594,320
Retail store, net	1,090,008	-	-	1,090,008
Special events	86,908	-	-	86,908
Grants	44,402	-	-	44,402
Net assets released from restrictions:				
Satisfaction of program/donor restrictions	1,885,801	(1,862,604)	(23,197)	-
Total support	3,478,077	(904,816)	(23,197)	2,550,064
Revenue:				
Sales of homes	2,144,001	-	-	2,144,001
Mortgage loan discount amortization	431,995	-	-	431,995
Investment income	5,658	46,636	-	52,294
Other income	37,290	-	-	37,290
Total revenue	2,618,944	46,636	-	2,665,580
Total support and revenue	6,097,021	(858,180)	(23,197)	5,215,644
Expenses:				
Cost of homes sold and program support	4,193,801	-	-	4,193,801
Management and general	445,018	-	-	445,018
Fundraising	450,176	-	-	450,176
Total expenses	5,088,995	-	-	5,088,995
Change in net assets	1,008,026	(858,180)	(23,197)	126,649
Net assets at beginning of year	6,350,666	1,362,395	326,256	8,039,317
Net assets at end of year	$ 7,358,692	$ 504,215	$ 303,059	$ 8,165,966

See Notes to Consolidated Financial Statements.

San Diego Habitat for Humanity, Inc.

Consolidated Statement of Functional Expenses
Year Ended June 30, 2014

	Cost of Homes Sold and Program Support	Management and General	Fundraising	Total
Cost of homes sold - construction costs	$ 1,563,546	$ -	$ -	$ 1,563,546
Cost of homes sold - mortgage discount subsidy	553,935	-	-	553,935
Salaries	675,279	245,050	253,101	1,173,430
Payroll taxes	58,405	19,267	20,041	97,713
Employee benefits	70,758	35,314	17,796	123,868
Advertising and public relations	16,893	-	11,943	28,836
Bank charges and fees	15,102	229	4,843	20,174
Conferences, conventions and meetings	1,026	1,949	565	3,540
Depreciation	53,051	6,875	8,027	67,953
Homeowner and homeowner association support	5,958	-	-	5,958
Insurance	58,328	18,468	2,916	79,712
Interest and amortization of loan fees	190,418	19,691	7,161	217,270
Investment property expenses	-	2,078	-	2,078
Meals and entertainment	2,244	1,679	303	4,226
Non-capitalized construction materials and services	495,177	-	-	495,177
Occupancy and utilities	62,780	6,171	4,044	72,995
Office and other expenses	69,532	17,241	36,646	123,419
Outside services, consulting and volunteer expenses	16,811	4,448	542	21,801
Postage and shipping	869	1,624	2,101	4,594
Professional services	17,719	59,546	16,188	93,453
Real estate development costs	16,791	-	-	16,791
Taxes and licenses	3,331	661	-	3,992
Telephone	19,079	2,077	1,543	22,699
Tithes to HFHI	35,000	-	-	35,000
HFHI affiliate fee	8,300	-	-	8,300
Special event costs	114,326	-	58,596	172,922
Transportation and travel	69,143	2,650	3,820	75,613
Totals	$ 4,193,801	$ 445,018	$ 450,176	$ 5,088,995

See Notes to Consolidated Financial Statements.

San Diego Habitat for Humanity, Inc.

Consolidated Statement of Cash Flows
Year Ended June 30, 2014

Operating activities:	
Change in net assets	$ 126,649
Adjustments to reconcile change in net assets to net cash used in operating activities:	
Origination of non-interest bearing mortgages	(868,936)
Discount on origination of non-interest bearing mortgages	553,935
Mortgages retired for reacquisition of homes	234,769
In-kind contributions of construction costs	(448,054)
Change in value - beneficial interest in assets held by community foundation	(32,029)
Gain on disposal of fixed assets	(5,237)
Depreciation	67,953
Mortgage discount amortization	(431,995)
Amortization of loan fees	11,373
Amortization of discount on notes payable	38,015
Changes in operating assets and liabilities:	
Accounts receivable	437,138
Unconditional promises to give	5,000
Inventory	(116,621)
Prepaid expenses and deferred charges	111,279
Finished homes held for sale	(563,887)
Construction-in-process, net in-kind	(1,613,921)
Deposits and other assets	6,216
Accounts payable, accrued expenses and other liabilities	137,235
Mortgage payments received	679,744
Homeowner impounds	19,047
Deferred revenue	172,500
Refundable advances	102,563
Net cash used in operating activities	(1,377,264)
Investing activities:	
Proceeds from sale of property and equipment	6,300
Purchases of property and equipment	(93,571)
Net cash used in investing activities	(87,271)
Financing activities:	
Proceeds from issuance of notes payable	891,014
Principal payments on notes payable	(284,371)
Restricted cash	(88,805)
Net cash provided by financing activities	517,838
Net decrease in cash and cash equivalents	(946,697)
Cash and cash equivalents, beginning of year	2,286,099
Cash and cash equivalents, end of year	$ 1,339,402
Supplemental disclosure of cash flow information:	
Interest paid	$ 161,838

See Notes to Consolidated Financial Statements.

Note 1 - Organization and summary of significant accounting policies

Nature of activities

San Diego Habitat for Humanity, Inc. (a nonprofit corporation) is the local affiliate of Habitat for Humanity International, Inc. ("HFHI"), a nonprofit, ecumenical Christian housing ministry. By building homes in partnership with families in need, San Diego Habitat for Humanity, Inc. seeks to eliminate poverty housing and substandard living conditions in San Diego County, and to make decent shelter a matter of conscience and action. San Diego Habitat for Humanity, Inc. invites people of all backgrounds, faiths, or no faith, races and religions to build houses together in partnership with families in need. Although HFHI assists with information resources, training, publications and prayer support, San Diego Habitat for Humanity, Inc. is an independently governed entity.

An equal housing lender and provider, San Diego Habitat for Humanity, Inc. addresses the issues of substandard housing through home ownership. The purpose is to offer families a "hand up" instead of a "hand out," fostering self-sufficiency and independence. To be considered for home ownership, San Diego Habitat for Humanity, Inc. families must demonstrate a need for better housing, an ability to make mortgage payments, and a willingness to work in partnership with San Diego Habitat for Humanity, Inc. This partnership consists, in part, of each family completing 250-500 hours of "sweat equity" and making monthly mortgage payments. San Diego Habitat for Humanity, Inc. acquires the land, finds and qualifies the families, raises the funding, finds and supervises construction volunteers, builds the houses, and provides the mortgages.

Method of reporting

San Diego Habitat for Humanity, Inc.’s financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Principles of consolidation

The accompanying consolidated financial statements include the accounts of San Diego Habitat For Humanity and San Diego HFH Community Housing Corporation (collectively, "SDHFH" or the "Organization"). San Diego HFH Community Housing Corporation is a certified Community Housing Development Organization ("CHDO"). All material intra-organization transactions have been eliminated in consolidation.

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 as of the date of the consolidated financial statements, and revenues and expenses recognized during the reporting period. Actual results could differ from these estimates.

Net assets
SDHFH's net assets, revenues, gains, expenses and losses are classified as unrestricted, temporarily restricted and permanently restricted based on the existence or absence of donor-imposed restrictions. These classifications are defined as follows:

Unrestricted net assets - Net assets that do not contain donor restrictions or the donor-imposed restrictions have expired due to the Organization's fulfillment of the restrictions and/or the passage of time.

Temporarily restricted net assets - Net assets that contain donor-imposed restrictions that permit the Organization to use or expend the donated net assets as specified and are satisfied either by the passage of time and/or by the actions of SDHFH.

Permanently restricted net assets - Net assets that contain donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the Organization.

Cash and cash equivalents
SDHFH considers all highly liquid investments with an original maturity of three months or less, when purchased, to be cash equivalents.

Restricted cash
Restricted cash represents CHDO proceeds to be used to acquire, rehabilitate or develop additional real properties located in the respective city for resale to low-income households.

Accounts receivable
Accounts receivable generally consist of amounts due from homeowners for property taxes and insurance premiums, pursuant to the homeowners' impound agreements. The Organization has evaluated these accounts and has recorded an allowance for doubtful accounts based on the estimated eventual collection of these impound account deficits. There was no bad debt expense recorded for the fiscal year ended June 30, 2014.

It is the Organization's policy to charge off uncollectible accounts receivable when management determines the receivable will not be collected. However, the Organization can elect to enter into a revised mortgage agreement and payment schedule with a homeowner that will cure a default and avoid a charge off of amounts due without losing any of its rights under the original agreement.

Mortgage notes receivable
Mortgage notes receivable consist of non-interest bearing residential home loans made to qualified borrowers that are secured by a deed of trust, payable in monthly installments over the term of the note, generally ranging from 10 to 35 years. These non-interest bearing mortgages have been discounted based upon prevailing market rates for low income housing at the inception of each mortgage as calculated by HFHI. SDHFH's portfolio of mortgage notes receivable includes first trust deeds for direct loans made by SDHFH and second trust deeds funded by Cal Home Program First-Time Homebuyer loans. The Cal Home Program loans are no interest loans with a balloon payment due in 30 years.

Additionally, homes may be encumbered with a second, third and/or fourth trust deed in favor of either SDHFH or a local government agency to ensure compliance with the terms of the Organization's homeownership programs. These mortgage notes receivable are referred to as "silent." The primary purpose of these silent mortgages is to allow SDHFH or the agency to capture a portion of any equity appreciation over and above a specified amount if the home is sold or transferred to a nonqualified homeowner before a certain number of years have elapsed since the original sale to the qualified homeowner, usually 25 to 55; and to protect the homeowner by preventing predatory lenders from paying off the first mortgage and saddling the homeowner with an onerous new mortgage. These silent mortgage notes receivable typically bear no interest and are forgiven if the homeowner lives in the home for the required period of time and complies with all other covenants and restrictions per the deed of trust. Accordingly, since these silent mortgage notes receivable have no value unless or until a homeowner fails to comply with the covenants and restrictions of the terms of the home sale, SDHFH does not record a value for these silent mortgage notes receivable.

Allowance for mortgage notes receivable losses
SDHFH uses established underwriting criteria to ensure that only families who meet the Organization's financial and credit criteria are approved to be partner families and receive a non-interest bearing mortgage loan from SDHFH. This includes, but is not limited to, a thorough review of each prospective homeowner's credit report, sources of income and financial history.

SDHFH regularly reviews its portfolio of mortgage notes receivable and monitors the accounts for delinquencies. Homeowners whose mortgages are more than 30 days past due are considered to be in an early stage of default. During the period of delinquency of 16 to 60 days past due, the Organization contacts the homeowner using collection efforts and establishes a payment plan with the homeowner, if necessary. Thereafter, if forgoing collection efforts are not successful, the Organization attempts to enter into a mutually agreed-upon deed-in-lieu of foreclosure with the homeowner. Homeowners whose mortgages are more than 60 days past due, who have not made satisfactory payment arrangements or reached a deed-in-lieu of foreclosure agreement with SDHFH are subject to foreclosure proceedings. As of the date of these financial statements, there are no mortgages subject to foreclosure proceedings.

Non-interest bearing mortgages originated are discounted based on prevailing market rates at the time of sale, which results in the net mortgage receivable balances being generally less than 50% of the home's fair market value. Therefore, SDHFH believes that losses resulting from non-payment of mortgage notes receivable, given its collateral value, are not likely. Accordingly, SDHFH has not recorded an allowance for mortgage notes receivable losses.

Contributions
Unconditional promises to give are recognized as support when the underlying promises are received by SDHFH and are recorded at fair value, based on management's initial estimate of the present value of future cash flows expected to be received. Subsequent changes in estimates are recorded as an allowance for uncollectible promises to give.

Gifts of cash and other assets are reported as temporarily restricted support if they are received with donor stipulations that specify the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statement of activities and changes in net assets as net assets released from restrictions. Conditional promises to give are not recognized until they become unconditional, that is, when the conditions on which they depend are substantially met.

At June 30, 2014, SDHFH had no unconditional promises to give from donors.

Donated services
Donated services are recognized as contributions in accordance with ASC 958-605 and subsections, *Not-for-profit Entities - Revenue Recognition,* if the services (a) create or enhance nonfinancial assets or (b) require licensed skills, are performed by people with those skills, and would otherwise be purchased by SDHFH. A substantial number of volunteers have contributed their time during the year ended June 30, 2014 to SDHFH's construction program and supporting services. The value of this contributed time is not reflected in the consolidated financial statements since it does not require a licensed skill.

Donated construction materials, property and equipment and other donated goods
Donations of construction materials, property and equipment, and other goods are recorded as in-kind contributions at their estimated fair value at the date of donation.

Various companies and individuals have provided licensed labor and materials for current projects. During the year ended June 30, 2014, the Organization recognized $349,623 of in-kind materials and licensed labor as contribution revenue. The estimated value of these materials and services was capitalized into construction-in-process and allocated accordingly to the projects receiving benefit. The Organization also recognized $145,000 of donated land from a public source during the fiscal year ended June 30, 2014.

In addition to the construction-related in-kind contributions, SDHFH recognized $99,697 for donated goods and services supporting various programs and fundraising activities during the fiscal year ended June 30, 2014. Accordingly, the Organization recognized total in-kind contributions of $594,320 during the fiscal year ended June 30, 2014.

Government funding
SDHFH receives funds from various government agencies ("Agencies") for land acquisition, development and construction costs pursuant to various types of agreements. The following are details on the various types of funding agreements:

Grants: SDHFH receives grants from various sources to assist in purchasing and developing properties. These grants include various compliance requirements to be followed by SDHFH. These funds are recognized as grants in the consolidated statement of activities and changes in net assets.

Forgivable loans: SDHFH enters into various funding agreements that result in receiving funds to acquire and develop qualified properties, where funding received is considered a forgivable loan. The loans are typically forgiven after homes have been sold to qualified borrowers. Certain forgivable loans are transferred to the qualified home buyer at the time of purchase and the loans with the borrowers require the homeowner to continue to comply with certain provisions for specified periods of time. SDHFH records these forgivable loans as notes payable until they are forgiven.

Refundable advances: SDHFH enters into certain agreements that result in the receipt of funds that require SDHFH to continue to utilize these funds for specified low income housing purposes until a certain number of units have been sold. These advances are often sourced from Federal funds and require ongoing compliance with certain specified Federal requirements. Once related compliance requirements are satisfied, SDHFH will recognize these as unrestricted grants. SDHFH records these funds as refundable advances until the compliance requirements are satisfied.

Concentrations of credit risk
Financial instruments that potentially subject the Organization to concentrations of credit risk consist principally of cash, cash equivalents, and investments. The Organization places its cash, cash equivalents and investments with high credit quality financial institutions. At times, such amounts may exceed Federally insured limits. At June 30, 2014, the Organization had $1,086,000 in excess of Federally insured limits.

Inventories
Inventories consist primarily of donated building materials, which are used in the construction of homes, or are sold in the ReStore. Purchased inventory is valued at cost. Donated inventory is valued at its estimated fair value based on its expected selling price.

Pre-acquisition costs
The Organization capitalizes costs, generally including costs of surveying, zoning studies, design, engineering and legal, related to a property that are incurred for the express purpose of, but prior to, obtaining the property. These costs are reported as prepaid expenses and deferred charges.

Construction-in-process and finished homes held for sale
Construction-in-process represents costs incurred to build or rehabilitate single-family homes and condominiums for eventual sale to SDHFH partner families. The Organization’s projects consist of new single-family home and condominium developments and major rehabilitations of existing homes acquired by SDHFH. Since the purpose and mission of SDHFH is to build affordable housing for low-income families, the Organization does not generally write down the value of construction-in-process to estimated sales value, because any excess cost over sales value is a component of program services. Projects are classified as construction-in-process until the build/rehabilitation project is substantially completed, at which time they are reclassified as "finished homes held for sale."

Finished homes held for sale may include homes purchased from SDHFH partner families, acquired as part of a "Deed in Lieu of Foreclosure" or as part of a foreclosure. These homes usually require repairs or rehabilitation and then are resold to a qualifying family.

Revenue and costs on homes sold
Revenue is recognized on the sale of homes when title passes to eligible purchasers. The amount of home sale revenue SDHFH records is the total of the cash down payment, the face value of the non-interest bearing mortgage receivable, and the value of any government funding, such as notes payable forgiven and/or transferred to the homeowner at the time of sale (see *Government funding* above).

Cost of homes sold and program support consists of capitalized home construction costs and certain other related costs associated with the sale of a home. A mortgage discount subsidy, which is the discount on the non-interest mortgage with the borrower, is recognized as a cost of sale at the closing of the same. Cost of homes sold and program support is considered a program expense in the consolidated statement of functional expenses.

Deferred revenue

Deferred revenue consists primarily of amounts advanced to SDHFH pursuant to a down payment assistance grant (the "Grant") from the State of California Department of Housing and Community Development ("Cal Home"). The Grant allows SDHFH to receive a maximum of $1,500,000 in funds to provide down payment assistance to eligible low and moderate income homeowners. Actual assistance to each homeowner is limited based on a calculated gap between the price of the home and the financial resources available to the homeowner, but cannot exceed $60,000 per eligible family. During the year ended June 30, 2014, the Organization received the final 25% of the Grant amount, or $375,000. During the year ended June 30, 2014, the Organization recognized Grant revenue of $240,000 as sales of homes revenue. At June 30, 2014, SDHFH reported deferred revenue of $400,850, including $363,350 from Cal Home funds, representing Grant draws in excess of down payment assistance and expenses incurred.

Property, equipment and depreciation

Property and equipment are recorded at acquisition cost, including costs necessary to ready the asset for its intended use, or at fair market value, if donated. Expenses that materially increase property lives are capitalized. The cost of maintenance and repairs are charged to expenses as incurred. Depreciation expense is provided on a straight-line basis over the estimated useful lives of the respective assets, currently ranging from 3 to 7 years for equipment and vehicles and from 5 to 39 years for buildings and building improvements. When depreciable property is retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is reflected in the consolidated statement of activities and changes in net assets.

Homeowner impounds

As part of the mortgage servicing process, SDHFH collects monthly payments for property taxes and insurance from homeowners, along with their monthly mortgage payments. SDHFH then remits the property taxes and insurance, when due, directly to the County Tax Collector and insurance providers, using the impounded funds. The homeowner impounds balance at June 30, 2014 represents amounts collected by SDHFH for property taxes and insurance that have not yet been paid to the County Tax Collector and insurance providers.

Retirement plan

During the fiscal year ended June 30, 2013, SDHFH adopted a 403(b) plan. SDHFH does not contribute to the plan. All employees are eligible to participate in the plan commencing upon their date of hire.

Income taxes

SDHFH, a California nonprofit public benefit corporation, is exempt from Federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code of 1954, as amended, and the Revenue and Taxation Code of the State of California.

For the year ended June 30, 2014, management of SDHFH believes it has adequate support for all material tax positions and that it is more likely than not, based on the technical merits, that the positions will be sustained upon examination. SDHFH has analyzed the tax positions taken in its filings with the Internal Revenue Service and the California Franchise Tax Board. SDHFH believes that its income tax filing positions will be sustained upon examination and does not anticipate any adjustments that would result in a material adverse effect on the SDHFH's financial condition, results of operations or cash flows. Accordingly, SDHFH has not recorded any reserves, or related accruals for interest and penalties for uncertain income tax positions at June 30, 2014.

The Organization's Federal and state income tax returns prior to fiscal years 2011 and 2010, respectively, are closed. Management continually evaluates expiring statutes of limitations, audits, proposed settlements, changes in tax law and new authoritative rulings.

Functional expenses

Expenses related to more than one functional expense category are allocated based on reasonable estimates by the Organization. Salaries, benefits and other related expenses are allocated based on job function. Directly identifiable expenses are charged to construction and program support, management and general, or fundraising as applicable.

Subsequent events

Subsequent events have been evaluated through November 10, 2014, which is the date the consolidated financial statements were available to be issued.

Note 2 - Mortgage notes receivable

Mortgage notes receivable consist of non-interest bearing residential home loans made to qualified borrowers that are secured by a deed of trust and payable in monthly installments over the term of the note, generally ranging from 10 to 35 years. These non-interest bearing mortgages have been discounted based upon prevailing market rates for low income housing at the inception of each mortgage as calculated by HFHI. The discount on each mortgage is amortized using the effective interest rate method. During the year ended June 30, 2014, mortgages originated were discounted at an interest rate of 7.58% per annum. Accordingly, mortgage loan discount amortization for the year ended June 30, 2014 of $431,995 was included as revenue in the consolidated statement of activities and changes in net assets.

Mortgage notes receivable and the related discount at June 30, 2014 are summarized as follows:

Mortgage notes receivable	$	12,019,577
Less: Unamortized discount		(6,343,816)
Net present value of mortgage notes receivable	$	5,675,761

SDHFH is party to an arrangement with Northern Trust Bank (the "Bank") in which it previously sold, with recourse, six non-interest bearing mortgage notes receivable. These mortgage notes receivable have a carrying value of $109,763 at June 30, 2014. In accordance with ASC 860, *Transfers and Servicing,* the Organization treats the sale of mortgage notes receivable in which the Organization retains an interest as a secured obligation. Accordingly, the amount of receivables subject to recourse was recorded in mortgages receivable with a corresponding amount recorded in accounts payable, accrued expenses and other liabilities in the consolidated statement of financial position. See Note 7.

The Organization services these mortgages by collecting the monthly payments, and remitting the principal portion of these payments to the Bank. If a mortgage were to default, SDHFH may be required to re-purchase the mortgage at its discounted value and would in turn re-acquire all of the rights and obligations as the note holder.

SDHFH has pledged various mortgage notes receivable as collateral to secure notes payable and obligations to its creditors. These arrangements may restrict SDHFH's ability to sell, transfer or re-pledge these mortgages.

Scheduled mortgage notes receivable collections are summarized as follows:

Year Ending June 30,		Amounts
2015	$	673,682
2016		660,698
2017		648,568
2018		625,775
2019		605,500
Thereafter		8,805,354
Total	$	12,019,577

Note 3 - Construction-in-process

Construction-in-process and real estate development costs are summarized by project as follows:

El Cajon - Foundation Lane II	$	373,252
Escondido - Citracado Parkway		58,008
Escondido - Elm Street		1,150,895
Imperial Beach -10th & Donax		665,195
Lakeside - Lakeshore Drive		1,136,925
National City - 3rd Street		218,805
Total	$	3,603,080

The following is a summary of home building activity:

	Number of Homes		Cost
Home construction in process, beginning of year	15	$	1,541,105
Costs incurred on homes during fiscal 2014 - new and existing projects	17		3,054,149
Costs transferred to finished homes	(3)		(992,174)
Totals	29	$	3,603,080

Note 4 - Finished homes held for sale

Finished homes held for sale consisted of the following developments:

National City - E. 10th Street	$	371,885
Oceanside - Libby Village Way		265,752
Oceanside - Lemon Street		298,184
Total	$	935,821

Following is a summary of finished homes activity:

	Number of Homes	Cost
Finished homes, beginning of year	2	$ 371,934
Costs transferred to finished homes from construction in process	3	992,174
Reacquisition of previously sold homes	4	1,056,115
Homes sold to new owners	(6)	(1,484,402)
Totals	3	$ 935,821

Note 5 - Property and equipment, net

Property and equipment consists of the following:

Land	$ 1,146,349
Buildings and improvements	1,273,829
Vehicles	175,848
Equipment	197,325
Total	2,793,351
Less: accumulated depreciation	(488,186)
Property and equipment, net	$ 2,305,165

Land, buildings and improvements consist of SDHFH's corporate headquarters and two ReStores located in San Diego and Escondido, California.

Depreciation expense for the year ended June 30, 2014 was $67,953.

Note 6 - Retail store, net

SDHFH operates two home improvement stores (the "ReStores") in San Diego and Escondido, California. The ReStores sell new and used home furnishings and building and home improvement materials to the general public. Donations to the ReStores are made by contractors and other businesses, organizations and individuals that have surplus or discontinued merchandise.

The purpose of the ReStores is to raise funds to support SDHFH programs. Accordingly, expenses of operating the ReStores are reported as program expenses in the consolidated statement of functional expenses. The amount of revenue reported from the ReStores includes cash receipts plus the fair market value of donated goods sold, net of the cost of purchased inventory sold. As most revenue earned by the ReStores is from the sale of donated goods, ReStore revenue is classified as support in the consolidated statement of activities and changes in net assets.

Net ReStore revenue is summarized as follows:

Donations to retail store	$	1,205,616
Sales of donated and purchased items		1,088,995
Delivery surcharges		26,599
Fair market value of donated items sold and cost of purchased inventory sold		(1,231,202)
Net revenue from retail store	$	1,090,008

Note 7 - Accounts payable, accrued expenses and other liabilities

Accounts payable, accrued expenses, and other liabilities consist of the following:

Accounts payable and other accrued expenses	$	374,434
Accrued compensation		143,626
Secured obligations from the sale of mortgage notes receivable		109,763
Contingent liability - project		58,494
Total	$	686,317

Secured obligations from the sale of mortgage notes receivable relates to mortgage notes receivable sold to Northern Trust Bank with recourse (see Note 2). The contingent liability - project relates to estimated costs for a completed construction project in El Cajon, California (see Note 14).

Note 8 - Notes payable - J.P. Morgan Chase Bank

Notes payable - J.P. Morgan Chase Bank consists of:

The Commercial Note in the amount of $353,000 bears interest at 5.30% per annum and is payable in installments of $5,051 per month for 84 months, maturing in January 2017. The Commercial Note is secured by a beneficial interest in a portfolio of mortgage notes receivable held by the Organization.	$	145,613
The Mortgage Note originally in the amount of $1,987,000 bears interest at 5.60% per annum and is payable in 83 monthly installments of $13,871, with a final balloon payment of approximately $1,542,000 due in January 2017. The Mortgage Note is secured by a deed of trust on the Organization's corporate headquarters and retail store in San Diego, California.		1,717,718
Total	$	1,863,331

The Mortgage Note and Commercial Note have prepayment penalties during the first five years that the notes are outstanding. Furthermore, the note agreements between SDHFH and J.P. Morgan Chase Bank require SDHFH to comply with certain covenants, including the following financial covenants:

- Current Ratio (as defined in the agreement) of not less than 1.25 to 1.00;
- Debt Service Coverage Ratio (as defined in the agreement) of not less than 1.25 to 1.00

At June 30, 2014, the Organization was not in compliance with the Debt Service Coverage Ratio covenant contained in the note agreements. The Organization was in the process of refinancing and did not deem it necessary to obtain a waiver. The Organization refinanced its loans with J.P. Morgan Chase Bank and entered into a borrowing agreement with California Bank & Trust as of July 25, 2014.

The Organization also has a line of credit with J.P. Morgan Chase Bank, due March 20, 2015, which accrues interest at 30-day LIBOR plus 3.835%, secured by substantially all the Organization's assets. At June 30, 2014, the Organization had no outstanding balance owed.

The following table summarizes the principal payments due for notes payable - J.P. Morgan Chase Bank:

Year Ending June 30,	Amounts
2015	$ 124,851
2016	131,694
2017	1,606,786
Total	$ 1,863,331

Note 9 - Notes payable - governmental agencies

Notes payable - governmental agencies as of June 30, 2014 consist of the following:

Notes payable, San Diego Housing Commission, requires payments of $248 per month through 2021. The notes have been discounted using imputed interest rates between 9.75% to 11.50%.	$ 14,385
Note payable, City of Oceanside, secured by certain mortgage receivables. The note bears no interest, requires monthly payments of $5,000 and matures in August 2029. The note has been discounted using a 6.0% imputed interest rate.	592,518
Total	$ 606,903

Notes payable to the San Diego Housing Commission and City of Oceanside require monthly payments. The following table summarizes the scheduled maturities of these three notes:

Year Ending June 30,	Amounts
2015	26,653
2016	28,368
2017	30,198
2018	32,151
2019	34,231
Thereafter	455,302
Total	$ 606,903

Note 10 - Forgivable notes payable - governmental agencies

Forgivable notes payable - governmental agencies as of June 30, 2014 consist of the following:

Note payable, City of Oceanside, secured by the development at Libby Lake, with no interest or payments, forgivable and transferrable to the purchaser of each home.	$ 135,000
Note payable, City of Imperial Beach, secured by the development at 10th and Donax with no interest or payments, forgivable and transferrable to the purchaser of each home.	542,804
Note payable, City of Escondido, pursuant to Home Investment Partnership Program Funds from HUD, secured by the development at Elm Street, with no interest or payments, forgivable and transferrable to the purchaser of each home.	398,197
Note payable, City of El Cajon, pursuant to Home Investment Partnership Program Funds from HUD, secured by deeds of trust on land acquired for construction of low-income housing. This loan requires no payments and will be transferred to the purchasers of the homes in the Foundation Lane Phase II development. The promissory note bears no interest unless SDHFH defaults under the terms of the note.	132,780
Total	$ 1,208,781

SDHFH is awarded funding by various governmental agencies, generally in the form of a loan to finance, in part, the acquisition and/or development of specific housing projects. These loans are secured by deeds of trust on the related project property. The loans generally are non-interest bearing and have a maturity date of the earlier of one to two years or the sale/transfer of the property. Upon project completion, if SDHFH sells/transfers the property to a qualified buyer, the proportionate debt owed by SDHFH on the property is forgiven and transfers to the buyer as a mortgage on the property.

The grant/loan agreements usually require a written disposition and development agreement ("DDA") between SDHFH and the city. These agreements require SDHFH to comply with a number of requirements, including a promise to complete the project within a reasonable period of time and an agreement to sell the home or homes to moderate to low-income families as defined in the DDA. If SDHFH were to fail to comply with the terms of the DDA, it could be required to repay principal and interest as specified in the DDA. As of June 30, 2014, management believes that SDHFH is in material compliance with all DDAs and related grant/loan agreements.

As set forth herein, the terms and conditions do not require SDHFH to utilize cash to repay the obligation. Moreover, there are no scheduled maturities of the related debt, since SDHFH is relieved of an obligation to repay the loan upon transfer of the property to a qualified buyer. Accordingly, SDHFH does not believe a table setting forth scheduled maturities of this debt would be meaningful.

Note 11 - Refundable advances

Refundable advances as of June 30, 2014 consist of the following:

Home funds - City of National City - refundable advances to be utilized for purchase and development of qualifying properties. Utilization of these funds must continue to meet compliance requirements during compliance period. After compliance activities and periods are met, these funds shall become unrestricted.	$ 544,512
Home funds - City of El Cajon - refundable advances to be utilized for purchase and development of qualifying properties. Utilization of these funds must continue to meet compliance requirements during compliance period. After compliance activities and periods are met, these funds shall become unrestricted.	280,405
Total	$ 824,917

Note 12 - Notes payable - HFHI

Notes payable - HFHI consists of:

On December 12, 2013, SDHFH entered into a Loan and Security Agreement (the "FlexCap Note") with HFHI under which SDHFH borrowed $980,000 with a maturity date of December 31, 2020. This loan represented a refinancing of two existing FlexCap notes, resulting in lower quarterly payments. The new FlexCap Note is payable in quarterly installments of $40,026 including interest at 3.80% per annum. SDHFH was required to establish a reserve fund of $40,026, reported herein as "deposits and other assets."	$ 918,276
Total	$ 918,276

SDHFH is required to comply with the following covenants, which apply to the FlexCap Note:

- At all times, maintain minimum net assets of $250,000; have at least 10 mortgage loans in its performing mortgage pool;
- Own free and clear of all liens and encumbrances at least 40% of the total of mortgage loans in the performing mortgage pool.

- The mortgage receivables pledged by SDHFH must have aggregate mortgage payments equal to or greater than 105% of the quarterly payment; and have aggregate values equal to or greater than 125% of the outstanding note balance.

As of June 30, 2014, management believes SDHFH was in compliance with the terms and conditions of the FlexCap Note.

The following table summarizes the scheduled maturities of notes payable - HFHI:

Year Ending June 30,	Amounts
2015	$ 127,006
2016	131,901
2017	136,985
2018	142,265
2019	147,749
Thereafter	232,370
Total	$ 918,276

Note 13 - Related party transactions

SDHFH remits a discretionary portion of its unrestricted contributions (excluding in-kind contributions) to HFHI on an annual basis. These funds are used to construct homes in economically depressed areas around the world. For the year ended June 30, 2014, SDHFH remitted $35,000 in tithes to HFHI.

In addition, SDHFH paid a U.S. Stewardship and Organizational Sustainability Fee of $8,300 to HFHI in this period.

As described in Note 12, SDHFH is party to the FlexCap Note with HFHI. Total amounts due under this note payable as of June 30, 2014 were $918,276.

Note 14 - Commitments and contingencies

During a portion of the year ended June 30, 2014, SDHFH managed the affairs of two homeowner associations (“HOAs”) that are connected with projects that the Organization previously sold to partner families. SDHFH managed the affairs of these HOAs with the oversight and approval of each HOA’s governing board. SDHFH was also responsible for keeping a separate set of books and records and a separate checking account for each HOA. Prior to June 30, 2014, the responsibility for these HOAs was transferred to property management companies selected by the homeowners of each community. SDHFH no longer manages the HOAs.

At June 30, 2014, the Organization had certain contingent liabilities related to its completed Foundation Lane project in the City of El Cajon ("El Cajon"). Pursuant to an agreement with El Cajon, SDHFH was permitted to finalize and sell the four-unit development on Foundation Lane prior to the completion of two required infrastructure improvements - the construction of a masonry fence ("Fence Improvement") and the construction of street access to an adjacent arterial street ("Street Improvement"). SDHFH accrued $58,494 to record the estimated cost of the Fence Improvement at June 30, 2011 and expensed it as a component of cost of homes sold. During the year ended June 30, 2013, SDHFH acquired property adjacent to the Foundation Lane site. SDHFH believes that it may not be required to complete the improvements. However, until a formal release is received from El Cajon's City Council, SDHFH will maintain its existing reserve and as a result retains a liability for $58,494 for the year ended June 30, 2014.

SDHFH leases various systems and equipment under noncancellable leases running through October 2016. Equipment rental expense for the year ended June 30, 2014 was $16,307.

In January 2014, the Company entered into a lease agreement for its new ReStore located in Escondido, California for a 27 month term with $64,132 annual rent expense.

Future minimum rental payments under these leases are as follows:

Year Ending June 30,	Amounts
2015	$ 84,425
2016	56,846
2017	411
Total	$ 141,682

Note 15 - Temporarily restricted net assets

Temporarily restricted net assets consist of amounts restricted by donor-imposed stipulations as follows:

Escondido - Elm St	$ 429,989
Imperial Beach - 10th & Donax	1,000
Parker Foundation - NRI manager	18,000
Unappropriated investment income	55,226
Total	$ 504,215

Note 16 - Permanently restricted net assets

Permanently restricted net assets at June 30, 2014 consist of a beneficial interest in assets held by The San Diego Foundation (the "Foundation") which is holding them as an endowed component fund ("Fund") for the benefit of the Organization. The Fund is subject to the Foundation's investment and spending policies, which currently result in a distribution to the Organization of 5%, annually, of the 36-month average principal market value of the Fund. Distributions are generally made semi-annually. The Organization reports the fair value of the Fund as a beneficial interest in assets held at a community foundation in the consolidated statement of financial position and reports distributions received as a reduction to the Fund balance. Changes in the value of the Fund are reported as temporarily restricted investment income in the consolidated statement of activities and net assets.

Interpretation of relevant law

The Organization has interpreted the State of California's Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Organization has classified as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The earnings of the donor-restricted endowment fund are classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

(1) The duration and preservation of the fund;
(2) The purposes of the Organization and the donor-restricted endowment fund;
(3) General economic conditions;
(4) The possible effect of inflation and deflation;
(5) The expected total return from income and the appreciation of investments;
(6) Other resources of the Organization; and
(7) The investment policies of the Organization.

The following is a summary of changes in endowment net assets for the year ended June 30, 2014:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Fund balance, beginning of year	$ -	$ -	$ 326,256	$ 326,256
Fund appreciation	-	48,339	-	48,339
Investment expenses	-	(1,703)	-	(1,703)
Distributable grants approved	-	(14,607)	-	(14,607)
Transfers	-	23,197	(23,197)	-
Fund balance, ending of year	$ -	$ 55,226	$ 303,059	$ 358,285

Funds with deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Organization to retain as a fund of perpetual duration. There were no deficiencies of this nature that were reported in unrestricted net assets as of June 30, 2014.

Return objectives and risk parameters

The Organization has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Organization must hold in perpetuity. Under this policy, as approved by the Board of Directors, the endowment assets are invested in a manner that follows the policies of the Foundation. Actual returns in any given year may vary from this expected return. See Note 17.

Strategies for achieving objectives

To satisfy its long-term rate-of-return objectives, the Organization relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Organization uses a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk parameters.

Spending policy and how the investment objectives relate to the spending policy

The Organization follows the policies of the Foundation in determining the distribution amount to be appropriated each year. In establishing this policy, the Organization considered the long-term expected return on its endowment. Accordingly, over the long-term, the Organization expects the current spending policy to allow its endowment to grow at an average annual rate equal to the general inflation rate. This is consistent with the Organization's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

Note 17 - Assets and liabilities measured at fair value on a recurring basis

The Organization values its financial assets and liabilities based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, a fair value hierarchy that prioritizes observable and unobservable inputs is used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices are available in active markets for identical investments as of the reporting date. The type of investments in Level 1 include listed equities, bond instruments, and mutual funds held in the name of the Organization, and exclude listed equities and other securities held indirectly through commingled funds.

Level 2: Pricing inputs, including broker quotes, are generally those other than exchange quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies.

Level 3: Pricing inputs are unobservable for the investment, including situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation. Investments that are included in this category generally include privately held investments and partnership interests.

The inputs and methodology used for valuing the Organization's financial assets and liabilities are not indicators of the risks associated with those instruments.

There have been no changes in methodology during the year.

The following table sets forth by level, within the fair value hierarchy, SDHFH's assets at fair value as of June 30, 2014:

	Level 1	Level 2	Level 3	Total
Beneficial interest in assets held by community foundation	$ -	$ -	$ 358,285	$ 358,285
Total assets at fair value	$ -	$ -	$ 358,285	$ 358,285

The following table sets forth a summary of changes in the fair value of SDHFH's Level 3 assets for the year ended June 30, 2014:

Balance, beginning of year	$ 326,256
Investment return	46,636
Distributed to SDHFH	(14,607)
Balance, end of year	$ 358,285

The following table represents SDHFH's Level 3 financial instruments, the valuation techniques used to measure the fair value of those financial instruments, and the significant unobservable inputs and the ranges of values for those inputs for 2014:

Instrument	Fair Value	Principal Valuation Technique	Unobservable Inputs	Significant Input Values	Weighted Average
Beneficial interest in assets held by community foundation	$ 358,285	Valuation of underlying assets as provided by trustee	Investment period (liquidity)	N/A	N/A

The Organization's investments consist entirely of the beneficial interest in assets held at the Foundation and are classified as Level 3 investments as described above. Accordingly, the changes in the value of Level 3 financial instruments is set forth in the table above.

The beneficial interest in assets held at the Foundation has been valued, as a practical expedient, at the fair value of the Organization's share of the Foundation's investment pool as of June 30, 2014. The Foundation values securities and other financial instruments on a fair value basis of accounting. The estimated fair values of certain investments of the Foundation, which include private placements and other securities for which prices are not readily available, are determined by the management of the Foundation and may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may be realized. Accordingly, the estimated fair values may differ significantly from the values that would have been used had a ready market existed for these investments. The Foundation's target asset allocation for the Fund is 22% domestic (U.S.) equities, 19% fixed income instruments (domestic and international), 20% alternative investments, 6% global equities, 22% international equities and 11% real assets. The beneficial interest in assets held at the Foundation is not redeemable by the Organization.