



***CONSOLIDATED FINANCIAL STATEMENTS
WITH INDEPENDENT AUDITORS' REPORT***

YEARS ENDED JUNE 30, 2018 AND 2017

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INDEPENDENT AUDITORS' REPORT

To The Board of Directors
Paterson Habitat for Humanity, Inc. and Subsidiary
Paterson, New Jersey

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Paterson Habitat for Humanity, Inc. and Subsidiary, which comprise the consolidated statements of financial position as of June 30, 2018 and 2017, and the related consolidated statements of activities and changes in net assets, functional expenses, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

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 and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. The financial statements of Paterson Habitat ReStore, LLC were not audited in accordance with *Government Auditing Standards*.

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 Paterson Habitat for Humanity, Inc. and Subsidiary as of June 30, 2018 and 2017, 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.

Other Matters:

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2018 on our consideration of Paterson Habitat for Humanity, Inc. and Subsidiary's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Paterson Habitat for Humanity, Inc. and Subsidiary's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Paterson Habitat for Humanity, Inc. and Subsidiary's internal control over financial reporting and compliance.

Dorfman Abrams Music, LLC

Saddle Brook, New Jersey

October 15, 2018

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

ASSETS

	June 30,	
	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 2,217,786	\$ 2,396,665
Escrows and security deposits	196,969	97,536
Mortgages receivable, net	2,156,703	1,123,824
Grants and other receivables	201,477	411,659
Prepaid expenses	81,745	90,508
Houses available for sale	1,837,382	3,740,826
Houses under construction	2,065,741	2,212,699
ReStore inventory	74,589	87,652
Property, land, and equipment, net	305,962	330,669
Investment in joint ventures	3,818,055	5,671,679
	<u> </u>	<u> </u>
Total assets	<u>\$ 12,956,409</u>	<u>\$ 16,163,717</u>

LIABILITIES AND NET ASSETS

Liabilities:		
Accounts payable and accrued expenses	\$ 267,622	\$ 242,332
Tithe payable	30,947	18,529
Deferred revenue	232,437	99,082
Notes payable	5,009,636	7,036,286
	<u> </u>	<u> </u>
Total liabilities	<u>5,540,642</u>	<u>7,396,229</u>
Net assets:		
Unrestricted	7,415,767	8,767,488
	<u> </u>	<u> </u>
Total liabilities and net assets	<u>\$ 12,956,409</u>	<u>\$ 16,163,717</u>

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

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

	Year ended June 30,	
	2018	2017
Support and revenues:		
Private support:		
Contributions and private grants	\$ 826,171	\$ 1,650,554
Donated services and materials	93,266	64,111
Special events, net of expenses of \$59,972 and \$56,981 for 2018 and 2017, respectively	306,651	329,410
Total private support	1,226,088	2,044,075
Governmental support:		
Federal and state awards	668,845	1,132,004
Total governmental support	668,845	1,132,004
Other operating revenues:		
Sale of houses	2,161,600	780,000
Mortgage loan discount amortization	539,979	48,308
Investment in joint ventures	110,264	110,264
ReStore sales	1,027,079	1,004,807
Gain on termination of joint venture	555,593	
Other	13,855	71,327
Total other operating revenues	4,408,370	2,014,706
Total support and revenues	6,303,303	5,190,785
Expenses:		
Program services:		
Housing and Community Engagement	6,189,190	3,665,952
ReStore	725,804	652,942
Total program services	6,914,994	4,318,894
Supporting services:		
Management and general	433,099	347,418
Fundraising	306,931	226,481
Total supporting services	740,030	573,899
Total expenses	7,655,024	4,892,793
Change in net assets	(1,351,721)	297,992
Net assets, beginning of year	8,767,488	8,469,496
Net assets, end of year	\$ 7,415,767	\$ 8,767,488

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

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended June 30,	
	2018	2017
Cash flows from operating activities:		
Change in net assets	\$ (1,351,721)	\$ 297,992
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation and amortization	97,533	79,347
Gain on termination of joint venture	(555,593)	
Amortization of discounts on mortgages receivable, net	603,098	395,562
Write-off of discounts for mortgages sold	(480,884)	
Transfers to homeowners in return for mortgages	(2,161,600)	(780,000)
Payments on mortgages from homeowners	189,036	249,639
Sale of mortgages	735,724	
Loss on sale of mortgages	81,747	
Investment income in joint ventures	(110,264)	(110,264)
Changes in assets and liabilities:		
(Increase) decrease in:		
Escrow and security deposits	(99,433)	50,510
Grants and other receivables	210,182	(98,173)
Prepaid expenses	8,763	(13,490)
Houses available for sale	1,903,444	(857,640)
Houses under construction	146,958	(34,772)
ReStore inventory	13,063	(13,063)
Increase (decrease) in:		
Accounts payable and accrued expenses	25,290	24,929
Tithe payable	12,418	5,262
Deferred revenue	133,355	(253,628)
Net cash used by operating activities	<u>(598,884)</u>	<u>(1,057,789)</u>
Cash flows from investing activities:		
Distributions received from joint venture	46,506	53,464
Investment in joint venture	(1,285,056)	
Purchase of property, land and equipment	<u>(9,083)</u>	<u>(6,100)</u>
Net cash provided (used) by investing activities	<u>(1,247,633)</u>	<u>47,364</u>
Cash flows from financing activities:		
Proceeds from loan payable	1,892,285	
Debt issuance costs	(220,947)	
Repayments on notes payable	<u>(3,700)</u>	<u>(8,817)</u>
Net cash provided (used) by financing activities	<u>1,667,638</u>	<u>(8,817)</u>
Net decrease in cash and cash equivalents	(178,879)	(1,019,242)
Cash and cash equivalents, beginning of year	<u>2,396,665</u>	<u>3,415,907</u>
Cash and cash equivalents, end of year	<u>\$ 2,217,786</u>	<u>\$ 2,396,665</u>

Supplemental Schedule of Non-Cash Investing and Financing Activities

Termination of joint venture agreement by exercise of put option	<u>\$ 3,202,438</u>	<u>\$</u>
Cancellation of note payable related to terminated joint venture agreement	<u>\$ 3,758,031</u>	<u>\$</u>

Supplemental Cash Flow Information

Cash paid for interest	<u>\$ 59,764</u>	<u>\$ 64,289</u>
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The accompanying notes are an integral part of these consolidated financial statements.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF FUNCTIONAL EXPENSES

Years Ended June 30, 2018 and 2017

	Program services				Supporting services				Total program and supporting services			
	Housing and Community Engagement		ReStore		Management and general		Fundraising		Total supporting services			
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017		
Salaries and wages	\$ 699,455	\$ 689,553	\$ 282,795	\$ 239,471	\$ 141,211	\$ 122,812	\$ 232,582	\$ 168,826	\$ 373,793	\$ 291,638	\$ 1,356,043	\$ 1,220,662
Payroll taxes and employee benefits	240,358	173,008	77,444	58,208	98,745	42,700	69,110	40,225	167,855	82,925	485,657	314,141
Total salaries and related expenses	939,813	862,561	360,239	297,679	239,956	165,512	301,692	209,051	541,648	374,563	1,841,700	1,534,803
Construction costs	4,085,398	1,882,166									4,085,398	1,882,166
Community building	705	1,164									705	1,164
Title	136,244	117,054									136,244	117,054
Office	13,045	8,589			53,511	38,333			53,511	38,333	66,556	46,922
Postage	4,747	2,837					4,043	15,934	4,043	15,934	8,790	18,771
Telephone and utilities	24,319	22,961			16,778	18,103			16,778	18,103	41,097	41,064
Insurance	28,714	18,018									28,714	18,018
Real estate taxes	104,305	153,010									104,305	153,010
Interest expense	59,764	64,289			91,055	73,938		1,496	92,251	75,434	59,764	64,289
Professional fees	55,413	35,306			17,936	18,128			17,936	18,128	147,664	110,740
Depreciation and amortization	74,530	54,127	5,067	7,092							662,193	443,870
Discounts on mortgages	662,193	443,870									662,193	443,870
Facilities expenses			296,153	293,738							296,153	293,738
Marketing and other expenses			44,305	36,955							44,305	36,955
Donation pickup expense			20,040	17,478							20,040	17,478
Miscellaneous					13,863	33,404			13,863	33,404	13,863	33,404
Total expenses	\$ 6,189,190	\$ 3,665,952	\$ 725,804	\$ 652,942	\$ 433,099	\$ 347,418	\$ 306,931	\$ 226,481	\$ 740,030	\$ 573,899	\$ 7,655,024	\$ 4,892,793

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

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

1. Summary of significant accounting policies

This summary of significant accounting policies of Paterson Habitat for Humanity, Inc. and Subsidiary (PHFH) is presented to assist in understanding PHFH's consolidated financial statements. The consolidated financial statements and notes are representations of PHFH's management, which is responsible for their integrity and objectivity. These accounting policies conform to accounting principles generally accepted in the United States of America as promulgated in *FASB Accounting Standards Codification* (the Codification) and have been consistently applied in the preparation of the consolidated financial statements.

History and objective of PHFH

Paterson Habitat for Humanity, Inc. and Subsidiary, an affiliate of Habitat for Humanity International, was organized as a not-for-profit corporation under the laws of the State of New Jersey in 1984 with the mission of eliminating poverty housing from Passaic County, New Jersey, and to make decent, affordable shelter for all people throughout the world a matter of conscience. As such, PHFH builds and sells Energy Star certified, quality affordable housing to low-income qualified homeowners, primarily in the City of Paterson, New Jersey. Eligible homeowners generally are families living in substandard housing who are unable to secure adequate housing by conventional means. Contribution of money and materials are the principal funding sources of PHFH operations. Volunteer labor is also central to PHFH's ability to build new homes and offer them to qualified families at affordable prices through zero-interest mortgages.

When PHFH began operating in 1984, eligible homeowner incomes were adequate to purchase homes at PHFH's cost. Since the 1990's, PHFH's building costs have increased far more rapidly than the income of eligible homeowners. Therefore, in order to provide affordable housing to eligible buyers, PHFH subsidizes the sale of each house. Because homes currently are sold for an amount below actual cost, fundraising and volunteer services must provide the financial resources for the subsidy.

PHFH seeks to not only raise living standards for families through homeownership, but also to revitalize neighborhoods and communities. PHFH's financial counseling and mentoring programs address personal debt and money management issued for homeowner families, and continues to excel in foreclosure prevention with only ten foreclosures in its 30-year plus history. Finally, limited resources are directed to carefully selected community programs to support safe streets, effective public education, and other goals that affect the quality of life for Habitat homeowner families and their neighbors.

Beginning in May 2012, PHFH opened the ReStore to sell used goods and construction materials to help raise additional revenue which is used to further the mission of PHFH.

Principles of consolidation

The consolidated financial statements include the accounts of Paterson Habitat for Humanity, Inc. and Paterson Habitat ReStore, LLC. ReStore is a wholly-owned subsidiary of PHFH. All material intercompany balances and transactions have been eliminated in consolidation.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

1. Summary of significant accounting policies (continued)

Basis of presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. Net assets, revenues, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of PHFH and changes therein are classified and reported as follows:

Unrestricted net assets - Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that may or will be met, either by actions of PHFH and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. PHFH had no temporarily restricted net assets at June 30, 2018 or 2017.

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that they be maintained permanently by PHFH. Generally, the donors of these assets permit the PHFH to use all or part of the income earned on any related investments for general or specific purposes. PHFH had no permanently restricted net assets at June 30, 2018 or 2017.

Cash and cash equivalents

Cash consists of demand deposit accounts, which are highly liquid financial instruments with maturities of three months or less. Cash does not include amounts held in escrow, such as potential homeowner's monies pending closing.

Escrows and security deposits

PHFH maintains escrow and security deposits on behalf of homeowners. These accounts are used to collect homeowner deposits to be used to pay escrow expenses (such as property taxes and homeowners' insurance premiums), and for the payment of maintenance expenses on property that share common facilities.

Sale of houses/mortgages receivable

Sale of houses is recognized when the home is complete and risk of ownership has transferred to the new homeowner. Mortgages from homeowners do not bear interest and generally have a maximum life of up to 30 years. Required monthly repayments are calculated on a level payment basis. PHFH discounts the mortgages received each accounting period using an interest rate stipulated by Habitat for Humanity International, Inc. (HFHI). This practice facilitates the combining of all Subsidiary consolidated financial statements by HFHI. Discounting has no effect on the cash flows of PHFH. Mortgage discounts are amortized to income on a straight-line basis over the life of the underlying mortgages.

PHFH reviews mortgages receivable for collectability based on previous experience and determinations by management and the Board of Directors. In management's opinion, the collateral is sufficient to realize the mortgages receivable without any allowance.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

1. Summary of significant accounting policies (continued)

Grants and other receivables

Financial assistance received from federal, state, and local governmental entities in the form of grants are recognized on a cost reimbursement basis and are recorded in federal and state awards on the consolidated statements of activities and changes in net assets. Grants receivable from government agencies are periodically reviewed by management for collectability. The balance of grants receivable has been determined to be collectible. Therefore, no allowance has been recorded.

Houses available for sale and under construction

Houses available for sale are stated at cost.

Houses under construction consists of material, labor, and equipment costs related to home construction such as indirect labor, supplies, and tool costs. These costs are recorded as houses under construction on the consolidated statements of financial position as they are incurred. Land costs are included in houses under construction and are stated at the lower of cost or the fair value at the date of purchase. Also included in land costs are any costs incurred in development. When homes are sold, the corresponding costs are then expensed in the consolidated statements of activities and changes in net assets as program services under the caption construction costs.

Property, land, and equipment

Property, land, and equipment purchased are stated at cost. Replacements, betterments, and additions to property, land, and equipment are capitalized. PHFH capitalizes all property, land, and equipment with a value of \$1,000 or greater that extend the useful life of the asset. Depreciation and amortization of buildings, equipment, furnishings, and improvements are provided on a straight-line basis over the estimated useful lives ranging from 5 to 39 years.

Donations of property, land, and equipment are recorded as contributions at the fair value of the asset, based on values of comparable assets, at the date of the gift. Such donations are reported as unrestricted contributions unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property, land, and equipment are reported as temporarily restricted contributions.

Investment in joint ventures

PHFH accounts for its investment in joint ventures under the equity method. Under the equity method of accounting the PHFH's share of net income (loss) of the joint venture is recognized as income from investment in joint ventures on the PHFH's consolidated statements of activities, and distributions received from the joint ventures are treated as a reduction of the investment account.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

1. Summary of significant accounting policies (continued)

Deferred financing fees

Deferred financing fees represent costs incurred related to the issuance of New Market Tax Credit notes payable. During the year ended June 30, 2018, PHFH adopted FASB guidance regarding the presentation on the statement of financial position of the costs of issuance of debt and related amortization expense in the statement of activities. The new guidance requires presenting such unamortized cost as a direct reduction from the face amount of the debt on the statement of financial position. Amortization of those costs is provided on the straight-line method over the remaining term of the applicable indebtedness (3 - 29 years). Amortization expense for the years ended June 30, 2018 and 2017 was \$63,743 and \$42,100, respectively.

Estimated amortization expense for each of the next five years ending June 30 is as follows:

Year ending June 30:	
2019	\$ 31,760
2020	31,760
2021	25,375
2022	18,989
2023	18,989
	<u>18,989</u>
	<u>\$ 126,873</u>

Deferred revenue

Deferred revenue represents revenues received in advance not yet earned.

Grant revenues, contributions, and restrictions

PHFH receives some of its grant revenues from the federal, state, county, and city agencies. Revenue from grants is recognized upon performance of the granting activity and recognition of the related program expenditures. Amounts received from granting agencies in excess of expenditures incurred to date are recorded as deferred revenue.

Any of the funding sources, may at their discretion perform an audit which could result in the return of funds, as a result of non-compliance by PHFH with the terms of the grant agreements. No provision has been made for any liabilities that may arise from such audits since the amounts, if any, cannot be determined at this date.

Contributions, including unconditional pledges, are recorded as made. All contributions are available for unrestricted use unless specifically restricted by the donor. Conditional pledges are recognized when the conditions on which they depend are substantially met. Donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets. Contributions with restrictions that are met in the same reporting period as they are received are reported as unrestricted support.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

1. Summary of significant accounting policies (continued)

Donated services

Amounts are reported in the consolidated financial statements for voluntary donations of services when those services create or enhance non-financial assets or require specialized skills provided by individuals possessing those skills and which would typically be purchased if not provided by donation. Donated materials and services are recorded as contributions at their estimated fair value at the date of donation.

Numerous volunteers donate their time to PHFH program services and fundraising activities during the year. These services are not reflected in the consolidated financial statements since these services do not require specialized skills. Volunteers worked approximately 29,840 and 30,700 hours for the years ended June 30, 2018 and 2017, respectively.

Estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Functional allocation of expenses

The costs of providing various programs and support services have been summarized on a functional basis in the consolidated statements of activities and in the consolidated statements of functional expenses. Accordingly, certain expenses have been allocated among the programs and supporting services based on management's best estimates.

Reclassifications

Certain 2017 amounts have been reclassified to conform to the 2018 presentation.

Income taxes

PHFH is a tax-exempt organization as defined by Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for federal income tax has been made. PHFH is also exempt from state and local income taxes.

ReStore is a single member LLC of PHFH, and as such is not required to file a tax return.

Uncertain tax positions

As of June 30, 2018, management believes that based on evaluation of PHFH's tax positions that any liability as a result of uncertain tax positions would not be material. Management continually evaluates expiring statutes of limitations, changes in tax law, and new authoritative rulings to assist in evaluating PHFH's tax positions. Accrued interest and penalties associated with uncertain tax positions, if any, would be recognized as part of the income tax position. Income tax returns are filed in the U.S. federal jurisdiction and state jurisdictions. U.S. federal and state income tax returns prior to fiscal year 2014 are closed.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

2. Risks and uncertainties

Financial instruments that potentially subject PHFH to credit risk consist principally of cash and cash equivalents, mortgage receivables, and grants and pledges receivable. PHFH maintains its cash and cash equivalents in bank deposit accounts and money market accounts, the balances of which, at times, may exceed federally insured limits. Concentration of credit risk with respect to mortgages receivable is reduced since PHFH holds the trust deeds as security on the mortgages. Exposure to credit risk is reduced by placing such deposits in high quality financial institutions. Concentration of credit risk with respect to grants and pledges receivable is limited due to the fact that the grant receivables are mainly derived from governmental agencies and that pledges receivable are mainly derived from established organizations and have short payment periods.

3. Mortgages receivable

Mortgages receivable consists of non-interest bearing mortgages that are collateralized by the houses. Mortgages on houses sold during the years ended June 30, 2018 and 2017 were discounted at the HFHI stipulated interest rate of 7.57% and 7.47%, respectively.

	<u>2018</u>	<u>2017</u>
Face value of mortgages	\$ 3,313,271	\$ 2,158,178
Less unamortized discount	<u>1,156,568</u>	<u>1,034,354</u>
Mortgages receivable, net	<u>\$ 2,156,703</u>	<u>\$ 1,123,824</u>

A provision for impairment of loans has not been recorded since PHFH holds the trust deeds as security on the mortgages.

4. Property, land, and equipment

Property, land, and equipment consist of the following:

	<u>2018</u>	<u>2017</u>
Building, land, and improvements	\$ 407,695	\$ 401,177
Construction equipment	64,773	77,225
Furniture and equipment	38,192	41,231
Vehicles	<u>10,775</u>	<u>22,969</u>
	521,435	542,602
Less accumulated depreciation	<u>215,473</u>	<u>211,933</u>
	<u>\$ 305,962</u>	<u>\$ 330,669</u>

Depreciation expense for the years ended June 30, 2018 and 2017 was \$33,790 and \$37,247, respectively.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

5. Investments in joint ventures

In November 2010, PHFH entered into a joint venture agreement, along with five other Habitat Affiliates, with HFHI-SA Leverage VII, LLC ("Joint Venture") in order to receive funding from U.S. Bancorp Community Development Corp. (USBCDC) to financially assist PHFH and five other Habitat Affiliates, with building new low-income housing in the neighborhoods they individually serve. USBCDC contributed these funds to PHFH and five Habitat Affiliates in order to take advantage of New Markets Tax Credits (NMTC). PHFH transferred property, with an aggregate value of \$2,824,434, as an initial contribution to obtain a 17.14% ownership interest in the joint venture. In addition to investing in the joint venture, the PHFH was able to secure a 15 year loan payable in the amount of \$3,758,031 with HFHI-SA NMTC IV, LLC (a community development entity). Embedded in this transaction was a put option feature that was exercised by PHFH in January 2018 that enabled PHFH to terminate the transaction. PHFH surrendered its interest in the joint venture which at the time totaled \$3,202,438 and the loan payable of \$3,758,031 was fully forgiven. As a result of the exercise of the put option, a gain of \$555,593 was recognized.

In December 2013, PHFH entered into a joint venture agreement, along with two other Habitat Affiliates, with NFH Northeast 1 Leverage Lender, LLC ("Joint Venture") in order to receive funding from Citibank (CITI) to financially assist PHFH and the two Habitat Subsidiaries with building new low-income housing in the neighborhoods they individually serve. CITI contributed these funds to PHFH and two Habitat Affiliates in order to take advantage of New Market Tax Credits (NMTC). PHFH transferred property, with an aggregate value of \$2,535,500, as an initial capital contribution to obtain a 44.70% ownership interest in the joint venture. In addition to investing in the joint venture, the PHFH was able to secure a 30 year loan payable in the amount of \$3,504,640 with CITI NMTC Subsidiary XVI, LLC (a community development entity). In July 2020, PHFH has the ability to exercise a put option, which would enable PHFH to terminate this transaction or, if the put option is not exercised, PHFH would be fully forgiven of the total amount of the loan payable at the end of the 30 year period.

In April 2018, PHFH entered into a joint venture agreement, along with four other Habitat Affiliates, with HFHI NMTC Leverage Lender 2018, LLC ("Joint Venture") in order to receive funding from U.S. Bancorp Community Development Corp. (USBCDC) to financially assist PHFH and the four Habitat Subsidiaries with building new low-income housing in the neighborhoods they individually serve. USBCDC contributed these funds to PHFH and four Habitat Affiliates in order to take advantage of New Market Tax Credits (NMTC). PHFH transferred property, with an aggregate value of \$1,285,056 as an initial capital contribution to obtain a 21.84% ownership interest in the joint venture. In addition to investing in the joint venture, the PHFH was able to secure a 30 year loan payable in the amount of \$1,892,285 with HFHI NMTC SUB-CDE III, LLC (a community development entity). In April 2025, PHFH has the ability to exercise a put option, which would enable PHFH to terminate this transaction or, if the put option is not exercised, PHFH would be fully forgiven of the total amount of the loan payable at the end of the 30 year period.

Under the terms of each new market tax credit joint ventures, the PHFH is required to build one home per year in the City of Paterson for the next seven years.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

5. Investments in joint ventures (continued)

The table below sets forth a summary of changes in the investment in joint ventures:

	<u>2018</u>	<u>2017</u>
Balance at July 1	\$ 5,671,679	\$ 5,614,879
Income from investment in joint venture	110,264	110,264
Distributions received from joint venture	(46,506)	(53,464)
New joint venture investment	1,285,056	
Exercise of put option to terminate joint venture	<u>(3,202,438)</u>	
Balance at June 30	<u>\$ 3,818,055</u>	<u>\$ 5,671,679</u>

6. Line of credit

PHFH has an available secured line of credit with Columbia Bank in the amount of \$500,000. The line of credit is collateralized by the administrative office of PHFH. Interest is payable monthly at the bank's prime rate less 2.00% not to fall below 4.00%. The effective interest rate as of June 30, 2018 and 2017 was 5.00% and 4.25%, respectively. The line of credit matures in April 2019. There were no borrowings against the line during either of the years ended June 30, 2018 or 2017 and there are no commitment fees on unused balances.

PHFH has an available unsecured line of credit with Valley National Bank in the amount of \$500,000. Interest is payable monthly at the bank's prime rate. The effective interest rate as of June 30, 2018 and 2017 was 5.875% and 5.25%, respectively. The line of credit matures in January 2019. There were no borrowings against the line during either of the years ended June 30, 2018 or 2017 and there are no commitment fees on unused balances.

PHFH has an available unsecured line of credit with Atlantic Stewardship Bank in the amount of \$750,000. Interest is payable monthly at the bank's prime rate. The effective interest rate as of June 30, 2018 and 2017 was 5.50% and 4.75%, respectively. The line of credit matures in April 2019. There were no borrowings against the line during either of the years ended June 30, 2018 or 2017 and there are no commitment fees on unused balances.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

7. Notes payable

Notes payable consist of the following at June 30:

	<u>2018</u>	<u>2017</u>
<p>Mortgage note payable to New Jersey Housing Mortgage Finance Agency (NJHMFA) in monthly installments of \$742 including 1% interest through December 2017, collateralized by certain mortgages receivable. This note contains restrictive covenants, including among other things, certain financial reporting requirements and maintaining minimum tangible net assets. As of June 30, 2018 and 2017, PHFH complied with all covenants.</p>	\$	\$ 3,700
<p>Note payable due to a community development entity (HFHI-SA NMTC IV, LLC). Debt required interest only payments until June 2018 at 0.75%. The loan matures in January 2026. The note is subject to certain non-financial covenants. Embedded in the note payable agreement was a put option feature that was exercised in January 2018. Under the terms of the put option agreement, HFHI-SA Leverage VII, LLC purchased the ownership interest. Exercise of the option effectively allowed PHFH to extinguish its outstanding debt owed to HFHI-SA Investment Fund, LLC. (See note 5)</p>		3,758,031
<p>Note payable due to a community development entity (HFHI NMTC SUB-CDE III, LLC). Debt requires interest only payments until April 2025 at .068%. The loan matures in April 2048. The loan is secured by substantially all the assets acquired by PHFH from the project loan proceeds. The note is subject to certain financial and non-financial covenants. Embedded in the note payable agreement is a put option feature that is exercisable in April 2025. Under the terms of the put option agreement, HFHI NMTC Leverage Lender 2018, LLC, is expected to purchase the ownership interest. Exercise of the option will effectively allow PHFH to extinguish its outstanding debt owed to HFHI NMTC SUB-CDE III, LLC. The value of the put option is not material to the consolidated financial statements and therefore is not recorded in the books and records. (See note 5)</p>		1,892,285

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

7. Notes payable (continued)

	<u>2018</u>	<u>2017</u>
Note payable due to a community development entity (Citi NMTC Subsidiary XVI, LLC). Debt requires interest only payments until June 2020 at 1.03%. The loan matures in January 2043. The loan is secured by substantially all the assets acquired by PHFH from the project loan proceeds. The note is subject to certain non-financial covenants. Embedded in the note payable agreement is a put option feature that is exercisable in July 2020. Under the terms of the put option agreement, HFH Northeast 1 Leverage Lender, LLC, is expected to purchase the ownership interest. Exercise of the option will effectively allow PHFH to extinguish its outstanding debt owed to HFH NMTC Investment Fund, LLC. The value of the put option is not material to the consolidated financial statements and therefore is not recorded in the books and records. (See note 5)	\$ 3,504,640	\$ 3,504,640
Unamortized deferred financing fees	5,396,925 <u>(387,289)</u>	7,266,371 <u>(230,085)</u>
Notes payable	<u>\$ 5,009,636</u>	<u>\$ 7,036,286</u>

Annual principal payments due during the next five years and in total thereafter under the aforementioned borrowings are approximately as follows:

Year ending June 30:	
2019	\$
2020	
2021	
2022	
2023	
Thereafter	<u>5,396,925</u>
	<u>\$ 5,396,925</u>

Interest expense for the years ended June 30, 2018 and 2017 was \$59,764 and \$64,289, respectively.

PATERSON HABITAT FOR HUMANITY, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018 and 2017

8. Sale of mortgages

During the year ended June 30, 2018, PHFH sold mortgages to a local financial institution for 90% of the outstanding face value of \$817,471; therefore, there was a loss of \$81,747 on the transaction. The sale of mortgages resulted in the reversal of \$480,884 of previously recorded mortgage discount expense. The \$480,884 is included in mortgage loan discount amortization revenue in the consolidated statements of activities and changes in net assets.

There were no sale of mortgages during the year ended June 30, 2017.

9. Retirement plan

During the year ended June 30, 2018, PHFH established a defined contribution plan for the benefit of its employees. The plan is administered by an independent pension administrator and is an employer/employee contribution based plan where PHFH will match 4% of an employee's annual compensation while they are actively contributing to the plan. Employees are vested upon three years of service. Total retirement plan contributions for the year ended June 30, 2018 amounted to \$52,887.

10. Commitments

In August 2018, PHFH amended the existing lease for an operating facility in Wayne, NJ for the PHFH ReStore. The lease was extended for five additional years through March 31, 2024. Under the conditions of the lease agreement, PHFH is responsible for its monthly rent and its pro-rata share of the property's real estate taxes and operating expenses. Total rent and common area maintenance charges paid for the year ended June 30, 2018 and 2017 was \$252,333 and \$251,888, respectively.

Future minimum lease payments for the remaining term of the lease are as follows:

Year ending June 30:	
2019	\$ 259,625
2020	278,000
2021	278,000
2022	278,000
2023	278,000
Thereafter	<u>208,500</u>
	<u>\$ 1,580,125</u>

11. Subsequent events

Subsequent events have been evaluated through October 15, 2018, which is the date the consolidated financial statements were available to be issued.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To The Board of Directors
Paterson Habitat for Humanity, Inc. and Subsidiary
Paterson, New Jersey

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Paterson Habitat for Humanity, Inc. and Subsidiary, which comprise the consolidated statements of financial position as of June 30, 2018, 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, and have issued our report thereon dated October 15, 2018. The financial statements of Paterson Habitat ReStore, LLC were not audited in accordance with Government Auditing Standards and, accordingly, this report does not include reporting on internal control over financial reporting or instances of reportable non-compliance associated with Paterson Habitat ReStore, LLC.

Internal Control over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Paterson Habitat for Humanity, Inc. and Subsidiary's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of Paterson Habitat for Humanity, Inc. and Subsidiary's internal control. Accordingly, we do not express an opinion on the effectiveness of Paterson Habitat for Humanity, Inc. and Subsidiary's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Paterson Habitat for Humanity, Inc. and Subsidiary's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dayman Abrams Music, LLC

Saddle Brook, New Jersey

October 15, 2018