

AOF/PACIFIC AFFORDABLE HOUSING CORP.

AUDITED FINANCIAL STATEMENTS

DECEMBER 31, 2003

with

INDEPENDENT AUDITORS' REPORT

Audited Financial Statements

AOF/PACIFIC AFFORDABLE HOUSING CORP.

December 31, 2003

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CARTER & COMPANY

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
AOF/Pacific Affordable Housing Corp.
Huntington Beach, California

We have audited the statement of financial position of AOF/Pacific Affordable Housing Corp. ("the Corporation") as of December 31, 2003, and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The 2002 financial statements of AOF/Pacific Affordable Housing Corp. were audited by other auditors whose report, dated February 18, 2003, expressed an unqualified opinion.

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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2003 financial statements referred to above present fairly, in all material respects, the financial position of AOF/Pacific Affordable Housing Corp. as of December 31, 2003, and the results of its activities and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Carter & Company

Atlanta, Georgia
February 13, 2004

STATEMENTS OF FINANCIAL POSITION
AOF/PACIFIC AFFORDABLE HOUSING CORP.

	December 31,	
	<u>2003</u>	<u>2002</u>
ASSETS		
Cash and cash equivalents	\$ 465,000	\$ 258,022
Certificates of deposit – Note E	186,257	83,359
Escrow deposits and other assets	0	34,550
Accounts receivable	27,945	30,531
Mortgage escrows	1,000	0
Property inventories – Note C	190,564	362,055
Vehicle and equipment, net of accumulated depreciation of \$1,756 in 2003 and \$0 in 2002	32,231	0
Investment in partnerships – Note G	<u>1,125</u>	<u>1,125</u>
	<u>\$ 904,122</u>	<u>\$ 769,642</u>
LIABILITIES AND UNRESTRICTED NET ASSETS		
Notes payable – Note C	\$ 190,000	\$ 306,089
Notes payable – lines of credit – Note D	2,523	3,791
Accrued expenses	<u>114,210</u>	<u>108,149</u>
	306,733	418,029
Unrestricted net assets	<u>597,389</u>	<u>351,613</u>
	<u>\$ 904,122</u>	<u>\$ 769,642</u>

See independent auditors' report and notes to financial statements.

STATEMENTS OF ACTIVITIES

AOF/PACIFIC AFFORDABLE HOUSING CORP.

	Year Ended December 31,	
	2003	2002
Revenue from sale of properties	\$3,141,000	\$2,794,655
Cost of properties sold	<u>2,870,122</u>	<u>2,534,473</u>
GROSS PROFIT BEFORE MANAGEMENT, DEVELOPMENT AND CONSULTING FEE INCOME	270,878	260,182
Management, development and consulting fees	<u>404,361</u>	<u>294,527</u>
GROSS PROFIT	675,239	554,709
General and administrative expenses	<u>435,352</u>	<u>336,060</u>
NET OPERATING INCOME	239,887	218,649
Other income (expense):		
Interest and other income	7,645	3,334
Interest expense	0	(26,918)
Depreciation expense	<u>(1,756)</u>	<u>0</u>
	<u>5,889</u>	<u>(23,584)</u>
INCREASE IN UNRESTRICTED NET ASSETS	245,776	195,065
Unrestricted net assets at beginning of year	<u>351,613</u>	<u>156,548</u>
UNRESTRICTED NET ASSETS AT END OF YEAR	<u>\$ 597,389</u>	<u>\$ 351,613</u>

See independent auditors' report and notes to financial statements.

STATEMENTS OF CASH FLOWS

AOF/PACIFIC AFFORDABLE HOUSING CORP.

	Year Ended December 31,	
	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from buyers	\$ 3,159,558	\$ 2,781,097
Cash paid for properties and to suppliers and employees	(3,042,647)	(1,777,126)
Management, development and consulting fee income received	388,389	306,407
Interest income received	7,645	3,334
Interest paid	<u>(51,725)</u>	<u>(41,342)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	461,220	1,272,370
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in certificates of deposit	(102,898)	(51,881)
Cash used to purchase vehicle and equipment	<u>(33,987)</u>	<u>0</u>
NET CASH USED IN INVESTING ACTIVITIES	(136,885)	(51,881)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of mortgage notes payable	2,896,000	812,979
Mortgage principal payments and pay-offs	(3,012,089)	(1,906,165)
Net payments on lines of credit	<u>(1,268)</u>	<u>(8)</u>
NET CASH USED IN FINANCING ACTIVITIES	<u>(117,357)</u>	<u>(1,093,194)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	206,978	127,295
Cash and cash equivalents at beginning of year	<u>258,022</u>	<u>130,727</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 465,000</u>	<u>\$ 258,022</u>

See independent auditors' report and notes to financial statements.

STATEMENTS OF CASH FLOWS – Continued

AOF/PACIFIC AFFORDABLE HOUSING CORP.

	Year Ended December 31,	
	<u>2003</u>	<u>2002</u>
RECONCILIATION OF INCREASE IN UNRESTRICTED NET ASSETS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Increase in unrestricted net assets	\$ 245,776	\$ 195,065
Adjustments to reconcile increase in unrestricted net assets to net cash provided by operating activities:		
Depreciation	1,756	0
Decrease (increase) in escrow deposits and other assets	34,550	(34,550)
Decrease (increase) in accounts receivable	2,586	(1,678)
(Increase) decrease in mortgage escrows	(1,000)	2,030
Decrease in property inventories	171,491	1,074,389
Increase in accrued expenses	<u>6,061</u>	<u>37,114</u>
	<u>\$ 461,220</u>	<u>\$ 1,272,370</u>

SUPPLEMENTAL INFORMATION ON NON-CASH INVESTING AND FINANCING ACTIVITIES

None

See independent auditors' report and notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

AOF/PACIFIC AFFORDABLE HOUSING CORP.

December 31, 2003

NOTE A – NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

AOF/Pacific Affordable Housing Corp. ("the Corporation") was incorporated in 1997 as a nonprofit corporation organized under the laws of the State of California. The Corporation is a subordinate of The American Opportunity Foundation, Inc. ("AOF"), a Georgia nonprofit corporation which is exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code ("the Code"). AOF has received a group exemption as a central organization whose subordinates are recognized as exempt from federal income taxation under Section 501(c)(3) of the Code. The Corporation has no stockholders and is governed by a Board of Trustees. The Corporation was organized to acquire, rehabilitate, and sell affordable housing to low-income, elderly and/or mentally or physically challenged persons or families. The Corporation uses FHA insured 203(k) acquisition and rehabilitation loans or look alike conventional loans to acquire and rehabilitate the properties. On property acquisitions acquired at a 10% and 30% discount from the U.S. Department of Housing and Urban Development ("HUD"), the program restricts earnings on each one to four-unit dwelling sale to 10% of the total cost of the property. The properties are sold to persons making 115% or less of the median income adjusted for family size. The Corporation also serves as the managing general partner in various limited partnerships established to acquire, develop, rehabilitate and operate apartment complexes for low-income persons or families.

The following accounting policies are presented to assist the reader in understanding the Corporation's financial statements:

Revenue Recognition: Revenue from the sale of properties acquired and rehabilitated is recognized at the closing of the sale of the properties. Revenues from management and consulting fees are recognized in the period earned and revenues from development fees are recognized when the short-term development contracts are completed and collectibility is determined.

Cost Recognition: Direct and indirect acquisition and construction costs related to the acquisition and rehabilitation of the properties are capitalized as costs of the properties. These costs include capitalized interest of \$2,004 and \$6,406 at December 31, 2003 and 2002, respectively. These costs are expensed upon the closing of the sale of the respective property.

Property Inventories: Inventories are stated at the lower of cost (specific identification method) or net realizable value. Cost includes direct and indirect costs incurred in acquiring and rehabilitating one to four-unit dwellings purchased primarily under the HUD ARR (acquisition, rehabilitation and resale) program.

NOTES TO FINANCIAL STATEMENTS – Continued

AOF/PACIFIC AFFORDABLE HOUSING CORP.

December 31, 2003

NOTE A – NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Vehicle and Equipment: Equipment is stated at cost. Depreciation is computed on the straight-line method over an estimated useful life of three years for equipment and seven years for vehicles.

Investment in Partnerships: The Corporation accounts for its investment in various limited partnerships under the cost method of accounting, as more fully described in Note G.

Income Taxes: AOF/Pacific Affordable Housing Corp. is a non-profit corporation exempt from income taxes under §501(c)(3) of the Internal Revenue Code.

Cash and Cash Equivalents: For purposes of reporting cash flows, the Corporation considers unrestricted demand deposits and all unrestricted, highly liquid investments, with original maturities of three months or less, which can be readily converted to cash on demand, without penalty, to be cash equivalents. Cash and cash equivalents at December 31, 2003 included approximately \$289,000 in excess of federally insured limits.

Estimates: The preparation of 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 the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Functional Expenses: The costs of providing various programs and other activities are summarized on a functional basis as follows for the years ended December 31:

	<u>2003</u>	<u>2002</u>
Program Services		
Housing project	\$3,193,515	\$2,847,508
Supporting Services		
General and administrative	<u>113,715</u>	<u>49,943</u>
	<u>\$3,307,230</u>	<u>\$2,897,451</u>

NOTE B – GRANT AGREEMENT AND RELATED PROMISSORY NOTE

On June 27, 2002, the Corporation entered into a Grant Agreement ("the Grant") with the City of San Jose ("the City") whereby the City provided the Corporation with a \$4,775,000 conditional grant to assist in the acquisition and pre-development of a 130-unit housing facility for low-income households ("the

NOTES TO FINANCIAL STATEMENTS – Continued

AOF/PACIFIC AFFORDABLE HOUSING CORP.

December 31, 2003

NOTE B – GRANT AGREEMENT AND RELATED PROMISSORY NOTE – Continued

Project"). The Project is to include 99 rental units, 1 manager unit, and 30 units held for sale. The Affordability Restriction Agreement ("ARA") entered into in relation to the Grant includes certain restrictions, including a requirement that the 99 rental units be leased or rented, or available for lease or rent, to "eligible households," as defined. Additionally, the ARA limits the selling price of the units held for sale and restricts the households to which these units can be sold.

In connection with the \$4,775,000 grant received from the City of San Jose in November 2002, the Corporation entered into an agreement with San Carlos Willard Associates, L.P. ("San Carlos") whereby the Corporation is to loan San Carlos the funds received under the Grant for the purpose of acquiring and developing the Project, more fully described above. The non-recourse \$4,775,000 Promissory Note ("the Note") is unsecured and bears interest equal to the applicable federal rate for long-term debt instruments under Section 1264(d) of the Internal Revenue Code, as amended, determined at the time of each disbursement thereof, compounded annually (5.69% in 2003 and 2002). Annual payments of principal and interest equal to one percent of Net Cash Flow, as defined, shall be due and receivable commencing on January 1, 2003, and on every January 1 thereafter. The Note, plus all outstanding accrued interest, is due and receivable in November 2062. There were no payments made from net cash flow during 2003 and 2002.

As of December 31, 2003 and 2002, the Corporation had received \$3,528,939 and \$3,358,742, respectively, from the City and had loaned this amount to San Carlos. Due to the uncertainty of collection of the note and related interest income, income will be recorded when payments are received on the loan. The amount of interest income that has been earned but not recorded in the financial statements was \$289,063 and \$93,167 at December 31, 2003 and 2002, respectively.

NOTE C – NOTES PAYABLE

The Corporation has financing agreements with various lenders ("Construction Lenders"), including a \$1,000,000 line of credit facility with a bank, whereby the Construction Lenders issue to the Corporation construction loans to purchase and rehabilitate one to four-unit dwellings. The total amount outstanding under these construction loans was \$190,000 and \$306,089 at December 31, 2003 and 2002, respectively. The construction loan outstanding at December 31, 2003 accrues interest at the Construction Lenders' index rate, as defined, plus 1.5%, matures in 2004, and was secured by the property. The maximum amount of borrowings provided for by the loans was sufficient to acquire and rehabilitate the related housing. For HUD 203(k) insured loans the maximum borrowings also provided an amount sufficient to pay four months principal, interest, tax and insurance expense on the loans, and the interest rate is fixed.

NOTES TO FINANCIAL STATEMENTS – Continued

AOF/PACIFIC AFFORDABLE HOUSING CORP.

December 31, 2003

NOTE D – NOTES PAYABLE – LINES OF CREDIT

The Corporation has an agreement with a bank that provides for a \$25,000 line of credit through February 2004, bearing interest at 3.15%. This line of credit is secured by all accounts of the Corporation held by the bank and specifically by a \$32,220 certificate of deposit. In February 2004, this line of credit was extended through February 2005, subject to the same terms and conditions. Amounts outstanding under this agreement totaled \$2,286 at December 31, 2003 and 2002.

The Corporation has an additional agreement with this bank that provides for a \$25,000 line of credit through February 2004, bearing interest at the prime rate plus 5% (9% at December 31, 2003). This line of credit is unsecured. Amounts outstanding under this agreement totaled \$237 and \$842 at December 31, 2003 and 2002, respectively.

NOTE E – RELATED PARTY TRANSACTIONS

The Corporation has entered into asset management agreements with each of the limited partnerships more fully described in Note G. At December 31, 2003, the Corporation was earning monthly asset management fees of approximately \$15,000 from these arrangements, adjusted each year based on the increase in the Consumer Price Index. During the years ended December 31, 2003 and 2002, the Corporation recognized revenues of \$219,528 and \$120,725, respectively, under these arrangements. Additionally, the Corporation has entered into development arrangements with certain of the limited partnerships. During the years ended December 31, 2003 and 2002, the Corporation recognized revenues of \$168,777 and \$157,800, respectively, under these development arrangements.

During each of the years ended December 31, 2003 and 2002, the Corporation recorded costs of \$36,000 to AOF as an overhead reimbursement fee. At December 31, 2003 and 2002, accrued expenses included \$36,000 of fees payable to AOF.

The Corporation has a consulting agreement with a related non-profit entity whereby the Corporation is to receive \$16,000 annually for consulting services. During each of the years ended December 31, 2003 and 2002, the Corporation recorded consulting fee income of \$16,000 relating to this agreement. At December 31, 2003, accounts receivable included \$16,000 related to these fees.

NOTE F – EMPLOYEE BENEFIT PLAN

The Corporation has a multi-employer defined contribution plan ("the Plan") with AOF covering substantially all of its employees who are at least twenty and one half years of age and have completed six months of service. The Corporation can make discretionary contributions to the Plan as determined by its Board of Trustees. Expenses related to the Plan were approximately \$15,000 and \$10,000 during each of the years ended December 31, 2003 and 2002, respectively.

NOTES TO FINANCIAL STATEMENTS – Continued

AOF/PACIFIC AFFORDABLE HOUSING CORP.

December 31, 2003

NOTE G – INVESTMENT IN PARTNERSHIPS

The Corporation owns, as a general partner, a less than 1% interest in various limited partnerships established to acquire, develop, rehabilitate and operate apartment complexes for low-income persons or families. The limited partners generally have the right to replace the Corporation as general partner, approve the sale or refinancing of principal assets, and approve the acquisition of principal partnership assets. Additionally, the Corporation is not required to fund any additional capital or any liabilities of the partnerships. The Corporation has elected to account for its investment in the partnerships under the cost method of accounting due to the lack of a significant or controlling interest in the partnerships. Under the cost method of accounting, income is recognized upon receipt of distributions. There were minimal distributions received during the years ended December 31, 2003 and 2002.