



Keegan, Linscott & Kenon, PC

Certified Public Accountants
Certified Fraud Examiners
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HABITAT FOR HUMANITY TUCSON, INC.
AUDITED FINANCIAL STATEMENTS
AS OF AND FOR THE YEARS ENDED JUNE 30, 2011 AND 2010



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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Habitat for Humanity Tucson, Inc.
Tucson, Arizona

We have audited the accompanying statements of financial position of Habitat for Humanity Tucson, Inc. as of June 30, 2011 and 2010, and the related statements of activities and changes in net assets, cash flows and functional expenses for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Habitat for Humanity Tucson, Inc. as of June 30, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 3 to the financial statements, the Organization changed its method of accounting for donated HabiStore inventories in 2011.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 15, 2011 on our consideration of Habitat for Humanity Tucson, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of those reports 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 internal controls over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Keegan, Linscott & Kenon, P.C.

Tucson, Arizona
November 15, 2011



STATEMENTS OF FINANCIAL POSITION
AS OF JUNE 30,

	2011	2010, Restated
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,269,043	\$ 2,182,817
Grants and contracts receivable	29,512	68,299
Pledges receivable	51,300	75,000
Mortgages receivable net of discount, due within one year	667,411	607,686
Inventories	1,683,927	1,878,527
Prepaid expenses and other current assets	18,402	64,912
Total current assets	4,719,595	4,877,241
Property and equipment, net	1,762,178	275,346
Mortgages receivable net of discount, due after one year	4,670,838	4,287,531
Land held for investment	66,000	234,127
Beneficial interest in remainder trust	29,081	20,940
Refundable deposits	15,500	15,500
Investments - restricted	19,219	15,798
Total assets	\$ 11,282,411	\$ 9,726,483
Liabilities		
Current liabilities:		
Accounts payable	\$ 167,519	\$ 61,062
Accrued salaries	21,659	53,666
Accrued leave	61,890	46,256
Other accrued liabilities	25,843	31,337
Agency payable	19,434	21,093
Current obligations under capital leases	3,586	3,045
Current maturities of long-term debt	1,037,482	1,347,685
Total current liabilities	1,337,413	1,564,144
Obligations under capital leases	5,544	8,976
Deferred compensation	40,000	-
Long-term debt	1,096,169	33,750
Total liabilities	2,479,126	1,606,870
Net assets		
Unrestricted net assets	8,039,809	7,541,695
Temporarily restricted net assets	743,476	557,918
Permanently restricted net assets	20,000	20,000
Total net assets	8,803,285	8,119,613
Total liabilities and net assets	\$ 11,282,411	\$ 9,726,483

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30,

	2011				2010, Restated			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues and Other Support								
Cash contributions	\$ 725,409	\$ 1,216,419	\$ -	\$ 1,941,828	\$ 708,998	\$ 1,016,742	\$ -	\$ 1,725,740
In-kind contributions (Habitat)	497,076	-	-	497,076	258,922	-	-	258,922
In-kind contributions (HabiStore)	850,950	-	-	850,950	907,232	-	-	907,232
Net sales to homeowners	839,631	-	-	839,631	751,411	-	-	751,411
Interest income - mortgages	479,152	-	-	479,152	367,706	-	-	367,706
Grant/contract revenues	1,143,467	-	-	1,143,467	525,527	-	-	525,527
HabiStore sales	902,128	-	-	902,128	872,634	-	-	872,634
Second mortgages collected	-	-	-	-	5,750	-	-	5,750
Change in value of remainder trust	-	8,141	-	8,141	-	2,813	-	2,813
Interest and investment income	7,287	-	-	7,287	3,787	-	-	3,787
Realized gains (losses)	(1,928)	-	-	(1,928)	136,509	-	-	136,509
Other income	211,395	-	-	211,395	37,887	-	-	37,887
Net assets released from restrictions	1,039,002	(1,039,002)	-	-	677,089	(677,089)	-	-
Total revenues and other support	6,693,569	185,558	-	6,879,127	5,253,452	342,466	-	5,595,918
Expenses								
Program services - homes	3,073,449	-	-	3,073,449	2,681,846	-	-	2,681,846
Program services - land	765,493	-	-	765,493	680,745	-	-	680,745
Program - HabiStore	1,713,760	-	-	1,713,760	1,572,314	-	-	1,572,314
Supporting services								
Fundraising	327,568	-	-	327,568	319,563	-	-	319,563
Management and general	315,185	-	-	315,185	287,703	-	-	287,703
Total expenses	6,195,455	-	-	6,195,455	5,542,171	-	-	5,542,171
Change in net assets	498,114	185,558	-	683,672	(288,719)	342,466	-	53,747
Net assets, beginning of year	\$ 7,541,695	\$ 557,918	\$ 20,000	\$ 8,119,613	\$ 7,830,414	\$ 215,452	\$ 20,000	\$ 8,065,866
Net assets, end of year	<u>\$ 8,039,809</u>	<u>\$ 743,476</u>	<u>\$ 20,000</u>	<u>\$ 8,803,285</u>	<u>\$ 7,541,695</u>	<u>\$ 557,918</u>	<u>\$ 20,000</u>	<u>\$ 8,119,613</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30,

	2011	2010, Restated
Cash Flows From Operating Activities		
Change in net assets	\$ 683,672	\$ 53,747
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Loss on write-down of land held for construction inventory	400,000	545,574
Loss on write-down of land held for investments	168,127	100,000
Loss on disposal of fixed assets	12,624	3,277
Depreciation	74,500	43,641
Unrealized gain on restricted investments	(3,421)	(1,751)
Change in split interest agreement	(8,141)	(2,813)
Changes in operating assets and liabilities:		
Grants receivable	38,787	19,247
Pledges receivable	23,700	(75,000)
Mortgages receivable	(443,032)	(80,949)
Prepaid expenses and other current assets	46,510	(49,927)
Inventories	(205,400)	473,542
Accounts payable	106,457	(351,104)
Accrued salaries	(32,007)	8,746
Accrued leave	15,634	(4,721)
Other accrued liabilities	(5,494)	25,371
Agency payables	(1,659)	1,408
Deferred compensation	40,000	-
Net cash provided by operating activities	910,857	708,288
Cash Flows From Investing Activities		
Acquisition of property and equipment	(448,956)	(8,420)
Addition to land investment	-	(4,798)
Net cash used in investing activities	(448,956)	(13,218)
Cash Flows From Financing Activities		
Principal payments on long-term borrowings	(372,784)	(223,882)
Payments made on capital lease obligations	(2,891)	(1,979)
Net cash used in financing activities	(375,675)	(225,861)
Net increase in cash and cash equivalents	86,226	469,209
Cash and cash equivalents at beginning of year	2,182,817	1,713,608
Cash and cash equivalents at end of year	\$ 2,269,043	\$ 2,182,817
Supplemental Disclosure of Cash Flow Information		
Cash paid during the year for interest	\$ 85,612	\$ 39,321
Supplemental Schedule of Non-Cash Investing and Financing Activities		
Non-cash capital acquisitions	\$ 1,125,000	\$ 14,000
Donated property and equipment	\$ -	\$ 8,600

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2011

	<u>Program Services</u>	<u>Program HabiStore</u>	<u>Management and General</u>	<u>Fundraising</u>	<u>Total</u>
Expenses					
Compensation of current officers, directors, trustees, and key employees	\$ 292,775	\$ 90,094	\$ 63,068	\$ 109,296	\$ 555,233
Other salaries and wages	406,701	145,348	79,556	67,478	699,083
Pension plan contributions, including 401k and 403b employer contributions	15,371	5,824	4,638	7,590	33,423
Other employee benefits	132,905	50,456	55,924	42,261	281,546
Payroll taxes	51,926	23,219	12,061	11,300	98,506
Total personnel	<u>899,678</u>	<u>314,941</u>	<u>215,247</u>	<u>237,925</u>	<u>1,667,791</u>
Grants and other assistance to government and organizations in the U.S.	67,993	-	-	-	67,993
Fees for services (non-employees)					
Legal	2,689	-	-	-	2,689
Accounting	-	1,799	20,602	-	22,401
Investment management fees	-	-	66	-	66
Other	6,317	48,547	5,737	774	61,375
Total fees for services	<u>9,006</u>	<u>50,346</u>	<u>26,405</u>	<u>774</u>	<u>86,531</u>
Advertising and marketing	40,628	102,758	409	28,877	172,672
Office expenses	21,795	19,499	12,483	11,774	65,551
Information technology	10,549	910	2,412	9,355	23,226
Occupancy	13,988	190,183	20,945	2,401	227,517
Travel	8,703	2,181	2,580	411	13,875
Conferences, conventions, and meetings	14,648	330	4,292	1,997	21,267
Insurance	48,553	23,702	3,149	986	76,390
Other expenses					
Construction costs	1,784,833	80	-	11,514	1,796,427
Land development costs	765,493	-	-	-	765,493
HabiStore cost of goods sold	-	866,248	-	-	866,248
Habitat International Tithe	40,000	-	-	-	40,000
Bank and credit card fees	190	11,388	827	6,762	19,167
Employee/volunteer retention	19,383	3,361	1,090	262	24,096
Equipment rent, repair, and maintenance	10,046	9,524	6,406	3,709	29,685
Vehicle expenses	22,521	18,630	7,465	195	48,811
Special events	2,872	890	-	7,476	11,238
Mortgage servicing expenses	2,527	-	-	-	2,527
Miscellaneous expenses	7,524	774	539	-	8,837
Total other expenses	<u>2,655,389</u>	<u>910,895</u>	<u>16,327</u>	<u>29,918</u>	<u>3,612,529</u>
Total expenses before interest and depreciation	3,790,930	1,615,745	304,249	324,418	6,035,342
Interest	35,067	49,608	438	500	85,613
Depreciation and amortization	12,945	48,407	10,498	2,650	74,500
Total expenses	<u>\$ 3,838,942</u>	<u>\$ 1,713,760</u>	<u>\$ 315,185</u>	<u>\$ 327,568</u>	<u>\$ 6,195,455</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2010, RESTATED

	Program Services	Program HabiStore	Management and General	Fundraising	Total
Expenses					
Compensation of current officers, directors, trustees, and key employees	\$ 195,658	\$ 72,360	\$ 55,404	\$ 102,795	\$ 426,217
Other salaries and wages	350,865	126,108	70,122	83,551	630,646
Pension plan contributions, including 401k and 403b employer contributions	14,387	5,010	4,183	6,334	29,914
Other employee benefits	89,300	36,944	42,474	25,441	194,159
Payroll taxes	43,557	16,000	10,289	13,740	83,586
Total personnel	693,767	256,422	182,472	231,861	1,364,522
Grants and other assistance to government and organizations in the U.S.	97,140	-	-	-	97,140
Fees for services (non-employees)					
Legal	3,596	-	736	-	4,332
Accounting	-	2,000	28,000	-	30,000
Investment management fees	-	-	125	-	125
Other	5,275	40,884	5,623	713	52,495
Total fees for services	8,871	42,884	34,484	713	86,952
Advertising and marketing	31,862	78,111	634	33,755	144,362
Office expenses	18,581	15,112	14,733	8,200	56,626
Information technology	5,541	241	1,594	5,766	13,142
Occupancy	13,784	218,380	19,841	2,465	254,470
Travel	4,677	96	373	177	5,323
Conferences, conventions, and meetings	17,748	60	3,220	308	21,336
Insurance	54,611	23,465	4,040	1,160	83,276
Other expenses					
Construction costs	1,542,852	-	-	12,934	1,555,786
Land development costs	714,302	-	-	-	714,302
HabiStore cost of goods sold	-	871,590	-	-	871,590
Habitat International Tithe	55,553	-	-	-	55,553
Bank and credit card fees	-	10,520	2,312	5,998	18,830
Employee/volunteer retention	5,701	3,963	376	297	10,337
Equipment rent, repair, and maintenance	8,291	12,451	5,014	3,390	29,146
Vehicle expenses	13,421	19,437	7,524	91	40,473
Special events	8,774	48	-	6,511	15,333
Mortgage servicing expenses	3,904	-	-	-	3,904
Miscellaneous expenses	15,902	201	42	661	16,806
Total other expenses	2,368,700	918,210	15,268	29,882	3,332,060
Total expenses before interest and depreciation	3,315,282	1,552,981	276,659	314,287	5,459,209
Interest	38,465	-	464	392	39,321
Depreciation and amortization	8,844	19,333	10,580	4,884	43,641
Total expenses	<u>\$ 3,362,591</u>	<u>\$ 1,572,314</u>	<u>\$ 287,703</u>	<u>\$ 319,563</u>	<u>\$ 5,542,171</u>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THE FINANCIAL STATEMENTS

NOTES TO FINANCIAL STATEMENTS

1. Organization

An independently and locally governed affiliate of Habitat for Humanity International; Habitat for Humanity Tucson, Inc., (“Habitat,” or the “Organization”) was incorporated as a tax-exempt nonprofit organization in the State of Arizona in 1980 and is primarily and directly responsible for its own operations. Habitat works to end poverty housing in Pima and Santa Cruz counties by creating opportunities for home ownership in partnership with low-income families, and by making safe, decent, affordable housing a matter of community conscience and action. Habitat builds market-quality homes utilizing volunteer labor and sells homes to qualified low-income families for minimal cash down and utilizing a 15-25 year non-interest bearing mortgage. Habitat requires each of its home buyers to provide “sweat-equity” by participating in a significant amount of labor in its home construction program, and/or in some other form of community service. In addition, each buyer is provided pre-purchase and post-purchase homeowner education and counseling.

Habitat’s Program Services include its home construction program, homeowner educational services, volunteer management, and advocacy for affordable housing. In 2011, Habitat also started a rehab program for weatherization upgrades on thirty (30) older homes in low income areas of Tucson. Costs associated with the construction of homes and homeowner services are expensed in program services—homes in the accompanying statement of activities and changes in net assets. Costs incurred by Habitat related to land held for construction or investment purposes are expensed in program services—land in the statement of activities and changes in net assets.

In addition to home building activities, Habitat also operates a retail thrift operation (d.b.a. the HabiStore). The HabiStore specializes in selling surplus new and used building and home improvement materials, appliances and furniture to the public. The HabiStore receives donated usable materials from retail businesses, contractors, individuals and other organizations. Costs associated with operation of the HabiStore are expensed in program-HabiStore in the accompanying statement of activities and changes in net assets. All net proceeds from the operation of the HabiStore help support and enhance Habitat’s non-profit mission-related activities.

2. Summary of Significant Accounting Policies

Basis of Presentation

The Organization follows accounting standards set by the Financial Accounting Standards Board (“FASB”). The FASB sets generally accepted accounting principles (“GAAP”) that the Organization follows to ensure the consistent reporting of its financial condition, changes in net assets and cash flows. References to GAAP issued by the FASB in the accompanying footnotes is to the FASB Accounting Standards Codification (“ASC”).

The Organization’s financial statements have been prepared in accordance with standards of accounting and financial reporting under ASC 958, *Not-for-Profit Entities* and the AICPA Audit and Accounting Guide, *Not-for-Profit Entities*. Under this authoritative guidance, the Organization is required to provide financial statements which are prepared to focus on the Organization as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions.

Resources are reported for accounting purposes in separate classes of net assets based on the existence or absence of donor-imposed restrictions. In the accompanying financial statements, net assets having similar characteristics have been combined into similar categories.

NOTES TO FINANCIAL STATEMENTS

Summary of Significant Accounting Policies (continued)

Basis of Presentation (continued)

- **Unrestricted** – Net assets that are not subject to donor-imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of the Board of Directors. Restricted net assets received and expended in the same year are classified as unrestricted.
- **Temporarily Restricted** – Net assets whose use by the Organization is subject to donor-imposed stipulations that can be fulfilled by actions of the Organization pursuant to those stipulations or that expire through the passage of time.
- **Permanently Restricted** – Net assets that are subject to donor-imposed stipulations that assets be maintained permanently by the Organization. The donors of these assets permit the Organization to use all or part of the investment return of these assets for continuing operations which may be subject to certain restrictions.

Expenses are generally reported as decreases in unrestricted net assets. Expirations of donor-imposed stipulations that simultaneously increase one class of net assets and decrease another are reported as transfers between the applicable classes of net assets. Gains and losses on investments and other assets and liabilities are reported as increases and decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or law.

Endowment Funds

The Organization's endowment was established to support, further and enhance the mission of Habitat. This agency advised endowment is held and managed at the Community Foundation for Southern Arizona (the "Foundation"). Agency advised funds represent assets transferred by Habitat to the Foundation to establish an endowment for the benefit of Habitat (i.e., Habitat has specified themselves as the beneficiary).

The Organization has interpreted the "Management of Charitable Funds Act" (Arizona's version of the Uniform Prudent Management of Institutional Funds Act or UPMIFA) as requiring the preservation of the fair value of the original gift. As a result of this interpretation, the Organization classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) if applicable, 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 remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by the law.

The Organization is subject to the Foundation's investment and spending policies for endowment assets. These policies attempt to provide a predictable stream of funding to programs supported by the endowment funds while seeking to maintain the purchasing power of the endowment assets. The endowment assets are invested in a balanced portfolio comprised of fixed income securities and equities.

NOTES TO FINANCIAL STATEMENTS

Summary of Significant Accounting Policies (continued)

Endowment Funds (continued)

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 current law requires the Organization to retain for a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, deficiencies of this nature that are reported in unrestricted net assets were \$781 and \$4,202 as of June 30, 2011 and 2010, respectively. These deficiencies resulted from unfavorable market fluctuations.

Revenue Recognition

- **Contributions** – Unconditional promises to give are recognized as revenue when the gifts' underlying promises are received by Habitat. The Organization reports contributions of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets to a specific time period or a specific purpose. When a donor restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities and changes in net assets as net assets released from restrictions.
- **Sales to Homeowners** – Sales to homeowners represent the sale of homes built by Habitat. The resulting mortgages are non-interest bearing and have been discounted based upon prevailing market rates for low-income housing at the inception of the mortgages. The sales to homeowners in the statement of activities and changes in net assets are presented net of the applicable discount. Habitat recognizes the income from the sales to homeowners on the completed contract method when home closings occur.
- **Grants and Contracts** – The Organization is funded through various grants, cost reimbursement and performance-based contracts. Revenue is recognized as follows:
 - Grants and cost reimbursement contracts – as costs are incurred under the contract.
 - Performance-based contracts – as performance units of services are provided.

The Organization accounts for grants and contracts as exchange transactions. Revenue is recognized as an increase in the statement of activities and changes in net assets as stipulated performance is executed, or as expenditures are incurred in accordance with applicable agreements under expenditure reimbursement contracts. A receivable is recorded to the extent contract revenue exceeds payment received; conversely, advances in excess of costs incurred are deferred and recognized as revenue when the related expense is incurred.

- **In-Kind Contributions** – Support arising from donated goods, property and services is recognized in the financial statements at its fair value. Donated services are recognized when the services received:
 - a) Create or enhance non-financial assets, or
 - b) Require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.

NOTES TO FINANCIAL STATEMENTS

Summary of Significant Accounting Policies (continued)

Revenue Recognition (continued)

The Organization utilizes the services of outside volunteers to perform a variety of tasks that assist the Organization. The fair value of these services is not recognized in the accompanying financial statements since they do not meet the criteria for recognition under accounting principles generally accepted in the United States of America.

Habitat receives many in-kind contributions of materials and supplies used in the construction and furnishing of its homes. Total amounts of contributed supplies and materials for the years ended June 30, 2011 and 2010 were \$497,076 and \$258,922, respectively. In addition to the materials and supplies, in 2011 and 2010, Habitat received 54,050 and 42,171 hours, respectively, donated from volunteers assisting the organization.

Habitat also received considerable non-cash contributions of furniture, household items, and other materials used for re-sale and operations at the HabiStore. The total value of items donated to the HabiStore for the years ended June 30, 2011 and 2010 was \$850,950 and \$907,232, respectively.

During the years ended June 30, 2011 and 2010, Habitat received gift cards from local home improvement and grocery retailers in the aggregate amount of \$16,900 and \$30,000, respectively. The remaining balances accumulated on all cards of \$20,891 and \$18,852 have been included in supplies and materials inventory for the years ended June 30, 2011 and 2010, respectively.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash in bank accounts and money market accounts with original maturities of three months or less. Cash equivalents are stated at cost plus accrued interest, which approximates fair value and are classified as Level 1 assets. The Organization places its cash and cash equivalents with high credit quality institutions. At times, such amounts may be in excess of the FDIC insurance limit; however, management does not believe it is exposed to any significant credit risk related to cash and cash equivalents. All such cash accounts are monitored by management to mitigate risk.

Grants and Contracts Receivables

Grants and contracts receivables are stated at the amount the Organization expects to collect. Habitat maintains allowances for doubtful accounts for estimated losses resulting from the inability of its grantors and customers to make required payments. Management considers the following factors when determining the collectability of specific grantor accounts: grantor credit-worthiness, past transactions history with the grantor, current economic industry trends, and changes in grantor payment terms. If the financial condition of the Organization's grantors were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received.

At June 30, 2011 and 2010, grants and contracts receivables are considered fully collectible by management; therefore, no allowance for doubtful accounts has been provided.

NOTES TO FINANCIAL STATEMENTS

Summary of Significant Accounting Policies (continued)

Mortgages Receivable

Mortgages receivable consist of non-interest bearing mortgages, which are secured by real estate and payable in monthly installments. The majority of the mortgages have an original maturity of 18-25 years. These mortgages have been discounted at various rates ranging from 6.07% to 11.91% based on the prevailing market rates for low-income housing at the inception of the mortgages. Interest income (mortgage discount amortization) is recorded using the effective interest method over the lives of the mortgages. Receivables related to the mortgages are considered past-due or delinquent by the Organization when they are 30 days late.

Habitat's estimate for allowance for loan losses is based on historical collection experience and a review of the status of the mortgages receivable. Through its Homeowner Services program, Habitat works with delinquent homeowners to identify opportunities for financial budgeting improvement. The Organization has historically experienced great success in educating delinquent homeowners, and structuring payment plans to cure delinquencies within a minimal amount of time. It is reasonably possible that Habitat's estimate of the allowance for loan losses will change in future years. Due to the historical success experienced by the Organization in regards to collecting mortgages receivable, management has determined that all receivables are collectible as of June 30, 2011 and 2010. Accordingly, no allowance for loan losses is reported as of June 30, 2011 and 2010 in the accompanying financial statements.

At times, Habitat sells receivable residential mortgage loans to financial institutions, and obtains servicing assets as a result of the sale. Gain or loss on sale of the receivables depends in part on both the previous carrying amount of the financial assets involved in the transfer and the proceeds received. Habitat continues to service the sold mortgage loans, and remits related payment collections to the purchasing financial institutions in accordance with sale agreements. Due to the fact that payments are remitted in arrears in accordance with sales contracts, the Organization has reported an agency payable in the accompanying statements of financial position, reflective of the fact that certain collections related to the sold mortgages had not been remitted to the purchasing financial institutions as of June 30, 2011 and 2010.

Inventories

HabiStore purchased inventories are stated at the lower of cost or market value.

The Organization's inventories also include land held for construction, construction-in-progress, and completed homes, and are stated at the lower of cost (specific identification) or market (net realizable value).

All direct material and equipment costs and those indirect costs related to home construction are recorded as construction-in-process inventory on the statement of financial position as they are incurred. Land costs included in construction-in-process are stated at the lower of cost or market value. When revenue from the sale of a home is recognized, the corresponding costs are then expensed in the statement of activities and changes in net assets as program services.

Land Held for Investment

Land held for investment represents donated or purchased properties that are currently unavailable for the construction of homes. Land held for investment is reported at the lower of cost or fair value, and is initially measured at acquisition cost (including brokerage and other transaction fees) if purchased or at fair value if received as a contribution or through an agency transaction.

NOTES TO FINANCIAL STATEMENTS

Summary of Significant Accounting Policies (continued)***Land Held for Investment (continued)***

Due to the current decline in the Tucson, Arizona real estate market, the Organization reviewed the carrying value of the land held for investment for possible impairment. As a result, land held for investment with a carrying amount of \$334,127 was written down to a fair value of \$234,127 at June 30, 2010 and \$66,000 at June 30, 2011, resulting in impairment charges of \$100,000 and \$168,127, respectively, which are included as expenses in program services-land in the accompanying statements of activities and changes in net assets.

Property and Equipment

Property and equipment are stated at cost if purchased, or fair value, if donated. Depreciation and amortization are calculated using the straight-line method over the estimated useful lives of the assets or the applicable lease terms.

Depreciation is calculated using the straight-line method over the following estimated useful lives of the assets:

Buildings	39 years
Building improvements	7-39 years
Office and construction equipment and furniture	3-15 years
Vehicles	3-5 years

The Organization's policy is to capitalize expenditures for property and equipment and donated property and equipment received that exceed \$5,000 and have a useful life greater than one year. When items are retired or disposed of, the cost and accumulated depreciation are removed from the accounts and any gain or loss is included in the statement of activities and changes in net assets. Repairs or betterments in excess of \$5,000 that materially prolong the useful lives of assets are capitalized. Repairs and maintenance for normal upkeep are expensed as incurred.

Leased property and equipment meeting capital lease criteria are capitalized at the lower of present value of the related lease payments or the fair value of the leased asset at the inception of the lease. Amortization is calculated on the straight-line method based on the lease term.

In accordance with ASC 360-10, *Property, Plant and Equipment*, The Organization periodically reviews the carrying value of long-lived assets held and used, and assets to be disposed of, for possible impairment when events and circumstances warrant such a review. Through June 30, 2011, the Organization had not experienced impairment losses on its long-lived assets.

Investments - Restricted

In accordance with ASC 958-605, *Not-for-Profit Entities – Revenue Recognition*, the Organization measures the fair value of agency advised funds held at the Community Foundation for Southern Arizona using the fair value of the underlying assets. Annual distributions from the funds are reported as investment income. Investment income, gains and losses are reported in the accompanying statement of activities and changes in net assets as increases or decreases in net assets.

NOTES TO FINANCIAL STATEMENTS

Summary of Significant Accounting Policies (continued)

Investments – Restricted (continued)

The Community Foundation for Southern Arizona on behalf of the Organization invests in professionally managed portfolios that contain equity and fixed income securities. Such investments are exposed to various risks such as market and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term would materially affect investment balances and the amounts reported in the accompanying financial statements.

Income Taxes

The Organization is exempt from federal income tax under Section 501(c)(3), as confirmed by a determination letter issued by the Internal Revenue Service and is classified as other than a private foundation under IRC Section 509(a)(1).

On July 1, 2009, the Organization adopted the accounting standard on accounting for uncertainty in income taxes. Management evaluated the Organization's tax positions and concluded that the Organization had taken no uncertain tax positions that require adjustment to the financial statements to comply with the provisions of the accounting standard. In addition, Management is not aware of any matters which would cause the Organization to lose its tax-exempt status. In general, the Organization is no longer subject to income tax examinations by the U.S. federal, state or local tax authorities for years before 2008.

The Organization recognizes interest and penalties related to unrecognized tax benefits as accrued expenses in its accompanying financial statements. During the year ended June 30, 2011, the Organization did not recognize any interest and penalties.

Advertising and Marketing Costs

Habitat expenses advertising and marketing costs as they are incurred. Advertising and marketing expense totaled \$172,671 and \$144,362 for the years ended June 30, 2011 and 2010, respectively.

Allocation of Common Expenses

Certain direct, indirect and administrative expenses are incurred which benefit more than one program or grant; therefore, the Organization allocates these expenses accordingly using time charged by employees, square footage and various other methods.

Defined Contribution Plan

Effective July 2001, Habitat initiated a 401(k) defined contribution plan (401(k) Plan) to provide retirement and incidental benefits for its employees. Under the Plan, all employees who had completed one (1) year of service were permitted to make contributions to the Plan, and were eligible to receive matching contributions. During 2008, the Plan was amended to allow all full-time employees to make contributions to the Plan (the one year of service requirement was eliminated for employee contributions, not for employer matching). Habitat makes discretionary matching contributions to the Plan that meet safe-harbor requirements as described by the Plan document. Employees may contribute up to 100% of compensation, up to a maximum of \$16,500 and a \$5,500 catch up contribution if the employee is fifty (50) years of age or older. Matching Safe Harbor Contributions made by Habitat are equal to 3% of the employee's compensation for the Plan year plus 50% of each eligible employee's contributions that exceed 3% of compensation for the Plan year, not to exceed 5% of the employee's compensation for the Plan year. Elective deferrals are vested upon entering the plan. Matching Safe Harbor Contributions are 100% vested after three (3) years of service. For the years ended June 30, 2011 and 2010, matching contributions totaled \$33,423 and \$29,914, respectively.

NOTES TO FINANCIAL STATEMENTS

Summary of Significant Accounting Policies (continued)

Use of 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 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. Significant estimates made by management include the allowance for doubtful accounts, allowance for loan losses, valuation of donated services and goods, and valuations of inventory and land held for investment.

3. Accounting Change

On July 1, 2010, the Organization elected to change its method of valuing its donated HabiStore inventory. Previously, such inventory was initially recorded at the approximate fair value at the date of donation. However, in accordance with ASC 958-605-25-4, *Not-for-Profit Entities – Revenue Recognition*, the donated inventory will not be recorded in the financial statements. The Organization believes this is preferable because many of the donated items are used or are overstock items. Consequently, the value of such donations is not readily determinable until the merchandise is sold. Sales are recorded at the point of sale.

As a result of this change, in accordance with ASC 250, *Accounting Changes and Error Corrections*, comparative financial statements of prior years have been adjusted to apply the new method retrospectively. The following financial statement line items for fiscal year 2010 were affected by the change in accounting principle:

NOTES TO FINANCIAL STATEMENTS

Accounting Change (continued)

Statement of Activities and Changes in Net Assets - 2010

	<u>As Originally Reported</u>	<u>As Adjusted</u>	<u>Effect of Change</u>
Expenses			
Program - HabiStore	\$ 1,551,004	\$ 1,572,314	\$ 21,310
Change in net assets	75,057	53,747	(21,310)
Net assets, June 30, 2009	8,270,969	8,065,866	(205,103)
Net assets, June 30, 2010	8,346,026	8,119,613	(226,413)

Statement of Financial Position - June 30, 2010

	<u>As Originally Reported</u>	<u>As Adjusted</u>	<u>Effect of Change</u>
Inventories	\$ 2,104,940	\$ 1,878,527	\$ (226,413)
Unrestricted net assets	7,768,108	7,541,695	(226,413)

Statement of Functional Expenses - 2010

	<u>As Originally Reported</u>	<u>As Adjusted</u>	<u>Effect of Change</u>
HabiStore cost of goods sold	\$ 850,280	\$ 871,590	\$ 21,310

4. New Accounting Pronouncements

FASB ASC 820, *Fair Value Measurements and Disclosures*, defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. In January 2010, FASB issued Accounting Standards Update (“ASU”) No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*, which requires additional disclosures and clarifies existing guidance for disclosures required by FASB ASC 820. The guidance in ASU No. 2010-06 is effective for interim and annual reporting beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward activity in Level 3 fair value measurements. Those disclosures are affective for fiscal years beginning after December 15, 2010.

NOTES TO FINANCIAL STATEMENTS

5. Fair Value Measurements

Effective July 1, 2008, the Organization adopted ASC 820, *Fair Value Measurements and Disclosures* (“ASC 820”), for financial assets and liabilities measured at fair value on a recurring basis. This statement provides a definition of fair value which focuses on an exit price rather than an entry price, establishes a framework for measuring fair value which emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and requires expanded disclosure about fair value measurements. In accordance with ASC 820, the Organization may use valuation techniques consistent with the market, income, and cost approach to measure fair value. The adoption of ASC 820 did not have a material impact on the Organization’s statements of financial position, activities and changes in net assets, or cash flows.

To increase consistency and comparability in fair value measurements and related disclosures, the Organization utilizes the fair value hierarchy required by ASC 820 which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

- | | |
|---------|---|
| Level 1 | Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the Organization has the ability to access at the measurement date. |
| Level 2 | Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly. |
| Level 3 | Valuations based on inputs that are unobservable and significant to the overall fair value measurement. |

Inputs are used in applying the various valuation techniques and broadly refer to the assumptions that market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, specific and broad credit data, liquidity statistics, and other factors. The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Organization in determining fair value is greatest for instruments categorized in Level 3. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Fair value is a market-based measure considered from the perspective of a market participant who holds the asset or owes the liability rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Organization’s own assumptions are set to reflect those that market participants would use in pricing the asset or liability at the measurement date. The Organization uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified from Level 1 to Level 2 or Level 2 to Level 3.

The Organization defines active markets for equity instruments based on the average daily trading volume both in absolute terms and relative to the market capitalization for the instrument. The Organization defines active markets for debt instruments based on both the average daily trading volume and the number of days with trading activity.

NOTES TO FINANCIAL STATEMENTS

Fair Value Measurements (continued)

The beneficial interest in the remainder trust held at Habitat for Humanity International, Inc., is classified within Level 3 of the fair value hierarchy due to the lack of a market in which the Organization's beneficial interest in the remainder trust could be bought or sold. Fair value of the beneficial interest is determined based on expected cash flows.

The restricted investments held at the Community Foundation of Southern Arizona are classified within Level 3 of the fair value hierarchy due to the lack of a market in which the Organization's units of participation in the Foundation's pooled income trust (i.e., the beneficial interest) could be bought or sold. The Organization measures the fair value of its beneficial interest using the fair value of the underlying assets (net asset value).

The land held for investment is classified within Level 2 of the fair value hierarchy due to there being an inactive market for these types of lots. The Organization used comparable sales as a proxy to determine fair value of its land held for investment.

The following table presents the Organization's financial assets that are measured at fair value on a recurring basis June 30, 2011, consistent with the fair value hierarchy provisions of ASC 820:

Description	6/30/2011	Assets at Fair Value at June 30, 2011 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Beneficial interest in remainder trust	\$ 29,081	\$ -	\$ -	\$ 29,081
Beneficial interest in restricted investments held at Community Foundation of Southern Arizona	19,219	-	-	19,219
Total	<u>\$ 48,300</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 48,300</u>

Description	Fair Value Measurements at June 30, 2011 Using Significant Unobservable Inputs (Level 3)		
	Beneficial Interest in Remainder Trust	Restricted Investments	Total
Balance, July 1, 2010	\$ 20,940	\$ 15,798	\$ 36,738
Total gains or losses (realized/unrealized) included in changes in net assets	8,141	3,421	11,562
Balance, June 30, 2011	<u>\$ 29,081</u>	<u>\$ 19,219</u>	<u>\$ 48,300</u>

NOTES TO FINANCIAL STATEMENTS

Fair Value Measurements (continued)

The following are the major categories of assets and liabilities measured at fair value on a nonrecurring basis during the year ended June 30, 2011, consistent with the fair value hierarchy provisions of ASC 820:

Description	6/30/2011	Assets at Fair Value at June 30, 2011 Using:			Total Losses for the Year Ended 6/30/2011
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Land held for investment	\$ 66,000	\$ -	\$ 66,000	\$ -	\$ (168,127)
Total	\$ 66,000	\$ -	\$ 66,000	\$ -	\$ (168,127)

The following table presents the Organization's financial assets that are measured at fair value on a recurring basis June 30, 2010, consistent with the fair value hierarchy provisions of ASC 820:

Description	6/30/2010	Assets at Fair Value at June 30, 2010 Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Beneficial interest in remainder trust	\$ 20,940	\$ -	\$ -	\$ 20,940
Beneficial interest in restricted investments held at Community Foundation of Southern Arizona	15,798	-	-	15,798
Total	\$ 36,738	\$ -	\$ -	\$ 36,738

Description	Fair Value Measurements at June 30, 2010 Using Significant Unobservable Inputs (Level 3)		
	Beneficial Interest in Remainder Trust	Restricted Investments	Total
Balance, July 1, 2009	\$ 18,127	\$ 14,227	\$ 32,354
Total gains or losses (realized/unrealized) included in changes in net assets	2,813	1,571	4,384
Balance, June 30, 2010	\$ 20,940	\$ 15,798	\$ 36,738

NOTES TO FINANCIAL STATEMENTS

Fair Value Measurements (continued)

The following are the major categories of assets and liabilities measured at fair value on a nonrecurring basis during the year ended June 30, 2010, consistent with the fair value hierarchy provisions of ASC 820:

Description	6/30/2010	Assets at Fair Value at June 30, 2010 Using:			Total Losses for the Year Ended 6/30/2010
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Land held for investment	\$ 234,127	\$ -	\$ 234,127	\$ -	\$ (100,000)
Total	\$ 234,127	\$ -	\$ 234,127	\$ -	\$ (100,000)

6. Inventories

Inventories consist of the following as of June 30:

	2011	2010, Restated
Land held for construction	\$ 869,779	\$ 1,611,000
Construction-in-progress	429,564	130,140
Supplies and materials	21,341	19,032
Completed homes inventory	351,595	115,505
HabiStore inventory	11,648	2,850
	\$ 1,683,927	\$ 1,878,527

Due to the changing conditions in the real estate market, management conducted a review of its land held for construction inventory. As a result, a provision for inventory losses of \$400,000 and \$545,574 was charged to program services-land in 2011 and 2010, respectively, to write down inventory to its net realizable value.

In November 2004, Habitat purchased 70.53 acres of land in Pima County. The land was platted for approximately 393 lots known as the Corazon del Pueblo Residential Cluster project. All infrastructures have been installed and land developed with the exception of common area sidewalks (which are 95% complete for the total project and 100% complete in areas with occupied houses) and landscaping. Habitat has thus far sold 312 lots to other builders. To date Habitat has closed on 31 houses within the project and at June 30, 2011, there were 50 lots available for Habitat's mission. Habitat originally financed the purchase and development of the land through an acquisition loan of \$3,250,000. The acquisition loan was replaced with an \$8,000,000 non-revolving construction loan that was collateralized by the assets and revenues of Habitat. That loan and all debt associated with it was retired in February 2007. During the year ended June 30, 2011, Habitat sold eight of the developed lots. As of June 30, 2011, all remaining lots are included in land held for construction.

NOTES TO FINANCIAL STATEMENTS

7. Property and Equipment

Property and equipment consist of the following as of June 30:

	<u>2011</u>	<u>2010</u>
Land	\$ 347,944	\$ 31,000
Buildings	1,258,007	98,316
Building improvements	209,983	143,492
Vehicles	90,911	90,911
Office and construction equipment and furniture	<u>164,867</u>	<u>172,549</u>
	2,071,712	536,268
Less accumulated depreciation	<u>309,534</u>	<u>260,922</u>
	<u>\$ 1,762,178</u>	<u>\$ 275,346</u>

8. Mortgages Receivable

During fiscal years 2011 and 2010, fifteen (15) and fourteen (14) homes, respectively, were sold to qualifying applicants. The resulting mortgages are non-interest bearing and the presentation of their book value has been discounted based upon the prevailing market rates for low-income housing at the inception of the mortgages (fiscal year 2011 and 2010 discount rates were 7.69% and 7.81%, respectively). Sales to homeowners for the years ended June 30 are as follows:

	<u>2011</u>	<u>2010</u>
Gross sales to homeowners	\$ 1,562,522	\$ 1,438,400
Less discount on sales to homeowners	<u>722,891</u>	<u>686,989</u>
Net sales to homeowners	<u>\$ 839,631</u>	<u>\$ 751,411</u>

Habitat directly finances all of the homes that it sells. Each mortgage is issued as a zero-interest mortgage to the buyer. Habitat discounts the mortgages using the prevailing market rates for low-income housing at the time the home is sold. The discount is amortized using the effective interest method. Mortgages receivable as of June 30 are as follows:

	<u>2011</u>	<u>2010</u>
Mortgages receivable at face value	\$ 9,598,488	\$ 8,892,090
Less unamortized discounts on mortgages	<u>4,260,239</u>	<u>3,996,873</u>
	<u>\$ 5,338,249</u>	<u>\$ 4,895,217</u>

NOTES TO FINANCIAL STATEMENTS

Mortgages Receivable (continued)

Future collections on these mortgages will be received over the next five years and thereafter as follows:

2012	\$	667,411
2013		657,576
2014		641,059
2015		625,868
2016		610,819
Thereafter		<u>6,395,755</u>
Total	\$	<u><u>9,598,488</u></u>

At times, Habitat will identify high performing mortgages receivable for sale to financial institutions. During 2011, Habitat sold none of its mortgages receivable. During 2010, Habitat sold eight (8) such mortgages receivable to Northern Trust Bank and recognized a gain of \$139,287 as a result of the sale. To date, Habitat has executed the sale of thirty nine (39) mortgages receivable.

Habitat continues to service the sold mortgages receivable by collecting payments from homeowners on behalf of the purchasing financial institutions. Homeowner payments are remitted by Habitat to the purchasing financial institutions in arrears. Accordingly, the Organization has reported an agency payable liability in the amount of \$19,434 and \$21,093 in the accompanying financial statements reflective of the homeowner payments held by Habitat at June 30, 2011 and 2010, respectively, that must be subsequently remitted to the purchasing financial institutions.

In accordance with ASC 860, *Transfers and Servicing*, the transfers of mortgages receivable by Habitat to purchasing financial institutions are accounted for as sales and result in the related receivables being excluded from the mortgages receivable balance on the statement of financial position. The agreements underlying sales of receivables contain provisions that indicate that Habitat is responsible for homeowner payment defaults on sold receivables, and in the event a loan is delinquent by ninety (90) days or more, Habitat shall use its best efforts to replace the non-performing loan with a substitute loan of substantially equal principal balance and a maturity date not longer than the non-performing loan.

Due to the Organization's continued involvement with the sold receivables as a servicer of the mortgages, Habitat management has further considered the servicing asset obtained by the Organization in accordance with ASC 860, *Transfers and Servicing*. Habitat management does not believe that the servicing asset resulting from the sale of mortgages has any significant value. Accordingly, no servicing assets have been recognized in the accompanying financial statements at June 30, 2011 and 2010.

NOTES TO FINANCIAL STATEMENTS

9. Long-Term Debt

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

	<u>2011</u>	<u>2010</u>
Northern Trust Bank \$2,500,000 Line of Credit (\$2,000,000 before December 2010). Interest calculated at the LIBOR rate plus 1% with a floor of 2.5%. Secured by Deeds of Trust and beneficial interest in certain notes receivable. Interest payable in monthly installments. Line of credit matures in December 2011.	\$ 542,686	\$ 193,875
Northern Trust Bank \$500,000 Line of Credit (\$1,000,000 before December 2010). Interest calculated at the LIBOR rate plus 1% with a floor of 2.5%. Interest payable in monthly installments. Line of credit matures in December 2011.	350,000	998,810
Diamond Ventures, Inc. non-revolving loan. Interest at 2% per annum is due and payable each month. Secured by Deeds of Trust. Principal payments due when land is sold that is included in the Deeds of Trust. Loan matures in April 2012.	105,000	155,000
Habitat for Humanity International (as part of the SHOPS grant), 0% note payable. Principal payable in monthly installments of \$703 beginning July 2011 through July 2015.	33,750	33,750
Northern Trust Bank mortgage loan. Due in monthly principal and interest installments of \$8,044 with interest at 5.89% per annum through September 2020 when a balloon payment for all remaining principal and interest becomes due. Secured by a Deed of Trust. The agreement requires a specific debt coverage ratio be maintained as measured at fiscal year-end. The Organization was in compliance with this debt covenant as of June 30, 2011.	<u>1,102,215</u>	<u>-</u>
	2,133,651	1,381,435
Less: current portion of long-term debt	<u>1,037,482</u>	<u>1,347,685</u>
Long-term debt	<u>\$ 1,096,169</u>	<u>\$ 33,750</u>

NOTES TO FINANCIAL STATEMENTS

Long-Term Debt (continued)

The scheduled maturities of debt principal payments are summarized as follows as of June 30, 2011:

2012	\$ 1,037,482
2013	41,902
2014	43,956
2015	46,143
2016	39,858
Thereafter	924,310
Total	<u>\$ 2,133,651</u>

Substantially all assets of Habitat, including all receivables and fixed assets have been pledged as collateral for the various lines of credits.

10. Beneficial Interest in Remainder Trust

In 2001, Habitat received a beneficial interest in a remainder trust held and administered by Habitat for Humanity International. Since the gift annuity will not be received until the death of the joint interest donors, the gift value has been discounted over the estimated remaining life of the donors. The fair value of the beneficial interest in the gift annuity is recorded in the accompanying financial statements based upon the estimated present value, and using a discount rate of 6.00%. The asset is included in temporarily restricted net assets with a value of \$29,081 and \$20,940 at June 30, 2011 and 2010, respectively. The change in value of the remainder trust for the years ended June 30, 2011 and 2010 was \$8,141 and \$2,813, respectively.

11. Lease Obligations

Prior to January 2011, the HabiStore operated out of leased facilities acquired in November 2005 and a leased warehouse space acquired in August 2005 through non-cancelable operating leases. The leases were five (5) year leases that called for monthly payments of \$13,694 and \$1,942 respectively (plus applicable taxes and charges) with 3.5% annual increases in base lease costs. Total lease payments for the years ended June 30, 2011 and 2010 were \$116,721 and \$189,598, respectively.

On September 30, 2010, Habitat executed the purchase of a new facility to serve as the retail location for the HabiStore. The new facility is located at 935 W. Grant Road, Tucson, AZ. The purchase price for the facility was \$1,475,000. A down-payment of \$350,000 was paid by Habitat upon closing of the purchase and the Organization obtained financing in the form of a first mortgage for the remaining \$1,125,000 (see Note 9). For the two-month period subsequent to purchase, Habitat leased the facility to the seller (an unrelated party). As a result, Habitat received \$21,614 in rental income during 2011 which is included in other income on the statement of activities and changes in net assets. HabiStore operations commenced at the new location in January 2011.

NOTES TO FINANCIAL STATEMENTS

Lease Obligations (continued)

Habitat also leases certain equipment under an agreement that is classified as a capital lease (which was entered into during 2010). The cost of the equipment under capital leases is included in the statement of financial position as property and equipment and was \$14,000 at June 30, 2011 and 2010. Accumulated amortization of the equipment totaled \$6,125 and \$2,625 at June 30, 2011 and June 30, 2010, respectively. Amortization of the equipment under capital lease is included in depreciation expense.

The future minimum lease payments required under the capital lease and the present value of the minimum future lease payments as of June 30, 2011, are as follows:

<u>Year Ended</u>	<u>Amount</u>
2012	\$ 5,862
2013	5,862
2014	<u>1,620</u>
Total minimum lease payments	13,344
Less executory costs	(2,390)
Less amount representing interest	<u>(1,824)</u>
Present value of net minimum lease payments	9,130
Less current obligations	<u>(3,586)</u>
Long-term obligations	<u><u>\$ 5,544</u></u>

12. Temporarily Restricted Net Assets

Temporarily restricted net assets consisted of the following at June 30:

	<u>2011</u>	<u>2010</u>
Remainder trust restricted until received	\$ 29,081	\$ 20,940
Contributions temporarily restricted as to use	<u>714,395</u>	<u>536,978</u>
	<u><u>\$ 743,476</u></u>	<u><u>\$ 557,918</u></u>

13. Permanently Restricted Net Assets

Permanently restricted net assets of \$20,000 consist of the endowment fund to be held indefinitely. The income derived from the fund is restricted for the purchase of kitchen equipment for Habitat's various home builds. Per the endowment policy, if kitchen equipment is not needed (all kitchen appliances are currently being contributed) then Habitat can use income from the endowment for the Organization's general building efforts.

NOTES TO FINANCIAL STATEMENTS

Permanently Restricted Net Assets (continued)

The composition of endowment net assets and the changes in endowment net assets as of June 30, 2011 are as follows:

Endowment net asset composition by type of fund as of June 30, 2011:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (781)	\$ -	\$ 20,000	\$ 19,219
Total funds	<u>\$ (781)</u>	<u>\$ -</u>	<u>\$ 20,000</u>	<u>\$ 19,219</u>

Changes in endowment net assets for the fiscal year ended June 30, 2011:

Endowment net assets, June 30, 2010	\$ (4,202)	\$ -	\$ 20,000	\$ 15,798
Investment return				
Investment income	-	393	-	393
Net appreciation / (depreciation)	-	3,028	-	3,028
Total investment return	-	3,421	-	3,421
Other changes	-	-	-	-
Transfer between funds	3,421	(3,421)	-	-
Endowment net assets, June 30, 2011	<u>\$ (781)</u>	<u>\$ -</u>	<u>\$ 20,000</u>	<u>\$ 19,219</u>

The composition of endowment net assets and the changes in endowment net assets as of June 30, 2010 are as follows:

Endowment net asset composition by type of fund as of June 30, 2010:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ (4,202)	\$ -	\$ 20,000	\$ 15,798
Total funds	<u>\$ (4,202)</u>	<u>\$ -</u>	<u>\$ 20,000</u>	<u>\$ 15,798</u>

Changes in endowment net assets for the fiscal year ended June 30, 2010:

Endowment net assets, June 30, 2009	\$ (5,773)	\$ -	\$ 20,000	\$ 14,227
Investment return				
Investment income	-	258	-	258
Net appreciation / (depreciation)	-	1,313	-	1,313
Total investment return	-	1,571	-	1,571
Other changes	-	-	-	-
Transfer between funds	1,571	(1,571)	-	-
Endowment net assets, June 30, 2010	<u>\$ (4,202)</u>	<u>\$ -</u>	<u>\$ 20,000</u>	<u>\$ 15,798</u>

NOTES TO FINANCIAL STATEMENTS

14. Advertising and Marketing Costs

The following costs are included in advertising and marketing costs for the years ended June 30:

	<u>2011</u>	<u>2010</u>
Direct advertising and marketing	\$ 108,640	\$ 48,395
Direct mail campaigns	41,237	53,278
Donated in-kind advertising	20,164	39,014
Newsletters and annual report	2,631	3,675
	<u>\$ 172,672</u>	<u>\$ 144,362</u>

15. Commitments and Contingencies***Collection of Second Mortgages***

In addition to the non-interest bearing mortgage received from the sale of each home, Habitat may issue a contingent second mortgage. The second mortgages, issued by Habitat, represent the excess of the market value of the home over the original loan at the date the second mortgage is executed. Should the homeowner pay off the primary mortgage early or default on the mortgage, the second mortgage would become due. Due to the recent and current decline in the real estate market, the second mortgage payoff is considered remote by Habitat, and therefore no receivable has been recorded in the current year financial statements. During the years ended June 30, 2011 and 2010, Habitat collected \$0 and \$5,750, respectively, of second mortgages that were paid off early.

Contract with the Pascua Yaqui Tribe

In May 2003, Habitat entered into a contract with the Pascua Yaqui tribe to build twenty two (22) homes for tribal members. Of these, five (5) homes were to be located on the reservation and sold directly to the tribe and seventeen (17) homes were to be located off of the reservation, and sold directly to Pascua Yaqui homeowners. Half of the principal payments from the mortgages receivable received by Habitat from the Pascua Yaqui homeowners covered under this contract are deposited into an interest-bearing account, held by both Habitat and the Pascua Yaqui tribe. Monies in the account (which totaled \$59,203 and \$27,198 as of June 30, 2011 and 2010, respectively) are designated for future home building projects with the Pascua Yaqui tribe and are included in cash and cash equivalents in the accompanying financial statements.

In 2009, Habitat and the Pascua Yaqui tribe agreed to reduce the target number of homes in the agreement to twenty (20) homes. In April of 2010 Habitat was notified by leadership of the Pascua Yaqui tribe that sewer connection fees were still owed to Pima County for five (5) homes previously built under the contract with the tribe. The total amount of fees owed for the homes has not been communicated to Habitat by Pima County as of the date of the financial statements. The Organization considers payment of the sewer fees probable, and based upon prior experience Habitat estimates the sewer fees to be \$5,000 per home, or \$25,000 in the aggregate. As of June 30, 2011 and 2010, Habitat recorded a liability related to the probable payment of these fees.

NOTES TO FINANCIAL STATEMENTS

Commitments and Contingencies (continued)

Neighborhood Stabilization Program 2 (“NSP2”) Agreement

On April 1, 2010, Habitat entered into a \$1,225,000 NSP2 Consortium Funding Agreement with Pima County for the construction of thirty five (35) homes in the Corazon del Pueblo subdivision, targeted to low, moderate, or middle household income homebuyers in Tucson, Arizona. The funds originate with the U.S. Department of Housing and Urban Development (“HUD”) and are passed through Pima County. Costs are reimbursed as expenses are incurred. Under the terms of the agreement, the Organization is required to develop and sell all thirty five (35) homes by February 11, 2013. Any expenditure incurred after February 11, 2013 will not be eligible for reimbursement. As of June 30, 2011, nine (9) homes were completed, fifteen (15) homes were in progress, and construction is expected to start on the remaining eleven (11) homes during 2012. For the year ended June 30, 2011 and 2010, the Organization received \$524,030 and \$0, respectively, under this agreement, which is reported as a component of grant/contract revenues on the accompanying statements of activities and changes in net assets.

Federal Home Loan Bank

On December 1, 2007 (Project Approval Date), the Organization entered into a \$640,000 Affordable Housing Program (“AHP”) Direct Subsidy Agreement with the Federal Home Loan Bank (“FHLB”) of San Francisco (through Alliance Bank of Arizona) for the construction of forty (40) homes in the Corazon del Pueblo subdivision, targeted to low-income, first-time homebuyers in Tucson, Arizona. Under the terms of the original AHP subsidy, the Organization was required to develop and sell all forty (40) homes within a four (4) year period, or by November 30, 2011.

In March 2010, Management determined that only thirty (30) homes would be completed by November 30, 2011, the original deadline. Habitat submitted a request to deobligate \$160,000 of the funds related to the ten (10) homes which would not be completed by the deadline. The modification was granted in April 2010. Habitat then entered into a second Affordable Housing Program (“AHP”) Direct Subsidy Agreement with the Federal Home Loan Bank (“FHLB”) of San Francisco (through Alliance Bank of Arizona) in the amount of \$160,000 for the construction of the remaining ten (10) homes. The Project Approval Date of the second agreement is May 28, 2010, and the Organization is required to develop and sell all ten (10) homes within a four (4) year period, or by May 27, 2014.

The AHP agreements contain deed restrictions on the completed units and a retention agreement. The retention period shall remain in effect for a period of five (5) years from closing on an occupied unit that is part of this project. AHP funding must be repaid up to the full amount if the approved project is not completed within a four (4) year period. As of June 30, 2011, twenty nine (29) homes were completed, and the Organization expects to complete the one remaining home by November 30, 2011. Management expects to complete the additional ten homes well within the compliance period that ends May 27, 2014. As of June 30, 2011, the Organization had received \$464,000 under the agreement.

Credit and Operational Risk

Due to the fact that Habitat’s programs are concentrated in Pima County, Arizona, the level of contributions, home sales and collections of mortgages receivable may be affected by changes in economic or other conditions which affect this locale.

NOTES TO FINANCIAL STATEMENTS

Commitments and Contingencies (continued)

Credit and Operational Risk (continued)

In addition to geographic concentration risk, management also notes the following risk factors that may affect the Organization's future ability to carry out its mission, including: the Organization's ongoing dependency on contributions as a significant portion of total operating revenue; the rate at which the Organization collects its long-term mortgages receivable versus the obligations presented by the Organization's short-term liabilities; risk of loss due to loan defaults, the limited marketability of the mortgages receivable for resale; and the risk that an investor may mandate the Organization repurchase or replace a loan sold if the loan becomes delinquent.

Litigation

The Organization is involved in legal proceedings in the normal course of its business operations. The Organization does not believe that any pending or threatened proceeding would have a material adverse effect on its financial position or results of operations.

Deferred Compensation Agreement

At July 1, 2010, the Organization entered into a three-year employment agreement with an executive officer. Under the agreement, the Organization is committed to pay \$5,000 per annum of earned deferred compensation commencing from July 1, 2003. The employee is eligible for payment of this benefit at separation of employment. Benefits accrued as of June 30, 2011 totaled \$40,000 and are included in deferred compensation in the accompanying statement of financial position.

16. Related Party Transactions

Habitat's broker for the acceptance and immediate sale of stock gifts is also a member of Habitat's Board of Directors. A transaction fee is charged for the services rendered. During the year ended June 30, 2011, a transaction related to the immediate conversion of \$3,286 worth of stock gifts to cash was executed. The related broker transaction fee was less than \$5.

The business partner of one of Habitat's Board Members is Habitat's 401(k) investment manager. The Board Member receives no monetary compensation from Habitat.

Several members of the management team at Habitat serve on the Corazon del Pueblo Home Owners' Association Board of Directors. No additional compensation is received from either organization for these duties.

During 2010, a local concrete contracting company won the bid, in a competitive bidding process, for construction work at the Corazon del Pueblo project. The owners of the concrete company are related to the spouse of a senior member of management at Habitat. Habitat's Senior Construction Manager is responsible for selecting all contractors through competitive bid for the work to be performed.

A senior member of Habitat management is a Board Member with the Southern Arizona Land Trust, the other major land-holder at the Corazon del Pueblo development.

A senior member of Habitat management serves on the City of Tucson's Housing Commission and the City of Tucson's Independent Audit Commission. Grant and contract funding provided to Habitat from the City of Tucson originates with different municipal commissions and departments.

NOTES TO FINANCIAL STATEMENTS

Related Party Transactions (continued)

A senior member of Habitat management serves as a Board member of the Pima County Community Land Trust. In addition, he serves on a steering committee convened by the Community Foundation for Southern Arizona (CFSA) to launch the Tucson Nonprofit Loan Fund (TNLF). However, currently Habitat Tucson is not a grant or loan beneficiary of either CFSA or TNLF.

A senior member of Habitat management serves on the New Beginnings for Women and Children Board of Directors. The Treasurer of Habitat's Board of Directors also serves as President of the New Beginnings for Women and Children Board of Directors.

The chairman of Habitat's Audit Committee is also the Treasurer of the Board of Directors for the Community Foundation for Southern Arizona, which manages Habitat's endowment fund. The chairman is not compensated by either organization.

17. Subsequent Events

The Organization evaluated subsequent events through November 15, 2011, which represents the date the financial statements were available to be issued. Material subsequent events that required recognition or additional disclosure at that date included the following:

On September 15, 2011, Habitat, along with two other Habitat affiliates, formed a joint venture (HFHI-SA NMTC VI, LLC) to take advantage of New Market Tax Credit ("NMTC") financing. NMTC financing allows an entity to receive a loan or investment capital from outside investors, who will receive new markets tax credits to be applied against their federal tax liability.