

**AFFORDABLE HOUSING
RESOURCES, INC. AND
SUBSIDIARY**

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004 and 2003

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

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MULLINS CLEMMONS & MAYES, PLLC

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Affordable Housing Resources, Inc.:

We have audited the accompanying consolidated statements of financial position of Affordable Housing Resources, Inc. and subsidiary (a nonprofit organization) as of December 31, 2004 and 2003 and the related consolidated statements of activities, cash flows and functional expenses for the years then ended. These consolidated financial statements are the responsibility of management of Affordable Housing Resources, Inc. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Affordable Housing Resources, Inc. and subsidiary as of December 31, 2004 and 2003 and the changes in their net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2005, on our consideration of Affordable Housing Resources, Inc. and subsidiary's internal control over financial reporting and our tests of their compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplemental schedules on pages 17 through 19 are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements. The supplemental schedule of federal financial assistance for the year then ended December 31, 2004 on page 20 is presented for the purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.



Brentwood, Tennessee
March 28, 2005

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2004 AND 2003**

| | <u>2004</u> | <u>2003</u> |
|--|-----------------------------|-----------------------------|
| <u>ASSETS</u> | | |
| Cash and cash equivalents | \$ 2,248,752 | \$ 1,633,513 |
| Accounts receivable: | | |
| The Resource Foundation | 44,289 | 141,341 |
| Other | 488,725 | 330,089 |
| Prepaid expenses and other assets | 15,976 | 28,583 |
| Notes receivable, net of allowance for uncollectible loans of \$183,961 in 2004 and \$145,229 in 2003 | 4,015,881 | 3,214,887 |
| Inventory - housing units | 9,751,803 | 9,906,576 |
| Property, building and equipment, net | 478,271 | 489,696 |
| Escrow funds held | 48,085 | 48,747 |
| TOTAL ASSETS | <u>\$ 17,091,782</u> | <u>\$ 15,793,432</u> |
| <u>LIABILITIES AND NET ASSETS</u> | | |
| Accounts payable | \$ 644,050 | \$ 685,912 |
| Accrued liabilities | 307,277 | 183,797 |
| Escrow funds | 66,874 | 6,984 |
| Short-term obligations | 3,308,675 | 4,279,723 |
| Long-term obligations | 5,306,572 | 4,175,493 |
| Total liabilities | <u>9,633,448</u> | <u>9,331,909</u> |
| COMMITMENTS AND CONTINGENCIES | - | - |
| NET ASSETS: | | |
| Unrestricted | 2,161,211 | 2,085,549 |
| Temporarily restricted | 3,503,873 | 2,764,724 |
| Permanently restricted | 1,793,250 | 1,611,250 |
| Total net assets | <u>7,458,334</u> ✓ | <u>6,461,523</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 17,091,782</u> | <u>\$ 15,793,432</u> |

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

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2004

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|--------------|---------------------------|---------------------------|--------------|
| SUPPORT AND REVENUES: | | | | |
| Public support: | | | | |
| Financial institutions | \$ 64,258 | \$ - | \$ - | \$ 64,258 |
| Federal, state and other grants | - | 1,120,389 | 182,000 | 1,302,389 |
| Other | 84,077 | - | - | 84,077 |
| Total public support | 148,335 | 1,120,389 | 182,000 | 1,450,724 |
| Revenues: | | | | |
| Rental income | 13,220 | - | - | 13,220 |
| Counseling and mortgage fees | 180,972 | - | - | 180,972 |
| Loan servicing fees | 49,445 | - | - | 49,445 |
| Management fees | 12,155 | - | - | 12,155 |
| Interest income | 185,657 | 10,702 | - | 196,359 |
| Gain on sale of rental property and housing units | 791,575 | - | - | 791,575 |
| Total revenues | 1,233,024 | 10,702 | - | 1,243,726 |
| Net assets released from restrictions due to satisfaction of program restrictions | 391,942 | (391,942) | - | - |
| Total support and revenues | 1,773,301 | 739,149 | 182,000 | 2,694,450 ✓ |
| EXPENSES: | | | | |
| Program services: | | | | |
| Low-income housing assistance | 1,494,788 | - | - | 1,494,788 |
| Supporting services: | | | | |
| Management and general | 202,852 | - | - | 202,852 |
| Total expenses | 1,697,639 | - | - | 1,697,639 ✓ |
| CHANGE IN NET ASSETS | 75,662 | 739,149 | 182,000 | 996,811 |
| NET ASSETS: | | | | |
| Beginning of year | 2,085,549 | 2,764,724 | 1,611,250 | 6,461,523 |
| End of year | \$ 2,161,211 | \$ 3,503,873 | \$ 1,793,250 | \$ 7,458,334 |

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

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2003

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|--------------|---------------------------|---------------------------|--------------|
| SUPPORT AND REVENUES: | | | | |
| Public support: | | | | |
| Financial institutions | \$ 59,710 | \$ 25,000 | \$ - | \$ 84,710 |
| Federal, state and other grants | - | 573,791 | 650,000 | 1,223,791 |
| Other | 32,034 | 5,000 | - | 37,034 |
| Total public support | 91,744 | 603,791 | 650,000 | 1,345,535 |
| Revenues: | | | | |
| Rental income | 11,960 | - | - | 11,960 |
| Counseling and mortgage fees | 100,126 | - | - | 100,126 |
| Loan servicing fees | 34,524 | - | - | 34,524 |
| Management fees | 34,841 | - | - | 34,841 |
| Interest income | 136,943 | 16,823 | - | 153,766 |
| Gain on sale of rental property and housing units | 384,526 | - | - | 384,526 |
| Total revenues | 702,920 | 16,823 | - | 719,743 |
| Net assets released from restrictions due to satisfaction of program restrictions | 509,709 | (509,709) | - | - |
| Total support and revenues | 1,304,373 | 110,905 | 650,000 | 2,065,278 |
| EXPENSES: | | | | |
| Program services: | | | | |
| Low-income housing assistance | 1,227,687 | - | - | 1,227,687 |
| Supporting services: | | | | |
| Management and general | 169,730 | - | - | 169,730 |
| Total expenses | 1,397,417 | - | - | 1,397,417 |
| CHANGE IN NET ASSETS | (93,044) | 110,905 | 650,000 | 667,861 |
| NET ASSETS: | | | | |
| Beginning of year | 2,178,593 | 2,653,819 | 961,250 | 5,793,662 |
| End of year | \$ 2,085,549 | \$ 2,764,724 | \$ 1,611,250 | \$ 6,461,523 |

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

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003

| | 2004 | 2003 |
|--|---------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Change in net assets | \$ 996,811 | \$ 667,861 |
| Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities: | | |
| Depreciation | 29,645 | 35,528 |
| Amortization of notes receivable | 205,054 | 201,845 |
| Provision for uncollectible notes receivable | 95,000 | 60,000 |
| Net changes in other assets and liabilities: | | |
| Accounts receivable | (61,584) | (166,526) |
| Prepaid expenses and other assets | 73,159 | (68,118) |
| Inventory - housing units | 154,773 | (1,832,227) |
| Accounts payable and accrued liabilities | 81,618 | (87,997) |
| Net cash provided by (used in) operating activities | <u>1,574,476</u> | <u>(1,189,634)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Collection of notes receivable | 432,703 | 285,314 |
| Issuance of notes receivable | (1,533,751) | (1,036,093) |
| Purchases of property and equipment | <u>(18,220)</u> | <u>(19,277)</u> |
| Net cash used in investing activities | <u>(1,119,268)</u> | <u>(770,056)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from short-term obligations | 1,143,786 | 2,608,023 |
| Proceeds from long-term obligations | 4,015,057 | 2,729,922 |
| Principal payments on debt obligations | <u>(4,998,812)</u> | <u>(3,267,815)</u> |
| Net cash provided by financing activities | <u>160,031</u> | <u>2,070,130</u> |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 615,239 | 110,440 |
| CASH AND CASH EQUIVALENTS, BEGINNING | <u>1,633,513</u> | <u>1,523,073</u> |
| CASH AND CASH EQUIVALENTS, ENDING | <u>\$ 2,248,752</u> | <u>\$ 1,633,513</u> |

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

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 2004

| | Program Services | Supporting Services | |
|---|-------------------------------------|------------------------------|---------------------|
| | Low-Income Housing Assistance | Management and General | Totals |
| Payroll and related costs | \$ 797,872 | \$ 140,801 | \$ 938,673 |
| Specific projects - Community Service | 18,059 | - | 18,059 |
| Automobile | 11,329 | - | 11,329 |
| Provision for uncollectible notes receivable | 95,000 | - | 95,000 |
| Depreciation | 23,930 | 4,223 | 28,153 |
| Amortization of notes receivable | 205,054 | - | 205,054 |
| Direct program expenses related to houses rented: | | | |
| Insurance | 200 | - | 200 |
| Interest | 1,503 | - | 1,503 |
| Depreciation | 1,492 | - | 1,492 |
| Utilities | - | - | - |
| Maintenance and repairs | - | - | - |
| Taxes | 948 | - | 948 |
| Equipment rental and maintenance | 7,671 | 1,354 | 9,025 |
| Insurance | 24,370 | 4,301 | 28,671 |
| Professional fees | 47,567 | 8,394 | 55,961 |
| Occupancy | 60,836 | 10,736 | 71,572 |
| Office expense | 21,179 | 3,738 | 24,917 |
| Contract labor | 37,706 | 6,654 | 44,360 |
| Promotion | 56,135 | 9,906 | 66,041 |
| Communications | 14,241 | 2,513 | 16,754 |
| Training | 11,716 | - | 11,716 |
| Travel and food | 23,438 | 4,136 | 27,574 |
| Miscellaneous | 34,542 | 6,096 | 40,637 |
| Total expenses | <u>\$ 1,494,788</u> | <u>\$ 202,852</u> | <u>\$ 1,697,639</u> |

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

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 2003

| | Program Services | Supporting Services | |
|---|-------------------------------------|------------------------------|---------------------|
| | Low-Income Housing Assistance | Management and General | Totals |
| Payroll and related costs | \$ 646,913 | \$ 114,161 | \$ 761,074 |
| Specific projects - Community Service | 18,616 | - | 18,616 |
| Automobile | 8,179 | - | 8,179 |
| Provision for uncollectible notes receivable | 60,000 | - | 60,000 |
| Depreciation | 28,930 | 5,105 | 34,035 |
| Amortization of notes receivable | 172,695 | - | 172,695 |
| Direct program expenses related to houses rented: | | | |
| Insurance | 200 | - | 200 |
| Interest | 1,544 | - | 1,544 |
| Depreciation | 1,493 | - | 1,493 |
| Utilities | - | - | - |
| Maintenance and repairs | 842 | - | 842 |
| Taxes | 985 | - | 985 |
| Equipment rental and maintenance | 8,327 | 1,469 | 9,796 |
| Insurance | 18,967 | 3,347 | 22,314 |
| Professional fees | 51,892 | 9,157 | 61,049 |
| Occupancy | 51,993 | 9,175 | 61,168 |
| Office expense | 13,723 | 2,422 | 16,145 |
| Contract labor | 26,811 | 4,731 | 31,542 |
| Promotion | 53,518 | 9,444 | 62,962 |
| Communications | 14,728 | 2,599 | 17,327 |
| Training | 1,311 | - | 1,311 |
| Travel and food | 19,229 | 3,393 | 22,622 |
| Miscellaneous | 26,791 | 4,727 | 31,518 |
| Total expenses | <u>\$ 1,227,687</u> | <u>\$ 169,730</u> | <u>\$ 1,397,417</u> |

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

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

NOTE 1 – THE ENTITY

Affordable Housing Resources, Inc. ("AHR") was chartered in 1989 as a Tennessee not-for-profit corporation. During 2001, AHR Development, Inc. ("AHRD") was chartered as a Tennessee not-for-profit corporation, with AHR as its sole member. Certain of the assets and liabilities of AHR were transferred to AHRD at its inception. During 2003, AHRD began doing business as The Home Company ("THC"). These consolidated financial statements include the accounts of AHR and THC, collectively referred to as the "Agency".

The purpose of the Agency is to "create affordable housing and strong neighborhoods" by increasing home ownership opportunities for families and individuals who are unable to obtain assistance through traditional public and private funding sources in the greater Nashville area. The Agency is supported principally by service fees, sale of single-family homes, private and public contributions and grants from the U.S Department of Housing and Urban Development (through the Metropolitan Development and Housing Agency - "MDHA") and the Neighborhood Reinvestment Corporation.

The following program and supporting services are included in the accompanying consolidated financial statements:

Low-Income Housing Assistance – includes various lending and development programs. The loan products include down payment and closing cost assistance loans and construction financing for single-family properties. Homeownership programs include promoting homeownership opportunities in Nashville, Tennessee, development of quality new affordable housing, acquisition and rehabilitation of single family properties, land acquisition and development, consumer home buyer education to prepare new homeowners, and developing community leadership programs.

Management and General – includes the functions necessary to ensure an adequate working environment and costs not identifiable with a single program or fund-raising activity, including costs associated with providing coordination and articulation of the Agency's program strategy, business management, general record keeping, budgeting and related purposes.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

As mentioned in Note 1, these consolidated financial statements include the accounts of AHR and THC. All intercompany balances and transactions have been eliminated.

Accounting Periods

All references to 2004 and 2003 in these consolidated financial statements refer to the years ended December 31, 2004 and 2003, respectively, unless otherwise noted.

Basis of Accounting

The financial records of the Agency are maintained on the accrual basis of accounting.

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) DECEMBER 31, 2004 AND 2003

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Contributions and Support

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

Contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those respective net asset classes. When the restriction is fulfilled (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted and reported in the consolidated statement of activities as net assets released from restrictions.

Permanently restricted net assets are those contributed with donor stipulations that the funds must be held in perpetuity with the use of income for unrestricted or temporarily restricted purposes. Contributions received from the Neighborhood Reinvestment Revolving Loan and Capital Projects Fund, which grants home ownership and improvement loans, are considered to be permanently restricted by the donor. The investment earnings on these funds are unrestricted.

The Agency also receives grant revenue from federal, state and local agencies, principally from MDHA. Grant revenue is recognized in the period that a liability is incurred for eligible expenditures under the terms of the grant.

The Agency reports any gifts of equipment or materials as unrestricted support unless explicit donor restrictions specify how the assets must be used. Gifts of long-lived assets with explicit restrictions as to how the assets are to be used or funds restricted for the acquisition of long-lived assets are reported as restricted support. Expirations of donor restrictions are recognized when the donated or acquired long-lived assets are placed in service.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, cash in various bank accounts, and all highly liquid unrestricted investments with an original maturity of three months or less. The Agency may, at times, maintain bank accounts whose balances exceed federally insured limits. However, the Agency has not experienced any losses in such accounts, and believes it is not exposed to any significant credit risk related to cash and cash equivalents.

Inventory – Housing Units

The Agency is responsible for rehabilitation and construction of single-family housing projects. Accordingly, all land, construction, and rehabilitation or renovation costs are reported as inventory until such time as the units are sold.

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) **DECEMBER 31, 2004 AND 2003**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, Building and Equipment

Property, building and equipment additions, major renewals and betterments are recorded at cost at the date of purchase, at fair value at the date of gift if the value is readily determinable, or other reasonable basis, as determined by the Board of Directors, if cost is unknown. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation is computed by using the straight-line method over the estimated useful lives of the assets. See Note 4 for further details.

Deferred Revenue

Deferred revenue consists of grants received in advance of the eligible expenditures.

Donated Materials and Services

Donated materials are recognized as contributions at their estimated fair values at date of receipt. The value of donated services is not reflected in the consolidated financial statements because of the lack of an objective basis by which to measure such value.

Income Taxes

The Agency qualifies as a tax-exempt organization under section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes is included in the accompanying consolidated financial statements.

Provision for Uncollectible Notes

A note receivable is considered impaired when, based on current information, it is probable that all amounts of principal and interest due will not be collected according to the terms of the note agreement. Generally, a note receivable is considered impaired when the individual debtor cannot be located or has declared bankruptcy. The allowance for uncollectible notes is established by charges to program services expense and is maintained at an amount, which management believes will be adequate to absorb losses on existing loans. Uncollectible loans are charged to the allowance account in the period in which such a determination is made.

Functional Allocation of Expenses

Expenses, which are directly related to a function, are charged to that function. Expenses that are related to more than one function are allocated to the applicable functions based upon various allocation methods in order to reflect the total cost of each function.

Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2004 AND 2003

NOTE 3 – NOTES RECEIVABLE

Loans to homebuyers are made for terms of 4 to 15 years, at annual interest rates ranging from 3% to 7.5%. There are also noninterest-bearing notes receivable, in the amounts of \$1,520,078 and \$1,397,409 in 2004 and 2003, respectively, that are, in substance, grants that are forgiven over a period up to 15 years, as long as the homeowner continues to own the property. During 2004 and 2003, amortization of these notes amounted to \$205,054 and \$201,845, respectively.

Notes receivable (excluding noninterest-bearing notes) consisted of the following at December 31, 2004:

| | <u>Waller</u> | <u>Home</u> | <u>MDHA</u> | <u>NRC & Section 8</u> | <u>Second Mortgages</u> | <u>Total</u> |
|--------------------------|---------------|-------------|-------------|--------------------------------|-----------------------------|--------------|
| Total notes receivable | \$503,004 | \$164,493 | \$186,312 | \$1,131,717 | \$696,295 | \$2,681,821 |
| Number of loans | 105 | 29 | 36 | 69 | 36 | 275 |
| Loan delinquency status: | | | | | | |
| Current and up to | | | | | | |
| 90 days delinquent | \$500,089 | \$149,930 | \$180,733 | \$1,123,257 | \$684,882 | \$2,638,891 |
| Percent of total | 99% | 91% | 97% | 99% | 98% | 98% |
| Over 90 days delinquent | \$2,915 | \$14,563 | \$5,579 | \$8,460 | \$11,413 | \$42,930 |
| Percent of total | 1% | 9% | 3% | 1% | 2% | 2% |

Notes receivable are collateralized by the related real estate.

NOTE 4 – PROPERTY, BUILDING AND EQUIPMENT

Property, building and equipment consisted of the following as of December 31, 2004 and 2003:

| | <u>2004</u> | <u>2003</u> |
|--------------------------------------|------------------|------------------|
| Rental property: | | |
| Land | \$ 10,000 | \$ 10,000 |
| Structures | 42,397 | 42,397 |
| Land | 53,500 | 53,500 |
| Building and improvements | 420,605 | 411,709 |
| Furniture, equipment and autos | 101,043 | 91,720 |
| Total cost | 627,545 | 609,326 |
| Accumulated depreciation | (149,274) | (119,630) |
| Net property, building and equipment | <u>\$478,271</u> | <u>\$489,696</u> |

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2004 AND 2003

NOTE 5 – NOTES PAYABLE

Notes payable consisted of the following as of December 31, 2004 and 2003:

| | <u>2004</u> | <u>2003</u> |
|---|--------------------|--------------------|
| Notes payable to bank, maturing at various dates through December, 2005, interest at an annual rate of the bank's prime rate minus 1% | \$1,042,525 | \$ - |
| Notes payable to bank, maturing at various dates through October, 2005, interest at an annual rate of the bank's prime rate minus 1% | 949,112 | - |
| Note payable to bank, matures July, 2006, interest at an annual rate of the bank's prime rate plus ½% | 918,179 | - |
| Note payable to bank, matures December, 2005, interest at an annual rate of the bank's prime rate minus 1% | 873,571 | 873,571 |
| Note payable to a financial institution, matures September, 2007, interest an annual rate of 4.5% | 500,000 | 500,000 |
| Note payable to bank, matures December, 2012, interest at an annual rate of 4% | 499,124 | 499,124 |
| Note payable to Heron Foundation, matures September, 2008, interest an annual rate of 4.5% | 400,000 | - |
| Note payable to financial institution, matures March, 2018, interest at an annual rate of 4% | 346,544 | 370,377 |
| Note payable to bank, matures February, 2006, interest at an annual rate of the bank's prime rate minus 1% | 321,208 | - |
| Note payable to bank, matures September, 2010, interest at an annual rate of 5.75% | 312,518 | 226,070 |
| Note payable to bank, matures December, 2014, interest at an annual rate of 4.5% | 300,000 | - |
| Note payable to bank, matures June, 2011, interest at an annual rate of 3% | 250,000 | 250,000 |

Continued on next page

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2004 AND 2003

NOTE 5 – NOTES PAYABLE (CONTINUED)

| | <u>2004</u> | <u>2003</u> |
|--|-------------|-------------|
| Note payable to bank, matures November, 2012, interest at an annual rate of 4% | \$ 250,000 | \$ 250,000 |
| Note payable to bank, matures June, 2013, interest at an annual rate of 4% | 250,000 | 250,000 |
| Note payable to Metropolitan Department of Housing Association, matures November, 2022, noninterest bearing | 250,000 | 250,000 |
| Note payable to financial institution, matures April, 2023, noninterest bearing | 250,000 | 125,000 |
| Notes payable to bank, maturing at various dates through September, 2005, interest at an annual rate of the bank's prime rate minus 1% | 241,112 | - |
| Note payable to financial institution, matures May, 2019, interest at an annual rate of 4% | 200,000 | - |
| Note payable to bank, matures December, 2012, interest at an annual rate of 4% | 100,000 | 100,000 |
| Note payable to bank, matures December, 2013, interest at an annual rate of 4% | 100,000 | 100,000 |
| Note payable to Nashville Housing Fund, matures September, 2005, interest at an annual rate of 4% | 89,043 | - |
| Note payable to Nashville Housing Fund, matures February, 2005, interest at an annual rate of 4% | 85,000 | - |
| Note payable to Tennessee Housing Development Agency, matures July, 2034, noninterest bearing | 58,999 | - |
| Note payable to bank, matures December, 2005, interest at an annual rate of the bank's prime rate plus ½% | 28,312 | 31,608 |
| Notes payable to bank, maturing at various dates through August, 2004, interest at an annual rate of the bank's prime rate minus 1% | - | 1,507,146 |

Continued on next page

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2004 AND 2003

NOTE 5 – NOTES PAYABLE (CONTINUED)

| | <u>2004</u> | <u>2003</u> |
|---|--------------------|--------------------|
| Note payable to Nashville Housing Fund, matures July, 2004, interest at an annual rate of 4.0% | \$ - | \$1,000,000 |
| Notes payable to bank, maturing at various dates through June, 2004, interest at an annual rate of the bank's prime rate minus 1% | - | 771,147 |
| Notes payable to bank, maturing at various dates through July, 2004, interest at an annual rate of the bank's prime rate minus 1% | - | 529,779 |
| Note payable to bank, matures April, 2005, interest at an annual rate of the bank's prime rate minus 1% | - | 381,351 |
| Note payable to Nashville Housing Fund, matures September, 2004, interest at an annual rate of 4% | - | 169,043 |
| Note payable to Nashville Housing Fund, matures May, 2004, interest at an annual rate of 4.25% | - | 125,000 |
| Note payable to Nashville Housing Fund, matures March, 2004, interest at an annual rate of 4.75% | - | 64,000 |
| Note payable to Nashville Housing Fund, matures March, 2004, interest at an annual rate of 4.25% | - | 47,000 |
| Note payable to Nashville Housing Fund, matures December, 2004, noninterest bearing | - | <u>35,000</u> |
| Total | 8,615,247 | 8,455,216 |
| Notes with short-term maturities | <u>(3,308,675)</u> | <u>(4,279,723)</u> |
| Long-term notes | <u>\$5,306,572</u> | <u>\$4,175,493</u> |

The prime rate of interest at December 31, 2004 was 5.25%. Most of the above notes are secured by deeds of trust on the related real estate.

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**
DECEMBER 31, 2004 AND 2003**NOTE 5 – NOTES PAYABLE (CONTINUED)**

Following is schedule of future principal payments on long-term notes as of December 31, 2004:

| | |
|---------------------------|--------------------|
| Year ending December 31,: | |
| 2005 | \$ 27,136 |
| 2006 | 1,274,314 |
| 2007 | 636,435 |
| 2008 | 338,013 |
| 2009 | 39,652 |
| Thereafter | <u>2,991,022</u> |
| Total | <u>\$5,306,572</u> |

NOTE 6 – AFFILIATIONS

The Agency is affiliated with The Resource Foundation, Inc. ("TRF"), a Tennessee not-for-profit corporation, which merged its affordable rental housing development projects to low- and very low-income families into the Agency in 1997. The Agency and TRF share the same location and certain personnel. Operating expenses, applicable salaries and related personnel expenses are allocated on a pro-rata basis.

Effective July 19, 1999, the Agency was chartered by the Washington D.C.-based Neighborhood Reinvestment Corporation ("NRC") as a certified NeighborWorks Homeownership Center. NRC is a congressionally chartered, public nonprofit corporation with more than 200 chartered NeighborWorks organizations serving more than 1,000 communities throughout the United States. NRC provides technical assistance, training and grants to assist the Agency in achieving its neighborhood revitalization programs.

NOTE 7 – RESTRICTED NET ASSETS

Temporarily restricted net assets were released from donor restrictions as follows:

| | <u>2004</u> | <u>2003</u> |
|------------|------------------|------------------|
| NRC grants | \$ 95,187 | \$198,500 |
| HOME funds | <u>296,755</u> | <u>311,211</u> |
| Total | <u>\$391,942</u> | <u>\$509,709</u> |

Temporarily restricted net assets consisted of the following at December 31, 2004 and 2003:

| | <u>2004</u> | <u>2003</u> |
|---|--------------------|--------------------|
| HOME investment grants | \$ 484,487 | \$ 498,606 |
| HOME subrecipient grants for revolving construction fund | 2,387,123 | 1,699,948 |
| NRC grants | 54,500 | - |
| Revolving loans and available cash for low-income housing and down payment assistance | 572,763 | 561,168 |
| Other | <u>5,000</u> | <u>5,000</u> |
| Total | <u>\$3,503,873</u> | <u>\$2,764,722</u> |

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2004 AND 2003

NOTE 7 – RESTRICTED NET ASSETS (CONTINUED)

Permanently restricted net assets consisted of the following at December 31, 2004 and 2003:

| | <u>2004</u> | <u>2003</u> |
|--------------------|--------------------|--------------------|
| NRC capital grants | <u>\$1,793,250</u> | <u>\$1,611,250</u> |

NOTE 8 – ESCROW FUNDS HELD

In September, 1999, the Agency assumed the management and administrative responsibilities for the existing MDHA lease purchase program. The Agency's duties included administration of the program, collection of the lease payments, homebuyer counseling, and collection and eviction activities. Funds collected under the lease purchase program were held in escrow until applied toward the down payment at the time the property is purchased, or refunded if the tenant ceases to participate in the program. The Agency received 8% of the gross rents as an administrative fee for these activities. This program was discontinued during 2004.

NOTE 9 - CONTINGENCIES

The disbursement of funds received under federal and state governmental grant programs generally requires compliance with the terms and conditions specified in the grant agreements and is subject to audit by the grantor agencies. Any disallowed claims resulting from such audits could become a liability of the Agency. In management's opinion, any such disallowed claims will not have a material affect on the Agency.

NOTE 10 – LOAN SERVICING

Down payment assistance loans were sold to Neighborhood Housing Services of America ("NHSA") and are serviced by the Agency for NHSA.

The Agency has entered into a Master Participation Agreement with several financial institutions to provide loan origination services and loan servicing for qualified first mortgage loans. The Agency receives a servicing fee equal to ½% of the amounts collected in connection with these services.

None of the above loans are included in the consolidated financial statements.

NOTE 11 – SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash payments for interest totaled \$257,343 and \$185,413 for 2004 and 2003, respectively.

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY**SUPPLEMENTAL SCHEDULES - NEIGHBORHOOD REINVESTMENT CAPITAL FUND
(PERMANENTLY RESTRICTED NET ASSETS)**

SCHEDULES OF FINANCIAL POSITION AS OF DECEMBER 31, 2004 AND 2003:

| | <u>2004</u> | <u>2003</u> |
|--|----------------------------|----------------------------|
| <u>ASSETS</u> | | |
| Cash and cash equivalents | \$ 434,533 | \$ 735,329 |
| Grant receivable | 182,000 | - |
| Loans receivable | 1,131,717 | 830,921 |
| Property, plant and equipment | <u>45,000</u> | <u>45,000</u> |
| TOTAL ASSETS | <u><u>\$ 1,793,250</u></u> | <u><u>\$ 1,611,250</u></u> |
| <u>LIABILITIES AND NET ASSETS</u> | | |
| Net assets - permanently restricted | <u><u>\$ 1,793,250</u></u> | <u><u>\$ 1,611,250</u></u> |

SCHEDULES OF ACTIVITIES FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2003:

| | <u>2004</u> | <u>2003</u> |
|------------------------------|----------------------------|----------------------------|
| SUPPORT AND REVENUES: | | |
| Capital grant - NRC | <u>\$ 182,000</u> | <u>\$ 650,000</u> |
| Change in net assets | 182,000 | 650,000 |
| NET ASSETS, BEGINNING | <u>1,611,250</u> | <u>961,250</u> |
| NET ASSETS, ENDING | <u><u>\$ 1,793,250</u></u> | <u><u>\$ 1,611,250</u></u> |

NOTES:

Investment income and interest on outstanding loans was earned on the net assets of the Neighborhood Reinvestment Capital Fund and was available for unrestricted use by the Agency. All of these amounts were transferred to the unrestricted funds during those years. There were no proceeds from capital projects in excess of the amount of funds necessary to maintain the net assets at a level disclosed in the Capital Funds Agreement with NRC. Accordingly, no funds were transferred from the Capital Fund for that purpose.

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

**SUPPLEMENTAL CONSOLIDATING STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2004**

| | Affordable Housing Resources, Inc. | AHR Development, Inc. (d/b/a The Home Company) | Eliminations | Consolidated |
|---|---|---|------------------------------|-----------------------------|
| <u>ASSETS</u> | | | | |
| Cash and cash equivalents | \$ 1,134,450 | \$ 1,114,302 | \$ - | \$ 2,248,752 |
| Accounts receivable: | | | | |
| The Resource Foundation | 2,870 | 41,419 | - | 44,289 |
| Other | 2,350,347 | 979,869 | (2,841,491) | 488,725 |
| Prepaid expenses and other assets | 12,307 | 3,669 | - | 15,976 |
| Notes receivable | 2,495,803 | 1,520,078 | - | 4,015,881 |
| Inventory - housing units | - | 9,751,803 | - | 9,751,803 |
| Property, building and equipment, net | 422,299 | 55,972 | - | 478,271 |
| Escrow funds held | 48,085 | - | - | 48,085 |
| TOTAL ASSETS | <u>\$ 6,466,161</u> | <u>\$ 13,467,112</u> | <u>\$ (2,841,491)</u> | <u>\$ 17,091,782</u> |
| <u>LIABILITIES AND NET ASSETS</u> | | | | |
| Accounts payable | \$ 763,626 | \$ 2,721,915 | \$ (2,841,491) | \$ 644,050 |
| Accrued liabilities | 304,848 | 2,429 | - | 307,277 |
| Escrow funds | 66,865 | 9 | - | 66,874 |
| Notes payable | 4,067,185 | 4,548,062 | - | 8,615,247 |
| Total liabilities | 5,202,524 | 7,272,415 | (2,841,491) | 9,633,448 |
| NET ASSETS | <u>1,263,637</u> | <u>6,194,697</u> | <u>-</u> | <u>7,458,334</u> |
| TOTAL LIABILITIES AND NET ASSETS | <u>\$ 6,466,161</u> | <u>\$ 13,467,112</u> | <u>\$ (2,841,491)</u> | <u>\$ 17,091,782</u> |

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

**SUPPLEMENTAL CONSOLIDATING STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2004**

| | Affordable Housing Resources, Inc. | AHR Development, Inc. (d/b/a The Home Company) | Eliminations | Consolidated |
|--|---|---|---------------------|---------------------|
| SUPPORT AND REVENUES: | | | | |
| Public support: | | | | |
| Financial institutions | \$ 64,258 | \$ - | \$ - | \$ 64,258 |
| Federal, state and other grants | 219,120 | 1,083,269 | - | 1,302,389 |
| Other | 84,077 | - | - | 84,077 |
| Total public support | <u>367,455</u> | <u>1,083,269</u> | <u>-</u> | <u>1,450,724</u> |
| Revenues: | | | | |
| Rental income | - | 13,220 | - | 13,220 |
| Counseling and mortgage fees | 180,972 | - | - | 180,972 |
| Loan servicing fees | 49,445 | - | - | 49,445 |
| Management fees | - | 12,155 | - | 12,155 |
| Interest income | 195,107 | 1,252 | - | 196,359 |
| Gain on sale of rental property and housing units | - | 791,575 | - | 791,575 |
| Total revenues | <u>425,524</u> | <u>818,202</u> | <u>-</u> | <u>1,243,726</u> |
| Total support and revenues | 792,979 | 1,901,471 | - | 2,694,450 |
| TOTAL EXPENSES | <u>1,016,466</u> | <u>681,173</u> | <u>-</u> | <u>1,697,639</u> |
| CHANGE IN NET ASSETS | <u>\$ (223,487)</u> | <u>\$ 1,220,298</u> | <u>\$ -</u> | <u>\$ 996,811</u> |

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

SUPPLEMENTAL SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE
FOR THE YEAR ENDED DECEMBER 31, 2004

| CFDA Number | Grantor/Programs/Contract Number | Receivable (Deferred), Beginning | Cash Receipts | Expended/ Earned | Returned to Grantor | Receivable (Deferred), Ending |
|---|--------------------------------------|--|---------------------|---------------------|------------------------|-------------------------------------|
| <u>FEDERAL PROGRAMS:</u> | | | | | | |
| Major Program: | | | | | | |
| 14.239 | HOME Investment Partnerships Program | \$ - | \$ 992,321 | \$ 970,702 | \$ 21,619 | \$ - |
| Other Programs: | | | | | | |
| Neighborhood Reinvestment Corporation: | | | | | | |
| None | Capital and Revolving Loan Funds | - | - | 182,000 | - | 182,000 |
| None | Operating Funds | - | 95,187 | 149,687 | - | 54,500 |
| Total | | \$ - | \$ 1,087,508 | \$ 1,302,389 | \$ 21,619 | \$ 236,500 |

Note: In accordance with the requirements of the Neighborhood Reinvestment Corporation, all capital and revolving loan funds are considered to be permanently restricted. The amounts received during the year are reported as expended.

MULLINS CLEMMONS & MAYES, PLLC

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

To the Board of Directors of
Affordable Housing Resources, Inc.:

We have audited the consolidated financial statements of Affordable Housing Resources, Inc. and subsidiary as of and for the year ended December 31, 2004, and have issued our report thereon dated March 28, 2005. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Affordable Housing Resources, Inc. and subsidiary's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the consolidated financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Mullins Clemmons & Mayes, PLLC

Brentwood, Tennessee
March 28, 2005

MULLINS CLEMMONS & MAYES, PLLC

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Directors of
Affordable Housing Resources, Inc.:

Compliance

We have audited the compliance of Affordable Housing Resources, Inc. and subsidiary with the types of compliance requirements described in the *U.S. Office of Management and Budget ("OMB") Circular A-133 Compliance Supplement* that are applicable to each of their major federal programs for the year ended December 31, 2004. Affordable Housing Resources, Inc. and subsidiary's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs on page 24. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of their major federal programs is the responsibility of Affordable Housing Resources, Inc. and subsidiary's management. Our responsibility is to express an opinion on Affordable Housing Resources, Inc. and subsidiary's compliance based on our audit.

We conducted our audit of compliance in accordance with U.S. generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Affordable Housing Resources, Inc. and subsidiary's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Affordable Housing Resources, Inc. and subsidiary's compliance with those requirements.

In our opinion, Affordable Housing Resources, Inc. and subsidiary complied, in all material respects, with the requirements referred to above that are applicable to each of their major federal programs for the year ended December 31, 2004.

Internal Control Over Compliance

The management of Affordable Housing Resources, Inc. and subsidiary is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Affordable Housing Resources, Inc. and subsidiary's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Mullins Clemmons & Hayes, PLLC

Brentwood, Tennessee

March 28, 2005

AFFORDABLE HOUSING RESOURCES, INC. AND SUBSIDIARY

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2004**

SUMMARY OF AUDITORS' RESULTS:

An unqualified opinion was issued on the consolidated financial statements. No instances of noncompliance, which would be material to the consolidated financial statements, were disclosed. An unqualified opinion was issued on compliance with the requirements of major programs. There were no audit findings, which are required to be reported under the requirements on OMB Circular A-133.

The major program for the year ended December 31, 2004 was as follows:

| <u>CFDA No.</u> | <u>Program/Source</u> |
|---------------------|--------------------------------------|
| 14.239 | HOME Investment Partnerships Program |

All programs with federal expenditures in excess of \$500,000 would be designated as Type A programs, as defined in OMB Circular A-133. All other programs were designated as Type B programs, as defined in OMB Circular A-133. Affordable Housing Resources, Inc. and subsidiary qualified as a low-risk auditee, as defined in OMB Circular A-133.

FINDINGS AND QUESTIONED COSTS:

There were no findings and questioned costs related to the current audit or the previous year's audit.