

KNOXVILLE HABITAT FOR HUMANITY, INC.

Knoxville, Tennessee

FINANCIAL STATEMENTS

June 30, 2018 and 2017



KNOXVILLE HABITAT FOR HUMANITY, INC.

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Knoxville Habitat for Humanity, Inc.
Knoxville, Tennessee

Report on the Financial Statements

We have audited the accompanying financial statements of Knoxville Habitat for Humanity, Inc. (the "Organization"), which comprise the statements of financial position as of June 30, 2018 and 2017, the related statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Knoxville Habitat for Humanity, Inc. as of June 30, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Pugh & Company, P.C.

Certified Public Accountants
Knoxville, Tennessee
December 19, 2018



An independently owned member
RSM US Alliance



TSCPA
Members of the Tennessee Society
Of Certified Public Accountants

KNOXVILLE HABITAT FOR HUMANITY, INC.

STATEMENTS OF FINANCIAL POSITION

As of June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 1,132,478	\$ 1,039,658
Mortgages Receivable - Current Portion	1,056,667	1,049,421
Contributions Receivable	39,000	137,500
Other Receivables	103,699	26,528
Inventory	31,458	33,955
Prepaid Expenses and Deposits	53,418	39,214
Homes Under Construction	453,931	473,760
Total Current Assets	<u>2,870,651</u>	<u>2,800,036</u>
NONCURRENT ASSETS		
Mortgages Receivable, Net	6,402,531	6,391,220
Beneficial Interest in Assets Held by Others	100,188	98,872
Property and Equipment, Net	757,994	604,772
Lease-to-Own Property	609,697	598,226
Real Estate Owned	383,783	502,336
Total Noncurrent Assets	<u>8,254,193</u>	<u>8,195,426</u>
TOTAL ASSETS	<u>\$ 11,124,844</u>	<u>\$ 10,995,462</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts Payable	\$ 64,001	\$ 63,156
Accrued Expenses	45,365	93,778
Mortgage Escrow Accounts	263,512	264,233
Installment Loans - Current Portion	17,979	7,402
Mortgages Sold with Recourse - Current Portion	255,717	240,455
Lease-to-Own Payments	44,811	38,777
Total Current Liabilities	<u>691,385</u>	<u>707,801</u>
NONCURRENT LIABILITIES		
Installment Loans	60,879	7,646
Long-Term Line of Credit	88,776	0
Mortgages Sold with Recourse	1,748,453	1,726,473
Total Noncurrent Assets	<u>1,898,108</u>	<u>1,734,119</u>
TOTAL LIABILITIES	<u>2,589,493</u>	<u>2,441,920</u>
NET ASSETS		
Unrestricted	8,247,745	8,372,448
Temporarily Restricted	187,606	81,094
Permanently Restricted	100,000	100,000
Total Net Assets	<u>8,535,351</u>	<u>8,553,542</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 11,124,844</u>	<u>\$ 10,995,462</u>

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

KNOXVILLE HABITAT FOR HUMANITY, INC.

STATEMENT OF ACTIVITIES

For the Year Ended June 30, 2018

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
REVENUE AND SUPPORT				
Contributions and Grants	\$ 812,036	\$ 739,098	\$ 0	\$ 1,551,134
In-Kind Contributions	76,108	0	0	76,108
Home Sales, Net	1,136,138	0	0	1,136,138
Mortgage Discount Amortization	573,449	0	0	573,449
Fundraising Events, Net of Direct Expenses	76,560	0	0	76,560
ReStore Sales, Net	919,508	0	0	919,508
Rental Income	16,587	0	0	16,587
Other Revenues	80,993	0	0	80,993
Total Revenue and Support	<u>3,691,379</u>	<u>739,098</u>	<u>0</u>	<u>4,430,477</u>
NET ASSETS RELEASED FROM RESTRICTIONS	<u>632,586</u>	<u>(632,586)</u>	<u>0</u>	<u>0</u>
TOTAL REVENUES AND SUPPORT	<u>4,323,965</u>	<u>106,512</u>	<u>0</u>	<u>4,430,477</u>
EXPENSES				
Program Services:				
Construction, Supervision and Support	2,528,429	0	0	2,528,429
Family Support and Education	343,816	0	0	343,816
ReStore Retail Operations	693,015	0	0	693,015
Support Services:				
Management and Administrative	652,080	0	0	652,080
Fundraising and Development	246,206	0	0	246,206
TOTAL EXPENSES	<u>4,463,546</u>	<u>0</u>	<u>0</u>	<u>4,463,546</u>
OTHER REVENUES (EXPENSES)				
Interest Income and Investment Return, Net	12,545	0	0	12,545
Gain (Loss) on Sale of Assets	2,333	0	0	2,333
Total Other Revenues (Expenses), Net	<u>14,878</u>	<u>0</u>	<u>0</u>	<u>14,878</u>
CHANGE IN NET ASSETS	(124,703)	106,512	0	(18,191)
TOTAL NET ASSETS, BEGINNING OF YEAR	<u>8,372,448</u>	<u>81,094</u>	<u>100,000</u>	<u>8,553,542</u>
TOTAL NET ASSETS, END OF YEAR	<u>\$ 8,247,745</u>	<u>\$ 187,606</u>	<u>\$ 100,000</u>	<u>\$ 8,535,351</u>

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

KNOXVILLE HABITAT FOR HUMANITY, INC.

STATEMENT OF ACTIVITIES (Continued)

For the Year Ended June 30, 2017

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
REVENUE AND SUPPORT				
Contributions and Grants	\$ 1,119,644	\$ 534,698	\$ 0	\$ 1,654,342
In-Kind Contributions	107,698	0	0	107,698
Home Sales, Net	1,088,457	0	0	1,088,457
Mortgage Discount Amortization	556,241	0	0	556,241
Fundraising Events, Net of Direct Expenses	132,734	0	0	132,734
ReStore Sales, Net	817,934	0	0	817,934
Rental Income	18,991	0	0	18,991
Other Revenues	40,798	0	0	40,798
Total Revenue and Support	<u>3,882,497</u>	<u>534,698</u>	<u>0</u>	<u>4,417,195</u>
NET ASSETS RELEASED FROM RESTRICTIONS	<u>818,199</u>	<u>(818,199)</u>	<u>0</u>	<u>0</u>
TOTAL REVENUES AND SUPPORT	<u>4,700,696</u>	<u>(283,501)</u>	<u>0</u>	<u>4,417,195</u>
EXPENSES				
Program Services:				
Construction, Supervision and Support	2,418,959	0	0	2,418,959
Family Support and Education	306,846	0	0	306,846
ReStore Retail Operations	695,446	0	0	695,446
Support Services:				
Management and Administrative	593,384	0	0	593,384
Fundraising and Development	327,286	0	0	327,286
TOTAL EXPENSES	<u>4,341,921</u>	<u>0</u>	<u>0</u>	<u>4,341,921</u>
OTHER REVENUES (EXPENSES)				
Interest Income and Investment Return, Net	12,765	0	0	12,765
Gain (Loss) on Sale of Assets	(49,556)	0	0	(49,556)
Total Other Revenues (Expenses), Net	<u>(36,791)</u>	<u>0</u>	<u>0</u>	<u>(36,791)</u>
CHANGE IN NET ASSETS	321,984	(283,501)	0	38,483
TOTAL NET ASSETS, BEGINNING OF YEAR	<u>8,050,464</u>	<u>364,595</u>	<u>100,000</u>	<u>8,515,059</u>
TOTAL NET ASSETS, END OF YEAR	<u>\$ 8,372,448</u>	<u>\$ 81,094</u>	<u>\$ 100,000</u>	<u>\$ 8,553,542</u>

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

KNOXVILLE HABITAT FOR HUMANITY, INC.

STATEMENT OF FUNCTIONAL EXPENSES

For the Year Ended June 30, 2018

	Program Services				Supporting Services			Total Program and Supporting Services
	Construction, Supervision and Support	Family Support and Education	ReStore Retail Operations	Total	Management and Administrative	Fundraising and Development	Total	
Salaries and Related Benefits	\$ 468,561	\$ 295,054	\$ 418,880	\$ 1,182,495	\$ 393,406	\$ 178,468	\$ 571,874	\$ 1,754,369
Costs of Construction	1,723,919	0	0	1,723,919	0	0	0	1,723,919
Property Expense	20,143	0	285	20,428	0	0	0	20,428
Occupancy	37,073	5,260	161,092	203,425	42,083	2,630	44,713	248,138
Office Expense	1,498	3,619	99	5,216	27,972	12,929	40,901	46,117
Professional Fees	2,587	3,502	0	6,089	22,265	0	22,265	28,354
Insurance	5,269	495	16,321	22,085	12,350	247	12,597	34,682
Supplies and Equipment	16,885	10,416	12,537	39,838	56,994	5,528	62,522	102,360
Taxes and Licenses	642	0	0	642	25,500	0	25,500	26,142
Telephone	3,652	487	16,069	20,208	3,895	243	4,138	24,346
Travel, Conferences, Meetings	5,620	6,345	460	12,425	23,752	8,708	32,460	44,885
Homeowner Services	0	4,655	0	4,655	160	0	160	4,815
Vehicle Expense	29,239	0	22,973	52,212	0	0	0	52,212
Interest Expense	138,359	0	1,585	139,944	2	0	2	139,946
Advertising and Marketing	19,331	9,230	11,350	39,911	3,847	31,765	35,612	75,523
Volunteer Appreciation	5,328	0	706	6,034	16,147	2,087	18,234	24,268
Tithes and Donations	0	0	0	0	17,000	0	17,000	17,000
Miscellaneous	3,227	4,080	17,208	24,515	2,672	1,583	4,255	28,770
Depreciation and Amortization	47,096	673	13,450	61,219	4,035	2,018	6,053	67,272
TOTAL EXPENSES	\$ 2,528,429	\$ 343,816	\$ 693,015	\$ 3,565,260	\$ 652,080	\$ 246,206	\$ 898,286	\$ 4,463,546

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

KNOXVILLE HABITAT FOR HUMANITY, INC.

STATEMENT OF FUNCTIONAL EXPENSES

For the Year Ended June 30, 2017

	Program Services				Supporting Services			Total Program and Supporting Services
	Construction, Supervision and Support	Family Support and Education	ReStore Retail Operations	Total	Management and Administrative	Fundraising and Development	Total	
Salaries and Related Benefits	\$ 438,612	\$ 249,271	\$ 426,450	\$ 1,114,333	\$ 374,137	\$ 235,891	\$ 610,028	\$ 1,724,361
Costs of Construction	1,662,423	0	0	1,662,423	111	0	111	1,662,534
Property Expense	41,506	0	0	41,506	4,491	0	4,491	45,997
Occupancy	37,435	4,991	164,712	207,138	39,930	2,496	42,426	249,564
Office Expense	1,148	2,490	76	3,714	28,220	9,566	37,786	41,500
Professional Fees	548	17,907	0	18,455	16,472	0	16,472	34,927
Insurance	5,682	550	18,136	24,368	11,168	275	11,443	35,811
Supplies and Equipment	13,547	9,094	11,422	34,063	29,756	4,635	34,391	68,454
Taxes and Licenses	2,113	0	0	2,113	13,445	0	13,445	15,558
Telephone	4,627	617	20,360	25,604	4,935	309	5,244	30,848
Travel, Conferences, Meetings	3,535	11,958	1,448	16,941	24,988	12,537	37,525	54,466
Homeowner Services	0	4,491	0	4,491	0	0	0	4,491
Vehicle Expense	24,999	0	19,642	44,641	0	0	0	44,641
Interest Expense	127,819	0	259	128,078	0	0	0	128,078
Advertising and Marketing	2,710	1,484	1,836	6,030	9,099	51,707	60,806	66,836
Volunteer Appreciation	3,849	373	479	4,701	10,398	4,738	15,136	19,837
Tithes and Donations	0	0	0	0	23,000	0	23,000	23,000
Miscellaneous	17,108	3,173	21,684	41,965	550	3,791	4,341	46,306
Depreciation and Amortization	31,298	447	8,942	40,687	2,684	1,341	4,025	44,712
TOTAL EXPENSES	<u>\$ 2,418,959</u>	<u>\$ 306,846</u>	<u>\$ 695,446</u>	<u>\$ 3,421,251</u>	<u>\$ 593,384</u>	<u>\$ 327,286</u>	<u>\$ 920,670</u>	<u>\$ 4,341,921</u>

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

KNOXVILLE HABITAT FOR HUMANITY, INC.

STATEMENTS OF CASH FLOWS

	For the Years Ended June 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	\$ (18,191)	\$ 38,483
Adjustments to Reconcile Change in Net Assets to		
Net Cash Provided by (Used in) Operating Activities:		
Depreciation and Amortization	67,272	44,712
(Gain) Loss on Sale of Assets	(2,333)	49,556
Home Sales, Net	(1,136,138)	(1,088,457)
Mortgage Discount Amortization	(573,449)	(556,241)
Mortgage Payments Received	957,005	917,747
Proceeds from Sales of Mortgages	510,750	330,000
Amortization of Discount on Other Long-Term Debt	137,206	127,278
Donated Property and Equipment	0	(20,000)
Income from Beneficial Interest, Net	(5,772)	(8,552)
(Increase) Decrease in Assets:		
Contributions Receivable	98,500	(137,500)
Other Receivables	(77,171)	1,728
Inventory	2,497	47,998
Prepaid Expenses	(14,204)	7,453
Homes Under Construction	19,829	(180,066)
Lease-to-Own Property	(11,471)	(85,572)
Real Estate Owned	241,864	416,564
Increase (Decrease) in Liabilities:		
Accounts Payable and Accrued Expenses	(41,534)	39,126
Mortgage Escrow Accounts	(721)	(76,813)
Total Adjustments	172,130	(171,039)
Net Cash Provided by (Used In) Operating Activities	153,939	(132,556)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Property and Equipment	(240,161)	(7,106)
Proceeds from Sales of Property and Equipment	22,000	500
Distributions from Beneficial Interest	4,456	4,518
Net Cash Provided by (Used in) Investing Activities	(213,705)	(2,088)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net Borrowing (Repayment) on Lines of Credit	88,776	0
Proceeds from Notes Payable	92,077	0
Principal Payments on Notes Payable	(28,267)	(25,233)
Net Cash Provided by (Used in) Financing Activities	152,586	(25,233)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	92,820	(159,877)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	1,039,658	1,199,535
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 1,132,478	\$ 1,039,658
Supplemental Disclosures of Cash Flow Information:		
Cash Paid During the Year for Interest	\$ 2,740	\$ 800
Supplementary Disclosures of Noncash Investing Activities:		
Reduction of Mortgages Sold with Recourse	\$ 301,484	\$ 296,452
Transfer of Mortgages Receivable to Real Estate Owned	\$ 123,311	\$ 309,230
Transfer of Real Estate Owned to Property and Equipment	\$ 0	\$ 66,263

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

KNOXVILLE HABITAT FOR HUMANITY, INC.

NOTES TO FINANCIAL STATEMENTS

June 30, 2018 and 2017

NOTE 1 - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - Knoxville Habitat for Humanity, Inc. ("Habitat" or the "Organization"), is a not-for-profit corporation, incorporated in the State of Tennessee in 1985. The purpose of Habitat is to provide simple, decent, affordable homes to low income families. Homes are sold at no profit and financed with noninterest-bearing mortgages. The activities of the Organization are funded by a diverse group of supporters including local and state government agencies, foundations, churches, individuals, and businesses.

Habitat is an affiliate of Habitat for Humanity International, Inc. ("Habitat International"), a nondenominational Christian not-for-profit organization whose purpose is to create decent, affordable housing for those in need, and to make decent shelter a matter of conscience with people everywhere. Although Habitat International assists with information resources, training publications, prayer support, and in other ways, Knoxville Habitat for Humanity is primarily and directly responsible for its own operations.

Habitat operates a ReStore, a retail operation, where donations of used clothing, household furnishings, appliances, and other miscellaneous items are sold to the general public. In addition, building supplies not utilized by Habitat in home construction and certain purchased inventory items are also sold at ReStore. Profits from merchandise sales are used to assist in Habitat's mission of building homes.

Basis of Accounting - The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Financial Accounting Standards Board (FASB). The financial statements are prepared on the accrual basis of accounting.

Basis of Presentation - Habitat is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Contributions are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence and/or nature of any donor restrictions. Contributions that are restricted by the donor are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Contributions of assets other than cash are recorded at their estimated fair value. In-kind revenue is recorded based on its estimated fair value on the date of receipt.

Net Assets - Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of Habitat and changes therein are classified and reported as follows.

- *Unrestricted Net Assets* - not subject to donor-imposed stipulations or the donor-imposed restrictions have expired. All gifts, grants, and bequests are considered unrestricted unless specifically restricted by the donor.
- *Temporarily Restricted Net Assets* - includes resources for which use is limited by donor-imposed stipulations that either expire by the passage of time or can be fulfilled by actions of Habitat pursuant to those stipulations. When a donor-imposed restriction is fulfilled or when a time restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying statement of activities as net assets released from restrictions.
- *Permanently Restricted Net Assets* - includes resources for which use is limited by donor-imposed stipulations that neither expire by the passage of time nor can be fulfilled or otherwise removed by actions of Habitat.

NOTE 1 - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes - Habitat qualifies as a tax-exempt organization under Section 501(c)(3) of the U.S. Internal Revenue Code; therefore, no expense has been recognized for income taxes in the accompanying financial statements. Habitat files annual returns of organizations exempt from income taxes with the IRS. Contributions to Knoxville Habitat for Humanity are deductible as charitable gifts for federal income tax purposes.

Presentation of Certain Taxes - Habitat collects various taxes from customers and remits these amounts to applicable taxing authorities. The Organization's accounting policy is to exclude these taxes from revenues and cost of sales.

Cash and Cash Equivalents - For purposes of the statements of cash flows, Habitat considers all highly liquid investments with an initial maturity of three months or less when purchased to be cash equivalents.

Donated Services and Materials - Donated services and materials are recognized as contributions in accordance with accounting standards at their estimated fair value if the services (a) create or enhance Habitat's non-financial assets or (b) require specialized skills that are performed by people with those skills that would otherwise be purchased. No amounts have been reflected in these financial statements for certain donated volunteer services because they do not qualify for recording under the guidelines of accounting standards; however, a substantial number of volunteers have donated a significant amount of time and perform a variety of tasks and services that assist Habitat in its programs, supporting services, ReStore retail operations, and fundraising campaigns. Donated materials consist primarily of construction materials.

Donations of inventory items held for sale in the ReStore are recognized when sold because Habitat does not have an objective measurement basis for determining fair value of these items. ReStore net sales in June 30, 2018 and 2017 were \$919,508 and \$817,934 and, which were net of \$19,131 and \$23,027, respectively, of purchased costs of goods sold.

Escrow Reserves - Habitat services a portion of its portfolio of mortgages receivable. Included in cash are amounts received from homeowners for insurance, property taxes, homeowner dues, etc. These amounts are used to pay amounts as they become due. Also, Habitat receives payments from potential buyers in various stages of the homeownership program to be used for closing costs at the time the home purchase is complete. These amounts are held in escrow accounts until the disbursement is made at closing or refunded to the individual if they do not complete the program and become a homeowner. Mortgage escrow as of June 30, 2018 and 2017 totaled \$262,691 and \$260,662, respectively, for tax and insurance escrow, and \$821 and \$3,571, respectively, for potential homeowner deposits.

Home Sales and Mortgage Notes Receivable - Transfers to homeowners are recorded at the gross amount of payments to be received over the lives of the mortgage notes receivable. Transfers for the years ended June 30, 2018 and 2017 were \$1,718,500 and \$1,841,330, respectively. These mortgage payments do not include interest and, accordingly, the mortgages have been discounted at various interest rates based upon prevailing market rates for low income housing at the inception of the mortgages. Discounts are amortized using the straight-line method over the term of the mortgages. The discounted value of mortgages at the time of sale is generally less than the homes' fair market value. Discounts on mortgages issued during the years ended June 30, 2018 and 2017, net of unamortized discounts totaled \$582,362 and \$752,873, respectively. Income recognized from mortgage discount amortization was \$573,449 and \$556,241 for the years ended June 30, 2018 and 2017, respectively.

Management believes that losses resulting from non-payment of mortgages are not probable and reasonably estimable, and accordingly, no allowance for mortgage notes receivable has been recorded. In addition, Habitat can reclaim houses through foreclosure in the event that a loan is deemed to be uncollectible, and management believes any reclaimed house can be resold at or above the amount of unpaid, discounted loan principal plus costs to sell the home. Past due status is based on contractual terms of the mortgage notes receivable. At 120 days past due, the mortgages receivable become subject to foreclosure.

NOTE 1 - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

“Silent” Mortgages Receivable - In order to protect against the resale of Habitat’s homes for a profit, the Organization holds a “silent” mortgage on every Habitat home that represents the difference between the estimated fair market value of the home and the mortgage receivable as of the transfer date. As long as the homeowner makes timely payments on the first mortgage and the second mortgage, where applicable, Habitat will forgive a portion of the outstanding principal balance of the “silent” mortgage ratably over the course of the first mortgage loan. No payments are made on these “silent” mortgages unless a house is resold, in which case Habitat holds the right of first refusal. As gain contingencies are not likely to be realized, these “silent” mortgages are not recorded as assets on the statement of financial position.

Homes Under Construction and Real Estate Owned - Homes under construction represents houses which are currently under construction for families. Lease-to-own property consists of houses currently rented to families under a program in which the families can later purchase the houses. Real estate owned consists of land and improvements to be utilized as lots for future homeowners as well as foreclosed and uninhabited houses that are available for future homeowners. Purchased land and materials for the construction of houses are recorded at cost, and costs incurred to improve land are capitalized when incurred. Repossessed homes are recorded at the outstanding mortgage balance at the date of reclamation. Habitat records the value of donated land and material for the construction of homes at fair value at the date of the donation.

Inventory - Construction materials inventory consists of materials purchased in bulk for construction of future homes and preconstructed sheds to be delivered to completed homes. As of June 30, 2018 and 2017, construction materials were \$30,239 and \$22,595, respectively. Purchased ReStore inventory consists primarily of items purchased by Habitat and offered for public purchase at ReStore. Purchased inventory is stated at the lower of cost or net realizable value. The value of the purchased ReStore inventory as of June 30, 2018 and 2017 was \$1,219 and \$11,360, respectively. Donated inventory is not recorded until it is sold or used by Habitat.

Functional Expense Allocation - The costs of provided various programs and other activities have been summarized on a functional basis in the statement of activities and in the statement of functional expenses. Expenses that can be identified with a specific program or support service are charged directly to that program or support service. Indirect expenses are allocated among the programs and supporting services benefitted.

Advertising - Habitat recognizes advertising expenses as incurred. For the years ended June 30, 2018 and 2017, Habitat recognized a total of \$75,523 and \$66,835, respectively, in advertising and marketing expense.

Property and Equipment - Purchased property and equipment is valued at cost. Donated property and equipment is recorded at the estimated fair value at the date of the gift to the Organization. Purchases or donations of property and equipment of \$1,000 or more are capitalized. Depreciation is computed on the straight-line method over the estimated useful lives of three to forty years. Amortization is calculated for capitalized leasehold improvements using the straight-line method over the shorter of the useful life of the improvement or the remaining life of the lease.

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 certain reported amounts and disclosures. Accordingly, actual results could vary from those estimates. Management believes that these estimates and assumptions provide a reasonable basis for the fair presentation of the financial statements.

Reclassifications - Certain items in the 2017 financial statements may have been classified to conform to the 2018 financial statements.

Recent Accounting Pronouncements - In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which simplifies and improves how a not-for-profit organization classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity financial performance, and cash flows. Among other changes, the ASU replaces the three current classes of net assets with two new classes, “net assets with donor restrictions” and “net assets without donor restrictions” and expands disclosures about the nature and amount of any donor restrictions. ASU 2016-14 is effective for annual periods beginning after December 15, 2017, with early adoption permitted. The Organization is currently evaluating the impact the adoption of this guidance will have on its future financial statements.

Subsequent Events - Management has evaluated subsequent events through December 19, 2018, which is the date the financial statements were available to be issued, and has determined that there are no subsequent events that require disclosure.

NOTE 2 - CONCENTRATION OF CREDIT RISK

Habitat maintains its cash and cash equivalents accounts in several financial institutions in East Tennessee. The cash accounts are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per legal ownership. A summary of bank balances as of June 30, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
FDIC Insurance Covered Balances	\$ 1,089,812	\$ 852,763
Uninsured Balances	173,274	304,793
Total Bank Balances	<u>\$ 1,263,086</u>	<u>\$ 1,157,556</u>

NOTE 3 - BENEFICIAL INTEREST IN ASSETS HELD BY OTHERS

Knoxville Habitat for Humanity, Inc. maintains an account (“the Habitat Fund”) which is held and administered by the East Tennessee Foundation (“ETF”) for the benefit of Habitat. The fund is the property of the ETF, and as such the ETF shall have the ultimate authority and control of all property of the fund and income derived therefrom, for the charitable purposes of the ETF. Under the terms of Habitat’s agreement with the ETF, at the ETF’s discretion, only the net income of the fund, or an amount calculated according to the annual spending rate (a percentage of market value) shall be distributed to Habitat each year. In establishing the fund, Habitat granted variance power to the ETF. That power gives the ETF the right to make fund distributions to another not-for-profit organization of its choice or amend the terms of the agreement as it sees necessary if Habitat ceases to exist or the governing body of the ETF votes that support of Habitat (a) is no longer necessary, (b) is incapable of fulfillment, or (c) is inconsistent with the charitable needs of the East Tennessee community. At June 30, 2018, the endowment has a value of \$100,188, which is reported in the statement of financial position as beneficial interest in assets held by others. The endowment fund has donor restrictions as of June 30, 2018 in the amount of \$100,000, for which the associated net assets have been classified as permanently restricted net assets.

Habitat’s beneficial interest in assets held by the East Tennessee Foundation is recorded at fair value, which is estimated as the fair value of the underlying assets. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A valuation hierarchy has been established for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities as of the measurement date. Level 2 inputs are quoted prices for similar assets or liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on an entity’s assumptions used to measure assets or liabilities at fair value. A financial asset or liability’s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Habitat’s beneficial interest in assets held by the ETF are held in the ETF’s long-term commingled investment fund, for which there is no active market. This investment fund is comprised of fixed income, equity, and alternative investments and is reported at fair value using Level 3 inputs. The fair value measurements consider observable data that may include closing prices, calculated net asset per share, pricing models, and discounted cash flows.

The table below includes a roll forward of Habitat’s beneficial interest in assets held by others, which is measured at fair value on a recurring basis and classified within Level 3 of the valuation hierarchy.

	<u>2018</u>	<u>2017</u>
Fair Value at Beginning of Year	\$ 98,872	\$ 94,838
Interest and Dividends	3,428	647
Net Realized Gain (Loss)	6,502	3,456
Net Unrealized Gain (Loss)	(2,884)	5,655
Administrative Fees	(1,275)	(1,206)
Distributions	(4,455)	(4,518)
Fair Value at End of Year	<u>\$ 100,188</u>	<u>\$ 98,872</u>

NOTE 4 - MORTGAGES RECEIVABLE

Habitat sells homes to qualifying families and provides interest free first mortgages for up to thirty years. Initially, the qualifying family contributes “sweat equity” during the construction phase, and then the home is deeded to the family when the “sweat equity” requirements are met. Mortgage payments, net of insurance, taxes, and other escrow items are applied to reduce the mortgages receivable. Second mortgages are sometimes provided for periods of three to twenty-five years to assist homeowners with closing costs.

First and second (where applicable) mortgages are recorded at present value based upon prevailing market rates for low income housing at the inception of the mortgage. The difference between the face amount of the note and its present value is accounted for as a discount and amortized over the life of the note using the straight-line method. The notes have been discounted at various rates ranging from 7.39% to 8.48%. First and second mortgages receivable as of June 30, 2018 and 2017 are as follows, with first mortgages that have been sold with recourse to the Tennessee Housing Development Agency (THDA) shown separately (Note 8).

	Unpledged	Sold to THDA with Recourse	Total
<u>2018</u>			
Face Value	\$ 12,128,391	\$ 4,500,571	\$ 16,628,962
Less Unamortized Discounts	(6,673,363)	(2,496,401)	(9,169,764)
Net Present Value	<u>\$ 5,455,028</u>	<u>\$ 2,004,170</u>	<u>\$ 7,459,198</u>
<u>2017</u>			
Face Value	\$ 12,000,232	\$ 4,291,305	\$ 16,291,537
Less Unamortized Discounts	(6,526,519)	(2,324,377)	(8,850,896)
Net Present Value	<u>\$ 5,473,713</u>	<u>\$ 1,966,928</u>	<u>\$ 7,440,641</u>

Principal payments due on mortgage notes receivable as of June 30, 2018 are as follows:

	Unpledged	THDA Mortgages with Recourse	Total
2019	\$ 800,951	\$ 255,717	\$ 1,056,668
2020	784,069	254,687	1,038,756
2021	758,003	251,740	1,009,743
2022	727,426	247,437	974,863
2023	691,015	247,437	938,452
Thereafter	8,366,927	3,243,553	11,610,480
	<u>\$ 12,128,391</u>	<u>\$ 4,500,571</u>	<u>\$ 16,628,962</u>

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment as of June 30, 2018 and 2017 is summarized as follows:

	2018	2017
Buildings and Real Estate	\$ 792,379	\$ 739,324
Equipment, Furniture, Fixtures	90,778	41,848
Vehicles	259,371	141,195
Leasehold Improvements - ReStore	39,088	39,088
Other Fixed Assets	40,236	40,236
	<u>1,221,852</u>	<u>1,001,691</u>
Less Accumulated Depreciation	(463,858)	(396,919)
	<u>\$ 757,994</u>	<u>\$ 604,772</u>

Depreciation expense of \$59,455 and amortization expense of \$7,817 was charged to operations for the year ended June 30, 2018 (\$36,895 and \$7,817 in 2017).

NOTE 6 - HOME CONSTRUCTION COSTS

The following is a summary of home building activity for the years ended June 30, 2018 and 2017:

	Number	Costs
Homes Under Construction, July 1, 2017	12	\$ 473,760
Additional Costs Incurred on Beginning Inventory		433,759
New Homes Started During the Year	20	1,072,467
Lease-to-Own Program	3	197,744
Transfers to Homeowners	(22)	(1,723,799)
Homes Under Construction, June 30, 2018	<u>13</u>	<u>\$ 453,931</u>
Homes Under Construction, July 1, 2016	7	\$ 293,694
Additional Costs Incurred on Beginning Inventory		259,948
New Homes Started During the Year	21	1,482,345
Lease-to-Own Program	2	100,196
Transfers to Homeowners	(18)	(1,662,423)
Homes Under Construction, June 30, 2017	<u>12</u>	<u>\$ 473,760</u>

NOTE 7 - LONG-TERM DEBT (INSTALLMENT LOANS)

The following is a summary of installment loans payable as of June 30, 2018 and 2017:

	2018	2017
Note payable to First Tennessee Bank for purchase of a vehicle; original amount of loan is \$14,026 at annual interest rate of 4.25%; monthly payments of principal and interest totaling \$319 for forty-eight months, beginning July 2016, with final payment June 2020; loan secured by a 2015 Dodge Ram 1500 truck. The note was paid off during 2018.	\$ 0	\$ 10,742
Note payable to First Tennessee Bank for purchase of a vehicle; original amount of loan is \$15,000 at annual interest rate of 3.99%; monthly payments of principal and interest totaling \$339 for forty-eight months, beginning August 2014, with final payment July 2018; loan secured by a 2007 Isuzu NPR box truck. The note was paid off during 2018.	0	4,306
Note payable to SmartBank for purchase of a vehicle; original amount of loan is \$58,475 at annual interest rate of 3.77%; monthly payments of principal and interest totaling \$1,072 for sixty months, beginning October 2017, with final payment September 2022; loan secured by a 2018 Isuzu FTR truck.	50,396	0
Note payable to Home Federal Bank for purchase of a vehicle; original amount of loan is \$33,602 at annual interest rate of 4.0%; monthly payments of principal and interest totaling \$620 for sixty months, beginning September 2017, with final payment August 2022; loan secured by a 2016 Ford F-250.	<u>28,462</u>	<u>0</u>
	78,858	15,048
Less Current Maturities	<u>(17,979)</u>	<u>(7,402)</u>
	<u>\$ 60,879</u>	<u>\$ 7,646</u>

Future maturities of installment loans are as follows:

Year Ending June 30,	Total
2019	\$ 17,979
2020	18,240
2021	18,966
2022	19,716
2023	3,957
Total	<u>\$ 78,858</u>

NOTE 8 - MORTGAGES SOLD WITH RECOURSE

Habitat sells certain mortgage receivables to THDA under its "New Start Program". These loans are sold with recourse, meaning that Habitat has an obligation to repurchase the loans if certain conditions of the sale are not met, including the requirement for each homeowner to make timely payments under the terms of the mortgage notes. The recourse is in place until each loan has been repaid in full by the homeowner. As a result of the obligation for Habitat to repurchase these loans, these transactions are not treated as sales to THDA, but are instead treated as secured borrowings. The outstanding balances of the mortgages receivable that were transferred to THDA are therefore included in the mortgages receivable balances on the statement of financial position (Note 4). A corresponding long-term debt obligation to THDA has been recorded for the same amount of these transferred mortgages receivable. These long-term debt obligations are noninterest-bearing, with maturities that correspond with the future principal payments due on the related mortgages receivable and are secured by noninterest-bearing first mortgages held by Habitat with a discounted value of \$2,004,170 as of June 30, 2018 (\$1,966,928 as of June 30, 2017). The notes payable have an undiscounted balance of \$4,500,571 as of June 30, 2018 (\$4,291,305 as of June 30, 2017). Discount rates ranging from 7.39% to 8.48% were applied to arrive at the net present value of the notes payable at issuance. Revenue of \$309,230 (included in Home Sales, Net) has been recognized in 2018 (\$198,514 in 2017) to present the difference between the undiscounted notes payable balances and their present value at the time of issuance. The discount is amortized to interest expense using the straight-line method over the respective terms of the notes. The unamortized discount as of June 30, 2018 amounted to \$2,496,401 (\$2,324,377 as of June 30, 2017).

NOTE 9 - LINES OF CREDIT

The Organization has a \$350,000 line of credit that expires November 20, 2022. Interest is variable and is secured by a First Deed of Trust on the office property on 1501 Washington Avenue, Knoxville, Tennessee. There were no outstanding borrowings on this line of credit as of June 30, 2018 or 2017.

The Organization has a \$250,000 "step-down" revolving line of credit as of June 30, 2018 that expires August 25, 2022. As of August 25, 2018, the maximum borrowings available will be \$200,000, 2019 - \$150,000, 2020 - \$100,000 and at 2021, \$50,000 will be available as part of the "step-down" agreement. There is no interest charged, and the line is unsecured. There was a balance of \$88,776 as of June 30, 2018.

NOTE 10 - RESTRICTED NET ASSETS

Temporarily restricted net assets to be used for construction of homes and specific events/programs were \$187,607 as of June 30, 2018 (\$81,094 as of June 30, 2017).

Net assets were released from donor restrictions during the year ended June 30, 2018 by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors. The construction of homes totaled \$606,586 (\$765,290 in 2017) and the accomplishment of grant requirements totaled \$26,000 for the year ended June 30, 2018 (\$52,909 for the year ended June 30, 2017).

Permanently restricted net assets consist of endowments held by the East Tennessee Foundation and were \$100,000 as of June 30, 2018 and 2017. See Note 3.

NOTE 11 - RELATED PARTY TRANSACTIONS

During the years ended June 30, 2018 and 2017, Habitat recorded \$17,000 and \$23,000, respectively, in tithes to Habitat for Humanity International to be used to construct homes in economically depressed areas around the world. Additionally, Habitat paid a "U.S. Stewardship and Organization Stability" fee of \$15,000 to Habitat for Humanity International for the years ended June 30, 2018 and 2017.

NOTE 12 - OPERATING LEASES

Habitat has an operating lease agreement for its ReStore retail operations. Rent expense, which is included in occupancy costs in the statement of functional expenses, paid under this lease was \$138,000 for the year ended June 30, 2018 (\$126,000 in 2017). A security deposit of \$9,000 was paid at the inception of this lease and is included as of June 30, 2018 and 2017 in the statement of financial position.

The future minimum rental payments for the years ending June 30:

2019	\$	150,000
2020		153,000
2021		156,000
2022		156,000
2023		156,000
Thereafter		390,000
	\$	<u>1,161,000</u>

The Organization also leased storage space for its retail operations on a month-to-month basis during the year ended June 30, 2018 for a total of \$730 (\$1,752 in 2017).

Habitat leases one of its vacant lots for a cell tower structure under a multi-year operating lease. The monthly lease payments vary month to month, based on certain criteria. Lease income recorded by Habitat under this lease total \$16,087 and \$17,791 for the years ended June 30, 2018 and 2017, respectively.

Habitat also rents foreclosed properties to tenants under month-to-month agreements. Total rent received was \$500 and \$1,200 for the years ended June 30, 2018 and 2017, respectively.

Additionally, participants in Habitat's homeownership program lease homes under lease-to-own agreements. While working toward homeownership, these tenants pay monthly rent. These payments will be applied to the mortgage loan once the tenant completes the program and assumes the debt. Lease-to-own payments held by Habitat under this program totaled \$44,811 and \$38,777 as of June 30, 2018 and 2017, respectively.

NOTE 13 - RETIREMENT PLAN

The Organization has a SIMPLE IRA retirement plan covering substantially all of its employees. Eligible employees can make contributions to the plan up to the maximum allowed each year by the IRS. Habitat will match the employee contributions up to 3% of gross compensation. Retirement expense is \$30,827 for the year ended June 30, 2018 (\$32,322 in 2017) and is included in "Salaries and Related Benefits" in the statement of functional expenses.

NOTE 14 - CONTINGENCIES

The nature and scope of Habitat's operations bring it into regular contact with the general public and a variety of businesses and governmental entities in the ordinary course of business. Such activities inherently subject the Organization to the hazards of litigation. Habitat is not aware of any legal proceedings which could have a material adverse effect on the financial statements.

