

CONSOLIDATED FINANCIAL STATEMENTS

Massachusetts Housing Investment Corporation

Years ended June 30, 2002 and 2001

Massachusetts Housing Investment Corporation

Consolidated Financial Statements

Years ended June 30, 2002 and 2001

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Report of Independent Auditors

Board of Directors
The Massachusetts Housing Investment Corporation

We have audited the accompanying consolidated balance sheets of the Massachusetts Housing Investment Corporation (the Corporation) as of June 30, 2002 and 2001, and the related consolidated statements of revenues and expenditures and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Massachusetts Housing Investment Corporation at June 30, 2002 and 2001, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying consolidating balance sheets and statements of revenues and expenditures are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in our audits of the consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

Ernst & Young LLP

October 3, 2002

Massachusetts Housing Investment Corporation

Consolidated Balance Sheets

	June 30	
	2002	2001
Assets		
Cash	\$ 209,041	\$ 1,237,254
Money market deposits at member corporations—loan fund	250,000	252,123
Notes receivable—MHEF Partnerships	12,893,218	7,841,644
Notes receivable—MHIC, LLC	790,000	2,698,023
Amounts receivable and other assets	879,686	1,035,193
Furniture, equipment and leasehold improvements, net of accumulated depreciation and amortization of \$874,987 and \$774,023 in 2002 and 2001, respectively	157,824	128,055
Total assets	<u>\$15,179,769</u>	<u>\$13,192,292</u>
Liabilities and net assets		
Liabilities:		
Notes payable to member corporations	\$ 250,000	\$ 250,000
Notes payable—loan guarantee program	—	2,698,023
Unearned fees	10,755,119	6,554,066
Accrued interest and other liabilities	1,123,467	704,253
Total liabilities	<u>12,128,586</u>	<u>10,206,342</u>
Net assets—unrestricted	<u>3,051,183</u>	<u>2,985,950</u>
Total liabilities and net assets	<u>\$15,179,769</u>	<u>\$ 13,192,292</u>

See accompanying notes.

Massachusetts Housing Investment Corporation

Consolidated Statements of Revenues and Expenditures

	Year ended June 30	
	2002	2001
Revenues		
Interest revenue:		
Interest on deposits	\$ 221,373	\$ 812,464
Interest on project loans	73,619	1,203,502
Total interest revenue	<u>294,992</u>	2,015,966
Interest expense on notes payable	(77,268)	(1,333,810)
Net interest revenue before provision for loan losses	<u>217,724</u>	682,156
Provision for loan losses	-	(145,092)
Net interest revenue after provision for loan losses	<u>217,724</u>	537,064
Loan program fee revenue:		
Management and advisory fees	261,811	113,359
Portfolio and servicing fees	548,758	147,867
Financing commitment fees	384,366	169,462
Origination fees	363,226	97,704
Available earnings fee	11,372	6,950
CDFI grant award	-	684,761
Equity program revenue:		
Fees related to MHEF Partnerships	3,994,745	3,497,133
Other equity program fees	50,733	48,650
Total revenues	<u>5,832,735</u>	5,302,950
Expenditures		
Salaries and employee benefits	3,393,734	2,885,478
Occupancy, equipment and furniture	409,334	419,202
Professional services	1,129,383	581,866
Other expenditures	835,051	661,637
Total expenditures	<u>5,767,502</u>	4,548,183
Excess of revenues over expenditures	65,233	754,767
Net assets at beginning of year	<u>2,985,950</u>	2,231,183
Net assets at end of year	<u><u>\$3,051,183</u></u>	<u>\$2,985,950</u>

See accompanying notes.

Massachusetts Housing Investment Corporation

Consolidated Statements of Cash Flows

	Year ended June 30	
	2002	2001
Operating activities		
Excess of revenues over expenditures	\$ 65,233	\$ 754,767
Adjustments to reconcile excess of revenues over expenditures to net cash used in operating activities:		
Increase to provision for loan losses	-	145,092
Depreciation and amortization expense	100,964	123,777
Decrease/ (increase) in amounts receivable and other assets	155,507	(315,086)
Decrease in unearned fees	(3,539,730)	(2,138,009)
Increase (decrease) in accrued interest and other liabilities	419,214	(158,401)
Net cash used in operating activities	<u>(2,798,812)</u>	<u>(1,587,860)</u>
Investing activities		
Project loan advances	-	(16,118,528)
Project loan repayments	-	7,524,530
Payments received on notes receivable—MHIC, LLC	2,689,209	1,983,613
Funds advanced under notes receivable—MHIC, LLC	(790,000)	-
Decrease to loan guarantee funds on deposit	-	63,510
Decrease in money market deposits at member corporations	2,123	8,791,875
Loan guarantee advances	-	(130,065)
Loan guarantee repayments	-	2,699,539
Purchases of furniture, equipment and leasehold improvements	(130,733)	(74,266)
Net cash provided by investing activities	<u>1,770,599</u>	<u>4,740,208</u>
Financing activities		
Payments of notes payable to member corporations	-	(200,000)
Payments of notes payable to loan guarantee lenders	-	(2,220,430)
Net cash used in financing activities	<u>-</u>	<u>(2,420,430)</u>
Net (decrease) increase in cash	(1,028,213)	731,918
Cash at beginning of year	<u>1,237,254</u>	<u>505,336</u>
Cash at end of year	<u>\$ 209,041</u>	<u>\$ 1,237,254</u>

See accompanying notes.

Massachusetts Housing Investment Corporation

Consolidated Statements of Cash Flows (continued)

	Year ended June 30	
	2002	2001
Supplemental information:		
Unearned fees recorded in exchange for notes receivable	<u>\$7,195,711</u>	<u>\$ 668,703</u>
Cash paid for interest on notes payable to member corporations	<u>\$ 77,267</u>	<u>\$ 1,266,997</u>
Effect of Contribution and Participation Agreement (<i>Note 1</i>), net:		
Cash	\$ —	\$(11,413,245)
Project loans	—	(22,159,773)
Notes receivable—MHIC, LLC	—	<u>2,698,098</u>
Contributed members' capital	<u>\$ —</u>	<u>\$(30,875,000)</u>

See accompanying notes.

Massachusetts Housing Investment Corporation

Notes to Consolidated Financial Statements

June 30, 2002 and 2001

1. Background and Accounting Policies

Purpose

On July 1, 1990, the Massachusetts Housing Investment Corporation (MHIC) was formally established as a Massachusetts-chartered, Chapter 180, not-for-profit corporation. MHIC's mission is to pool the resources of Massachusetts' lenders and investors to improve and expand the financing of affordable housing throughout the state. MHIC has established two main financing programs to carry out its mission:

Loan program

The loan program focuses on providing debt financing to developers of affordable housing. From its inception in 1990 through December 2000, MHIC utilized a loan pool structure to extend this financing. The loan-pool was funded with the proceeds from below market rate loans (member loans) made to MHIC from participating member corporations. In January 2001, MHIC converted the loan pool to a limited liability company structure. As a result, the member loans were converted to equity interests in a new entity, MHIC, LLC (the LLC). In addition, the various project loans, deposit accounts and reserves owned by MHIC were transferred to the LLC in exchange for extinguishing the member loans. MHIC is the manager of the LLC (See Note 2, Loan Program Conversion).

Equity program

The equity program provides tax credit equity financing to developers of affordable housing. The initial role of the program was to assist member corporations in underwriting low-income housing tax credit investments. The program, through its wholly-owned subsidiary Massachusetts Housing Equity Fund, Inc. (MHEF), is now a full-service syndicator of limited partnerships (the Partnerships) structured for investment in low-income housing projects (Operating Partnerships) in Massachusetts. MHEF was formed in June 1993 and is currently the General Partner of eight Operating Partnerships.

Basis of Presentation

Net assets and revenues, gains and losses are classified based on the existence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified as follows:

Permanently restricted net assets—Net assets subject to donor-imposed stipulations that they be maintained in perpetuity by MHIC.

Massachusetts Housing Investment Corporation

Notes to Consolidated Financial Statements (continued)

1. Background and Accounting Policies (continued)

Temporarily restricted net assets—Net assets subject to donor-imposed stipulations that may or will be met by actions of MHIC and/or the passage of time.

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

Contributions of cash and other assets are reported as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

At June 30, 2002 and 2001, all of MHIC's net assets were classified as unrestricted.

Reclassification

Certain reclassifications have been made to 2001 amounts to conform to the 2002 presentation.

Principles of Consolidation

The consolidated financial statements include the accounts of MHIC and its wholly-owned subsidiary, MHEF. All significant intercompany transactions and balances have been eliminated in consolidation.

Furniture, Equipment and Leasehold Improvements

Furniture, equipment and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation is computed by the straight-line method using rates based on estimated useful lives.

Revenue Recognition

Loan program fee revenue reflects fees earned on a contractual basis for services provided to the LLC (see Note 2).

Equity program revenue reflects fees for services that include organization, syndication, underwriting, long-term asset management and partnership administration. The fees for syndicating and organizing the Partnerships are recognized when syndication is substantially complete. The fees for underwriting investments are recognized according to the percentage of work completed. The fees for asset management and partnership administration are recognized

Massachusetts Housing Investment Corporation

Notes to Consolidated Financial Statements (continued)

1. Background and Accounting Policies (continued)

evenly over the life of the Partnerships (estimated to be approximately 15 years). In addition, MHIC monitors the construction process for the project investments in the various Partnerships. The fee for this service is paid by the project's sponsor and is recognized over the estimated construction period.

Grants are recognized as revenue in the period in which the conditions, if any, of the grant are satisfied.

Income Tax Status

In February 1993, MHIC was granted tax-exempt status as a 501(c)(3) corporation under federal tax law. MHEF is a for-profit corporation and therefore is subject to federal and state income taxes.

Use of Estimates

Financial statements prepared in accordance with accounting principles generally accepted in the United States require the use of significant management estimates that affect the amounts and disclosures recorded in the consolidated financial statements. Actual results may differ from those estimates.

2. Loan Program Conversion

In January 2001, MHIC converted its loan-pool to an LLC structure. The initial capitalization of the LLC was effected by a Contribution Agreement whereby member corporations contributed loans made to MHIC under the former loan pool structure (member loans) to the LLC in exchange for LLC membership interests. In addition, MHIC and the LLC entered into a Participation Agreement that provided for the LLC to purchase an undivided 100% interest in the project loans, bank accounts and reserves owned by MHIC (associated with the former loan pool) in exchange for the discharge of the member loans.

The proceeds of member loans for member corporations that have elected to remain in the loan pool (and not convert to the LLC structure) are held in deposit accounts at those institutions. The terms of the member loans are pursuant to a Master Member Agreement and accrue interest at 1% less than the annual interest rate earned on the interest-bearing deposit accounts (see Note 4).

Massachusetts Housing Investment Corporation

Notes to Consolidated Financial Statements (continued)

2. Loan Program Conversion (continued)

MHIC earns advisory fees for managing the affairs of the LLC pursuant to the term of an Advisory Agreement. The scope of services under the Advisory Agreement includes managing the orderly underwriting, approval and origination of loans and acquisition of investments, servicing loans and investments, establishing loan and investment policies, supervising and managing the requisition and disbursement of funds for loans, investing idle funds, business development and various other services that may be required by the Company in the ordinary course of its business.

Under the terms of the Advisory Agreement, fees to MHIC are provided for as follows:

- A management and advisory fee equal to an annual percentage rate of 0.75% of the average value of the aggregate capital commitments of all Investor Members of the LLC during such payment period;
- A portfolio and servicing fee equal to an annual percentage rate of 1.50% of the average amount of Real Estate Investments outstanding during a given payment period;
- A financing commitment fee equal to an annual percentage rate of 0.50% of the average amount of funded and unfunded commitments for Real Estate Investments existing during a given payment period.

In addition, MHIC is entitled to an available earnings fee, based upon the degree to which the LLC achieves certain performance hurdles. MHIC shall receive the amounts described below in the following priority.

- First, after payment of a 4% return to the members of the LLC, MHIC shall receive 10% of all remaining available earnings until the members have received a return equal to the federal funds rate.
- Second, MHIC shall receive 40% of all remaining available earnings until members have received a return equal to the federal funds rate plus 2%.
- Third, MHIC shall receive 60% of all remaining available earnings until members have received a return equal to the federal funds rate plus 4%.
- Fourth, MHIC shall receive 75% of all remaining available earnings.

Under the terms of the Advisory Agreement, MHIC earned available earnings fees of \$45,488. For the year ended June 30, 2002, the Board of Directors ratified a one-time modification to the available earnings fee by calculating the available earnings fee at the first performance hurdle rate of 10% instead of the second performance hurdle rate of 40%.

Massachusetts Housing Investment Corporation

Notes to Consolidated Financial Statements (continued)

3. Massachusetts Housing Equity Fund, Inc. (MHEF)

As of June 30, 2002, MHIC's investment in MHEF amounted to \$2,883,900. MHEF, as general partner of the aforementioned Partnerships, has a .01% in their respective profits, losses and distributions. MHEF accounts for its investment in the Partnerships using the equity method. Under the equity method, the investments are carried at cost and adjusted for MHEF's share of income or loss from the Partnerships, additional investments and cash distributions.

The Partnerships, as limited partners in the various Operating Partnerships, are subject to risks inherent in the ownership of property which is beyond their control, such as fluctuations in occupancy rates and operating expenses, variations in rental schedules, proper maintenance of facilities and continued eligibility of tax credits. If the cost of operating a property exceeds the rental income earned thereon, the Partnership, or MHEF acting independently as an investor, may deem it in its best interest to voluntarily provide funds in order to protect its investment.

At June 30, 2002 and 2001, the Partnerships have combined total assets of \$192 million and \$166 million, respectively, and combined cumulative deficits of approximately \$96 million and \$72 million, respectively.

4. Notes Payable to Member Corporations

Prior to the conversion, MHIC funded a loan pool through unsecured notes issued to member corporations pursuant to a Master Membership Agreement. Under this agreement, all note proceeds not currently used to fund projects are deposited in interest-bearing deposit accounts at their respective lending institutions. Note proceeds that are not used to fund projects accrue interest at 1% less than the annual interest rate earned on the interest-bearing deposit accounts. All proceeds that are lent to projects earn interest at the prime rate less 1%. For the years ended June 30, 2002 and 2001, interest expense paid to member corporations totaled approximately \$1,810 and \$1,109,000, respectively, and is reflected in interest expense in the accompanying statements of revenues and expenditures. These notes are renewable annually (applicable only to members that elected not to convert to the LLC). If the notes are not renewed, they require no principal amortization for five years and then amortize over a subsequent five-year period at an amount equal to the stated amount of the note less the member's pro-rata share of unfunded losses. At June 30, 2002 and 2001, outstanding borrowings under these agreements totaled \$250,000.

Massachusetts Housing Investment Corporation

Notes to Consolidated Financial Statements (continued)

5. Notes Payable—Loan Guarantee Program

MHIC obtained a discretionary revolving line of credit of \$2,500,000 that was utilized as a source of fixed-rate funding for its loan guarantee program. A separate note evidences each advance under this line of credit and accrues interest at a rate of 70 basis points above the 5-year Treasury note in effect at the time of the advance. At June 30, 2001, borrowings under the line totaled \$2,451,813. In addition, MHIC has borrowed amounts under another facility that totaled \$246,210 at June 30, 2001. Both of these credit facilities have been fully repaid, with no principal or interest amounts outstanding at June 30, 2002.

6. MHEF Notes Receivable and Unearned Fees

Notes receivable represent the present value (using effective interest rates that range from 8% to 9%) of future cash payments that will be received by MHIC from the MHEF Partnerships for asset management and other services it will provide to the Partnerships, as specified in the Partnership Agreements. At June 30, 2002 and 2001, notes receivable included accrued interest of \$544,871 and \$668,703, respectively.

Unearned equity fees reflect MHIC's obligation to provide future services to the Partnerships as consideration for the aforementioned notes receivable. These services include underwriting investments, long-term asset management and partnership administration. This obligation is reduced as services are provided, according to the revenue recognition methodology associated with the particular service (see Note 1, Revenue Recognition). At June 30, 2002 and 2001, unearned fees were \$10,755,119 and \$6,554,066, respectively. Other unearned fees include development monitoring and loan commitment fees.

7. Leases

MHIC leases its facilities and certain furniture and equipment under operating leases that expire over future periods and require various minimum rental payments. Future minimum payments, by year and in aggregate, under these noncancelable operating leases consist of the following at June 30, 2002:

2003	\$ 319,409
2004	337,877
2005	336,260
2006	331,409
2007	331,409
	<hr/>
Total	<u>\$1,656,364</u>

Massachusetts Housing Investment Corporation

Notes to Consolidated Financial Statements (continued)

7. Leases (continued)

MHIC incurred lease expenses associated with office space and equipment of \$280,001 and \$273,173 in 2002 and 2001, respectively.

8. Employee Benefit Plan

As a tax-exempt 501(c)(3) corporation, MHIC established a noncontributory, defined contribution plan under Section 401(a) of the Internal Revenue Code covering all full-time employees. The employer contribution is based upon a percentage of employee salary. In July 1999, MHIC amended the Plan to include a 100% match of employee contributions up to 3% of a given employee's salary. MHIC contributed and charged to expense approximately \$148,000 and \$134,000 in 2002 and 2001, respectively, and is reflected in salaries and employee benefits in the accompanying statements of revenues and expenditures.

9. CDFI Grant Award

In 1999, MHIC applied for and received designation as a Community Development Finance Institution (CDFI). MHIC also applied for and received a grant award of \$1,000,000 from the CDFI Fund. The purpose of the grant is to add to MHIC's capacity to pursue its mission and grow. The proceeds from the grant can be used to expand existing programs, develop new ones or support its operations. To date, \$684,761 of that grant has been received; the remainder will only be received if MHIC can secure matching funds. The funded portion of the grant was recorded as income upon receipt of the proceeds in April 2001. As a condition to the funding of the grant, MHIC and the CDFI Fund executed an Assistance Agreement, which established target goals for MHIC to achieve and specific measurement criteria to be used in evaluating progress. The goals are merely guidelines to evaluate progress and achieving specific results are not a condition to retaining the grant award. The grant is revocable if MHIC substantially changes its mission or ceases to be a CDFI prior to June 30, 2004.

Other Financial Information

Massachusetts Housing Investment Corporation

Other Financial Information

Consolidating Balance Sheets

June 30, 2002

	<u>MHIC</u>	<u>MHEF</u>	<u>Elimination</u>	<u>Consolidated</u>
Assets				
Cash	\$ 164,911	\$ 44,130		\$ 209,041
Money market deposits at member corporations—loan fund	250,000			250,000
Investment in MHEF Partnerships	2,883,900		\$(2,883,900)	
Notes receivable—MHEF Partnerships	12,893,218			12,893,218
Notes receivable—MHIC, LLC	790,000			790,000
Amounts receivable and other assets	820,957	58,729		879,686
Due from parent		2,794,881	(2,794,881)	
Furniture, equipment and leasehold improvements, net of accumulated depreciation and amortization of \$874,987	157,824			157,824
Total assets	<u>\$17,960,810</u>	<u>\$2,897,740</u>	<u>\$(5,678,781)</u>	<u>\$15,179,769</u>
Liabilities and net assets				
Liabilities:				
Notes payable to member corporations	\$ 250,000			\$ 250,000
Due to subsidiary	2,794,881		\$(2,794,881)	
Unearned fees	10,755,119			10,755,119
Accrued interest and other liabilities	1,109,627	13,840		1,123,467
Total liabilities	<u>14,909,627</u>	<u>13,840</u>	<u>(2,794,881)</u>	<u>12,128,586</u>
Net assets—unrestricted	<u>3,051,183</u>	<u>2,883,900</u>	<u>(2,883,900)</u>	<u>3,051,183</u>
Total liabilities and net assets	<u>\$17,960,810</u>	<u>\$2,897,740</u>	<u>\$(5,678,781)</u>	<u>\$15,179,769</u>

See accompanying notes.

Massachusetts Housing Investment Corporation

Other Financial Information

Consolidating Statements of Revenues and Expenditures

For the year ended June 30, 2002

	MHIC	MHEF	Elimination	Consolidated
Revenues				
Interest revenue:				
Interest on bank deposits	\$ 219,763	\$ 1,610	\$	\$ 221,373
Interest on project loans	73,619			73,619
Total interest revenue	293,382	1,610		294,992
Interest expense on notes payable	(77,268)			(77,268)
Net interest revenue	216,114	1,610		217,724
Loan program fee revenue:				
Management and advisory fees	261,811			261,811
Portfolio and servicing fees	548,758			548,758
Financing commitment fees	384,366			384,366
Origination fees	363,226			363,226
Available earnings fee	11,372			11,372
Equity program revenue:				
Fees related to MHEF Partnerships	3,994,745			3,994,745
Other equity program fees	50,733			50,733
Income from investment in MHEF	(12,284)		12,284	
Total revenues	5,818,841	1,610	12,284	5,832,735
Expenditures				
Salaries and employee benefits	3,393,734			3,393,734
Occupancy, equipment and furniture	409,334			409,334
Professional services	1,129,383			1,129,383
Other expenditures	821,157	13,894		835,051
Total expenditures	5,753,608	13,894		5,767,502
Excess of revenues over expenditures	65,233	(12,284)	12,284	65,233
Net assets at beginning of year	2,985,950	2,896,184	(2,896,184)	2,985,950
Net assets at end of year	\$ 3,051,183	\$ 2,883,900	\$ (2,883,900)	\$ 3,051,183

See accompanying notes.