

The Massachusetts Housing Investment Corporation

Audited Consolidated Financial Statements

Years ended June 30, 1997 and 1996

**Contents**

Report of Independent Auditors.....	1
Audited Financial Statements	
Consolidated Balance Sheets .....	2
Consolidated Statements of Revenue and Expenditures.....	3
Consolidated Statements of Cash Flows.....	4
Notes to Financial Statements.....	5-7

Massachusetts Housing Investment Corporation  
Notes to Consolidated Financial Statements (continued)

Loan guarantee activity was as follows:

	1997			1996		
	Third Party	Direct	Total	Third Party	Direct	Total
Guarantees / Commitments	\$6,145,721	\$5,411,093	\$ 11,556,814	\$ 6,145,721	\$ 0	\$ 6,145,721
Beginning balance – loans	\$ 960,567	0	960,567	0	0	0
Loan disbursements	5,185,154	0	5,185,154	960,567	0	960,567
Loan repayments	(2,180,000)	0	(2,180,000)	0	0	0
Loans outstanding	<u>\$3,965,721</u>	<u>0</u>	<u>\$ 3,965,721</u>	<u>\$ 960,567</u>	<u>0</u>	<u>\$ 960,567</u>
Funds at risk	<u>\$3,965,721</u>	<u>\$5,411,093</u>	<u>\$ 9,376,814</u>	<u>\$6,145,721</u>	<u>\$ 0</u>	<u>\$ 6,145,721</u>

1. **Leases:** MHIC leases its facilities and certain furniture and equipment under operating leases which expire over the next sixty months 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, 1997:

1998	\$231,297
1999	\$238,060
2000	\$230,027
2001	\$238,886
2002	<u>\$241,839</u>
TOTAL	<b>\$1,180,109</b>

MHIC incurred rent expense associated with office space and equipment of approximately \$217,900 and \$183,000 in 1997 and 1996, 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 only source of contributions under the Plan is the annual employer contribution. The employer contribution is based upon a percentage of employee salary. MHIC contributed and charged to expense approximately \$71,000 in 1997 and \$58,000 in 1996.

Massachusetts Housing Investment Corporation  
Notes to Consolidated Financial Statements (continued)

2. **Notes Payable to Member Banks:** MHIC funds their loan pool through unsecured notes issued to member banks pursuant to a Master Membership Agreement. Under this agreement, all note proceeds not lent are required to be deposited in interest-bearing deposit accounts at the respective lending institutions. The notes accrue interest at 1% less than the annual interest rate earned on the interest-bearing accounts. All lent proceeds bear interest at the prime rate less 1%. The average rate in effect for lent proceeds was 7.25% at June 30, 1997. These notes are renewable annually. If they are not renewed, they require no principal amortization for five years and then amortize over a 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, 1997, outstanding borrowings under these agreements totaled \$53,425,000.

3. **Note Receivable and Unearned Fees:** The notes receivable from MHEF LPs represent the present value (using effective interest rates that range from 8% to 9%) of future cash payments that will be received by MHIC for asset management and other services it will provide to the Partnerships, as specified in the partnership agreement. At June 30, 1997 and 1996, notes receivable were \$5,731,167 and \$3,598,401, respectively. At June 30, 1997 and 1996, notes receivable included accrued interest of \$708,551 and \$347,013, respectively.

Unearned equity fees reflect the fact that MHIC is obligated to provide future services to the Partnerships as consideration for the aforementioned note receivable. These services include underwriting investments, and 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, 1997 and 1996, unearned equity fees were \$5,034,534 and \$3,533,055, respectively.

4. **Project Loans:** MHIC provides loans for the development of affordable housing throughout Massachusetts.

Project loan activity was as follows:

	<u>1997</u>	<u>1996</u>
Beginning balance	\$ 6,026,309	\$ 4,816,715
Loan disbursements	18,031,597	12,668,729
Loan repayments	<u>(14,572,113)</u>	<u>(11,459,135)</u>
Project loans outstanding	9,485,793	6,026,309
Allowance for loan losses	<u>(225,000)</u>	<u>(200,000)</u>
Project loans, net	<u>\$ 9,260,793</u>	<u>\$ 5,826,309</u>

Project loans earn a variable rate of interest pursuant to MHIC's established loan policy and are secured by the underlying real estate. In certain instances, the primary repayment of these loans will be received from the equity syndication payments provided to the project by the MHEF LP tax credit equity investment program. At June 30, 1997, MHIC had no delinquent or non-performing project loans and there have been no charge-offs recorded to date.

5. **Commitments:** At June 30, 1997, MHIC had unfunded commitments to originate loans of \$21,378,991. These commitments have been established pursuant to MHIC's loan policy.

6. **Loan Guarantee Program:** Under the loan guarantee program, MHIC utilizes its loan pool as collateral to provide guarantees for loans made by third parties (Third Party) or to obtain fixed-rate funding for loans that it directly originates (Direct). MHIC offers two products under the program. The first product is a project loan guarantee, whereby MHIC administers construction loans for other parties, and assumes the construction period risk by guaranteeing repayment of the loan. Such transactions are treated as off-balance sheet liabilities and therefore are not presented in the body of the financial statements. The second product consists of direct loans made by MHIC, where its loan pool is used as collateral to secure funding, which is then advanced to borrowers. The corresponding borrowing to fund such loans are invested in short-term government backed securities until the funds are advanced.

# Massachusetts Housing Investment Corporation

## Notes to Consolidated Financial Statements

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### 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 banks to improve and expand the financing of affordable housing throughout the state. To date, MHIC has established a loan pool which provides loans for affordable housing on a statewide basis to not-for-profit as well as for-profit developers. Prior to January 1994, MHIC managed a program that provided assistance to member banks in underwriting low-income housing tax credit investments. In June 1993, MHIC established a wholly-owned subsidiary, Massachusetts Housing Equity Fund, Inc. (MHEF), which is the General Partner of four limited partnerships (the Partnerships) structured for investment in low-income housing projects in Massachusetts.

**Principles of Consolidation:** The consolidated financial statements include the accounts of MHIC and its wholly-owned subsidiary, MHEF. All significant inter-company transactions and balances have been eliminated in consolidation.

**MHEF:** MHIC has capitalized MHEF in the amount of \$1,752,044. MHEF, as general partner of the aforementioned Partnerships, has a 1% interest 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 the Partnership's share of income, losses, additional investments and cash. At June 30, 1997, the Partnerships have combined total assets and a combined cumulative deficit of approximately \$58,261,918 and \$9,938,534 respectively.

**Accrual Basis:** The consolidated financial statements of MHIC have been prepared on an accrual basis.

**Project Loans and Allowance for Possible Project Loan Losses:** Loans are stated at the amount of unpaid principal, net of the allowance for loan losses. Interest on project loans is recognized as income by applying the interest rates to the principal amount outstanding. An allowance for project loan losses is maintained based upon the evaluation of the risks associated with the outstanding loans. Any losses or recoveries subsequently realized are charged or credited to the allowance.

**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 for Fees Related to MHEF LP's:** The Partnerships have contracted with MHIC to provide broad 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 complete. The fees for asset management and partnership administration are recognized 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. During 1997 and 1996, MHIC recognized fees of approximately \$2,512,000 and \$1,795,000 for services provided and costs incurred in connection with the formation and operations of the Partnerships.

**Income Tax Status:** MHIC has been granted tax-exempt status as a 501(c)(3) corporation under federal tax law. MHEF is a for-profit corporation and therefore is taxable for federal and state income tax purposes.

**Risks and Uncertainties:** Financial statements prepared in accordance with generally accepted accounting principles require the use of significant management estimates which affect the amounts and disclosures recorded in the financial statements. Actual results may differ from those estimates.

# Massachusetts Housing Investment Corporation

## Consolidated Statements of Cash Flows

	----- Year ended June 30 -----	
	1997	1996
<b>Operating activities</b>		
Excess of revenue over expenditures	\$ 384,597	\$ 25,740
Adjustments to reconcile excess of revenue over		
Expenditures to net cash provided (used) by operating activities:		
Provision for loan losses	25,000	25,000
Depreciation and amortization expense	99,057	89,839
Increase in amounts receivable and other assets	(168,634)	3,152
Increase (decrease) in unearned fees	(788,651)	(256,937)
Increase in accrued interest and other liabilities	106,339	41,956
Total adjustments	(726,889)	(96,990)
Net cash provided (used) by operating activities	(342,292)	(71,250)
 <b>Investing activities</b>		
Project loans disbursed	(18,031,597)	(12,668,729)
Payments received on project loans	14,572,113	11,459,135
Increase in loan guarantee funds in short-term investments	(5,193,474)	
Decrease in money market deposits at member banks	2,984,484	659,594
Payments received on notes receivable	350,556	31,991
Purchases of furniture, equipment and leasehold improvements	(33,875)	(36,802)
Net cash (provided) used by investing activities	(5,351,793)	(554,811)
 <b>Financing activities</b>		
Proceeds from notes payable to member banks	475,000	550,000
Proceeds from notes payable to loan guarantee lenders	5,193,474	
Net cash provided by financing activities	5,668,474	550,000
 Net decrease in cash	 (25,611)	 (76,061)
Cash at beginning of year	97,191	173,252
Cash at end of year	\$ 71,580	\$ 97,191
 Supplemental disclosures of cash flow information:		
Non-cash investing activity:		
Unearned fee recorded in exchange for notes	\$ 2,483,322	\$ 2,748,555
Cash paid during the year for interest on notes payable to member banks	\$ 1,225,603	\$ 1,185,360

*See accompanying notes to consolidated financial statements.*

Massachusetts Housing Investment Corporation

Consolidated Statement of Revenue and Expenditures

	----- Year ended June 30 -----	
	1997	1996
<b>Revenue</b>		
Interest revenue:		
Interest on bank deposits	\$ 1,442,887	\$ 1,333,371
Interest on project loans	637,138	530,954
Total interest revenue	2,080,025	1,864,325
Interest expense on notes payable to member banks	(1,267,107)	(1,205,512)
Interest expense on loan guarantee notes payable	(78,235)	0
Net interest revenue before provision for loan losses	734,683	658,813
Provision for loan losses	(25,000)	(25,000)
Net interest revenue after provision for loan losses	709,683	633,813
Equity program revenue:		
Fees related to MHEF LP's	2,512,454	1,795,117
Other equity program fees	41,266	51,500
Total revenue	3,263,403	2,480,430
<b>Expenditures</b>		
Salaries and employee benefits	1,739,048	1,406,159
Occupancy, equipment and furniture	270,775	265,674
Professional services	464,569	396,471
Other expenses	404,414	386,386
Total expenditures	2,878,806	2,454,690
<b>Excess of revenue over expenditures</b>	\$ 384,597	\$ 25,740
Net assets at beginning of year	\$ 120,798	\$ 95,058
Net assets at end of year	\$ 505,395	\$ 120,798

See accompanying notes to consolidated financial statements.

Massachusetts Housing Investment Corporation

Consolidated Balance Sheets

	----- June 30 -----	
	1997	1996
<b>Assets</b>		
Cash	\$ 71,580	\$ 97,191
Loan fund:		
Project loans, net of allowance for loan losses of \$225,000 in 1997 and \$200,000 in 1996	9,260,793	5,826,309
Money market deposits at member banks	43,939,207	46,923,691
Total loan fund	<u>53,200,000</u>	<u>52,750,000</u>
Loan guarantee direct loans:		
Loan guarantee funds on deposit	5,193,474	0
Project loans	0	0
Total loan guarantee direct loans	<u>5,193,474</u>	<u>0</u>
Notes receivable	5,731,167	3,598,401
Amounts receivable and other assets	942,861	774,227
Furniture, equipment and leasehold improvements, net of accumulated depreciation and amortization of \$290,489 in 1997 and \$191,432 in 1996	106,018	171,200
<b>Total assets</b>	<u>\$ 65,245,100</u>	<u>\$ 57,391,019</u>
<b>Liabilities and net assets</b>		
Liabilities:		
Notes payable to member banks	\$ 53,425,000	\$ 52,950,000
Notes payable – loan guarantee program	5,193,474	
Unearned fees	5,667,741	3,973,070
Accrued interest and other liabilities	453,490	347,151
<b>Total Liabilities</b>	<u>64,739,705</u>	<u>57,270,221</u>
<b>Net Assets</b>	<u>505,395</u>	<u>120,798</u>
<b>Total liabilities and net assets</b>	<u>\$ 65,245,100</u>	<u>\$ 57,391,019</u>

*See accompanying notes to consolidated financial statements.*

## Report of Independent Auditors

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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, 1997 and 1996, 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 generally accepted auditing standards. 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, 1997 and 1996, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

*Ernst & Young LLP*

August 22, 1997