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CommunityBank of Texas, N.A.  
5999 Delaware  
Beaumont, Texas 77706-7607  
Attention: Mahesh S. Aiyer

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MULTIFAMILY LEASEHOLD DEED OF TRUST,  
FIXTURE FILING, ASSIGNMENT OF RENTS  
AND SECURITY AGREEMENT

(TEXAS)

## TABLE OF CONTENTS

	<u>PAGE</u>
1. DEFINITIONS.....	2
2. UNIFORM COMMERCIAL CODE SECURITY AGREEMENT .....	8
3. ASSIGNMENT OF RENTS; APPOINTMENT OF RECEIVER; LENDER IN POSSESSION .....	11
4. ASSIGNMENT OF LEASES; LEASES AFFECTING THE MORTGAGED PROPERTY .....	13
5. PAYMENT OF INDEBTEDNESS; PERFORMANCE UNDER LOAN DOCUMENTS; PREPAYMENT PREMIUM.....	15
6. EXCULPATION .....	16
7. DEPOSITS FOR TAXES, INSURANCE AND OTHER CHARGES .....	16
8. COLLATERAL AGREEMENTS .....	17
9. APPLICATION OF PAYMENTS.....	17
10. COMPLIANCE WITH LAWS.....	18
11. USE OF PROPERTY .....	18
12. PROTECTION OF LENDER'S SECURITY .....	18
13. INSPECTION .....	19
14. BOOKS AND RECORDS; FINANCIAL REPORTING .....	19
15. TAXES; OPERATING EXPENSES.....	21
16. LIENS; ENCUMBRANCES.....	22
17. PRESERVATION, MANAGEMENT AND MAINTENANCE OF MORTGAGED PROPERTY .....	22
18. ENVIRONMENTAL HAZARDS.....	23
19. PROPERTY AND LIABILITY INSURANCE.....	29
20. CONDEMNATION .....	30
21. TRANSFERS OF THE MORTGAGED PROPERTY OR INTERESTS IN BORROWER .....	31
22. EVENTS OF DEFAULT .....	34

311P 0886-28-0534

23.	REMEDIES CUMULATIVE.....	35
24.	FORBEARANCE .....	35
25.	[INTENTIONALLY DELETED] .....	35
26.	WAIVER OF STATUTE OF LIMITATIONS .....	35
27.	WAIVER OF MARSHALLING .....	36
28.	FURTHER ASSURANCES .....	36
29.	ESTOPPEL CERTIFICATE .....	36
30.	GOVERNING LAW; CONSENT TO JURISDICTION AND VENUE .....	37
31.	NOTICE .....	37
32.	SALE OF NOTE; CHANGE IN SERVICER .....	38
33.	SINGLE ASSET BORROWER.....	38
34.	SUCCESSORS AND ASSIGNS BOUND .....	38
35.	JOINT AND SEVERAL LIABILITY .....	38
36.	RELATIONSHIP OF PARTIES; NO THIRD PARTY BENEFICIARY .....	38
37.	SEVERABILITY; AMENDMENTS.....	38
38.	CONSTRUCTION .....	39
39.	LOAN SERVICING.....	39
40.	DISCLOSURE OF INFORMATION .....	39
41.	NO CHANGE IN FACTS OR CIRCUMSTANCES.....	39
42.	SUBROGATION .....	40
43.	ACCELERATION; REMEDIES .....	40
44.	RELEASE .....	44
45.	TRUSTEE.....	44
46.	[INTENTIONALLY OMITTED] .....	44
47.	NO FIDUCIARY DUTY .....	44
48.	FIXTURE FILING .....	45

49.	ADDITIONAL PROVISIONS REGARDING ASSIGNMENT OF RENTS .....	45
50.	LOAN CHARGES .....	45
51.	PROPERTY AND LIABILITY INSURANCE — DELIVERY OF POLICY TO LENDER.....	46
52.	ENTIRE AGREEMENT .....	46
53.	WAIVER OF TRIAL BY JURY.....	46
54.	NO DRILLING OR EXPLORATION.....	46
55.	[reserved] .....	47
56.	INDEMNIFICATION OF TRUSTEE.....	47
57.	ACCELERATION IN CASE OF BORROWER'S INSOLVENCY.....	47
58.	REPRESENTATIONS AND WARRANTIES REGARDING GROUND LEASE ....	47
59.	NOTICES UNDER GROUND LEASE.....	48
60.	BORROWER'S OBLIGATIONS TO COMPLY WITH GROUND LEASE .....	48
61.	LENDER'S RIGHT TO CURE GROUND LESSEE DEFAULTS .....	48
62.	COVENANTS TO PROTECT LEASEHOLD ESTATE .....	49
63.	GROUND LESSEE'S BANKRUPTCY .....	49
64.	GROUND LESSOR'S BANKRUPTCY .....	50
65.	OPTION TO RENEW OR EXTEND GROUND LEASE.....	50
66.	NO MERGER OF ESTATES .....	50
67.	NEW LEASE .....	51
68.	APPOINTMENT OF LENDER AS BORROWER'S ATTORNEY-IN-FACT.....	51
69.	CROSS-DEFAULT .....	52
70.	ANNUAL COMPLIANCE.....	52



**MULTIFAMILY LEASEHOLD DEED OF TRUST, FIXTURE FILING, ASSIGNMENT OF  
RENTS, AND SECURITY AGREEMENT**

THIS MULTIFAMILY LEASEHOLD DEED OF TRUST, FIXTURE FILING, ASSIGNMENT OF RENTS AND SECURITY AGREEMENT (the "Instrument") is dated as of the \_\_\_\_ day of March, 2013, by HCHA CYPRESSWOOD ESTATES, LLC, a limited liability company organized and existing under the laws of Texas, whose address is 8933 Interchange Drive, Houston, Texas 77054, File No.: 800533208, as trustor ("Borrower"), to George A. Casseb, as trustee ("Trustee"), whose address is 5999 Delaware, Beaumont, Texas 77706-7607, for the benefit of COMMUNITYBANK OF TEXAS, N.A., a national banking association, whose address for purposes of this Instrument, is 5999 Delaware, Beaumont, Texas 77706-7607, Attn: Mahesh S. Aiyer, as beneficiary ("Lender").

Borrower, in consideration of the Indebtedness and the trust created by this Instrument, irrevocably grants, conveys and assigns to Trustee, in trust, with power of sale, the Mortgaged Property, including the Land located in Harris County, State of Texas, and described in Exhibit A attached to this Instrument, subject, however, to the Permitted Exceptions (hereinafter defined).

TO SECURE TO LENDER (1) the repayment of the Indebtedness evidenced by Borrower's Promissory Note ("Note") payable to Lender, dated as of the date of this Instrument, and maturing no later than March 8, 2018 (as such date may be extended under the Loan Agreement), in the principal amount of \$3,500,000.00, and all renewals, extensions and modifications of the Indebtedness and (2) the performance of the covenants and agreements of Borrower contained in the Loan Documents.

Borrower warrants and represents that Borrower is lawfully seized of the Mortgaged Property and has the right, power and authority to grant, convey and assign the Mortgaged Property, and that the Mortgaged Property is unencumbered, except for those permitted encumbrances shown on Exhibit B attached hereto (collectively, the "Permitted Exceptions"). Borrower covenants that Borrower will warrant and defend generally the title to the Mortgaged Property against all claims and demands, subject to the Permitted Exceptions.

Covenants. Borrower and Lender covenant and agree as follows:

**1. DEFINITIONS.**

The following terms, when used in this Instrument (including when used in the above recitals), shall have the following meanings:

(a) **"Bankruptcy Code"** means the United States Bankruptcy Code, 11 U.S.C. Section 101 et seq., as amended from time to time.

(b) **"Borrower"** means all persons or entities identified as **"Borrower"** in the first paragraph of this Instrument, together with their successors and assigns.

(c) **"Collateral Agreement"** means, collectively, (a) the Replacement Reserve and Security Agreement dated of even date herewith executed by Borrower, and (b) the Operating Reserve and Security Agreement dated of even date herewith executed by Borrower.

(d) **"Environmental Permit"** means any permit, license, or other authorization issued under any Hazardous Materials Law with respect to any activities or businesses conducted on or in relation to the Mortgaged Property.

(e) **"Event of Ground Lessee Bankruptcy"** means either of the following actions taken by or with respect to Borrower: (i) Borrower pursuant to or within the meaning of the Bankruptcy Code (x) commences a voluntary case and such case is not dismissed within 90 days after filing, or (y) consents to the entry of an order for relief against it in an involuntary case and such case is not dismissed within 90 days after filing; or (ii) a court of competent jurisdiction enters an order or decree under the Bankruptcy Code that is for relief against Borrower in an involuntary case and such case is not dismissed within 90 days after filing.

(f) **"Event of Ground Lessor Bankruptcy"** means either of the following actions taken by or with respect to Ground Lessor: (i) Ground Lessor pursuant to or within the meaning of the Bankruptcy Code (x) commences a voluntary case and such case is not dismissed within 90 days after filing, or (y) consents to the entry of an order for relief against it in an involuntary case and such case is not dismissed within 90 days after filing; or (ii) a court of competent jurisdiction enters an order or decree under the Bankruptcy Code that is for relief against Ground Lessor in an involuntary case and such case is not dismissed within 90 days after filing.

(g) **"Event of Default"** means the occurrence of any event listed in Section 22.

(h) **"Fixtures"** means all property which is so attached to the Land or the Improvements as to constitute a fixture under applicable law, including: machinery, equipment, engines, boilers, incinerators, installed building materials; systems and equipment for the purpose of supplying or distributing heating, cooling, electricity,

gas, water, air, or light; antennas, cable, wiring and conduits used in connection with radio, television, security, fire prevention, or fire detection or otherwise used to carry electronic signals; telephone systems and equipment; elevators and related machinery and equipment; fire detection, prevention and extinguishing systems and apparatus; security and access control systems and apparatus; plumbing systems; water heaters, ranges, stoves, microwave ovens, refrigerators, dishwashers, garbage disposers, washers, dryers and other appliances; light fixtures, awnings, storm windows and storm doors; pictures, screens, blinds, shades, curtains and curtain rods; mirrors; cabinets, paneling, rugs and floor and wall coverings; fences, trees and plants; swimming pools; and exercise equipment.

(i) **"Governmental Authority"** means any board, commission, department or body of any municipal, county, state or federal governmental unit, or any subdivision of any of them, that has or acquires jurisdiction over the Mortgaged Property or the use, operation or improvement of the Mortgaged Property.

(j) **"Hazardous Materials"** means petroleum and petroleum products and compounds containing them, including gasoline, diesel fuel and oil; explosives; flammable materials; radioactive materials; polychlorinated biphenyls ("**PCBs**") and compounds containing them; lead and lead-based paint; asbestos or asbestos-containing materials in any form that is or could become friable; underground or above-ground storage tanks, whether empty or containing any substance; any substance the presence of which on the Mortgaged Property is prohibited by any federal, state or local authority; any substance that requires special handling; and any other material or substance now or in the future defined as a "**hazardous substance**," "**hazardous material**," "**hazardous waste**," "**toxic substance**," "**toxic pollutant**," "**contaminant**," or "**pollutant**" within the meaning of any Hazardous Materials Law.

(k) **"Hazardous Materials Laws"** means all federal, state, and local laws, ordinances and regulations and standards, rules, policies and other governmental requirements, administrative rulings and court judgments and decrees in effect now or in the future and including all amendments, that relate to Hazardous Materials and apply to Borrower or to the Mortgaged Property. Hazardous Materials Laws include, but are not limited to, the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. Section 9601, et seq., the Resource Conservation and Recovery Act, 42 U.S.C. Section 6901, et seq., the Toxic Substance Control Act, 15 U.S.C. Section 2601, et seq., the Clean Water Act, 33 U.S.C. Section 1251, et seq., and the Hazardous Materials Transportation Act, 49 U.S.C. Section 5101, et seq., and their state analogs.

(l) **"Ground Lease"** means the lease described in Exhibit C pursuant to which Borrower leases the Land, as such lease may from time to time be amended, modified, supplemented, renewed and extended.

(m) **"Ground Lessee Default"** means (i) a default by Borrower in making any payment of rent, additional rent or other sum of money payable by Borrower to

Ground Lessor under the Ground Lease, and all applicable notice and cure periods have expired, or (ii) a default by Borrower in performing or observing any of the terms, covenants or conditions of the Ground Lease (other than the payments referred to in clause (i)) required to be performed or observed by Ground Lessee, and all applicable notice and cure periods have expired.

(n) **"Ground Lessor"** means the lessor from time to time under the Ground Lease.

(o) **"Ground Lessor Default"** means a default by Ground Lessor in performing or observing any of the terms, covenants or conditions of the Ground Lease required to be performed or observed by Ground Lessor, and all applicable notice and cure periods have expired.

(p) **"Ground Rent"** means the rent payable under the Ground Lease.

(q) **"Impositions"** and **"Imposition Deposits"** are defined in Section 7(a).

(r) **"Improvements"** means the buildings, structures, improvements, and alterations now constructed or at any time in the future constructed or placed upon the Land, including any future replacements and additions.

(s) **"Indebtedness"** means the principal of, interest on, and all other amounts due at any time under, the Note, this Instrument or any other Loan Document, including prepayment premiums, late charges, default interest, and advances as provided in Section 12 to protect the security of this Instrument.

(t) [Intentionally omitted]

(u) **"Land"** means the land described in Exhibit A.

(v) **"Leases"** means all present and future leases, subleases, licenses, concessions or grants or other possessory interests now or hereafter in force, whether oral or written, covering or affecting the Mortgaged Property, or any portion of the Mortgaged Property (including proprietary leases or occupancy agreements if Borrower is a cooperative housing corporation), and all modifications, extensions or renewals.

(w) **"Leased Premises"** means the Land and any other real property leased by Borrower pursuant to the Ground Lease.

(x) **"Leasehold Estate"** means Borrower's interest in the Land and any other real property leased by Borrower pursuant to the Ground Lease, including (i) all rights of Borrower to renew or extend the term of the Ground Lease, (ii) all amounts deposited by Borrower with Ground Lessor under the Ground Lease, (iii) Borrower's right or privilege to terminate, cancel, surrender, modify or amend the Ground Lease, and (iv) all other options, privileges and rights granted and demised

to Borrower under the Ground Lease and all appurtenances with respect to the Ground Lease.

(y) **"Lender"** means the entity identified as **"Lender"** in the first paragraph of this Instrument and its successors and assigns, or any subsequent holder of the Note.

(z) **"Loan Agreement"** means that certain Letter Loan Agreement of even date herewith between the Borrower and Lender, as may hereinafter be amended.

(aa) **"Loan Documents"** means the Loan Agreement, the Note, this Instrument, all guaranties, all indemnity agreements, the Collateral Agreement, O&M Programs, and any other documents now or in the future executed by Borrower, governing and/or securing the loan evidenced by the Note, as such documents may be amended from time to time.

(bb) **"Loan Servicer"** means the entity that from time to time is designated by Lender to collect payments and deposits and receive notices under the Note, this Instrument and any other Loan Document, and otherwise to service the loan evidenced by the Note for the benefit of Lender. Unless Borrower receives notice to the contrary, the Loan Servicer is the entity identified as **"Lender"** in the first paragraph of this Instrument.

(cc) **"Mortgaged Property"** means all of Borrower's present and future right, title and interest in and to all of the following:

- (1) The Ground Lease and the Leasehold Estate
- (2) the Improvements;
- (3) the Fixtures;
- (4) the Personalty;
- (5) all water and water rights, timber, crops and mineral interests pertaining to the Land;
- (6) all building materials, appliances and equipment now or hereafter delivered to and intended to be installed in or on the Land or the Improvements (including, without limitation, all such building materials, appliances, and equipment stored by Borrower from time to time off the Land);
- (7) all current and future rights, including air rights, development rights, zoning rights and other similar rights or interests, easements, tenements, rights-of-way, strips and gores of land, streets, alleys, roads, sewer rights, waters, watercourses, and appurtenances related to or benefiting the Land or the

Improvements, or both, and all rights-of-way, streets, alleys and roads which may have been or may in the future be vacated;

- (8) all proceeds paid or to be paid by any insurer of the Leasehold Estate, the Improvements, the Fixtures, the Personalty or any other part of the Mortgaged Property, whether or not Borrower obtained the insurance pursuant to Lender's requirement;
- (9) all awards, payments and other compensation made or to be made by any municipal, state or federal authority with respect to the Land, the Improvements, the Fixtures, the Personalty or any other part of the Mortgaged Property, including any awards or settlements resulting from condemnation proceedings or the total or partial taking of the Land, the Improvements, the Fixtures, the Personalty or any other part of the Mortgaged Property under the power of eminent domain or otherwise and including any conveyance in lieu thereof;
- (10) all contracts, options and other agreements for the sale of the Land, the Improvements, the Fixtures, the Personalty or any other part of the Mortgaged Property entered into by Borrower now or in the future, including cash or securities deposited to secure performance by parties of their obligations;
- (11) all proceeds from the conversion, voluntary or involuntary, of any of the above into cash or liquidated claims, and the right to collect such proceeds;
- (12) all Rents and Leases;
- (13) all earnings, royalties, accounts receivable, issues and profits from the Land, the Improvements or any other part of the Mortgaged Property, and all undisbursed proceeds of the loan secured by this Instrument and, if Borrower is a cooperative housing corporation, maintenance charges or assessments payable by shareholders or residents;
- (14) all Imposition Deposits;
- (15) all refunds or rebates of Impositions by any municipal, state or federal authority or insurance company (other than refunds applicable to periods before the real property tax year in which this Instrument is dated);
- (16) to the extent transferable or assignable, all tenant security deposits which have not been forfeited by any tenant under any Lease;





(hh) "Rents" means all rents (whether from residential or non-residential space), revenues and other income of the Land or the Improvements, including subsidy payments received from any sources (including, but not limited to payments under any Housing Assistance Payments Contract), parking fees, laundry and vending machine income and fees and charges for food, health care and other services provided at the Mortgaged Property, whether now due, past due, or to become due, and deposits forfeited by tenants.

(ii) "Taxes" means all taxes, assessments, vault rentals and other charges, if any, general, special or otherwise, including all assessments for schools, public betterments and general or local improvements, which are levied, assessed or imposed by any public authority or quasi-public authority, and which, if not paid, will become a lien, on the Land or the Improvements.

(jj) "Transfer" means (A) a sale, assignment, transfer or other disposition (whether voluntary, involuntary or by operation of law); (B) the granting, creating or attachment of a lien, encumbrance or security interest (whether voluntary, involuntary or by operation of law); (C) the issuance or other creation of an ownership interest in a legal entity, including a partnership interest, interest in a limited liability company or corporate stock; (D) the withdrawal, retirement, removal or involuntary resignation of a partner in a partnership or a member or manager in a limited liability company; or (E) the merger, dissolution, liquidation, or consolidation of a legal entity. "Transfer" does not include (i) a conveyance of the Mortgaged Property at a judicial or non-judicial foreclosure sale under this Instrument or (ii) the Mortgaged Property becoming part of a bankruptcy estate by operation of law under the United States Bankruptcy Code. For purposes of defining the term "Transfer," the term "partnership" shall mean a general partnership, a limited partnership, a joint venture and a limited liability partnership, and the term "partner" shall mean a general partner, a limited partner and a joint venturer.

## 2. UNIFORM COMMERCIAL CODE SECURITY AGREEMENT.

(a) This Instrument is also a security agreement under the Uniform Commercial Code for any of the Mortgaged Property which, under applicable law, may be subject to a security interest under the Uniform Commercial Code, whether acquired now or in the future, and all products and cash and non-cash proceeds thereof (collectively, "UCC Collateral"), and Borrower hereby grants to Lender a security interest in the UCC Collateral. Borrower hereby authorizes Lender to file financing statements, continuation statements and financing statement amendments in such form as Lender may require to perfect or continue the perfection of this security interest and Borrower agrees, if Lender so requests, to execute and deliver to Lender such financing statements, continuation statements and amendments. Borrower shall pay all filing costs and all costs and expenses of any record searches for financing statements that Lender may reasonably require. Without the prior written consent of Lender, Borrower shall not create or permit to exist any other lien or security interest in any of the UCC Collateral. If an Event of



Default has occurred and is continuing, in addition to the remedies provided in Section 43 hereof, during the continuance of an Event of Default hereunder, Lender may, at its option, do any one or more of the following:

(1) Either personally, or by means of a court appointed receiver, take possession of all or any of the UCC Collateral and exclude therefrom Borrower and all others claiming under Borrower, and thereafter hold, store, use, operate, manage, maintain and control, make repairs, replacements, alterations, additions and improvements to and exercise all rights and powers of Borrower with respect to the UCC Collateral or any part thereof. In the event Lender demands, or attempts to take possession of the UCC Collateral in the exercise of any rights under this Instrument, Borrower agrees to promptly turn over and deliver possession thereof to Lender;

(2) Without notice to or demand upon Borrower, make such payments and do such acts as Lender may deem necessary to protect its security interest in the UCC Collateral (including, without limitation, paying, purchasing, contesting or compromising any Lien or Encumbrance, whether superior or inferior to such security interest) and in exercising any such powers or authority to pay all reasonable expenses (including, without limitation, litigation costs and reasonable attorneys' fees) incurred in connection therewith;

(3) Require Borrower from time to time to assemble the UCC Collateral, or any portion thereof, at a place designated by Lender and reasonably convenient to both parties, and deliver promptly such UCC Collateral to Lender, or an agent or representative designated by Lender. Lender, and its agents and representatives, shall have the right to enter upon any or all of Borrower's premises and property to exercise Lender's rights hereunder;

(4) Realize upon the UCC Collateral or any part thereof as herein provided or in any manner permitted by law and exercise any and all of the other rights and remedies conferred upon Lender by this Instrument, any other Loan Document, or by law, either concurrently or in such order as Lender may determine;

(5) Sell or cause to be sold in such order as Lender may determine, as a whole or in such parcels as Lender may determine, the UCC Collateral and the remainder of the Mortgaged Property;

(6) Sell, lease, or otherwise dispose of the UCC Collateral at public sale, upon terms and in such manner as Lender may determine. Lender may be a purchaser at any sale; and

(7) Exercise any remedies of a secured party under the Uniform Commercial Code of Texas or any other applicable law.

(b) Unless the UCC Collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, to a foreclosure under Section 43, Lender shall give Borrower at least five (5) days' prior written notice of the time and place of any public sale of the UCC Collateral or other intended disposition thereof to be made. Such notice may be mailed to Borrower at the address set forth above.

(c) The proceeds of any sale under Subsection (iv) above shall be applied as follows:

(1) To the repayment of the reasonable costs and expenses of taking, holding, and preparing for the sale and the selling of the UCC Collateral (including, without limitation, costs of litigation and attorneys' fees) and the discharge of all Impositions, Liens and Encumbrances, and claims thereof, if any, on the UCC Collateral prior to the security interest granted herein (except any Impositions or Liens and Encumbrances subject to which such sale shall have been made);

(2) To the payment of the Indebtedness in such order as Lender shall determine; and

(3) The surplus, if any, shall be paid to the Borrower or to whomsoever may be lawfully entitled to receive the same, or as a court of competent jurisdiction may direct.

Lender shall have the right to enforce one or more remedies hereunder, successively or concurrently, and such action shall not operate to estop or prevent Lender from pursuing any further remedy that it may have. Any repossession or retaking or sale of the UCC Collateral pursuant to the terms hereof shall not operate to release Borrower until full payment of any deficiency has been made in cash.

Upon its recording in the real property records, this Instrument shall be effective as a financing statement filed as a fixture filing. In addition, a carbon, photographic or other reproduced copy of this Instrument and/or any financing statement relating hereto shall be sufficient for filing and/or recording as a financing statement. The filing of any other financing statement relating to any personal property, rights or interests described herein shall not be construed to diminish any right or priority hereunder. Information concerning the security interest created by this Instrument may be obtained from Lender, as secured party, at the address of Lender stated above. The mailing address of Borrower, as debtor, is as stated above.

PP 4886-28-8686

**3. ASSIGNMENT OF RENTS; APPOINTMENT OF RECEIVER; LENDER IN POSSESSION.**

(a) As part of the consideration for the Indebtedness, Borrower absolutely and unconditionally assigns and transfers to Lender all Rents. It is the intention of Borrower to establish a present, absolute, and irrevocable transfer and assignment to Lender of all Rents and to authorize and empower Lender to collect and receive all Rents without the necessity of further action on the part of Borrower. Promptly upon request by Lender, Borrower agrees to execute and deliver such further assignments as Lender may from time to time reasonably require. Borrower and Lender intend this assignment of Rents to be immediately effective and to constitute an absolute present assignment and not an assignment for additional security only. For purposes of giving effect to this absolute assignment of rents, and for no other purpose, Rents shall not be deemed to be a part of the "Mortgaged Property". However, if this present, absolute and unconditional assignment of Rents is not enforceable by its terms under the laws of the Property Jurisdiction, then the Rents shall be included as a part of the Mortgaged Property and it is the intention of the Borrower that in this circumstance this Instrument create and perfect a lien on Rents in favor of Lender, which lien shall be effective as of the date of this Instrument.

(b) If an Event of Default has occurred and is continuing, Borrower authorizes Lender to collect, sue for and compromise Rents and directs each tenant of the Mortgaged Property to pay all Rents to, or as directed by, Lender, and Borrower shall, upon Borrower's receipt of any Rents from any sources, pay the total amount of such receipts to the Lender. However, so long as no Event of Default has occurred and is continuing, Lender hereby grants to Borrower a revocable license to collect and receive all Rents, to hold all Rents in trust for the benefit of Lender and to apply all Rents to pay the installments of interest and principal then due and payable under the Note and the other amounts then due and payable under the other Loan Documents, including Imposition Deposits, and to pay the current costs and expenses of managing, operating and maintaining the Mortgaged Property, including utilities, Taxes and insurance premiums (to the extent not included in Imposition Deposits), tenant improvements and other capital expenditures. So long as no Event of Default has occurred and is continuing, the Rents remaining after application pursuant to the preceding sentence may be retained by Borrower free and clear of, and released from, Lender's rights with respect to Rents under this Instrument. From and during the continuance of an Event of Default, and without the necessity of Lender entering upon and taking and maintaining control of the Mortgaged Property directly, or by a receiver, Borrower's license to collect Rents shall automatically terminate and Lender shall without notice be entitled to all Rents as they become due and payable, including Rents then due and unpaid, and Borrower shall pay to Lender upon demand all Rents to which Lender is entitled. At any time during the continuance of an Event of Default, Lender may give, and Borrower hereby irrevocably authorizes Lender to give, notice to all tenants of the Mortgaged Property instructing them to pay all

Rents to Lender; provided, however, that the giving of any such notice by Lender shall not affect, in any way, Lender's entitlement to the Rents as of the date on which the Event of Default occurs. No tenant shall be obligated to inquire further as to the occurrence or continuance of an Event of Default, and no tenant shall be obligated to pay to Borrower any amounts which are actually paid to Lender in response to such a notice. Any such notice by Lender shall be delivered to each tenant personally, by mail or by delivering such demand to each rental unit. Borrower shall not interfere with and shall cooperate with Lender's collection of such Rents.

(c) Borrower represents and warrants to Lender that Borrower has not executed any prior assignment of Rents (other than an assignment of Rents securing indebtedness that will be paid off and discharged with the proceeds of the loan evidenced by the Note), that Borrower has not performed, and Borrower covenants and agrees that it will not perform, any acts and has not executed, and shall not execute, any instrument which would prevent Lender from exercising its rights under this Section 3, and that at the time of execution of this Instrument there has been no anticipation or prepayment of any Rents for more than one month prior to the due dates of such Rents. Borrower shall not collect or accept payment of any Rents more than two months prior to the due dates of such Rents.

(d) If an Event of Default has occurred and is continuing, Lender may, regardless of the adequacy of Lender's security or the solvency of Borrower and even in the absence of waste, enter upon and take and maintain full control of the Mortgaged Property in order to perform all acts that Lender in its discretion determines to be necessary or desirable for the operation and maintenance of the Mortgaged Property, including the execution, cancellation or modification of Leases, the collection of all Rents, the making of repairs to the Mortgaged Property and the execution or termination of contracts providing for the management, operation or maintenance of the Mortgaged Property, for the purposes of enforcing the assignment of Rents pursuant to Section 3(a), protecting the Mortgaged Property or the security of this Instrument, or for such other purposes as Lender in its reasonable discretion may deem necessary or desirable. Alternatively, if an Event of Default has occurred and is continuing, regardless of the adequacy of Lender's security, without regard to Borrower's solvency and without the necessity of giving prior notice (oral or written) to Borrower, Lender may apply to any court having jurisdiction for the appointment of a receiver for the Mortgaged Property to take any or all of the actions set forth in the preceding sentence. If Lender elects to seek the appointment of a receiver for the Mortgaged Property at any time an Event of Default has occurred and is continuing, Borrower, by its execution of this Instrument, expressly consents to the appointment of such receiver, including the appointment of a receiver ex parte if permitted by applicable law. Lender or the receiver, as the case may be, shall be entitled to receive a reasonable fee for managing the Mortgaged Property. Immediately upon appointment of a receiver or immediately upon the Lender's entering upon and taking possession and control of the Mortgaged Property, Borrower shall surrender possession of the Mortgaged

Property to Lender or the receiver, as the case may be, and shall deliver to Lender or the receiver, as the case may be, all documents, records (including records on electronic or magnetic media), accounts, surveys, plans, and specifications relating to the Mortgaged Property and all security deposits and prepaid Rents (Borrower may retain copies thereof). In the event Lender takes possession and control of the Mortgaged Property, Lender may exclude Borrower and its representatives from the Mortgaged Property. Borrower acknowledges and agrees that the exercise by Lender of any of the rights conferred under this Section 3 shall not be construed to make Lender a mortgagee-in-possession of the Mortgaged Property so long as Lender has not itself entered into actual possession of the Land and Improvements.

(e) If Lender enters the Mortgaged Property, Lender shall be liable to account only to Borrower and only for those Rents actually received. Lender shall not be liable to Borrower, anyone claiming under or through Borrower or anyone having an interest in the Mortgaged Property, by reason of any act or omission of Lender under this Section 3, and Borrower hereby releases and discharges Lender from any such liability to the fullest extent permitted by law, excluding the portion of any such liability arising exclusively from the gross negligence or willful misconduct of Lender or any of Lender's agents, employees, officers and/or invitees (collectively, the "Lender Parties").

(f) If the Rents are not sufficient to meet the costs of taking control of and managing the Mortgaged Property and collecting the Rents, any funds expended by Lender for such purposes shall become an additional part of the Indebtedness as provided in Section 12.

(g) Any entering upon and taking of control of the Mortgaged Property by Lender or the receiver, as the case may be, and any application of Rents as provided in this Instrument shall not cure or waive any Event of Default or invalidate any other right or remedy of Lender under applicable law or provided for in this Instrument.

#### **4. ASSIGNMENT OF LEASES; LEASES AFFECTING THE MORTGAGED PROPERTY.**

(a) As part of the consideration for the Indebtedness, Borrower absolutely and unconditionally assigns and transfers to Lender all of Borrower's right, title and interest in, to and under the Leases, including Borrower's right, power and authority to modify the terms of any such Lease, or extend or terminate any such Lease. It is the intention of Borrower to establish a present, absolute and irrevocable transfer and assignment to Lender of all of Borrower's right, title and interest in, to and under the Leases. Borrower and Lender intend this assignment of the Leases to be immediately effective and to constitute an absolute present assignment and not an assignment for additional security only. For purposes of giving effect to this absolute assignment of the Leases, and for no other purpose, the Leases shall not be deemed to be a part of the "Mortgaged Property". However, if this present, absolute and unconditional assignment of the Leases is

not enforceable by its terms under the laws of the Property Jurisdiction, then the Leases shall be included as a part of the Mortgaged Property and it is the intention of the Borrower that in this circumstance this Instrument create and perfect a lien on the Leases in favor of Lender, which lien shall be effective as of the date of this Instrument.

(b) Until an Event of Default has occurred and is continuing, Borrower shall have all rights, power and authority granted to Borrower under any Lease (except as otherwise limited by this Section or any other provision of this Instrument), including the right, power and authority to modify the terms of any Lease or extend or terminate any Lease. If an Event of Default has occurred and is continuing, the permission given to Borrower pursuant to the preceding sentence to exercise all rights, power and authority under Leases shall automatically terminate. Borrower shall comply with and observe Borrower's obligations under all Leases, including Borrower's obligations pertaining to the maintenance and disposition of tenant security deposits.

(c) Borrower acknowledges and agrees that the exercise by Lender, either directly or by a receiver, of any of the rights conferred under this Section 4 shall not be construed to make Lender a mortgagee-in-possession of the Mortgaged Property so long as Lender has not itself entered into actual possession of the Land and the Improvements. The acceptance by Lender of the assignment of the Leases pursuant to Section 4(a) shall not at any time or in any event obligate Lender to take any action under this Instrument or to expend any money or to incur any expenses. Lender shall not be liable in any way for any injury or damage to person or property sustained by any person or persons, firm or corporation in or about the Mortgaged Property except for that portion caused exclusively by the gross negligence or willful misconduct of any Indemnitee (as hereinafter defined). Prior to Lender's actual entry into and taking possession of the Mortgaged Property, Lender shall not (i) be obligated to perform any of the terms, covenants and conditions contained in any Lease (or otherwise have any obligation with respect to any Lease); (ii) be obligated to appear in or defend any action or proceeding relating to the Lease or the Mortgaged Property; or (iii) be responsible for the operation, control, care, management or repair of the Mortgaged Property or any portion of the Mortgaged Property. The execution of this Instrument by Borrower shall constitute conclusive evidence that all responsibility for the operation, control, care, management and repair of the Mortgaged Property is and shall be that of Borrower, prior to such actual entry and taking of possession.

(d) If an Event of Default has occurred and is continuing, and without the necessity of Lender entering upon and taking and maintaining control of the Mortgaged Property directly, by a receiver, or by any other manner or proceeding permitted by the laws of the Property Jurisdiction, Lender immediately shall have all rights, powers and authority granted to Borrower under any Lease, including the right, power and authority to modify the terms of any such Lease, or extend or terminate any such Lease.



(e) Borrower shall, promptly upon Lender's request, deliver to Lender an executed copy of each residential Lease then in effect. All Leases for residential dwelling units shall be substantially in the form approved by Lender, shall be for initial terms of at least six months and not more than two years, and shall not include options to purchase. If customary in the applicable market, residential Leases with terms of less than six months may be permitted with Lender's prior written consent.

(f) Except for any lease made in connection with providing tenant services such as cable, internet, laundry services, utility or similar services to tenants, Borrower shall not lease any portion of the Mortgaged Property for non-residential use except with the prior written consent of Lender, such consent not to be unreasonably withheld or conditioned, and Lender's prior written approval of the Lease Agreement. Borrower shall not modify the terms of, or extend or terminate, any Lease for non-residential use (including any Lease in existence on the date of this Instrument) without the prior written consent of Lender, such consent not to be unreasonably withheld, delayed or conditioned. However, Lender's consent shall not be required for the modification or extension of a non-residential Lease if such modification or extension is on terms at least as favorable to Borrower as those customary at such time in the applicable market and the income from the modified or extended Lease will not be less than the income received from the Lease as of the date of the modification or extension. Borrower shall, without request by Lender, deliver an executed copy of each non-residential Lease to Lender promptly after such Lease is signed. All non-residential Leases, including renewals or extensions of existing Leases, shall specifically provide that (1) such Leases are subordinate to the lien of this Instrument (unless waived in writing by Lender); (2) the tenant shall attorn to Lender and any purchaser at a foreclosure sale, such attornment to be self-executing and effective upon acquisition of title to the Mortgaged Property by any purchaser at a foreclosure sale or by Lender in any manner; (3) the tenant agrees to execute such further evidences of attornment as Lender or any purchaser at a foreclosure sale may from time to time request; (4) the Lease shall not be terminated by foreclosure or any other transfer of the Mortgaged Property; (5) after a foreclosure sale of the Mortgaged Property, Lender or any other purchaser at such foreclosure sale may, at Lender's or such purchaser's option, accept or terminate such Lease; and (6) the tenant shall, upon receipt after the occurrence of an Event of Default of a written request from Lender, pay all Rents payable under the Lease to Lender.

(g) Borrower shall not receive or accept Rent under any Lease (whether residential or non-residential) for more than two months in advance.

##### **5. PAYMENT OF INDEBTEDNESS; PERFORMANCE UNDER LOAN DOCUMENTS.**

Borrower shall pay the Indebtedness when due in accordance with the terms of the Note and the other Loan Documents and shall perform, observe and comply with all other provisions of the Note and the other Loan Documents.

## 6. EXCULPATION.

Borrower's personal liability for payment of the Indebtedness and for performance of the other obligations to be performed by it under this Instrument may be limited in the manner, and to the extent, provided in the Note.

## 7. DEPOSITS FOR TAXES, INSURANCE AND OTHER CHARGES.

(a) Notwithstanding any requirement of the Loan Agreement to the contrary, at the written request of Lender (which request may be made regardless of whether an Event of Default is then continuing), Borrower shall deposit with Lender on the same day monthly installments of principal or interest are due under the Note (or on another day designated in writing by Lender), and continuing on the same day each month until the Indebtedness is paid in full, 1/12 of the amount sufficient to accumulate with Lender the annual sum required to pay, before past due and accumulating penalties (1) any water and sewer charges which, if not paid, may result in a lien on all or any part of the Mortgaged Property, (2) the premiums for fire and other hazard insurance, rent loss insurance and such other insurance as Lender may require under Section 19, (unless Borrower has provided Lender with evidence that such premiums have been paid for the next 12 month period), (3) Taxes, and (4) amounts for other charges and expenses which Lender at any time reasonably deems necessary to protect the Mortgaged Property, to prevent the imposition of liens on the Mortgaged Property, or otherwise to protect Lender's interests, all as reasonably estimated from time to time by Lender. The amounts deposited under the preceding sentence are collectively referred to in this Instrument as the "Imposition Deposits". The obligations of Borrower for which the Imposition Deposits are required are collectively referred to in this Instrument as "Impositions". The amount of the Imposition Deposits shall be sufficient to enable Lender to pay each Imposition before the last date upon which such payment may be made without any penalty or interest charge being added. Lender shall maintain records indicating how much of the monthly Imposition Deposits and how much of the aggregate Imposition Deposits held by Lender are held for the purpose of paying Taxes, insurance premiums and each other obligation of Borrower for which Imposition Deposits are required. Any waiver by Lender of the requirement that Borrower remit Imposition Deposits to Lender may be revoked by Lender, in Lender's discretion, at any time upon notice to Borrower.

(b) Imposition Deposits shall be held in an institution (which may be Lender, if Lender is such an institution) whose deposits or accounts are insured or guaranteed by a federal agency. Lender shall not be obligated to open additional accounts or deposit Imposition Deposits in additional institutions when the amount of the Imposition Deposits exceeds the maximum amount of the federal deposit insurance or guaranty. Lender shall apply the Imposition Deposits to pay Impositions so long as no Event of Default has occurred and is continuing. Unless applicable law requires, Lender shall not be required to pay Borrower any interest, earnings or profits on the Imposition Deposits. Borrower hereby pledges and grants to Lender a security interest in the Imposition Deposits as additional security for all



of Borrower's obligations under this Instrument and the other Loan Documents. Any amounts deposited with Lender under this Section 7 shall not be trust funds, nor shall they operate to reduce the Indebtedness, unless applied by Lender for that purpose under Section 7(e).

(c) If Lender receives a bill or invoice for an Imposition, Lender shall pay the Imposition from the Imposition Deposits held by Lender prior to the date such Impositions become past due. Lender shall have no obligation to pay any Imposition to the extent it exceeds Imposition Deposits then held by Lender. Lender may pay an Imposition according to any bill, statement or estimate from the appropriate public office or insurance company without inquiring into the accuracy of the bill, statement or estimate or into the validity of the Imposition.

(d) If at any time the amount of the Imposition Deposits held by Lender for payment of a specific Imposition exceeds the amount reasonably deemed necessary by Lender, the excess shall be credited against future installments of Imposition Deposits. If at any time the amount of the Imposition Deposits held by Lender for payment of a specific Imposition is less than the amount reasonably estimated by Lender to be necessary, Borrower shall pay to Lender the amount of the deficiency within 15 days after notice from Lender.

(e) If an Event of Default has occurred and is continuing, Lender may apply any Imposition Deposits, in any amounts and in any order as Lender determines, in Lender's discretion, to pay any Impositions or as a credit against the Indebtedness. Upon payment in full of the Indebtedness, Lender shall refund to Borrower any Imposition Deposits held by Lender.

## **8. COLLATERAL AGREEMENTS.**

Borrower shall deposit with Lender such amounts as may be required by any Collateral Agreement and shall perform all other obligations of Borrower under each Collateral Agreement.

## **9. APPLICATION OF PAYMENTS.**

If at any time Lender receives, from Borrower or otherwise, any amount applicable to the Indebtedness which is less than all amounts due and payable at such time, then Lender may apply that payment to amounts then due and payable in any manner and in any order determined by Lender, in Lender's discretion. Neither Lender's acceptance of an amount which is less than all amounts then due and payable nor Lender's application of such payment in the manner authorized shall constitute or be deemed to constitute either a waiver of the unpaid amounts or an accord and satisfaction. Notwithstanding the application of any such amount to the Indebtedness, Borrower's obligations under this Instrument and the Note shall remain unchanged.

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## **10. COMPLIANCE WITH LAWS.**

Borrower shall comply with all laws, ordinances, regulations and requirements of any Governmental Authority and all recorded lawful covenants and agreements relating to or affecting the Mortgaged Property, including all laws, ordinances, regulations, requirements and covenants pertaining to health and safety, construction of improvements on the Mortgaged Property, fair housing, zoning and land use, and Leases. Borrower also shall comply with all applicable laws that pertain to the maintenance and disposition of tenant security deposits. Borrower shall at all times maintain records sufficient to demonstrate compliance with the provisions of this Section 10. Borrower shall take appropriate measures to prevent, and shall not engage in or knowingly permit, any illegal activities at the Mortgaged Property that could endanger tenants or visitors, result in damage to the Mortgaged Property, result in forfeiture of the Mortgaged Property, or otherwise materially impair the lien created by this Instrument or Lender's interest in the Mortgaged Property. Borrower represents and warrants to Lender that no portion of the Mortgaged Property has been or will be purchased with the proceeds of any illegal activity.

## **11. USE OF PROPERTY.**

Unless required by applicable law, Borrower shall not (a) except for any change in use approved by Lender, allow changes in the use for which all or any part of the Mortgaged Property is being used at the time this Instrument was executed, (b) convert any individual dwelling units or common areas to commercial use, (c) initiate or acquiesce in a change in the zoning classification of the Mortgaged Property, or (d) establish any condominium or cooperative regime with respect to the Mortgaged Property.

## **12. PROTECTION OF LENDER'S SECURITY.**

(a) If Borrower fails to perform any of its obligations under this Instrument or any other Loan Document, or if any action or proceeding is commenced which purports to affect the Mortgaged Property, Lender's security or Lender's rights under this Instrument, including eminent domain, insolvency, code enforcement, civil or criminal forfeiture, enforcement of Hazardous Materials Laws, fraudulent conveyance or reorganizations or proceedings involving a bankrupt or decedent, then Lender at Lender's option may make such appearances, disburse such sums and take such actions as Lender reasonably deems necessary to perform such obligations of Borrower and to protect Lender's interest, including (1) payment of fees and reasonable out-of-pocket expenses of attorneys, accountants, inspectors and consultants, (2) entry upon the Mortgaged Property to make repairs or secure the Mortgaged Property, (3) procurement of the insurance required by Section 19, and (4) payment of amounts which Borrower has failed to pay under Sections 15 and 17.

(b) Any amounts disbursed by Lender under this Section 12, or under any other provision of this Instrument that treats such disbursement as being made

under this Section 12, shall be added to, and become part of, the principal component of the Indebtedness, shall be immediately due and payable and shall bear interest from the date of disbursement until paid at the "Default Rate", as defined in each Note.

(c) Nothing in this Section 12 shall require Lender to incur any expense or take any action.

### **13. INSPECTION.**

Lender, its agents, representatives, and designees upon 72 hours prior notice to Borrower, may make or cause to be made entries upon and inspections of the Mortgaged Property (including environmental inspections and tests) during normal business hours and with at least 72 hours prior written notice (but no such notice will be required during the continuance of an Event of Default), or at any other reasonable time and as otherwise provided for in the Loan Agreement. Lender also reserves the right to reappraise the Mortgaged Property one time at Borrower's expense after the closing of the loan evidenced by this Instrument, to the extent and as provided for in the Loan Agreement.

### **14. BOOKS AND RECORDS; FINANCIAL REPORTING.**

(a) Borrower shall keep and maintain at all times at the Mortgaged Property or the management agent's offices, and upon Lender's request shall make available at the Mortgaged Property (or, at Borrower's option, at the management agent's office), complete and accurate (in all material respects) books of account and records (including copies of supporting bills and invoices) adequate to reflect correctly the operation of the Mortgaged Property, and copies of all written contracts, Leases, and other instruments which affect the Mortgaged Property. Upon 72 hours prior written notice to Borrower, the books, records, contracts, Leases and other instruments shall be subject to examination and inspection during normal business hours by Lender (but no such prior notice shall be required during the continuance of an Event of Default).

(b) Borrower shall furnish to Lender all financial and other information relating to Borrower and the Mortgaged Property as Lender shall reasonably request, including, without limiting, all of the following:

- (1) As soon as available, and in any event within thirty (30) days from the end of each fiscal quarter of Borrower, unaudited statements showing the financial condition of the Mortgaged Property at the close of such fiscal quarter, which statements shall include, without limitation, an income/operating statement signed by the property manager and/or a duly authorized officer of the general partner of Borrower, a summary report of rent collections for that fiscal quarter, a current rent roll (which shall include a summary of the number of units leased, available, and

RP 886-28-8615

occupied and any rental concessions), the fiscal quarter's budget, year to date activity, year to date budget, and all other matters as Lender may reasonably request;

- (2) As soon as available, and in any event within one hundred twenty (120) days from the end of each fiscal year of Borrower, an audited financial statement, prepared in a manner acceptable to Lender by a third party accounting firm acceptable to Lender, showing the financial condition of Borrower at the close of such fiscal year and the results of operation during such fiscal year, which financial statement shall include a balance sheet, income statement, statement of contingent liabilities, and statement of cash flows (sources and uses);
- (3) Within one hundred twenty (120) days after the end of each fiscal year of Borrower, and at any other time upon Lender's request, an accounting of all security deposits held pursuant to all Leases, including the name of the institution (if any) and the names and identification numbers of the accounts (if any) in which such security deposits are held and the name of the person to contact at such financial institution, along with any authority or release necessary for Lender to access information regarding such accounts;
- (4) Within one hundred twenty (120) days after the end of each fiscal year of Borrower, and at any other time upon Lender's request, a statement that identifies all owners of any interest in Borrower and the interest held by each, if Borrower is a corporation, all officers and directors of Borrower, and if Borrower is a limited liability company, all managers who are not members;
- (5) Upon Lender's request, a monthly property management report for the Mortgaged Property, showing the number of inquiries made and rental applications received from tenants or prospective tenants and deposits received from tenants and any other information requested by Lender; and
- (6) Borrower shall satisfy all other reporting requirements set forth in the Loan Agreement.

(c) Each of the statements, schedules and reports required by Section 14(b) shall be certified to be complete and accurate by an individual having authority to bind Borrower or the property manager where applicable, and shall be in such form and contain such detail as Lender may reasonably require.

(d) If Borrower fails to provide in a timely manner the statements, schedules and reports required by Section 14(b), Lender shall have the right to have Borrower's books and records audited, at Borrower's expense, by independent certified public accountants selected by Lender in order to obtain such statements, schedules and reports, and all related reasonable costs and expenses of Lender shall become immediately due and payable and shall become an additional part of the Indebtedness as provided in Section 12.

(e) If an Event of Default has occurred and is continuing, Borrower shall deliver to Lender upon written demand all books and records relating to the Mortgaged Property or its operation, provided, however, Borrower can keep copies thereof.

(f) Borrower authorizes Lender to obtain a credit report on Borrower at any time no more than once per calendar year (unless an Event of Default is then continuing, in which case there shall be no limitation).

#### **15. TAXES; OPERATING EXPENSES.**

(a) Subject to the provisions of Section 15(c) and Section 15(d), Borrower shall pay, or cause to be paid, all Taxes when due and before the addition of any interest, fine, penalty or cost for nonpayment.

(b) Subject to the provisions of Section 15(c), Borrower shall pay the expenses of operating, managing, maintaining and repairing the Mortgaged Property (including insurance premiums, utilities, repairs and replacements) before the last date upon which each such payment may be made without any penalty or interest charge being added.

(c) As long as no Event of Default exists and Borrower has timely delivered to Lender any bills or premium notices that it has received, Borrower shall not be obligated to pay Taxes, insurance premiums or any other individual Imposition to the extent that sufficient Imposition Deposits are held by Lender for the purpose of paying that specific Imposition. If an Event of Default exists, Lender may exercise any rights Lender may have with respect to Imposition Deposits without regard to whether Impositions are then due and payable. Lender shall have no liability to Borrower for failing to pay any Impositions to the extent that any Event of Default has occurred and is continuing, insufficient Imposition Deposits are held by Lender at the time an Imposition becomes due and payable or Borrower has failed to provide Lender with bills and premium notices as provided above.

(d) Borrower, at its own expense, may contest by appropriate legal proceedings, conducted diligently and in good faith, the amount or validity of any Imposition other than insurance premiums, if (1) Borrower notifies Lender of the commencement or expected commencement of such proceedings, (2) the Mortgaged Property is not in danger of being sold or forfeited, (3) Borrower deposits with Lender

1998-02-06 11:00 AM

reserves sufficient to pay the contested Imposition, if requested by Lender, and (4) Borrower furnishes whatever additional security is required in the proceedings or is reasonably requested by Lender, which may include the delivery to Lender of the reserves established by Borrower to pay the contested Imposition.

(e) Borrower shall promptly deliver to Lender a copy of all notices of, and invoices for, Impositions, and if Borrower pays any Imposition directly, Borrower shall promptly furnish to Lender receipts evidencing such payments.

#### **16. LIENS; ENCUMBRANCES.**

Borrower acknowledges that, to the extent provided in Section 21, the grant, creation or existence of any mortgage, deed of trust, deed to secure debt, security interest or other lien or encumbrance (a "Lien") on the Mortgaged Property (other than the lien of this Instrument) or on certain ownership interests in Borrower, whether voluntary, involuntary or by operation of law, and whether or not such Lien has priority over the lien of this Instrument, is a "Transfer" which constitutes an Event of Default, except any Permitted Exception.

#### **17. PRESERVATION, MANAGEMENT AND MAINTENANCE OF MORTGAGED PROPERTY.**

(a) Borrower (1) shall not commit waste or permit impairment or deterioration of the Mortgaged Property, (2) shall not abandon the Mortgaged Property, (3) shall restore or repair promptly, in a good and workmanlike manner, any damaged part of the Mortgaged Property to the equivalent of its original condition, or such other condition as Lender may approve in writing, whether or not insurance proceeds or condemnation awards are available to cover any costs of such restoration or repair, (4) shall keep the Mortgaged Property in good repair, including the replacement of Personalty and Fixtures with items of equal or better function and quality, (5) shall provide for professional management of the Mortgaged Property by a residential rental property manager reasonably satisfactory to Lender under a contract approved by Lender in writing, and (6) shall give notice to Lender of and, unless otherwise directed in writing by Lender, shall appear in and defend any action or proceeding purporting to affect the Mortgaged Property, Lender's security or Lender's rights under this Instrument. Borrower shall not (and shall not permit any tenant or other person to) remove, demolish or alter the Mortgaged Property or any part of the Mortgaged Property except in connection with the replacement of tangible Personalty.

(b) If, in connection with the making of the loan evidenced by the Note or at any later date, Lender waives in writing the requirement of Section 17(a)(5) above that Borrower enter into a written contract for management of the Mortgaged Property and if, after the date of this Instrument, Borrower intends to change the management of the Mortgaged Property, Lender shall have the right to approve such new property manager and the written contract for the management of the Mortgaged Property and require that Borrower and such new property

manager enter into an Assignment of Management Agreement on a form approved by Lender. If required by Lender (whether before or after an Event of Default), Borrower will cause any Affiliate of Borrower to whom fees are payable for the management of the Mortgaged Property to enter into an agreement with Lender, in a form approved by Lender, providing for subordination of those fees and such other provisions as Lender may reasonably require. "Affiliate of Borrower" means any corporation, partnership, joint venture, limited liability company, limited liability partnership, trust or individual controlled by, under common control with, or which controls Borrower (the term "control" for these purposes shall mean the ability, whether by the ownership of shares or other equity interests, by contract or otherwise, to elect a majority of the directors of a corporation, to make management decisions on behalf of, or independently to select the managing partner of, a partnership, or otherwise to have the power independently to remove and then select a majority of those individuals exercising managerial authority over an entity, and control shall be conclusively presumed in the case of the ownership of 50% or more of the equity interests).

## 18. ENVIRONMENTAL HAZARDS.

(a) Except for matters covered by a written program of operations and maintenance approved in writing by Lender (an "O&M Program"), those disclosed to Lender prior to the date hereof, or matters described in Section 18(b), Borrower shall not cause or knowingly permit any of the following:

- (1) the presence, use, generation, release, treatment, processing, storage (including storage in above ground and underground storage tanks), handling, or disposal of any Hazardous Materials on or under the Mortgaged Property or any other property of Borrower that is adjacent to the Mortgaged Property;
- (2) the transportation of any Hazardous Materials to, from, or across the Mortgaged Property;
- (3) any occurrence or condition on the Mortgaged Property or any other property of Borrower that is adjacent to the Mortgaged Property, which occurrence or condition is or may be in violation of Hazardous Materials Laws; or
- (4) any violation of or noncompliance with the terms of any Environmental Permit with respect to the Mortgaged Property or any property of Borrower that is adjacent to the Mortgaged Property.

The matters described in clauses (1) through (4) above are referred to collectively in this Section 18 as "Prohibited Activities or Conditions".



13P 0816-28-0620

(b) Prohibited Activities and Conditions shall not include the safe and lawful use and storage of quantities of (1) pre-packaged supplies, cleaning materials and petroleum products customarily used in the operation and maintenance of comparable multifamily properties, (2) cleaning materials, personal grooming items and other items sold in pre-packaged containers for consumer use and used by tenants and occupants of residential dwelling units in the Mortgaged Property; and (3) petroleum products used in the operation and maintenance of motor vehicles from time to time located on the Mortgaged Property's parking areas, so long as all of the foregoing are used, stored, handled, transported and disposed of in compliance with Hazardous Materials Laws.

(c) Borrower shall take all commercially reasonable actions (including the inclusion of appropriate provisions in any Leases executed after the date of this Instrument) to prevent its employees, agents, and contractors, and all tenants and other occupants from causing or permitting any Prohibited Activities or Conditions. Borrower shall not lease or allow the sublease or use of all or any portion of the Mortgaged Property to any tenant or subtenant for nonresidential use by any user that, in the ordinary course of its business, would cause or permit any Prohibited Activity or Condition.

(d) If an O&M Program has been established with respect to Hazardous Materials, Borrower shall comply in a timely manner with, and cause all employees, agents, and contractors of Borrower and any other persons present on the Mortgaged Property to comply with the O&M Program. All costs of performance of Borrower's obligations under any O&M Program shall be paid by Borrower, and Lender's reasonable out-of-pocket costs incurred in connection with the monitoring and review of the O&M Program and Borrower's performance shall be paid by Borrower upon demand by Lender. Any such out-of-pocket costs of Lender which Borrower fails to pay promptly shall become an additional part of the Indebtedness as provided in Section 12.

(e) Borrower represents and warrants to Lender that, except as previously disclosed by Borrower to Lender in writing:

- (1) Borrower has not at any time engaged in, caused or permitted any Prohibited Activities or Conditions;
- (2) to the best of Borrower's knowledge after reasonable and diligent inquiry, no Prohibited Activities or Conditions exist or have existed;
- (3) except to the extent previously disclosed by Borrower to Lender in writing, the Mortgaged Property does not now contain any underground storage tanks, and, to the best of Borrower's knowledge after reasonable and diligent inquiry, the Mortgaged Property has not contained any underground storage tanks in the past. If there is an underground storage tank located on the



Property which has been previously disclosed by Borrower to Lender in writing, that tank complies with all requirements of Hazardous Materials Laws;

- (4) Borrower has complied with all Hazardous Materials Laws, including all requirements for notification regarding releases of Hazardous Materials. Without limiting the generality of the foregoing, Borrower has obtained all Environmental Permits required for the operation of the Mortgaged Property in accordance with Hazardous Materials Laws now in effect and all such Environmental Permits are in full force and effect;
- (5) no event has occurred with respect to the Mortgaged Property that constitutes, or with the passing of time or the giving of notice would constitute, noncompliance with the terms of any Environmental Permit;
- (6) there are no actions, suits, claims or proceedings pending or, to the best of Borrower's knowledge after reasonable and diligent inquiry, threatened that involve the Mortgaged Property and allege, arise out of, or relate to any Prohibited Activity or Condition; and
- (7) Borrower has not received any complaint, order, notice of violation or other communication from any Governmental Authority with regard to air emissions, water discharges, noise emissions or Hazardous Materials, or any other environmental, health or safety matters affecting the Mortgaged Property or any other property of Borrower that is adjacent to the Mortgaged Property.

The representations and warranties in this Section 18 shall be continuing representations and warranties that shall be deemed to be made by Borrower throughout the term of the loan evidenced by the Note, until the Indebtedness has been paid in full.

(f) Borrower shall promptly notify Lender in writing upon the occurrence of any of the following events:

- (1) Borrower's discovery of any Prohibited Activity or Condition;
- (2) Borrower's receipt of or knowledge of any complaint, order, notice of violation or other communication from any Governmental Authority or other person with regard to present or future alleged Prohibited Activities or Conditions or any other environmental, health or safety matters affecting the Mortgaged

Property or any other property of Borrower that is adjacent to the Mortgaged Property; and

- (3) any representation or warranty in this Section 18 becomes untrue after the date of this Agreement.

Any such notice given by Borrower shall not relieve Borrower of, or result in a waiver of, any obligation under this Instrument, the Note, or any other Loan Document.

(g) Borrower shall pay promptly the reasonable costs of any environmental inspections, tests or audits ("Environmental Inspections") required by Lender in connection with any foreclosure or deed in lieu of foreclosure, or as a condition of Lender's consent to any Transfer under Section 21, or required by Lender following a reasonable determination by Lender that Prohibited Activities or Conditions may exist. Any such costs incurred by Lender (including the fees and out-of-pocket costs of attorneys and technical consultants whether incurred in connection with any judicial or administrative process or otherwise) which Borrower fails to pay promptly shall become an additional part of the Indebtedness as provided in Section 12. The results of all Environmental Inspections made by Lender shall at all times remain the property of Lender and Lender shall have no obligation to disclose or otherwise make available to Borrower or any other party such results or any other information obtained by Lender in connection with its Environmental Inspections. Lender hereby reserves the right, and Borrower hereby expressly authorizes Lender, to make available to any party, including any prospective bidder at a foreclosure sale of the Mortgaged Property, the results of any Environmental Inspections made by Lender with respect to the Mortgaged Property. Borrower consents to Lender notifying any such party (either as part of a notice of sale or otherwise) of the results of any of Lender's Environmental Inspections. Borrower acknowledges that Lender cannot control or otherwise assure the truthfulness or accuracy of the results of any of its Environmental Inspections and that the release of such results to prospective bidders at a foreclosure sale of the Mortgaged Property may have a material and adverse effect upon the amount which a party may bid at such sale. Borrower agrees that Lender shall have no liability whatsoever as a result of delivering the results of any of its Environmental Inspections to any third party, and Borrower hereby releases and forever discharges Lender from any and all claims, damages, or causes of action, arising out of, connected with or incidental to the results of, the delivery of any of Lender's Environmental Inspections in accordance with this Section 16(g).

(h) If any investigation, site monitoring, containment, clean-up, restoration or other remedial work ("Remedial Work") is necessary to comply with any Hazardous Materials Law or order of any Governmental Authority that has or acquires jurisdiction over the Mortgaged Property or the use, operation or improvement of the Mortgaged Property under any Hazardous Materials Law, Borrower shall, by the earlier of (1) the applicable deadline required by Hazardous Materials Law or (2) 30 days after notice from Lender demanding such action,

begin performing the Remedial Work, and thereafter diligently prosecute it to completion, and shall in any event complete the work by the time required by applicable Hazardous Materials Law. If Borrower fails to begin on a timely basis or diligently prosecute any required Remedial Work, Lender may, at its option, cause the Remedial Work to be completed, in which case Borrower shall reimburse Lender on demand for the reasonable cost of doing so. Any reimbursement due from Borrower to Lender shall become part of the Indebtedness as provided in Section 12.

(i) Borrower shall cooperate with any inquiry by any Governmental Authority and shall comply with any governmental or judicial order which arises from any alleged Prohibited Activity or Condition.

(j) Borrower shall indemnify, hold harmless and defend to the extent permitted by law (i) Lender, (ii) any prior owner or holder of the Note, (iii) the Loan Servicer, (iv) any prior Loan Servicer, (v) the officers, directors, shareholders, partners, employees and trustees of any of the foregoing, and (vi) the heirs, legal representatives, successors and assigns of each of the foregoing (collectively, the "Indemnitees") from and against all proceedings, claims, damages, penalties and reasonable costs (whether initiated or sought by Governmental Authorities or private parties), including reasonable fees and out-of-pocket expenses of attorneys and expert witnesses, investigatory fees, and remediation costs, whether incurred in connection with any judicial or administrative process or otherwise, arising directly or indirectly from any of the following (except that portion exclusively caused by the gross negligence or willful misconduct of any Indemnitee):

- (1) any breach of any representation or warranty of Borrower in this Section 18;
- (2) any failure by Borrower to perform any of its obligations under this Section 18;
- (3) the existence or alleged existence of any Prohibited Activity or Condition;
- (4) the presence or alleged presence of Hazardous Materials on or under the Mortgaged Property or any property of Borrower that is adjacent to the Mortgaged Property; and
- (5) the actual or alleged violation of any Hazardous Materials Law.

(k) Counsel selected by Borrower to defend Indemnitees shall be subject to the approval of those Indemnitees. However, any Indemnitee may elect to defend any claim or legal or administrative proceeding at the Borrower's expense.

(l) Borrower shall not, without the prior written consent of those Indemnitees who are named as parties to a claim or legal or administrative

proceeding (a "Claim"), settle or compromise the Claim if the settlement (1) results in the entry of any judgment that does not include as an unconditional term the delivery by the claimant or plaintiff to Lender of a written release of those Indemnitees, satisfactory in form and substance to Lender; or (2) may materially and adversely affect Lender, as determined by Lender in its reasonable discretion.

(m) Borrower shall, at its own cost and expense, do all of the following:

- (1) pay or satisfy any judgment or decree that may be entered against any Indemnitee or Indemnites in any legal or administrative proceeding incident to any matters against which Indemnites are entitled to be indemnified under this Section 18;
- (2) reimburse Indemnites for any reasonable expenses paid or incurred in connection with any matters against which Indemnites are entitled to be indemnified under this Section 18; and
- (3) reimburse Indemnites for any and all reasonable expenses, including reasonable fees and out-of-pocket expenses of attorneys and expert witnesses, paid or incurred in connection with the enforcement by Indemnites of their rights under this Section 18, or in monitoring and participating in any legal or administrative proceeding.

(n) In any circumstances in which the indemnity under this Section 18 applies, Lender may employ its own legal counsel and consultants to prosecute, defend or negotiate any claim or legal or administrative proceeding and Lender, with the prior written consent of Borrower (which shall not be unreasonably withheld, delayed or conditioned), may settle or compromise any action or legal or administrative proceeding. Borrower shall reimburse Lender upon demand for all reasonable costs and expenses incurred by Lender, including all reasonable costs of settlements entered into in good faith, and the fees and out-of-pocket expenses of such attorneys and consultants.

(o) The provisions of this Section 18 shall be in addition to any and all other obligations and liabilities that Borrower may have under applicable law or under other Loan Documents, and each Indemnitee shall be entitled to indemnification under this Section 18 without regard to whether Lender or that Indemnitee has exercised any rights against the Mortgaged Property or any other security, pursued any rights against any guarantor, or pursued any other rights available under the Loan Documents or applicable law. If Borrower consists of more than one person or entity, the obligation of those persons or entities to indemnify the Indemnites under this Section 18 shall be joint and several. The obligation of Borrower to indemnify the Indemnites under this Section 18 shall survive any repayment or discharge of the Indebtedness, any foreclosure proceeding, any

REP 006-28-0624

foreclosure sale, any delivery of any deed in lieu of foreclosure, and any release of record of the lien of this Instrument.

#### **19. PROPERTY AND LIABILITY INSURANCE.**

(a) Borrower shall keep the Improvements insured at all times against such hazards as Lender may from time to time require and as required by the Loan Agreement, which insurance shall include but not be limited to coverage against loss by fire and allied perils, general boiler and machinery coverage, and business income coverage. Lender's insurance requirements may change from time to time throughout the term of the Indebtedness. If Lender so requires, in its sole and reasonable discretion, such insurance shall also include sinkhole insurance, mine subsidence insurance, earthquake insurance, and, if the Mortgaged Property does not conform to applicable zoning or land use laws, building ordinance or law coverage. If any of the Improvements are located in an area identified by the Federal Emergency Management Agency (or any successor to that agency) as an area having special flood hazards, and if flood insurance is available in that area, Borrower shall insure such Improvements against loss by flood.

(b) All premiums on insurance policies required under Section 19(a) shall be paid in the manner provided in Section 7, unless Lender has designated in writing another method of payment. All such policies shall also be in a form approved by Lender in Lender's sole and reasonable discretion. All policies of property damage insurance shall include a non-contributing, non-reporting mortgage clause in favor of, and in a form approved by, Lender. Lender shall have the right to hold the original policies or duplicate original policies of all insurance required by Section 19(a). Borrower shall promptly deliver to Lender a copy of all renewal and other notices received by Borrower with respect to the policies and all receipts for paid premiums. At least 30 days prior to the expiration date of a policy, Borrower shall deliver to Lender the original (or a duplicate original) of a renewal policy in form reasonably satisfactory to Lender.

(c) Borrower shall maintain at all times commercial general liability insurance, workers' compensation insurance (if required by applicable law) and such other liability, errors and omissions and fidelity insurance coverages as Lender may from time to time require.

(d) All insurance policies and renewals of insurance policies required by this Section 19 shall be in such amounts and for such periods as Lender may from time to time reasonably require, and shall be issued by insurance companies reasonably satisfactory to Lender.

(e) Borrower shall comply with all insurance requirements and shall not permit any condition to exist on the Mortgaged Property that would invalidate any part of any insurance coverage that this Instrument requires Borrower to maintain.

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(f) In the event of loss, Borrower shall give prompt written notice to the insurance carrier and to Lender. Borrower hereby authorizes and appoints Lender as attorney-in-fact for Borrower to make proof of loss, to adjust and compromise any claims under policies of property damage insurance, to appear in and prosecute any action arising from such property damage insurance policies, to collect and receive the proceeds of property damage insurance, and to deduct from such proceeds Lender's expenses incurred in the collection of such proceeds. This power of attorney is coupled with an interest and therefore is irrevocable. However, nothing contained in this Section 19 shall require Lender to incur any expense or take any action. Lender may, at Lender's option, (1) hold the balance of such proceeds to be used to reimburse Borrower for the cost of restoring and repairing the Mortgaged Property to the equivalent of its original condition or to a condition approved by Lender (the "Restoration"), or (2) apply the balance of such proceeds to the payment of the Indebtedness, whether or not then due. To the extent Lender determines to apply insurance proceeds to Restoration, Lender shall do so in accordance with Lender's then-current policies relating to the restoration of casualty damage on similar multifamily properties.

(g) Lender shall not exercise its option to apply insurance proceeds to the payment of the Indebtedness if all of the following conditions are met: (1) no Event of Default has occurred and is continuing; (2) Lender determines, in its reasonable discretion, that there will be sufficient funds to complete the Restoration; (3) Lender determines, in its reasonable discretion, that the Rents from the Mortgaged Property after completion of the Restoration will be sufficient to meet all operating costs and other expenses, Imposition Deposits, deposits to reserves and loan repayment obligations relating to the Mortgaged Property; (4) Lender determines, in its discretion, that the Restoration will be completed before the earlier of (A) one year before the maturity date of the Note or (B) one year after the date of the loss or casualty; and (5) upon Lender's request, Borrower provides Lender evidence of the availability during and after the Restoration of the insurance required to be maintained by Borrower pursuant to this Section 19.

(h) If the Mortgaged Property is sold at a foreclosure sale or Lender acquires title to the Mortgaged Property, Lender shall automatically succeed to all rights of Borrower in and to any insurance policies and unearned insurance premiums and in and to the proceeds resulting from any damage to the Mortgaged Property prior to such sale or acquisition.

## 20. CONDEMNATION.

(a) Borrower shall promptly notify Lender of any action or proceeding relating to any condemnation or other taking, or conveyance in lieu thereof, of all or any part of the Mortgaged Property, whether direct or indirect (a "Condemnation"). Borrower shall appear in and prosecute or defend any action or proceeding relating to any Condemnation unless otherwise directed by Lender in writing. Provided Borrower receives written notice as described in the immediately preceding sentence, Borrower authorizes and appoints Lender as attorney-in-fact

for Borrower to commence, appear in and prosecute, in Lender's or Borrower's name, any action or proceeding relating to any Condemnation and to settle or compromise any claim in connection with any Condemnation. This power of attorney is coupled with an interest and therefore is irrevocable. However, nothing contained in this Section 20 shall require Lender to incur any expense or take any action. Borrower hereby transfers and assigns to Lender all right, title and interest of Borrower in and to any award or payment with respect to (i) any Condemnation, or any conveyance in lieu of Condemnation, and (ii) any damage to the Mortgaged Property caused by governmental action that does not result in a Condemnation.

(b) Lender may apply such awards or proceeds, after the deduction of Lender's reasonable expenses incurred in the collection of such amounts, at Lender's option, to the restoration or repair of the Mortgaged Property or to the payment of the Indebtedness, with the balance, if any, to Borrower. Unless Lender otherwise agrees in writing, any application of any awards or proceeds to the Indebtedness shall not extend or postpone the due date of any monthly installments referred to in the Note, Section 7 of this Instrument or any Collateral Agreement, or change the amount of such installments. Borrower agrees to execute such further evidence of assignment of any awards or proceeds as Lender may require.

## **21. TRANSFERS OF THE MORTGAGED PROPERTY OR INTERESTS IN BORROWER.**

(a) The occurrence of any of the following events shall constitute an Event of Default under this Instrument:

- (1) a Transfer of all or any part of the Mortgaged Property or any interest in the Mortgaged Property;
- (2) a Transfer of a Controlling Interest in Borrower;
- (3) a Transfer of a Controlling Interest in any entity which owns, directly or indirectly through one or more intermediate entities, a Controlling Interest in Borrower;
- (4) [RESERVED]; and
- (5) a conversion of Borrower from one type of legal entity into another type of legal entity, whether or not there is a Transfer.

Lender shall not be required to demonstrate any actual impairment of its security or any increased risk of default in order to exercise any of its remedies with respect to an Event of Default under this Section 21.

(b) The occurrence of any of the following events shall not constitute an Event of Default under this Instrument, notwithstanding any provision of



Section 21(a) and/or any provision set forth in any of the Loan Documents, to the contrary:

- (1) a Transfer to which Lender has consented;
- (2) a Transfer that occurs by devise, descent, or by operation of law upon the death of a natural person;
- (3) the grant of a leasehold interest in an individual dwelling unit for a term of two years or less not containing an option to purchase;
- (4) a Transfer of obsolete or worn out Personalty or Fixtures that are contemporaneously replaced by items of equal or better function and quality, which are free of liens, encumbrances and security interests other than those created by the Loan Documents or consented to by Lender;
- (5) the grant of an easement, if before the grant Lender determines that the easement will not materially affect the operation or value of the Mortgaged Property or Lender's interest in the Mortgaged Property, and Borrower pays to Lender, upon demand, all costs and expenses incurred by Lender in connection with reviewing Borrower's request; and
- (6) the creation of a tax lien or a mechanic's, materialman's or judgment lien against the Mortgaged Property which is bonded off, released of record or otherwise remedied to Lender's satisfaction within 30 days of the date of creation.

(c) Lender shall consent to a Transfer that would otherwise violate this Section 21 if, prior to the Transfer, Borrower has satisfied each of the following requirements:

- (1) the submission to Lender of all information required by Lender to make the determination required by this Section 21(c);
- (2) the absence of any Event of Default (or the Event of Default will be cured contemporaneously with the Transfer);
- (3) the transferee meets all of the eligibility, credit, management and other standards (including any standards with respect to previous relationships between Lender and the transferee and the organization of the transferee) customarily applied by Lender at the time of the proposed Transfer to the approval of borrowers in connection with the origination or purchase of similar mortgages, deeds of trust or deeds to secure debt on multifamily properties;



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- (4) the Mortgaged Property, at the time of the proposed Transfer, meets all standards as to its physical condition that are customarily applied by Lender at the time of the proposed Transfer to the approval of properties in connection with the origination or purchase of similar mortgages on multifamily properties;
  - (5) in the case of a Transfer of all or any part of the Mortgaged Property, or direct or indirect ownership interests in Borrower if transferor or any other person has obligations under any Loan Document, the execution by the transferee or one or more individuals or entities acceptable to Lender of an assumption agreement that is acceptable to Lender and that, among other things, requires the transferee to perform all obligations of transferor or such person set forth in such Loan Document, and may require that the transferee comply with any provisions of this Instrument or any other Loan Document which previously may have been waived by Lender;
  - (6) if a guaranty has been executed and delivered in connection with the Note, this Instrument or any of the other Loan Documents, the Borrower causes one or more individuals or entities acceptable to Lender to execute and deliver to Lender a guaranty in a form acceptable to Lender; and
  - (7) Lender's receipt of all of the following:
    - (A) a non-refundable review fee in the amount of \$3,000 and a transfer fee equal to 1 percent of the outstanding Indebtedness immediately prior to the Transfer.
    - (B) In addition, Borrower shall be required to reimburse Lender for all of Lender's reasonable out-of-pocket costs (including reasonable attorneys' fees) incurred in reviewing the Transfer request, to the extent such expenses exceed \$3,000.

(d) For purposes of this Section, the following terms shall have the meanings set forth below:

- (1) **"Initial Owners"** means, with respect to Borrower or any other entity, the persons or entities who on the date of the Note own in the aggregate 100% of the ownership interests in Borrower or that entity.
- (2) A Transfer of a **"Controlling Interest"** shall mean, with respect to any entity, the following:

- (i) if such entity is a general partnership or a joint venture, a Transfer of any general partnership interest or joint venture interest which would cause the Initial Owners to own less than 51% of all general partnership or joint venture interests in such entity;
- (ii) if such entity is a limited partnership, a Transfer of any general partnership interest;
- (iii) if such entity is a limited liability company or a limited liability partnership, a Transfer of any membership or other ownership interest which would cause the Initial Owners to own less than 51% of all membership or other ownership interests in such entity;
- (iv) if such entity is a corporation (other than a Publicly-Held Corporation) with only one class of voting stock, a Transfer of any voting stock which would cause the Initial Owners to own less than 51% of voting stock in such corporation;
- (v) if such entity is a corporation (other than a Publicly-Held Corporation) with more than one class of voting stock, a Transfer of any voting stock which would cause the Initial Owners to own less than a sufficient number of shares of voting stock having the power to elect the majority of directors of such corporation; and
- (vi) if such entity is a trust, the removal, appointment or substitution of a trustee of such trust other than (A) in the case of a land trust, or (B) if the trustee of such trust after such removal, appointment or substitution is a trustee identified in the trust agreement approved by Lender.

(3) **"Publicly-Held Corporation"** shall mean a corporation the outstanding voting stock of which is registered under Section 12(b) or 12(g) of the Securities and Exchange Act of 1934, as amended.

(e) No one percent (1%) transfer fee will be due for the transfers permitted in subparagraph (b) above.

## 22. EVENTS OF DEFAULT.

The occurrence of an Event of Default under and as defined in the Loan Agreement shall constitute an Event of Default under this Instrument.

### **23. REMEDIES CUMULATIVE.**

Each right and remedy provided in this Instrument is distinct from all other rights or remedies under this Instrument or any other Loan Document or afforded by applicable law, and each shall be cumulative and may be exercised concurrently, independently, or successively, in any order.

### **24. FORBEARANCE.**

(a) Lender may (but shall not be obligated to) agree with Borrower, from time to time, and without giving notice to, or obtaining the consent of, or having any effect upon the obligations of, any guarantor or other third party obligor, to take any of the following actions: extend the time for payment of all or any part of the Indebtedness; reduce the payments due under this Instrument, the Note, or any other Loan Document; release anyone liable for the payment of any amounts under this Instrument, the Note, or any other Loan Document; accept a renewal of the Note; modify the terms and time of payment of the Indebtedness; join in any extension or subordination agreement; release any Mortgaged Property; take or release other or additional security; modify the rate of interest or period of amortization of the Note or change the amount of the monthly installments payable under the Note; and otherwise modify this Instrument, the Note, or any other Loan Document.

(b) Any forbearance by Lender in exercising any right or remedy under the Note, this Instrument, or any other Loan Document or otherwise afforded by applicable law, shall not be a waiver of or preclude the exercise of any other right or remedy. The acceptance by Lender of payment of all or any part of the Indebtedness after the due date of such payment, or in an amount which is less than the required payment, shall not be a waiver of Lender's right to require prompt payment when due of all other payments on account of the Indebtedness or to exercise any remedies for any failure to make prompt payment. Enforcement by Lender of any security for the Indebtedness shall not constitute an election by Lender of remedies so as to preclude the exercise of any other right available to Lender. Lender's receipt of any awards or proceeds under Sections 19 and 20 shall not operate to cure or waive any Event of Default.

### **25. [INTENTIONALLY DELETED].**

### **26. WAIVER OF STATUTE OF LIMITATIONS.**

Borrower hereby waives the right to assert any statute of limitations as a bar to the enforcement of the lien of this Instrument or to any action brought to enforce any Loan Document.

## **27. WAIVER OF MARSHALLING.**

Notwithstanding the existence of any other security interests in the Mortgaged Property held by Lender or by any other party, Lender shall have the right to determine the order in which any or all of the Mortgaged Property shall be subjected to the remedies provided in this Instrument, the Note, any other Loan Document or applicable law. Lender shall have the right to determine the order in which any or all portions of the Indebtedness are satisfied from the proceeds realized upon the exercise of such remedies. Borrower and any party who now or in the future acquires a security interest in the Mortgaged Property and who has actual or constructive notice of this Instrument waives any and all right to require the marshalling of assets or to require that any of the Mortgaged Property be sold in the inverse order of alienation or that any of the Mortgaged Property be sold in parcels or as an entirety in connection with the exercise of any of the remedies permitted by applicable law or provided in this Instrument.

## **28. FURTHER ASSURANCES.**

Borrower shall execute, acknowledge, and deliver, at its sole cost and expense, all further acts, deeds, conveyances, assignments, estoppel certificates, financing statements, transfers and assurances as Lender may reasonably require from time to time in order to better assure, grant, and convey to Lender the rights intended to be granted, now or in the future, to Lender under this Instrument and the Loan Documents, provided that except as required for the above purposes, Borrower is not obligated to execute, acknowledge or deliver any such items that add to, modify or change the terms of the Loan Documents in a manner which is inconsistent with the terms of the Construction Commitment (under and as defined in the Loan Agreement).

## **29. ESTOPPEL CERTIFICATE.**

Within 10 days after a request from Lender, Borrower shall deliver to Lender a written statement, signed and acknowledged by Borrower, certifying to Lender or any person designated by Lender, as of the date of such statement, (i) that the Loan Documents are unmodified and in full force and effect (or, if there have been modifications, that the Loan Documents are in full force and effect as modified and setting forth such modifications); (ii) the unpaid principal balance of the Note; (iii) the date to which interest under the Note has been paid; (iv) that Borrower is not in default in paying the Indebtedness or in performing or observing any of the covenants or agreements contained in this Instrument or any of the other Loan Documents (or, if the Borrower is in default, describing such default in reasonable detail); (v) whether or not there are then existing any setoffs or defenses known to Borrower against the enforcement of any right or remedy of Lender under the Loan Documents; and (vi) any additional facts requested by Lender.

### 30. GOVERNING LAW; CONSENT TO JURISDICTION AND VENUE.

(a) This Instrument, and any Loan Document which does not itself expressly identify the law that is to apply to it, shall be governed by the laws of the jurisdiction in which the Land is located (the "Property Jurisdiction").

(b) Borrower and Lender agree that (1) any controversy arising under or in relation to the Note, this Instrument, or any other Loan Document shall be litigated exclusively in the Property Jurisdiction, and (2) the state and federal courts and authorities with jurisdiction in the Property Jurisdiction shall have exclusive jurisdiction over all controversies which shall arise under or in relation to the Note, any security for the Indebtedness, or any other Loan Document. Borrower and Lender irrevocably consent to service, jurisdiction, and venue of such courts for any such litigation and waive any other venue to which they might be entitled by virtue of domicile, habitual residence or otherwise.

### 31. NOTICE.

(a) All notices, demands and other communications ("notice") under or concerning this Instrument shall be in writing. Each notice shall be addressed to the intended recipient at its address set forth in this Instrument, and shall be deemed given on the earliest to occur of (1) the date when the notice is received by the addressee; (2) the first Business Day after the notice is delivered to a recognized overnight courier service, with arrangements made for payment of charges for next Business Day delivery; or (3) the third Business Day after the notice is deposited in the United States mail with postage prepaid, certified mail, return receipt requested. As used in this Section 31, the term "Business Day" means any day other than a Saturday, a Sunday or any other day on which Lender is not open for business.

(b) Any party to this Instrument may change the address to which notices intended for it are to be directed by means of notice given to the other party in accordance with this Section 31. Each party agrees that it will not refuse or reject delivery of any notice given in accordance with this Section 31, that it will acknowledge, in writing, the receipt of any notice upon request by the other party and that any notice rejected or refused by it shall be deemed for purposes of this Section 31 to have been received by the rejecting party on the date so refused or rejected, as conclusively established by the records of the U.S. Postal Service or the courier service.

(c) Any notice under the Note and any other Loan Document which does not specify how notices are to be given shall be given in accordance with this Section 31.

### **32. SALE OF NOTE; CHANGE IN SERVICER.**

The Note or a partial interest in the Note (together with this Instrument and the other Loan Documents) may be sold one or more times without prior notice to Borrower. A sale may result in a change of the Loan Servicer. There also may be one or more changes of the Loan Servicer unrelated to a sale of the Note. If there is a change of the Loan Servicer, Borrower will be given notice of the change.

### **33. SINGLE ASSET BORROWER.**

Until the Indebtedness is paid in full, Borrower (a) shall not acquire any real or personal property other than the Mortgaged Property and personal property related to the operation and maintenance of the Mortgaged Property; (b) shall not operate any business other than the management and operation of the Mortgaged Property; and (c) shall not maintain its assets in a way difficult to segregate and identify.

### **34. SUCCESSORS AND ASSIGNS BOUND.**

This Instrument shall bind, and the rights granted by this Instrument shall inure to, the respective successors and assigns of Lender and Borrower. However, a Transfer not permitted by Section 21 shall be an Event of Default.

### **35. JOINT AND SEVERAL LIABILITY.**

If more than one person or entity signs this Instrument as Borrower, the obligations of such persons and entities shall be joint and several.

### **36. RELATIONSHIP OF PARTIES; NO THIRD PARTY BENEFICIARY.**

(a) The relationship between Lender and Borrower shall be solely that of creditor and debtor, respectively, and nothing contained in this Instrument shall create any other relationship between Lender and Borrower.

(b) No creditor of any party to this Instrument and no other person shall be a third party beneficiary of this Instrument or any other Loan Document. Without limiting the generality of the preceding sentence, (1) any arrangement (a "Servicing Arrangement") between the Lender and any Loan Servicer for loss sharing or interim advancement of funds shall constitute a contractual obligation of such Loan Servicer that is independent of the obligation of Borrower for the payment of the Indebtedness, (2) Borrower shall not be a third party beneficiary of any Servicing Arrangement, and (3) no payment by the Loan Servicer under any Servicing Arrangement will reduce the amount of the Indebtedness.

### **37. SEVERABILITY; AMENDMENTS.**

The invalidity or unenforceability of any provision of this Instrument shall not affect the validity or enforceability of any other provision, and all other provisions shall remain in full force and effect. This Instrument contains the entire agreement

among the parties as to the rights granted and the obligations assumed in this Instrument. This Instrument may not be amended or modified except by a writing signed by the party against whom enforcement is sought.

### **38. CONSTRUCTION.**

The captions and headings of the sections of this Instrument are for convenience only and shall be disregarded in construing this Instrument. Any reference in this Instrument to an "Exhibit" or a "Section" shall, unless otherwise explicitly provided, be construed as referring, respectively, to an Exhibit attached to this Instrument or to a Section of this Instrument. All Exhibits attached to or referred to in this Instrument are incorporated by reference into this Instrument. Any reference in this Instrument to a statute or regulation shall be construed as referring to that statute or regulation as amended from time to time. Use of the singular in this Agreement includes the plural and use of the plural includes the singular. As used in this Instrument, the term "including" means "including, but not limited to."

### **39. LOAN SERVICING.**

All actions regarding the servicing of the loan evidenced by the Note, including the collection of payments, the giving and receipt of notice, inspections of the Property, inspections of books and records, and the granting of consents and approvals, may be taken by the Loan Servicer unless Borrower receives notice to the contrary. If Borrower receives conflicting notices regarding the identity of the Loan Servicer or any other subject, any such notice from Lender shall govern.

### **40. DISCLOSURE OF INFORMATION.**

Lender may furnish information regarding Borrower or the Mortgaged Property to third parties with an existing or prospective interest in the servicing, enforcement, evaluation, performance, purchase or securitization of the Indebtedness, including trustees, master servicers, special servicers, rating agencies, and organizations maintaining databases on the underwriting and performance of multifamily mortgage loans. Borrower irrevocably waives any and all rights it may have under applicable law to prohibit such disclosure, including any right of privacy.

### **41. NO CHANGE IN FACTS OR CIRCUMSTANCES.**

All information in the application for the loan submitted to Lender (the "Loan Application") and in all financial statements, rent rolls, reports, certificates and other documents submitted in connection with the Loan Application are complete and accurate in all material respects. There has been no material adverse change in any fact or circumstance that would make any such information incomplete or inaccurate.



## 42. SUBROGATION.

If, and to the extent that, the proceeds of the loan evidenced by the Note are used to pay, satisfy or discharge any obligation of Borrower for the payment of money that is secured by a pre-existing mortgage, deed of trust or other lien encumbering the Mortgaged Property (a "Prior Lien"), such loan proceeds shall be deemed to have been advanced by Lender at Borrower's request, and Lender shall automatically, and without further action on its part, be subrogated to the rights, including lien priority, of the owner or holder of the obligation secured by the Prior Lien, whether or not the Prior Lien is released.

## 43. ACCELERATION; REMEDIES.

At any time during the existence of an Event of Default, Lender, at Lender's option, may declare the Indebtedness to be immediately due and payable without further demand, and may invoke the power of sale and any other remedies permitted by Texas law or provided in this Instrument or in any other Loan Document. Borrower acknowledges that the power of sale granted in this Instrument may be exercised by Lender without prior judicial hearing. Lender shall be entitled to collect all costs and expenses incurred in pursuing such remedies, including attorneys' fees, costs of documentary evidence, abstracts and title reports.

If Lender invokes the power of sale, Lender may, by and through the Trustee, or otherwise, sell or offer for sale the Mortgaged Property in such portions, order and parcels as Lender may determine, with or without having first taken possession of the Mortgaged Property, to the highest bidder for cash at public auction. Such sale shall be made at the designated place in the county in which all or any part of the Land to be sold is situated (whether the parts or parcel, if any, situated in different counties are contiguous or not, and without the necessity of having any Personalty present at such sale) on the first Tuesday of any month between the hours of 10:00 a.m. and 4:00 p.m., after advertising the time, place and terms of sale and that portion of the Mortgaged Property to be sold by posting or causing to be posted written or printed notice of sale at least twenty-one (21) days before the date of the sale at the designated place in the county in which the sale is to be made and at the designated place in any other county in which a portion of the Land may be situated, and by filing such notice with the County Clerk(s) of the county(s) in which all or a portion of the Land may be situated, which notice may be posted and filed by the Trustee acting, or by any person acting for the Trustee, and Lender has, at least twenty-one (21) days before the date of the sale, served written or printed notice of the proposed sale by certified mail on each debtor obligated to pay the Indebtedness according to Lender's records by the deposit of such notice, enclosed in a postpaid wrapper, properly addressed to such debtor at debtor's most recent address as shown by Lender's records, in a post office or official depository under the care and custody of the United States Postal Service. The affidavit of any person having knowledge of the facts to the effect that such service was completed shall be prima facie evidence of the fact of service.

Trustee shall deliver to the purchaser at the sale, within a reasonable time after the sale, a deed conveying the Mortgaged Property so sold in fee simple with covenants of general warranty. Borrower covenants and agrees to defend generally the purchaser's title to the Mortgaged Property against all claims and demands. The recitals in Trustee's deed shall be prima facie evidence of the truth of the statements contained in those recitals. Trustee shall apply the proceeds of the sale in the following order: (a) to all reasonable costs and expenses of the sale, including reasonable Trustee's fees and attorneys' fees and costs of title evidence; (b) to the Indebtedness in such order as Lender, in Lender's discretion, directs; and (c) the excess, if any, to the person or persons legally entitled to the excess.

If all or any part of the Mortgaged Property is sold pursuant to this Section 43, Borrower will be divested of any and all interest and claim to the Mortgaged Property, including any interest or claim to all insurance policies, utility deposits, bonds, loan commitments and other intangible property included as a part of the Mortgaged Property. Additionally, after a sale of all or any part of the Land, Improvements, Fixtures and Personalty, Borrower will be considered a tenant at sufferance of the purchaser of the same, and the purchaser shall be entitled to immediate possession of such property. If Borrower shall fail to vacate the Mortgaged Property immediately, the purchaser may and shall have the right, without further notice to Borrower, to go into any justice court in any precinct or county in which the Mortgaged Property is located and file an action in forcible entry and detainer, which action shall lie against Borrower or its assigns or legal representatives, as a tenant at sufferance. This remedy is cumulative of any and all remedies the purchaser may have under this Instrument or otherwise.

In any action for a deficiency after a foreclosure under this Instrument, if any person against whom recovery is sought requests the court in which the action is pending to determine the fair market value of the Mortgaged Property, as of the date of the foreclosure sale, the following shall be the basis of the court's determination of fair market value:

- (a) the Mortgaged Property shall be valued "as is" and in its condition as of the date of foreclosure, and no assumption of increased value because of post-foreclosure repairs, refurbishment, restorations or improvements shall be made;
- (b) any adverse effect on the marketability of title because of the foreclosure or because of any other title condition not existing as of the date of this Instrument shall be considered;
- (c) the valuation of the Mortgaged Property shall be based upon an assumption that the foreclosure purchaser desires a prompt resale of the Mortgaged Property for cash within a six-month period after foreclosure;

- 33-30-02-333-11
- (d) although the Mortgaged Property may be disposed of more quickly by the foreclosure purchaser, the gross valuation of the Mortgaged Property as of the date of foreclosure shall be discounted for a hypothetical reasonable holding period (not to exceed 6 months) at a monthly rate equal to the average monthly interest rate on the Note for the twelve months before the date of foreclosure;
  - (e) the gross valuation of the Mortgaged Property as of the date of foreclosure shall be further discounted and reduced by reasonable estimated costs of disposition, including brokerage commissions, title policy premiums, environmental assessment and clean-up costs, tax and assessment, prorations, costs to comply with legal requirements and attorneys' fees;
  - (f) expert opinion testimony shall be considered only from a licensed appraiser certified by the State of Texas and, to the extent permitted under Texas law, a licensed appraiser, having at least five years' experience in appraising property similar to the Mortgaged Property in the county where the Mortgaged Property is located, and who has conducted and prepared a complete written appraisal of the Mortgaged Property taking into considerations the factors set forth in this Instrument; no expert opinion testimony shall be considered without such written appraisal;
  - (g) evidence of comparable sales shall be considered only if also included in the expert opinion testimony and written appraisal referred to in the preceding paragraph; and
  - (h) an affidavit executed by Lender to the effect that the foreclosure bid accepted by Trustee was equal to or greater than the value of the Mortgaged Property determined by Lender based upon the factors and methods set forth in subparagraphs (a) through (g) above before the foreclosure shall constitute prima facie evidence that the foreclosure bid was equal to or greater than the fair market value of the Mortgaged Property on the foreclosure date.

Lender may, at Lender's option, comply with these provisions in the manner permitted or required by Title 5, Section 51.002 of the Texas Property Code (relating to the sale of real estate) or by Chapter 9 of the Texas Business and Commerce Code (relating to the sale of collateral after default by a debtor), as those titles and chapters now exist or may be amended or succeeded in the future, or by any other present or future articles or enactments relating to same subject. Unless expressly excluded, the Mortgaged Property shall include Rents collected before a foreclosure sale, but attributable to the period following the foreclosure sale, and Borrower shall pay such Rents to the purchaser at such sale. At any such sale:

- (a) whether made under the power contained in this Instrument, Section 51.002, the Texas Business and Commerce Code, any other legal requirement or by virtue of any judicial proceedings or any other legal right, remedy or recourse, it shall not be necessary for Trustee to have physically present, or to have constructive possession of, the Mortgaged Property (Borrower shall deliver to Trustee any portion of the Mortgaged Property not actually or constructively possessed by Trustee immediately upon demand by Trustee) and the title to and right of possession of any such property shall pass to the purchaser as completely as if the property had been actually present and delivered to the purchaser at the sale;
- (i) each instrument of conveyance executed by Trustee shall contain a general warranty of title, binding upon Borrower;
- (j) the recitals contained in any instrument of conveyance made by Trustee shall conclusively establish the truth and accuracy of the matters recited in the Instrument, including nonpayment of the Indebtedness and the advertisement and conduct of the sale in the manner provided in this Instrument and otherwise by law and the appointment of any successor Trustee;
- (k) all prerequisites to the validity of the sale shall be conclusively presumed to have been satisfied;
- (l) the receipt of Trustee or of such other party or officer making the sale shall be sufficient to discharge to the purchaser or purchasers for such purchaser(s)' purchase money, and no such purchaser or purchasers, or such purchaser(s)' assigns or personal representatives, shall thereafter be obligated to see to the application of such purchase money or be in any way answerable for any loss, misapplication or nonapplication of such purchase money;
- (m) to the fullest extent permitted by law, Borrower shall be completely and irrevocably divested of all of Borrower's right, title, interest, claim and demand whatsoever, either at law or in equity, in and to the property sold, and such sale shall be a perpetual bar to any claim to all or any part of the property sold, both at law and in equity, against Borrower and against any person claiming by, through or under Borrower; and
- (n) to the extent and under such circumstances as are permitted by law, Lender may be a purchaser at any such sale.

#### **44. RELEASE.**

Upon payment of the Indebtedness, Lender shall release this Instrument. Borrower shall pay Lender's reasonable costs incurred in releasing this Instrument.

#### **45. TRUSTEE.**

- (a) Trustee may resign by giving of notice of such resignation in writing to Lender. If Trustee shall die, resign or become disqualified from acting under this Instrument or shall fail or refuse to act in accordance with this Instrument when requested by Lender or if for any reason and without cause Lender shall prefer to appoint a substitute trustee to act instead of the original Trustee named in this Instrument or any prior successor or substitute trustee, Lender shall have full power to appoint a substitute trustee and, if preferred, several substitute trustees in succession who shall succeed to all the estate, rights, powers and duties of the original Trustee named in this Instrument. Such appointment may be executed by an authorized officer, agent or attorney-in-fact of Lender (whether acting pursuant to a power of attorney or otherwise), and such appointment shall be conclusively presumed to be executed with authority and shall be valid and sufficient without proof of any action by Lender.
- (b) Any successor Trustee appointed pursuant to this Section shall, without any further act, deed or conveyance, become vested with all the estates, properties, rights, powers and trusts of the predecessor Trustee with like effect as if originally named as Trustee in this Instrument; but, nevertheless, upon the written request of Lender or such successor Trustee, the Trustee ceasing to act shall execute and deliver an instrument transferring to such successor Trustee, all the estates, properties, rights, powers and trusts of the Trustee so ceasing to act, and shall duly assign, transfer and deliver any of the property and monies held by the Trustee ceasing to act to the successor Trustee.
- (c) Trustee may authorize one or more parties to act on Trustee's behalf to perform the ministerial functions required of Trustee under this Instrument, including the transmittal and posting of any notices.

#### **46. [INTENTIONALLY OMITTED]**

#### **47. NO FIDUCIARY DUTY.**

Lender owes no fiduciary or other special duty to Borrower.

#### **48. FIXTURE FILING.**

This Instrument is also a fixture filing under the Uniform Commercial Code of Texas.

#### **49. ADDITIONAL PROVISIONS REGARDING ASSIGNMENT OF RENTS.**

In no event shall the assignment of Rents or Leases in Section 3 and Section 4 cause the Indebtedness to be reduced by an amount greater than the Rents actually received by Lender and applied by Lender to the Indebtedness, whether before, during or after (i) an Event of Default, or (ii) a suspension or revocation of the license granted to Borrower in Section 3(b) with regard to the Rents. Borrower and Lender specifically intend that the assignment of Rents and Leases in Section 3 and Section 4 is not intended to result in a pro tanto reduction of the Indebtedness. The assignment of Rents and Leases in Section 3 and Section 4 is not intended to constitute a payment of, or with respect to, the Indebtedness and, therefore, Borrower and Lender specifically intend that the Indebtedness shall not be reduced by the value of the Rents and Leases assigned. Such reduction shall occur only if, and to the extent that, Lender actually receives Rents pursuant to Section 3 and applies such Rents to the Indebtedness. Borrower agrees that the value of the license granted with regard to the Rents equals the value of the absolute assignment of Rents to Lender. The assignment of Rents contained in Section 3 shall terminate upon the release of this Instrument.

#### **50. LOAN CHARGES.**

Borrower and Lender intend at all times to comply with the laws of the State of Texas governing the maximum rate or amount of interest payable on or in connection with the Indebtedness (or applicable United States federal law to the extent that it permits Lender to contract for, charge, take, reserve or receive a greater amount of interest than under Texas law). If the applicable law is ever judicially interpreted so as to render usurious any amount payable under the Note, this Instrument or any other Loan Document, or contracted for, charged, taken, reserved or received with respect to the Indebtedness, or if acceleration of the maturity of the Indebtedness, or if any prepayment by Borrower results in Borrower having paid any interest in excess of that permitted by any applicable law, then Borrower and Lender expressly intend that all excess amounts collected by Lender shall be applied to reduce the unpaid principal balance of the Indebtedness (or, if the Indebtedness has been or would thereby be paid in full, shall be refunded to Borrower), and the provisions of the Note, this Instrument and the other Loan Documents immediately shall be deemed reformed and the amounts thereafter collectible under the Loan Documents reduced, without the necessity of the execution of any new documents, so as to comply with any applicable law, but so as to permit the recovery of the fullest amount otherwise payable under the Loan Documents. The right to accelerate the maturity of the Indebtedness does not include the right to accelerate any interest which has not otherwise accrued on the date of such acceleration, and Lender does not intend to collect any unearned

interest in the event of acceleration. All sums paid or agreed to be paid to Lender for the use, forbearance or detention of the Indebtedness shall, to the extent permitted by applicable law, be amortized, prorated, allocated and spread throughout the full term of the Indebtedness until payment in full so that the rate or amount of interest on account of the Indebtedness does not exceed the applicable usury ceiling. Notwithstanding any provision contained in the Note, this Instrument or any other Loan Document that permits the compounding of interest, including any provision by which any accrued interest is added to the principal amount of the Indebtedness, the total amount of interest that Borrower is obligated to pay and Lender is entitled to receive with respect to the Indebtedness shall not exceed the amount calculated on a simple (i.e., noncompounded) interest basis at the maximum rate on principal amounts actually advanced to or for the account of Borrower, including all current and prior advances and any advances made pursuant to the Instrument or any other Loan Document (such as for the payment of Impositions and similar expenses or costs).

**51. PROPERTY AND LIABILITY INSURANCE — DELIVERY OF POLICY TO LENDER.**

Notwithstanding the provisions of Section 19(b), Borrower shall not be required to deliver the original (or a duplicate original) of any renewal policy of insurance to Lender more than 15 days prior to the expiration date of the policy then held by Lender.

**52. ENTIRE AGREEMENT.**

THIS INSTRUMENT, THE NOTE AND THE OTHER LOAN DOCUMENTS REPRESENT THE FINAL AGREEMENT BETWEEN THE PARTIES AND CAN NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS OR SUBSEQUENT ORAL AGREEMENTS. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

**53. WAIVER OF TRIAL BY JURY.**

BORROWER AND LENDER EACH (A) COVENANTS AND AGREES NOT TO ELECT A TRIAL BY JURY WITH RESPECT TO ANY ISSUE ARISING OUT OF THIS INSTRUMENT OR THE RELATIONSHIP BETWEEN THE PARTIES AS BORROWER AND LENDER THAT IS TRIABLE OF RIGHT BY A JURY AND (B) WAIVES ANY RIGHT TO TRIAL BY JURY WITH RESPECT TO SUCH ISSUE TO THE EXTENT THAT ANY SUCH RIGHT EXISTS NOW OR IN THE FUTURE. THIS WAIVER OF RIGHT TO TRIAL BY JURY IS SEPARATELY GIVEN BY EACH PARTY, KNOWINGLY AND VOLUNTARILY WITH THE BENEFIT OF COMPETENT LEGAL COUNSEL.

**54. NO DRILLING OR EXPLORATION.**

Without the prior written consent of Lender, there shall be no drilling or exploring for or extraction, removal, or production of minerals from the surface or



subsurface of the Land. The term "minerals" as used herein shall include, without limiting the generality of such term, oil, gas, casinghead gas, coal, lignite, hydrocarbons, methane, carbon dioxide, helium, uranium and all other natural elements, compounds and substances, including sand and gravel.

**55. [RESERVED].**

**56. INDEMNIFICATION OF TRUSTEE.**

EXCEPT FOR GROSS NEGLIGENCE OR WILLFUL MISCONDUCT, TRUSTEE SHALL NOT BE LIABLE FOR ANY ACT OR OMISSION OR ERROR OF JUDGMENT. TRUSTEE MAY RELY ON ANY DOCUMENT BELIEVED BY HIM IN GOOD FAITH TO BE GENUINE. ALL MONEY RECEIVED BY TRUSTEE SHALL, UNTIL USED OR APPLIED AS HEREIN PROVIDED, BE HELD IN TRUST, BUT NEED NOT BE SEGREGATED (EXCEPT TO THE EXTENT REQUIRED BY LAW), AND TRUSTEE SHALL NOT BE LIABLE FOR INTEREST THEREON. BORROWER HEREBY INDEMNIFIES TRUSTEE AGAINST ALL LIABILITY AND EXPENSES THAT HE MAY INCUR IN THE PERFORMANCE OF HIS DUTIES HEREUNDER, EXCEPT TO THE EXTENT THE SAME RESULTS FROM TRUSTEE'S GROSS NEGLIGENCE OR WILLFUL MISCONDUCT.

**57. ACCELERATION IN CASE OF BORROWER'S INSOLVENCY.**

If Borrower shall voluntarily file a petition under Title 11 of the United States Code, or under any similar or successor Federal statute relating to bankruptcy, insolvency, arrangements or reorganizations, or under any state bankruptcy or insolvency act, or file an answer in an involuntary proceeding admitting insolvency or inability to pay debts, or if Borrower shall fail to obtain a vacation or stay of involuntary proceedings brought for the reorganization, dissolution or liquidation of Borrower, or if Borrower shall be adjudged a bankrupt, or if a trustee or receiver shall be appointed for Borrower or Borrower's property, or if the Mortgaged Property shall become subject to the jurisdiction of a Federal bankruptcy court or similar state court, or if Borrower shall make an assignment for the benefit of Borrower's creditors, or if there is an attachment, execution or other judicial seizure of any portion of Borrower's assets and such seizure is not discharged within ten (10) days, then Lender may, at Lender's option, declare all of the sums secured by this Instrument to be immediately due and payable without prior notice to Borrower, and Lender may invoke any remedies permitted by Section 43 of this Instrument. Any attorneys' fees and other expenses incurred by Lender in connection with Borrower's bankruptcy or any of the other aforesaid events shall be additional indebtedness of Borrower secured by this Instrument.

**58. REPRESENTATIONS AND WARRANTIES REGARDING GROUND LEASE.**

Borrower warrants and represents to Lender that, as of the date of this Instrument: (i) the Ground Lease is in full force and effect in accordance with its

terms; (ii) Borrower has not waived, canceled or surrendered any of its rights under the Ground Lease; (iii) Borrower is the sole owner of, and has good and indefeasible title to, the Leasehold Estate; (iv) the Leased Premises and the Mortgaged Property are free and clear of all liens, encumbrances and other matters affecting title, other than the lien of this Instrument and the Permitted Exceptions; (v) there is no existing Ground Lessee Default and to the best of Borrower's knowledge, no event has occurred which, with the passage of time or the giving of notice, or both, would constitute a Ground Lessee Default; and (vi) to the best of Borrower's knowledge, no event has occurred which, with the passage of time or the giving of notice, or both, would constitute a Ground Lessor Default.

#### **59. NOTICES UNDER GROUND LEASE.**

Borrower shall deliver to Lender, within 10 business days after Borrower's receipt, a true and correct copy of each notice, demand, complaint or request from Ground Lessor under, or with respect to, the Ground Lease.

#### **60. BORROWER'S OBLIGATIONS TO COMPLY WITH GROUND LEASE.**

Borrower shall (i) pay the Ground Rent and all other sums of money due and payable at any time and from time to time under the Ground Lease as and when such sums become due and payable, but in any event before the expiration of any grace period provided in the Ground Lease for the payment of any such sum, and (ii) at all times fully perform, observe and materially comply with all other terms, covenants and conditions of the Ground Lease to be performed, observed or complied with by Borrower as lessee under the Ground Lease. If the Ground Lease does not provide for a grace period for the payment of a sum of money, Borrower shall make the payment on or before the date on which the payment becomes due and payable. Borrower shall deliver evidence of the payment to Lender within 10 business days after receipt of a written request from Lender for evidence of the payment.

#### **61. LENDER'S RIGHT TO CURE GROUND LESSEE DEFAULTS.**

At any time after Lender receives notice of a Ground Lessee Default, (i) Lender may (but shall not be obligated to do so), make any payment, perform any obligation and take any other action Borrower would have the right to pay, perform or take under the Ground Lease which Lender deems necessary or desirable to cure the Ground Lessee Default, and (ii) Lender and its authorized agents shall have the right at any time or from time to time to enter the Land and Improvements, or any part thereof, to such extent and as often as Lender, in its discretion, deems necessary or desirable in order to cure the Ground Lessee Default, subject to the rights of the tenants and occupants of the Mortgaged Property. Subject to the expiration of any applicable notice, approval, or cure period, Lender may exercise its rights under this Section immediately after receipt of notice of a Ground Lessee Default. For purposes of exercising its rights under this Section, Lender shall be fully protected for any action taken or omitted to be

HT 086-28-0644

taken by Lender, in good faith, in reliance on any written notice from Ground Lessor stating that a Ground Lessee Default has occurred and is continuing even though Borrower may question or deny the existence or nature of the Ground Lessee Default. All expenditures made by Lender pursuant to this Section to cure a Ground Lessee Default shall become an additional part of the Indebtedness as provided in Section 12.

## **62. COVENANTS TO PROTECT LEASEHOLD ESTATE.**

Borrower shall not, without the written consent of Lender (which may be given or withheld by Lender in its discretion), (i) surrender the Leasehold Estate to Ground Lessor or terminate or cancel the Ground Lease, (ii) materially amend, modify or change the Ground Lease, either orally or in writing, or waive any of Borrower's rights under the Ground Lease, (iii) subordinate the Ground Lease or the Leasehold Estate to any mortgage, deed of trust or other lien on Ground Lessor's fee title to the Leased Premises, or (iv) except as otherwise provided in Section 63(b), reject or assume the Ground Lease or assign the Leasehold Estate pursuant to Section 365(h) of the Bankruptcy Code. Borrower absolutely and unconditionally transfers and assigns to Lender all of Borrower's rights to surrender, terminate, cancel, modify and change the Ground Lease, and any such surrender, termination, cancellation, modification or change made without the prior written consent of Lender shall be void and have no legal effect.

## **63. GROUND LESSEE'S BANKRUPTCY.**

(a) Borrower assigns to Lender, as additional security for the Indebtedness, Borrower's right to reject the Ground Lease under Section 365 of the Bankruptcy Code after the occurrence of an Event of Ground Lessee Bankruptcy, subject to Section 63(b).

(b) If, after the occurrence of an Event of Ground Lessee Bankruptcy, Borrower decides to reject the Ground Lease, Borrower shall give Lender written notice, at least 10 days in advance, of the date on which Borrower intends to apply to the Bankruptcy Court for authority and permission to reject the Ground Lease. Lender shall have the right, but not the obligation, within 10 days after receipt of Borrower's notice, to deliver to Borrower a notice ("**Lender's Assumption Notice**") in which (i) Lender demands that Borrower assume the Ground Lease and assign the Ground Lease to Lender, or its designee, in accordance with the Bankruptcy Code, and (ii) Lender agrees to cure or provide adequate assurance of prompt cure of all Ground Lessee Defaults reasonably susceptible of being cured by Lender and of future performance under the Ground Lease. If Lender timely delivers Lender's Assumption Notice to Borrower, Borrower shall not reject the Ground Lease and shall, within 15 days after receipt of Lender's notice, comply with the demand contained in clause (i) of Lender's notice. If Lender does not timely deliver Lender's Assumption Notice to Borrower, Borrower shall have the right to reject the Ground Lease.

#### **64. GROUND LESSOR'S BANKRUPTCY.**

(a) If, after the occurrence of an Event of Ground Lessor Bankruptcy, Ground Lessor rejects the Ground Lease pursuant to Section 365(h) of the Bankruptcy Code (i) Borrower, immediately after obtaining notice of the rejection, shall deliver a copy of the notice to Lender, (ii) Borrower shall not, without Lender's prior written consent (which may be given or withheld in Lender's discretion), elect to treat the Ground Lease as terminated pursuant to Section 365(h) or any other applicable provision of the Bankruptcy Code, and (iii) this Instrument and the lien created by this Instrument shall extend to and encumber Borrower's retained rights under the Ground Lease that are appurtenant to the Leased Premises for the balance of the term of the Ground Lease and for any renewal or extension of those rights under the Ground Lease. Borrower transfers and assigns to Lender, as additional security for the Indebtedness, Borrower's rights, after Ground Lessor's rejection of the Ground Lease, to treat the Ground Lease as terminated, and any termination of the Ground Lease made by Borrower without Lender's prior written consent shall be void and have no legal effect.

(b) Borrower transfers and assigns to Lender, as additional security for the Indebtedness, all of Borrower's rights to damages caused by Ground Lessor's rejection of the Ground Lease after the occurrence of an Event of Ground Lessor Bankruptcy and all of Borrower's rights to offset such damages against rent payable under the Ground Lease. As long as no Event of Default has occurred and is continuing, Lender agrees that it will not enforce its rights under the preceding sentence, but will permit Borrower to exercise such rights with Lender's prior written consent. Any amounts received by Lender as damages arising out of Ground Lessor's rejection of the Ground Lease shall be applied in the manner set forth in Section 9.

#### **65. OPTION TO RENEW OR EXTEND GROUND LEASE.**

Borrower shall give Lender written notice of Borrower's intention to exercise each option to renew or extend the term of the Ground Lease at least 90 days, but not more than 150 days, before the last day on which the option may be timely exercised. If Borrower intends to renew or extend the term of the Ground Lease, it shall deliver to Lender, together with the notice of such decision, a copy of the notice of renewal or extension it delivers to Ground Lessor. If Borrower does not intend to renew or extend the term of the Ground Lease or, if Borrower fails to deliver its written notice of exercise of its option to renew or extend the term of the Ground Lease at least 90 days before the last day on which the option may be timely exercised, Lender shall have the right, but shall not be obligated, to renew or extend the term of the Ground Lease for and on behalf of Borrower.

#### **66. NO MERGER OF ESTATES.**

If Borrower acquires the fee estate of Ground Lessor under the Ground Lease (the "Fee Estate") (i) there shall be no merger between the Fee Estate and the

Leasehold Estate unless all persons, including Lender, having an interest in the Ground Lease consent in writing to the merger, and (ii) simultaneously with Borrower's acquisition of the Fee Estate, the lien of this Instrument shall automatically, without the necessity of any further conveyance, be spread to cover the Fee Estate and as so spread shall be prior to the lien of any mortgage, deed of trust or other lien placed on the Fee Estate after the date of this Instrument. Promptly after Borrower's acquisition of the Fee Estate, Borrower, at its sole cost and expense, including payment of Lender's reasonable attorneys' fees and out-of-pocket disbursements, shall execute and deliver all documents and instruments necessary to subject the Fee Estate to the lien of this Instrument, and shall provide to Lender a title insurance policy insuring the lien of this Instrument as a first lien on the Fee Estate and the Leasehold Estate. If Lender acquires the Fee Estate and the Leasehold Estate (whether pursuant to the provisions of the Ground Lease, by foreclosure of this Instrument, or otherwise), the Fee Estate and the Leasehold Estate shall not merge as a result of such acquisition and shall remain separate and distinct for all purposes after such acquisition unless and until Lender shall elect to merge the Fee Estate and the Leasehold Estate.

#### **67. NEW LEASE.**

If (i) the Ground Lease is canceled or terminated for any reason before the natural expiration of its term, and (ii) Lender (or its designee) obtains from Ground Lessor a new lease in accordance with the term of the Ground Lease, Borrower shall have no right, title or interest in and to the new lease or the leasehold estate created by the new lease.

#### **68. APPOINTMENT OF LENDER AS BORROWER'S ATTORNEY-IN-FACT.**

Borrower makes, constitutes and appoints Lender as Borrower's attorney-in-fact, in Borrower's name, place and stead, with full power of substitution, to take all actions and to sign all documents and instruments which Lender, in its discretion, considers to be necessary or desirable to (i) cure a Ground Lessee Default pursuant to Section 61, (ii) perform or carry out any of the Borrower's covenants under Section 63, (iii) renew or extend the term of the Ground Lease pursuant to Section 65, (iv) appoint arbitrators and conduct arbitration proceedings pursuant to the Ground Lease, and (v) request and obtain estoppel certificates from Ground Lessor pursuant to the Ground Lease. Borrower gives and grants to Lender, as Borrower's attorney-in-fact, full power and authority to do and perform every act and sign every document and instrument necessary and proper to be done in the exercise of the foregoing power as fully as Borrower might or could do, and Borrower hereby ratifies and confirms all acts that Lender, as Borrower's attorney-in-fact, shall lawfully do or cause to be done by virtue of this power of attorney. This power of attorney, being coupled with an interest, shall be irrevocable as long as any of the Indebtedness remains unpaid.

**69. CROSS-DEFAULT.**

Borrower acknowledges and agrees that any default, event of default, or breach (however such terms may be defined) after the expiration of any applicable notice and/or cure periods under the Extended Use Agreement shall be an Event of Default under this Instrument and that any costs, damages or other amounts, including reasonable attorney's fees incurred by the Lender as a result of such an Event of Default by Borrower, including amounts paid to cure any default or event of default, under the Extended Use Agreement shall be an obligation of Borrower and become a part of the Indebtedness secured by this Instrument.

**70. ANNUAL COMPLIANCE.**

Borrower shall submit to Lender on an annual basis, evidence that the Mortgaged Property is in ongoing compliance with all income, occupancy and rent restrictions relating to the Mortgaged Property.

**62. [RESERVED]**

**63. [RESERVED]**

**IN WITNESS WHEREOF**, Borrower has signed and delivered this Instrument or has caused this Instrument to be signed and delivered by its duly authorized representative.

**ATTACHED EXHIBITS.** The following Exhibits are attached to this Instrument:

<input checked="" type="checkbox"/>	Exhibit A	Description of the Land (required).
<input checked="" type="checkbox"/>	Exhibit B	Permitted Exceptions
<input checked="" type="checkbox"/>	Exhibit C	Ground Lease

**[SIGNATURE PAGE TO FOLLOW]**

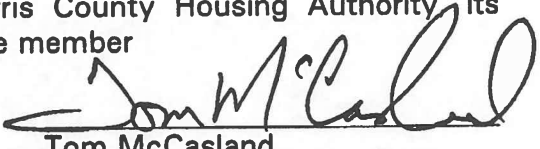
DATED AND EFFECTIVE AS OF the date first set forth above.

HCHA CYPRESSWOOD ESTATES, LLC, a  
Texas limited liability company

lou

By: Harris County Housing Authority, its  
sole member

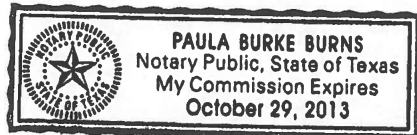
By:

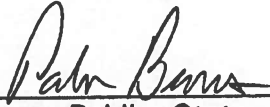
  
Tom McCasland,  
Manager

THE STATE OF TEXAS §

COUNTY OF Harris §

This instrument was acknowledged before me on March 13<sup>th</sup>,  
2013, by Tom McCasland, Manager of Harris County Housing Authority, sole  
member of HCHA CYPRESSWOOD ESTATES, LLC, a Texas limited liability  
company, on behalf of such limited liability company.



  
Notary Public, State of Texas

11 086-28-0649



## EXHIBIT A

All of Unrestricted Reserve "A" of HCHA CYPRESSWOOD ESTATES, an addition in Harris County, Texas according to the map or plat thereof, recorded under Film Code No. 636059 of the Map Records of Harris County, Texas.

D

## **EXHIBIT B**

### **(PERMITTED EXCEPTIONS)**

This conveyance is made and accepted subject to the following Permitted Encumbrances:

1. The following restrictive covenants of record itemized below:

Film Code No. 636059 of the Map Records of Harris County, Texas and those filed under Harris County Clerk's File No. 20090415920.

2. Shortages in area.

3. Standby fees, taxes and assessments by any taxing authority for the year 2013, and subsequent years, and subsequent taxes and assessments by any taxing authority for prior years due to change in land usage or ownership, but not those taxes or assessments for prior years because of an exemption granted to a previous owner of the property under Section 11.13, Texas Tax Code.

4. The following matters and all terms of the documents creating or offering evidence of the matters:

- a. A Mobil Pipe Line company right-of-way affecting the most southerly corner of the property, as depicted on the survey dated February 13, 2009, prepared by George Collison, Registered Public Land Surveyor No. 4461 and as set forth in instrument filed for record in Volume 1587, Page 116 of the Deed Records of Harris County, Texas, and as reflected on the map or plat thereof.
- b. The terms, conditions and stipulations of that certain Agreement for Underground Electric Service with CenterPoint Energy Houston Electric, LLC, filed for record under Harris County Clerk's File No(s). 20110084773.
- c. An easement 10 feet wide, as granted to Southwestern Bell Telephone Company by instrument filed under Harris County Clerk's File No. 20110071742, and defined therein.
- d. A 15 feet by 25 feet water meter easement, located along a portion of the easterly property line, as granted to the Harris County Municipal Utility District No. 200 by instrument filed under Harris County Clerk's File No. 20110182089, and as reflected and disclosed on survey dated July 13, 2011 prepared by Paul A. Jurica, Jr., R.P.L.S. No. 4264.

PP 086-28-0651

- PP 006-28-0652
- e. A 75 foot by 50 feet lift station site and access easement, located in the southeasterly corner of subject property, as granted to Harris County Municipal Utility District No. 200 by instrument filed under Harris County Clerk's File No. 20110298589.
  - f. Blanket Cable TV easement, as granted to Comcast of Houston, LLC by instrument filed under Harris county Clerk's File No. 20120514417.
  - g. Subject to the terms, conditions and stipulations contained in that certain instrument entitled Right To Purchase Option Agreement, filed under Harris County Clerk's File No. 20100126871.
  - h. Subject to the terms, conditions and stipulations contained in that certain Affidavit To the Public, regarding a Storm Water Quality Management Plan in effect on the subject property, as set forth by instrument(s) filed for record under Harris County Clerk's File No(s). 20100173343.
  - i. A 1/8<sup>th</sup> royalty interest in all oil, gas and other minerals, as set forth by instrument(s) recorded in Volume 1051, Page 409 of the Deed Records of Harris County, Texas. (Title to said interest not checked subsequent to its date of reservation.)
  - j. A 1/16<sup>th</sup> royalty interest in all oil, gas and other minerals, as set forth by instrument(s) recorded in Volume 1073, Page 473 of the Deed Records of Harris County, Texas. (Title to said interest not checked subsequent to its date of reservation.)
  - k. A 1/16<sup>th</sup> royalty interest in all oil, gas and other minerals, as set forth by instrument(s) recorded in Volume 1073, Page 475 of the Deed Records of Harris County, Texas. (Title to said interest not checked subsequent to its date of reservation.)
  - l. Terms, conditions and stipulations connected with that certain Mineral Estate created under Oil and Gas Lease recorded in Volume 305, Page 491 of the Contract Records of Harris County, Texas. Said lease being additionally subject to that certain Unit Agreement, establishing the Bammel Gas Unit, as set forth in instrument recorded in Volume 1925, Page 283 of the Contract Records of Harris County, Texas. Surface rights waived by instrument(s) filed for record under Harris County Clerk's File No(s). J249151 and J249152.
  - m. All oil, gas and other minerals as set forth by instrument(s) recorded in Volume 4002, Page 265 and Volume 4143, Page 613, both of

the Deed Records of Harris County, Texas. (Title to said interest not checked subsequent to its date of reservation.) Surface rights waived by instrument(s) filed for record under Harris County Clerk's File No(s). J249152.

- n. Subject property is located within the City of Houston or within its extra territorial jurisdiction (within 5 miles of the city limits by outside another municipality) and is subject to the terms, conditions, and provision of City of Houston Ordinance No. 85-1878 and 99-262, pertaining to, among other things the platting and re-platting of real property and to the establishment of building lines. A certified copy of said ordinance was filed of record on August 1, 1991, under Harris County Clerk's File No. N253886.
- o. Terms, conditions, stipulations contained in that certain Memorandum of Leases by and between Harris County Housing Authority and HCHA Cypresswood Estates, LLC, dated March 31, 2010, filed for record under Harris County Clerk's File No. 20100126866.

**EXHIBIT C**

Ground Lease dated on or about March 31, 2010, between Harris County Housing Authority, as ground lessor, and HCHA Cypresswood Estates, LLC, as ground lessee.

RP 086-28-0654

AFTER RECORDING  
HOLD FOR  
AMERICAN TITLE COMPANY

GF 170913-1043

CLOSER: C. York

✓✓

FILED

2013 MAR 15 PM 2:24

*Stan Stuart*  
COUNTY CLERK  
HARRIS COUNTY, TEXAS

ANY PROVISION HEREIN WHICH RESTRICTS THE SALE, RENTAL, OR USE OF THE DESCRIBED REAL  
PROPERTY BECAUSE OF COLOR OR RACE IS INVALID AND UNENFORCEABLE UNDER FEDERAL LAW.  
THE STATE OF TEXAS  
COUNTY OF HARRIS  
I hereby certify that this instrument was FILED in File Number Sequence on the date and at the time  
stamped herein by me, and was duly RECORDED, in the Official Public Records of Real Property of Harris  
County, Texas.

MAR 15 2013



*Stan Stuart*  
COUNTY CLERK  
HARRIS COUNTY, TEXAS





**Attachment L**

**Financial Statements for Fiscal Years 2014, 2015 and 2016 and  
Year to Date Financial Statement 2017**

**HARRIS COUNTY HOUSING AUTHORITY**  
**Houston, Texas**

**FINANCIAL STATEMENTS**  
**March 31, 2013**

**RESOLUTION NO. 14-**

**RESOLUTION APPROVING FINANCIAL STATEMENTS FOR THE HARRIS  
COUNTY HOUSING AUTHORITY**

**WHEREAS**, the Department of Housing and Urban Development requires that HCHA submit annual financial statements and audit information; and

**WHEREAS**, financial statements for the fiscal year ending March 31, 2013 have been prepared by independent auditors from the firm of CliftonLarsonAllen, LLP;

**NOW THEREFORE BE IT RESOLVED**, that that the Board of Commissioners of the Harris County Housing Authority approves the financial statements as presented by representatives from CliftonLarsonAllen.

This resolution shall be in full force and effect from and upon its adoption.

**PASSED**, by the Board of Commissioners this 15th day of January 2014.

Chairman: \_\_\_\_\_

Secretary: \_\_\_\_\_

## TABLE OF CONTENTS

	PAGE
<b>INDEPENDENT AUDITOR'S REPORT .....</b>	<b>1</b>
<b>MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&amp;A) .....</b>	<b>4</b>
<b>FINANCIAL STATEMENTS.....</b>	<b>10</b>
Statement of Net Position .....	11
Statement of Revenues, Expenses and Changes in Net Position .....	12
Statement of Cash Flows .....	13
Notes to Financial Statements.....	14
<b>SUPPLEMENTAL INFORMATION .....</b>	<b>30</b>
Financial Data Schedules:	
Entity-Wide Balance Sheet Summary.....	31
Entity-Wide Revenue and Expense Summary.....	33
<b>SINGLE AUDIT REPORT .....</b>	<b>35</b>
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> .....	36
Independent Auditor's Report on Compliance with Requirements that Could Have A Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133 .....	38
Schedule of Expenditures of Federal Awards .....	41
Notes to Schedule of Expenditures of Federal Awards.....	42
Schedule of Findings and Questioned Costs.....	43
Schedule of Prior Year Findings and Questioned Costs.....	48



CliftonLarsonAllen LLP  
www.cliftonlarsonallen.com

## Independent Auditor's Report

The Board of Commissioners  
Harris County Housing Authority  
Houston, Texas

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the enterprise fund of the Harris County Housing Authority (the Authority), as of and for the year ended March 31, 2013, and the related notes to the financial statements, which along with the aggregate discretely presented component units of the Authority collectively comprise the Authority's basic financial statements as listed in the table of contents.

### ***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.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of the discretely presented component units which represent \$77 million, \$19 million and \$8 million, respectively, of the assets, net position and revenues of the reporting entity. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the discretely presented component units, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of all the discretely presented component units were not audited in accordance with *Government Auditing Standards*. 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 auditors' 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, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the enterprise fund and the aggregate discretely presented component units of the Authority as of March 31, 2013, and the respective changes in financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Emphasis-of-Matter Regarding a Correction of an Error***

As described in Note 12 to the financial statements, the Authority incorrectly recognized revenue related to ground leases that should have been deferred over the life of the lease. Our opinion is not modified with respect to that matter.

### ***Other Matters***

#### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### ***Other Information***

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's basic financial statements. The financial data schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The financial data schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 23, 2013, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

*CliftonLarsonAllen LLP*

Baltimore, Maryland  
December 23, 2013



**HARRIS COUNTY HOUSING AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
March 31, 2013**

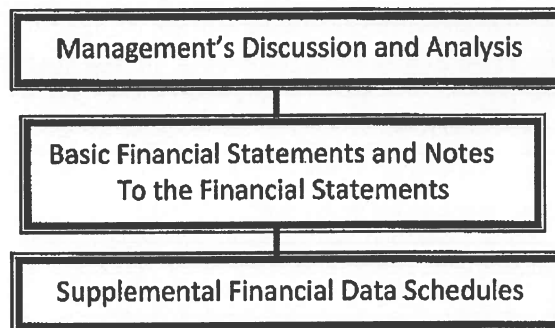
As management of the Harris County Housing Authority (the Authority), we offer the readers of the Authority's financial statements this narrative overview and analysis of our financial activities for the year ended March 31, 2013. We encourage readers to consider the information presented here in conjunction with the Authority's financial statements.

The Authority is a special purpose government operating in Harris County, Texas (the County). The Authority administers federal Department of Housing and Urban Development (HUD) Section 8 housing assistance grants. The Authority was authorized to operate by the County through adoption of an order and resolution of the County Commissioners Court (the Court) on March 20, 1975. Texas statute provides for the creation and operation of the Authority under Local Government Code (LGC) Chapter 392 - *Housing Authorities Established by Municipalities and Counties*. Under LGC Chapter 392, the Authority is a unit of government and its functions are essential for the wellbeing of the community.

Based on criteria prescribed by accounting principles generally accepted in the United States of America, the Authority is not considered a component unit of any other entity. The County's Commissioners Court appoints all of the Authority's commissioners and may remove commissioners under LGC Chapter 392, however, the Authority has complete legislative and administrative authority and it recruits and employs personnel.

The Authority presents this discussion and analysis of its financial performance during the fiscal year (FY) ended March 31, 2013, to assist the reader in focusing on significant issues and concerns.

The Authority's FY2013 annual financial report consists of three parts — the management's discussion and analysis, the basic financial statements (which includes notes to those financial statements) and the financial data schedules.



The primary focus of the Authority's financial statements is on the financial statements of a single business-type activity that combines all programs administered by the Authority. A separate column in the financial statements shows the combined transactions of the Authority's real estate limited partnership component units.

The financial results of the discretely presented component units are not addressed in this discussion and analysis.

**HARRIS COUNTY HOUSING AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
March 31, 2013**

**Financial Highlights for FY2013.**

- The Authority's assets exceeded its liabilities as of March 31, 2013 by \$30,154,116 (net position).
- Cash and cash equivalents as of March 31, 2013 were \$4,474,476.
- The Authority had \$37,750,906 in HUD grant revenue for the year ended March 31, 2013. The Authority had total expenses of \$42,182,103 for the year ended March 31, 2013, of which \$36,373,489 was for Housing Assistance Payments (HAP).
- The Authority's total net position decreased by \$793,689 during the year.
- During the year a prior period adjustment was recorded for \$1,526,740 to properly record deferred ground lease revenue.

**Overview of the Financial Statements**

This MD&A is intended to serve as an introduction to the Authority's basic financial statements. The basic financial statements included in this report are those of a special purpose government engaged only in business-type activities and includes two enterprise funds. The Authority's funds record transactions related to HUD Section 8 housing assistance grants and the investment in affordable housing projects. The basic financial statements are briefly described below.

- **Statement of Net Position** - reports the Authority's current financial assets and liabilities (short term spendable resources), along with restricted assets, fixed assets and long-term obligations.
- **Statement of Revenues, Expenses and Changes in Net Position** - reports the Authority's operating revenues by major source along with operating expenses.
- **Statement of Cash Flows** - reports the Authority's cash flows from operating, investing, capital and non-capital activities.
- **Notes to the financial statements** - The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

**Analysis of Entity Wide Net Position (Statement of Net Position)**

Between FY2012 to FY2013; the Authority saw the complete replacement of its entire board, the replacement of its Chief Executive Officer, the departure of both its Chief Administrative Officer and its Chief Financial Officer, along with many other changes in policies and procedures that improve accountability, efficiency and transparency in government. Not counting housing assistance payments or depreciation, expenses decreased by \$4,518,865 from \$9,701,189 to \$5,182,324, representing a 47% reduction in spending.

Over time, significant changes in the net position are an indicator of whether the Authority's financial health is improving or deteriorating. Assets exceeded liabilities by \$30,154,116 at the close of the fiscal year ended March 31, 2013, an overall decline of \$793,689 from March 31, 2012.

Total Current Assets increased by \$9,489,803 from the prior year due mostly to an increase in assets held for sale (land) in the amount of \$6,500,000 and an increase of \$2,009,732 in the inter-program due from Housing Choice Vouchers. Both balances are in Other Business Activities.

**HARRIS COUNTY HOUSING AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
March 31, 2013**

Capital Assets, net of depreciation, decreased by \$8,181,104 from the prior year. The decrease is primarily the result of moving land in Other Business Activities from Capital Assets to Assets Held for Sale – a current asset. The land's purchase price was \$6,500,000. Additionally, \$1,082,011 was expensed during 2013 to expenses for development costs and efforts that were not going to move into the construction phase.

Current Liabilities increased by \$194,345 from \$7,074,474 for the year ended March 31, 2012 to \$7,268,819 for the year ended March 31, 2013. This increase is due to the current portion of the Cypresswood Estates loan recorded in the current fiscal year.

Non-Current Liabilities increased by \$1,908,043 from \$1,651,766 from the year ended March 31, 2012 to \$3,559,809 for the year ended March 31, 2013. The increase is related to the Cypresswood Estates loan (for an Affordable Housing development) recorded as a long term liability in the current fiscal year.

	2013	As restated 2012	Increase/ (Decrease)
<b>Assets</b>			
Current assets	\$ 12,760,729	\$ 3,270,926	\$ 9,489,803
Notes receivable	4,496,420	4,496,420	-
Investment in partnership	273,940	273,940	-
Capital assets	<u>23,451,655</u>	<u>31,632,759</u>	<u>(8,181,104)</u>
Total assets	<u>40,982,744</u>	<u>39,674,045</u>	<u>1,308,699</u>
<b>Liabilities</b>			
Current liabilities	7,268,819	7,074,474	194,345
Noncurrent liabilities	<u>3,559,809</u>	<u>1,651,766</u>	<u>1,908,043</u>
Total liabilities	<u>10,828,628</u>	<u>8,726,240</u>	<u>2,102,388</u>
<b>Net position</b>	<u>\$ 30,154,116</u>	<u>\$ 30,947,805</u>	<u>\$ (793,689)</u>

**Net Position Categories**

	2013	2012	Increase/ (Decrease)
Invested in capital assets	\$ 19,877,137	\$ 29,724,828	\$ (9,847,691)
Restricted	8,269,250	1,880,748	6,388,502
Unrestricted	<u>2,007,729</u>	<u>(657,771)</u>	<u>2,665,500</u>
<b>Total net position, as restated</b>	<u>\$ 30,154,116</u>	<u>\$ 30,947,805</u>	<u>\$ (793,689)</u>

The Authority's Affordable Housing Division was created to facilitate the expansion of its mission to promote innovative housing communities and encourage clients to achieve self-sufficiency. The Affordable Housing Division is committed to the development and operation of safe and affordable housing communities with enhanced access to social services, job training and transportation.

**HARRIS COUNTY HOUSING AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
March 31, 2013**

The Authority is committed to building new affordable housing using the Low Income Housing Tax Credit Program with HOME, Neighborhood Stabilization Program (NSP), and Community Development Block Grant funds provided by the Harris County Community Services Department. This unique public/public partnership is well positioned to meet the needs of affordable housing in the unincorporated areas of Harris County. This has enabled the Authority to develop seven (7) senior Low Income Housing Tax Credit and one (1) CDBG/HOME developments.

**Analysis of Entity Wide Revenues (Statement of Revenues, Expenses and Change in Net Position)**

The Authority administers the following programs, which generate revenues for the year 2013 as follows:

	2013	As restated 2012	Increase/ (Decrease)
<b>Revenues - Operating</b>			
HUD PHA grants	\$ 37,750,906	\$ 35,844,402	\$ 1,906,504
Other government grants	1,954,741	6,240,541	(4,285,800)
Ground lease revenue	29,763	73,000	(43,237)
Other revenue	1,261,068	1,334,149	(73,081)
Total operating revenues	<u>40,996,478</u>	<u>43,492,092</u>	<u>(2,495,614)</u>
<b>Expenses</b>			
Housing assistance payments	36,373,489	36,569,356	(195,867)
Salaries and benefits	2,642,523	3,598,069	(955,546)
Office expense	2,008,772	3,241,516	(1,232,744)
Tenant services	-	398,969	(398,969)
General	531,029	2,462,635	(1,931,606)
Depreciation	554,163	842,456	(288,293)
Total expenses	<u>42,109,976</u>	<u>47,113,001</u>	<u>(5,003,025)</u>
Net income (loss) from operations	<u>(1,113,498)</u>	<u>(3,620,909)</u>	<u>2,507,411</u>
<b>Non-operating revenue (expenses)</b>			
Interest income	164,913	238,513	(73,600)
Interest expense	(72,127)	(75,096)	2,969
Gain (loss) on sale of fixed assets	227,023	(342,833)	569,856
Total non-operating revenues	<u>319,809</u>	<u>(179,416)</u>	<u>499,225</u>
Change in net position	(793,689)	(3,800,325)	3,006,636
Net position, beginning of year, as restated	<u>30,947,805</u>	<u>34,748,130</u>	<u>(3,800,325)</u>
Net position, end of year	<u>\$ 30,154,116</u>	<u>\$ 30,947,805</u>	<u>\$ (793,689)</u>

**HARRIS COUNTY HOUSING AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
March 31, 2013**

Total revenues for the years ended March 31, 2013 and 2012 were \$40,996,478 and \$43,492,092, respectively. The change from 2013 to 2012 reflects a decrease of \$2,495,614 due to the completion of the DHAP-IKE Program. In 2012, the total revenues were \$2,535,352 and 2013 was \$6,456.

HUD PHA grants increased \$1,906,504 from \$35,844,402 in 2012 to \$37,750,906 in 2013, due primarily to increased Housing Choice Voucher program revenues for Housing Assistance Payments.

Other government grants decreased by \$4,285,800 and other revenue decreased by \$73,081. This decrease is attributed to HCHA receiving no new grant funding for affordable housing development. The decrease in other revenue is attributed to the Affordable Housing program's fees earned from the component units where HCHA is the General Partner.

**Analysis of Entity Wide Expenses**

Total expenses for the year ended March 31, 2013 amounted to \$42,182,103 as compared to \$47,188,097 for the year ended March 31, 2012, a decrease of \$5,005,994. This decrease is attributed to a reduction in DHAP IKE administrative expenses with the closing of the DHAP IKE program.

Housing assistance payments decreased by \$195,867 primarily due to attrition with the HCV program to bring leasing down to the appropriate level.

Salaries and benefits decreased by \$955,546 primarily due to a 36% drop in the CEO salary and a 29% reduction of staff.

Office expense decreased by \$1,232,744 primarily due to significant cuts to ongoing expenses.

Tenant services decreased by \$398,969 primarily due to the reduction in the staffing of Case Managers for the DHAP-IKE & DHAP-IKE – TEXAS grants, which were completed near the beginning of the FY2013.

Interest expense of \$72,127 represents interest for a permanent loan for Cypresswood Estates.

The general expense decreased by \$1,931,606 due to decreases in consultant and professional fees, office rent, temporary services, and printing and reproduction and office supplies.

Depreciation expense decreased by \$288,293 primarily due to the fact that HCHA no longer depreciates \$1,000,000 of DHAP leasehold improvements written off at the end FY2012.

**Capital Assets**

The Authority's capital assets consist of land and buildings for affordable housing projects, leasehold improvements and business equipment used in administering the HUD grants and affordable housing projects.

The buildings are depreciated over thirty-nine years, leasehold improvements and equipment used in administering the HUD grants and affordable housing projects are being depreciated over three to ten years depending on asset type. The Authority's increase in capital assets during the year was primarily due to the completion of a development related to the affordable housing program.

**HARRIS COUNTY HOUSING AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
March 31, 2013**

**Capital Assets**

	<u>March 31, 2012</u>	<u>Net Additions/ Deletions</u>	<u>March 31, 2013</u>
Land	\$ 14,312,569	\$ (6,500,000)	\$ 7,812,569
Buildings	15,233,138	(9,865)	15,223,273
Leasehold Improvements	1,061,536	4,165	1,065,701
Furniture and equipment	996,380	(471,151)	525,229
Construction in progress	1,925,900	(1,098,901)	826,999
Accumulated depreciation	<u>(1,896,764)</u>	<u>(179,870)</u>	<u>(2,076,634)</u>
<b>Total</b>	<u>\$ 31,632,759</u>	<u>\$ (8,255,622)</u>	<u>\$ 23,377,137</u>

Additional information on the Authority's capital assets can be found in the notes to the Authority's basic financial statements for the year ended March 31, 2013.

**Economic Factors and Next Year's Budget**

Significant economic factors affecting the Authority are as follows:

- Debt of more than \$7 million due to HUD as a result of misspending or over-spending that occurred prior to FY2013
- An amount, yet to be finalized, which the Authority may owe back to HUD due the Authority's mismanagement of funds prior to FY2013
- Level of federal funding from the U.S. Department of Housing and Urban Development
- Local labor supply and demand, which can affect salary and wage rates
- Local inflationary, recession, and employment trends, which can affect resident incomes and therefore the amount of Housing Assistance Payments
- Inflationary pressure on utility rates, supplies, and other costs

The Section 8 Management Assessment Program (SEMAP) is HUD's assessment program to annually and remotely measure the performance of all public housing authorities that administer the HCVP. SEMAP enables HUD to better manage the Section 8 housing assistance programs administered by the Authority by identifying capabilities and deficiencies in program operations. The SEMAP score is based on 15 specific operations indicators. The Authority has had the highest rating under SEMAP for the past nine (9) years.

**Contacting the Authority's Financial Management**

The financial report is designed to provide a general overview of the Authority's finances for all those with an interest. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chief Executive Officer, Harris County Housing Authority, 8933 Interchange Dr., Houston, TX 77054, (713) 669-4549.

## FINANCIAL STATEMENTS

**HARRIS COUNTY HOUSING AUTHORITY**  
**STATEMENT OF NET POSITION**  
**March 31, 2013**

	Enterprise Fund	Component Units	Total Reporting Entity
<b>ASSETS</b>			
<b>CURRENT ASSETS</b>			
Cash and cash equivalents	\$ -	\$ 707,512	\$ 707,512
Cash and cash equivalents - restricted	4,474,476	3,065,362	7,539,838
Accounts receivable - tenants, net	4,077	27,858	31,935
Accounts receivable - HUD	7,938	-	7,938
Accounts receivable - miscellaneous	136,540	28,418	164,958
Accrued interest receivable from component units	1,564,860	-	1,564,860
Prepaid assets	72,838	1,988,932	2,061,770
Other assets	6,500,000	3,057,182	9,557,182
Total current assets	<u>12,760,729</u>	<u>8,875,264</u>	<u>21,635,993</u>
<b>NONCURRENT ASSETS</b>			
Investment in partnerships	273,940	-	273,940
Notes receivable - component units	4,496,420	-	4,496,420
Capital assets net of accumulated depreciation	23,377,137	68,397,093	91,774,230
Other assets	74,518	-	74,518
Total noncurrent assets	<u>28,222,015</u>	<u>68,397,093</u>	<u>96,619,108</u>
<b>TOTAL ASSETS</b>	<u>\$ 40,982,744</u>	<u>\$ 77,272,357</u>	<u>\$ 118,255,101</u>
<b>LIABILITIES AND NET POSITION</b>			
<b>CURRENT LIABILITIES</b>			
Accounts payable and accrued liabilities	\$ 4,857,305	\$ 804,494	\$ 5,661,799
Accrued wages and payroll taxes payable	51,139	-	51,139
Accrued compensated absences, current	88,341	-	88,341
Accrued interest payable to HCHA	-	1,564,860	1,564,860
Current portion of mortgage notes payable	-	455,508	455,508
Current portion of notes payable	53,992	-	53,992
Unearned revenue	466,540	603,854	1,070,394
Deferred ground lease revenue	1,751,502	-	1,751,502
Total current liabilities	<u>7,268,819</u>	<u>3,428,716</u>	<u>10,697,535</u>
<b>NONCURRENT LIABILITIES</b>			
Accrued compensated absences	19,037	-	19,037
Mortgage notes payable, net of current portion	-	39,226,521	39,226,521
Notes payable, net of current portion	3,446,008	-	3,446,008
Mortgage notes payable - HCHA	-	4,496,420	4,496,420
Noncurrent liabilities - other	94,764	10,588,414	10,683,178
Total noncurrent liabilities	<u>3,559,809</u>	<u>54,311,355</u>	<u>57,871,164</u>
Total liabilities	<u>10,828,628</u>	<u>57,740,071</u>	<u>68,568,699</u>
<b>NET POSITION</b>			
Invested in capital assets, net of related debt	19,877,137	-	19,877,137
Restricted net position for contract obligations	8,269,250	-	8,269,250
Unrestricted net position	2,007,729	19,532,286	21,540,015
Total net position	<u>30,154,116</u>	<u>19,532,286</u>	<u>49,686,402</u>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<u>\$ 40,982,744</u>	<u>\$ 77,272,357</u>	<u>\$ 118,255,101</u>

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



**HARRIS COUNTY HOUSING AUTHORITY**  
**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION**  
**Year Ended March 31, 2013**

	Enterprise Fund	Component Units	Total Reporting Entity
<b>OPERATING REVENUES</b>			
Rental income	\$ 829,590	\$ 7,746,939	\$ 8,576,529
HUD PHA grants	37,750,906	-	37,750,906
Ground lease revenues	29,763	-	29,763
Other government grants	1,954,741	-	1,954,741
Other revenues	431,478	362,312	793,790
Total operating revenues	40,996,478	8,109,251	49,105,729
<b>OPERATING EXPENSES</b>			
Administrative	4,651,295	1,873,869	6,525,164
Utilities	57,176	761,682	818,858
Ordinary maintenance and operations	165,653	876,411	1,042,064
General	308,200	1,693,611	2,001,811
Housing assistance payments	36,373,489	-	36,373,489
Total operating expenses	41,555,813	5,205,573	46,761,386
Operating income (loss) before depreciation	(559,335)	2,903,678	2,344,343
Depreciation and amortization	554,163	3,291,247	3,845,410
Total operating loss	(1,113,498)	(387,569)	(1,501,067)
<b>NON-OPERATING REVENUES (EXPENSES)</b>			
Interest income	164,913	2,412	167,325
Interest expense	(72,127)	(1,411,159)	(1,483,286)
Gain (loss) on sale of fixed assets	227,023	-	227,023
Total nonoperating revenues (expenses), net	319,809	(1,408,747)	(1,088,938)
<b>CHANGE IN NET POSITION</b>	(793,689)	(1,796,316)	(2,590,005)
<b>DISTRIBUTIONS</b>	-	(324,498)	(324,498)
<b>TOTAL NET POSITION, BEGINNING OF YEAR (As Restated)</b>	30,947,805	21,653,100	52,600,905
<b>TOTAL NET POSITION, END OF YEAR</b>	\$ 30,154,116	\$ 19,532,286	\$ 49,686,402

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

**HARRIS COUNTY HOUSING AUTHORITY**  
**STATEMENT OF CASH FLOWS**  
**Year Ended March 31, 2013**

<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
HUD subsidies	\$ 37,750,906
Governmental grants	1,954,741
Ground lease revenue	29,763
Other revenue	1,132,473
Administration and general	133,702
Salaries and benefits	(4,651,295)
Housing operations and tenant services	(222,829)
Housing assistance payments	<u>(36,373,489)</u>
Net cash flows used in operating activities	<u>(246,028)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>	
Increase in long term debt	3,500,000
Payments on notes payable	(1,907,931)
Proceeds on sale of assets	1,248,530
Gain on disposal of assets	195,183
Interest paid on notes payable	(72,127)
Acquisition of capital assets	<u>(15,231)</u>
Net cash flows provided by capital and related financing activities	<u>2,948,424</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Increase in notes receivable	(164,425)
Interest income	<u>164,913</u>
Net cash flows provided by investing activities	<u>488</u>
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>2,702,884</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b><u>1,771,592</u></b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b><u>\$ 4,474,476</u></b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Operating loss	\$ (1,113,498)
Adjustments to reconcile cash and cash equivalents used in operating activities	
Depreciation	554,163
Effects of changes in operating assets and liabilities:	
Accounts receivable	(72,832)
Prepaid expenses	(49,662)
Other assets	(74,518)
Accounts payable and accrued expenses	615,602
Accrued wages and payroll tax payable	(5,589)
Accrued compensated absences	(43,931)
Deferred revenue	<u>(55,763)</u>
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b><u>\$ (246,028)</u></b>

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

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization**

The Harris County Housing Authority (the Authority) was authorized to transact business and exercise all powers conferred under Texas statute by Harris County, Texas (the County) through adoption of an order and resolution of the County Commissioners Court (the Court) on March 20, 1975.

Texas statute provides for the creation and operation of the Authority under Local Government Code (LGC) Chapter 392 - *Housing Authorities Established by Municipalities and Counties*. Under LGC Chapter 392, the Authority is a unit of government and its functions are essential for the wellbeing of the community.

The March 20, 1975 Court order and resolution activated the Authority in accordance with LGC Chapter 392 by declaring the following:

- There is unsanitary or unsafe inhabited housing in the County;
- There is a shortage of safe or sanitary housing in the County available to persons of low income at rentals that they can afford; and
- There is need for a public housing authority to function in the County.

The Court's March 20, 1975 order and resolution also appointed commissioners of the Authority in accordance with LGC Chapter 392. There are five commissioners governing the Authority serving staggered two year terms. The staggered two year terms apply to two and three of the Authority's five commissioners, respectively, every other year. The Court appoints all Authority commissioners when terms expire.

On March 29, 1994, the Court merged the Authority with the County's Community Development Department (CDD). The Authority's grant contracts with the federal Department of Housing and Urban Development (HUD) were subsequently assumed by CDD and the Authority's commissioners were not reappointed by the Court.

On July 2, 2002, the Court approved a plan whereby the Authority would be reestablished and returned to its previous status as an independent entity. On March 1, 2003, the separation was completed and the Court appointed five new commissioners to govern the Authority.

On March 4, 2003, an Interlocal Agreement between the Authority and the County was approved by the Court, providing for the staffing of the Authority and continuing reimbursement to the County of all associated costs.

The agreement additionally provided for the provision of office space and telecommunications services by the County. The Interlocal Agreement was extended through February 28, 2010, with updates and modifications. At February 28, 2010, the Interlocal Agreement was not extended.

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Reporting Entity**

The Authority's financial statements include all of its accounts and activities. Under LGC Chapter 392, the Authority is a separate unit of government. Based on criteria prescribed by accounting principles generally accepted in the United States of America, the Authority is no longer considered a component unit of the County or any other entity. The Court appoints all Authority Commissioners and may remove commissioners under LGC Chapter 392, however, the Authority has complete legislative and administrative authority and it recruits and employs personnel. Considerations regarding the potential for inclusion of other entities, organizations or functions in the financial reporting entity are based on criteria prescribed by accounting principles generally accepted in the United States of America. These same criteria are evaluated in considering whether the Authority is a part of any other governmental or other type of reporting entity. As noted above, the Authority is not considered a component unit of any other entity.

The criteria for including organizations as component units within the Authority's reporting entity, as set forth in Section 2100 of the Governmental Accounting Standards Board's (GASB) *Codification of Government Accounting and Financial Reporting Standards*, include whether:

- The organization is legally separate (can be sued in their own name).
- The Authority holds the corporate powers of the organization.
- The Authority appoints a voting majority of the organization's board.
- The organization has the potential to impose a financial benefit/burden on the Authority.
- There is fiscal dependency by the organization on the Authority.

The Authority has formed Limited Liability Companies (LLC's) that participate in Limited Partnerships for the development and construction of affordable housing. Each of the LLC's formed by the Authority is the General Partner of the Limited Partnership. The financial statements of the limited partnerships are combined and reported as a discretely presented component unit based on these considerations.

*Discretely Presented Component Units* - The component unit column in the basic financial statements includes the financial data of the Authority's discrete component units. These units are reported in a separate column to emphasize that they are legally separate from the Authority and are governed by separate Boards. See Note 8 for additional details relating to the Authority's relationship with the component units.

The Partnerships included in the component units column include: Cornerstone Village Apartments, L.P., Louetta Village Apartments 45, L.P., Baybrook Park Retirement Center, Ltd., TX Bammel Housing L.P., Waterside Court, Ltd., Olive Grove Manor, Ltd and Sierra Meadows, Ltd.. Each partnership has developed apartment complexes and has set aside a predetermined number of units specifically for low to moderate income housing. The fiscal year end for the discretely presented component units is December 31, 2012. As the general partner of the partnerships, the Authority receives the audited financial statements for the partnerships. Therefore, complete financial statements for each of the Limited Partnerships can be obtained from the Chief Financial Officer, Harris County Housing Authority, 8933 Interchange Drive, Houston, TX 77054.

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Reporting Entity (continued)**

*Blended Component Units* - In the fiscal year ended March 31, 2013, the Authority formed an LLC for the development of Cypresswood Estates. For financial reporting purposes, Cypresswood Estates is included in the operations and activities of the Authority as a blended component unit.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**Basis of Presentation**

Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services. The Authority's activities are business-type in nature and the Authority does not engage in any governmental-type activities. As a result, government-wide financial statements which distinguish between governmental and business-type activities are not required. Accordingly, the basic financial statements and required supplementary information (RSI) of the Authority consist of Management's Discussion and Analysis (MD&A), Statement of Net Position, Statement of Revenues, Expenses and Changes in Net Position, Statement of Cash Flows and Notes to the Financial Statements.

**Measurement Focus and Basis of Accounting**

The Authority uses the Proprietary fund method of accounting as prescribed by GASB. The Proprietary fund method uses the economic resources measurement focus. The accounting objectives are the determination of operating income, changes in net position, financial position, and cash flows. All assets and liabilities associated with the proprietary fund's activities are included on the Statement of Net Position. Proprietary net position are segregated into Invested in Capital Assets Net of Related Debt, Restricted Net Position, and Unrestricted Net Position.

The accrual basis of accounting is used in proprietary fund types. The accrual basis of accounting recognizes revenues when earned. Expenses are recognized in the period incurred. Operating revenues and expenses generally result from providing services and delivering goods in connection with a proprietary fund's ongoing operations. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The principal operating revenues of the Authority are the moneys provided by the U.S. Department of Housing and Urban Development (HUD) and other government grants. The Authority's operating expenses consist primarily of Housing Assistance Payments (HAP) and related administrative costs for the HUD Section 8 and Disaster Housing Assistance Programs, including depreciation and allocations of overhead costs to the affordable housing operation.

**HARRIS COUNTY HOUSING AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
March 31, 2013**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Cash and Investments**

Cash and cash equivalents include amounts in demand deposits as well as short-term investments with a maturity date of 90 days or less from date of purchase. Certificates of Deposit are considered cash equivalents regardless of their maturity date. All investments are recorded at fair value based upon quoted market prices as of the PHA's fiscal year end, with the difference between the purchase price and market price being recorded as Interest Income.

**Restricted Assets**

Certain assets of the Authority are required to be segregated based on HUD Section 8 grant requirements. These assets are legally restricted for certain purposes, including HUD Family Self-Sufficiency program deposits.

In the financial statements, restricted net position is reported for amounts that are externally restricted by: 1) creditors (e.g. bond covenants), grantors, contributors, or laws and regulations of other governments; or, 2) law through constitutional provision or enabling legislation. These assets are generally unavailable to pay current liabilities of the Authority's HUD Section 8 grant programs.

**Accounts Receivable**

Accounts receivable consist of payments due from HUD and related affiliates, payments from tenants and other miscellaneous receivables arising from the normal course of operations. A reserve for uncollectible accounts is established based on management's estimates.

**Prepaid Assets**

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid assets.

**Investment in Partnerships**

The Authority has made contributions to the partnerships and has recognized the amount based on the fair value of the amount contributed.

**Capital Assets**

Capital assets of the Authority are defined as assets with individual costs of \$1,000 or more and estimated useful lives in excess of one year. All capital assets are stated at historical cost or estimated fair market value at the date of purchase. Donated capital assets are stated at their estimated fair market value on the date donated. Depreciation is computed using the straight-line method over the estimated useful life of the asset ranging from 3 to 10 years. Leasehold improvements are depreciated over a 10-year useful life. Equipment is depreciated over 3 to 5 years, depending on the type.

Capital assets include leasehold improvements made to the building the Authority is leasing and equipment used in the Authority's operations that benefit more than a single fiscal year.

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Impairment of Long-Lived Assets**

In accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, the Authority reviews its assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the fair value is less than the carrying amount of the asset, an impairment loss is recognized for the difference. No asset impairment losses have been recognized during the year ended March 31, 2013.

**Compensated Absences**

Accumulated compensatory leave, vacation and sick leave are recorded as an expense and liability as the benefit accrues for the employee. Eligible employees earn 10 days of sick leave per year. Sick leave benefits are recognized as they are used by the employees. Employees may accumulate up to 60 calendar days of sick leave benefits. Unused sick leave benefits are not paid at termination. Eligible employees accrue from two to five weeks of vacation per year, depending on years of service. Employees may accumulate up to two times the annual vacation amount. Employees will be paid for unused vacation time upon termination. A liability for vacation earned, but not taken, has been recorded.

Nonexempt employees earn compensatory time at one-and-a-half times their full pay times the excess of 40 hours worked. The compensatory time balance for nonexempt employees may not exceed 240 hours. Hours in excess of the 240-hour maximum must be paid to the nonexempt employee at the rate of one-and-a-half times the regular rate. Upon termination, nonexempt employees are paid one-half of the compensatory time earned at the current wage rate.

Exempt employees earn compensatory time at one times their full pay times the excess of 40 hours worked. Exempt employees can accumulate up to 240 hours of compensatory time. Upon termination, exempt employees are paid one-half of the compensatory time earned at the current wage rate. Compensatory time is carried forward indefinitely. Accordingly, a liability for compensatory time earned has been recorded.

**Net Position**

Certain assets may be classified as restricted net position on the Statement of Net Position because their use is restricted for specific purposes. It is the Authority's policy to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position are available.

Net position is displayed in three components:

*Net position, Invested in Capital Assets, Net of Related Debt:* This component of net position consists of all capital assets reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

**HARRIS COUNTY HOUSING AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
March 31, 2013**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Net Position (continued)**

*Restricted Net Position:* This component of net position consists of restricted assets when constraints are placed on the asset by creditors (such as debt covenants), grantors, contributors, laws, regulations, etc. The Authority's restricted net position consist of escrows held for debt service, investments in projects, program income, reserve accounts, and excess housing assistance payments, as applicable.

*Unrestricted Net Position:* This component consists of net position that does not meet the definition of "Net Position Invested in Capital Assets, Net of Related Debt," or "Restricted Net Position."

**Budgets**

The Authority's Finance Policies and Procedures provide for budget preparation annually primarily to satisfy HUD compliance requirements. The HUD Section 8 housing programs and the Department of Homeland Security's Disaster Housing Assistance Programs generate income through administrative fees paid by HUD to cover the Authority's costs to administer these programs. The affordable housing program generates ground lease revenue and developer fee revenue available for other housing programs. The annual administrative operating budget for the HUD Section 8, Disaster Housing Assistance Programs and affordable housing programs are incorporated into the Authority's overall annual operating budget that includes HAP and costs related to providing affordable housing to senior citizens. The annual budget process starts prior to the subsequent fiscal year. The Authority's Finance department projects the subsequent fiscal year's housing assistance payment obligations and the related income from administrative fees for the HUD Section 8, Disaster Housing Assistance Programs and affordable housing programs. The administrative budget is used to track actual expenses against those budgeted throughout the fiscal year. Annual budgets for administrative costs and HAP are approved by the Authority's Board of Commissioners and by HUD. Necessary changes to the budget are also approved by the Authority's Board of Commissioners and by HUD throughout the year. The Authority's finance department presents detailed administrative budget reports along with financial information on HAP affordable housing and other program costs to the Authority's Board of Commissioners for review at each board meeting.

**Risk Management**

The Authority's risk-of-loss exposure includes exposure to liability and accidental loss of real and personal property. The Authority insures for vehicle and property insurance, professional liability insurance and crime and fidelity policies through the Housing Authority Insurance Group.

All employees of the Authority are covered by workers' compensation program insurance. Premiums on workers' compensation are determined by position class code, at actuarially determined rates.

The Authority provides medical, dental, vision and basic life and disability insurance to eligible employees. The Authority's group insurance premiums, as well as employee payroll deductions for premiums for dependents and optional coverages, are paid to contracted insurance providers based upon monthly enrollment and premium calculations.



**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**New Accounting Pronouncements**

In fiscal year 2013, the Authority implemented GASB Statement Nos. 61, 62, and 63 as follows:

- GASB Statement No. 61, *The Financial Reporting Omnibus—an amendment of GASB Statements No. 14 and No. 34* modifies certain requirements for inclusion of component units in the financial reporting entity. This includes the concept of financial burden or benefit on the relationship between the primary government and the component unit. The implementation of this new standard had no impact on the Authority's 2013 financial statements.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* incorporates into GASB authoritative literature certain accounting and financial reporting guidance previously included in FASB, APB, and AICPA guidance issued before November 30, 1989. The implementation of this new standard modified certain language in disclosures related to the applicable basis of accounting in the Authority's 2013 financial statements.
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* revised the financial reporting for elements of the financial statements as a consumption or acquisition of net assets that are applicable to a future reporting period. These items are distinct from assets and liabilities. This statement also identifies net position. The implementation of this new standard revised the presentation in the financial statements for those items identified as deferred outflows and inflows and revised the names and certain captioning of the statements.

**NOTE 2 – DEPOSITS AND INVESTMENTS**

**Deposits**

Chapter 2257 of the Texas Government Code is known as the Public Funds Collateral Act. This act provides guidelines for the amount of collateral that is required to secure the deposit of public funds. Federal Depository Insurance (FDIC) currently is available for funds deposited at any one financial institution up to a maximum of \$250,000 each for demand deposits, time and savings deposits, and deposits pursuant to indenture. Noninterest-bearing accounts are fully insured, regardless of the balance of the account at all FDIC insured institutions. The Public Funds Collateral Act requires that the deposit of public funds be collateralized in an amount not less than the total deposit, reduced by the amount of FDIC insurance available. In accordance with the Sweep Agreement with Amegy Bank all funds are transferred to a Money Market Mutual Fund account on a daily basis.

**Investments**

Chapter 2256 of the Texas Government Code is known as the Public Funds Investment Act. This act authorizes the Authority to invest excess funds in fully collateralized or insured time deposits, direct debt securities of the United States or its Agencies, investment grade commercial paper, money market mutual funds and fully collateralized repurchase agreements pursuant to a written investment policy which primarily emphasizes the safety of principal and liquidity, addresses investment diversification, yield, and maturity.

**HARRIS COUNTY HOUSING AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
March 31, 2013**

**NOTE 2 – DEPOSITS AND INVESTMENTS (CONTINUED)**

**Investments (continued)**

The Authority's Investment policy is reviewed and approved annually by the Board of Commissioners. The Investment Policy includes a list of authorized investment instruments. In accordance with the Money Market Mutual Fund agreement with Amegy bank, the Authority's daily balance is used to purchase shares of Fidelity Institutional Money Market Government Portfolio Class I. Fidelity Institutional Money Market Government Portfolio Class I is ranked by Lipper as No. 29 out of 164 U.S. Government Money Market Funds for its one year performance, No. 4 out of 126 funds for its five year performance and No. 5 out of 77 funds for its 10 year performance. It is ranked Aaa by Moody's.

**Cash and Investments**

The Authority's cash and cash equivalents had a carrying value of \$4,474,476 and a bank balance of \$4,556,749 as of March 31, 2013. In accordance with the Money Market Mutual Fund Agreement with Amegy Bank, the entire amount in the sweep investment account purchases shares in Fidelity Institutional Money Market Government Portfolio Class I fund. This portfolio invests at least 80% of assets in U.S. Government securities and repurchase agreements for those securities, issued by entities that are chartered or sponsored by Congress but whose securities are neither issued nor guaranteed by the U.S. Treasury. Amegy Bank has provided assurance that the funds are invested in accordance with the Authority's investment policy.

**Restricted Cash**

All of the Authority's cash is restricted at March 31, 2013.

**Interest Rate Risk**

All investments carry the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Authority manages its exposure to interest rate risk is by investing in overnight instruments.

**Concentration of Credit Risk**

At March 31, 2013, the Authority had a sweep agreement which invested more than 30 percent of funds in a Money Market Mutual Fund. All deposits were fully collateralized as of March 31, 2013.

**Custodial Credit Risk**

Custodial credit risk is the risk that an entity will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if the counterparty fails. Of the Authority's \$4,474,476 in cash and cash equivalents at March 31, 2013, the entire balance is held in an investment account with one counterparty.

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 3 – CAPITAL ASSETS**

Capital asset activity for the year ended March 31, 2013, was as follows:

	Balance 2012	Additions	Transfers & Disposals	Balance 2013
Capital assets, not being depreciated:				
Land	\$ 14,312,569	\$ -	\$ (6,500,000)	\$ 7,812,569
Construction in progress	1,925,900	3,977	(1,102,878)	826,999
Total capital assets not being depreciated	16,238,469	3,977	(7,602,878)	8,639,568
Depreciable capital assets:				
Building	15,233,138	-	(9,865)	15,223,273
Leasehold Improvements	1,061,536	4,165	-	1,065,701
Furniture and equipment	996,380	7,089	(478,240)	525,229
Total depreciable capital assets	17,291,054	11,254	(488,105)	16,814,203
Less accumulated depreciation	(1,896,764)	(553,911)	374,041	(2,076,634)
Total capital assets, being depreciated, net	15,394,290	(542,657)	(114,064)	14,737,569
Total capital assets, net	\$ 31,632,759	\$ (538,680)	\$ (7,716,942)	\$ 23,377,137

During the year, the Board resolved to write off approximately \$257,000 in Construction in Progress for developments Humble Lakes and University Place as these developments were halted. In addition, approximately \$783,000 of Patriots by the Lake Construction in Progress was written off as this development has also been halted.

As of March 31, 2013, the Authority transferred \$6,500,000 of land related to the Patriots by the Lake project from capital assets to assets held for sale since the Authority decided to sell the land. The Authority is actively pursuing sales options. As of March 31, 2013, the land was stated at fair value.

Capital asset activity for the component units was as follows:

	Capital Assets	Accumulated Depreciation	Net Book Value
Louetta Village Apartments 45, LP	\$ 9,326,991	\$ (2,078,634)	\$ 7,248,357
Baybrook Park Retirement Center, Ltd	7,643,730	(2,451,527)	5,192,203
TX Bammel Housing, LP	16,452,719	(4,574,942)	11,877,777
Cornerstone Village Apartments, LP	11,793,416	(2,822,574)	8,970,842
Waterside Court, Ltd	15,735,011	(3,206,300)	12,528,711
Olive Grove Manor, Ltd	14,284,000	(2,023,416)	12,260,584
Sierra Meadows, Ltd	11,010,226	(691,607)	10,318,619
Totals	\$ 86,246,093	\$ (17,849,000)	\$ 68,397,093

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 4 – NOTES RECEIVABLE AND ACCRUED INTEREST RECEIVABLE**

The Authority has Subordinate Promissory Notes with the Partnerships that were funded with pass through funds from HOME Grants. The loans accrue interest on the outstanding balances at the applicable federal interest rate in effect at the time of the loan and mature on varying dates between the years of 2027 and 2038. As of March 31, 2013, total outstanding principal and accrued interest on these loans were \$4,496,420 and \$1,564,860, respectively.

Borrower	Loan Amount	Date of Loan	Interest Rate	Balance 3/31/2013	Accrued Interest Receivable
Louetta Village Apartments 45, LP	\$ 550,000	1/1/2005	4.27%	\$ 550,000	\$ 210,766
Baybrook Park Retirement Center, Ltd	625,000	6/21/2005	4.57%	625,000	190,932
TX Bammel Housing, LP	731,420	1/18/2005	4.27%	731,420	249,855
Cornerstone Village Apartments, LP	1,390,000	4/30/2005	5.00%	1,390,000	533,184
Waterside Court, Ltd	500,000	6/22/2006	5.32%	500,000	173,592
Olive Grove Manor, Ltd	700,000	12/21/2006	4.90%	700,000	206,531
<b>Total</b>				<b>\$ 4,496,420</b>	<b>\$ 1,564,860</b>

**NOTE 5 – NOTES PAYABLE**

On March 31, 2013, the Authority entered into an agreement with Community Bank of Texas for \$3,500,000 at an interest rate of 4.25%. The first payment on the loan will be on May 1, 2013 and the note is due on March 8, 2018. Monthly principal and interest payments of \$17,218 will be due annually and the entire unpaid balance will be due upon the maturity date.

Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
\$ 1,907,931	\$ 3,500,000	\$ (1,907,931)	\$ 3,500,000	\$ 53,992

Annual debt service for principal and interest over the next five years are as follows:

	Principal	Interest	Total
2014	\$ 53,992	\$ 135,405	\$ 189,397
2015	61,345	145,269	206,614
2016	64,004	142,611	206,615
2017	66,778	139,837	206,615
2018	3,253,881	139,539	3,393,420
<b>Total</b>	<b>\$ 3,500,000</b>	<b>\$ 702,661</b>	<b>\$ 4,202,661</b>

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 5 – NOTES PAYABLE (CONTINUED)**

Notes payable activity for the component units was as follows:

	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Louetta Village Apartments 45, LP	\$ 7,499,540	\$ -	\$ (325,154)	\$ 7,174,386	\$ 120,154
Baybrook Park Retirement Center, Ltd	3,779,657	-	(63,830)	3,715,827	-
TX Bammel Housing, LP	10,566,571	-	(410,416)	10,156,155	120,248
Cornerstone Village Apartments, LP	9,879,506	-	(548,066)	9,331,440	100,000
Waterside Court, Ltd	5,124,632	-	(57,245)	5,067,387	62,292
Olive Grove Manor, Ltd	4,657,273	-	(112,778)	4,544,495	52,814
<b>Totals</b>	<b>\$ 41,507,179</b>	<b>\$ -</b>	<b>\$ (1,517,489)</b>	<b>\$ 39,989,690</b>	<b>\$ 455,508</b>

**NOTE 6 – OTHER LIABILITIES**

The summary of changes in noncurrent liabilities is as follows:

	Balance March 31, 2012	Additions	Redemptions	Balance March 31, 2013	Due Within One Year
Family self-sufficiency escrow	\$ 94,764	\$ -	\$ -	\$ 94,764	\$ -
Accrued compensated absences	151,309	16,727	(60,658)	107,378	88,341
<b>Total</b>	<b>\$ 246,073</b>	<b>\$ 16,727</b>	<b>\$ (60,658)</b>	<b>\$ 202,142</b>	<b>\$ 88,341</b>

**NOTE 7 – LEASES**

Effective August 16, 2012, the Authority entered into a lease for office space at 8933 Interchange Dr., Houston, TX. The lease term is thirty seven (37) months and expires August 31, 2015. The Authority moved their administrative offices to this site in early 2010. For the year ending March 31, 2013, the base rent was \$18,476.25 each month.

The following is a schedule by years of required future minimum lease payments:

<b>Year Ending March 31:</b>	
2014	\$ 221,715
2015	221,715
2016	92,381
<b>Total minimum payments required</b>	<b>\$ 535,811</b>

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 8 – COMPONENT UNITS**

**Blended Component Unit**

HCHA Cypresswood Estates, LLC is the 100% owner of the Cypresswood Estates Development and was placed in service in June 2011. The Authority is the sole member of the LLC. The Authority received \$14,354 of developer fees during the fiscal year ended March 31, 2013 and all developer fees have been paid.

**Discretely Presented Component Units**

HCHA Cornerstone, LLC is a partner in Cornerstone Village Apartments, L.P.; HCHA Bammel, LLC is a partner in TX Bammel Housing, L.P.; HCHA Louetta, LLC is a partner in Louetta Village Apartments 45, L.P.; HCHA Baybrook Park, LLC is a partner in Baybrook Park Retirement Center, Ltd.; HCHA Olive Grove, LLC is a partner in Olive Grove Manor, Ltd.; HCHA Waterside, LLC is a partner in Waterside Court, Ltd; and HCHA Sierra Meadows, LLC, is a partner in Sierra Meadows, Ltd. The Authority is the sole member of each of the HCHA LLCs and each HCHA LLC is a .01% partner and the general partner of the partnership.

HCHA Cornerstone, LLC has negative equity of \$273 in Cornerstone Village Apartments, L.P. at December 31, 2012. The Authority and Cornerstone Village Apartments, L.P. have a sixty-five (65) year land lease agreement signed August 12, 2004. Cornerstone Village Apartments, L.P. prepaid twelve years of rent in 2005 which is being amortized at a rate of sixty-five thousand (\$65,000) per year. The Authority and JV Developers, LLC have a developer fee sharing agreement wherein JV Developers, LLC will pay a total of \$700,000 to the Authority in exchange for services. The payment of the development fees are predicated on the receipt of development fees paid from, or on behalf of Cornerstone Village Apartments, L.P. The Authority has a Note Receivable from Cornerstone Village Apartments, L.P. in the amount of \$1,390,000. The funds for the loan were a HOME Grant from Harris County.

HCHA Bammel, LLC has negative equity of \$497 in TX Bammel Housing, L.P. at December 31, 2012. The Authority and TX Bammel Housing, L.P. have a sixty-five (65) year land lease agreement signed January 1, 2005. Under the terms of the lease, the annual lease amount for TX Bammel Housing, L.P. is sixty-five thousand (\$65,000) with all but one thousand (\$1,000) of that waived, provided that the Project is leased to tenants in accordance with all applicable Low Income Housing requirements. The Authority has a Note Receivable from TX Bammel Housing, L.P. in the amount of \$731,420. The funds for the loan were a HOME Grant from Harris County.

HCHA Louetta, LLC has negative equity of \$298,439 in Louetta Village Apartments 45, L.P. at December 31, 2012. The Authority and Louetta Village Apartments 45, L.P. have a sixty-five (65) year land lease agreement signed January 12, 2005. Under the terms of the lease, the annual lease amount for Louetta Village Apartments 45, L.P. is sixty-five thousand (\$65,000) with all but one thousand (\$1,000) of that waived, provided that the Project is leased to tenants in accordance with all applicable Low Income Housing requirements. The Authority has a Note Receivable from Louetta Village Apartments 45, L.P. in the amount of \$550,000. The funds for the loan were a HOME Grant from Harris County.

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 8 – COMPONENT UNITS (CONTINUED)**

**Discretely Presented Component Units (continued)**

HCHA Baybrook Park Retirement Center, Ltd. has negative equity of \$133 in Baybrook Park Retirement Center, Ltd. at December 31, 2012. The Authority and Baybrook Park Retirement Center, Ltd. have a sixty-five (65) year land lease agreement signed June 21, 2005. Under the terms of the lease, the annual lease amount for Baybrook Park Retirement Center, Ltd. is sixty-five thousand (\$65,000) with all but one thousand (\$1,000) of that waived, provided that the Project is leased to tenants in accordance with all applicable Low Income Housing requirements. The Authority has a Note Receivable from Baybrook Park Retirement Center, Ltd. in the amount of \$625,000. The funds for the loan were a HOME Grant from Harris County.

HCHA Olive Grove, LLC has equity of \$273,773 in Olive Grove Manor, Ltd. at December 31, 2012. The Authority and Olive Grove Manor, Ltd. have an amended forty-five (45) year land lease agreement signed December 21, 2006. Under the terms of the lease, the annual lease amount for Olive Grove Manor, Ltd. is sixty-five thousand (\$65,000) with all but one thousand (\$1,000) of that waived, provided that the Project is leased to tenants in accordance with all applicable Low Income Housing requirements. The Authority has a Note Receivable from Olive Grove Manor, Ltd. in the amount of \$700,000. The funds for the loan were a HOME Grant from Harris County.

HCHA Waterside, LLC has negative equity of \$310 in Waterside Court, Ltd. at December 31, 2012. The Authority and Waterside Court, Ltd. have a forty-five (45) year land lease agreement signed June 22, 2006. Under the terms of the lease, the annual lease amount for Waterside Court, Ltd. is sixty-five thousand (\$65,000) with all but one thousand (\$1,000) of that waived, provided that the Project is leased to tenants in accordance with all applicable Low Income Housing requirements. The Authority has a Note Receivable from Waterside Court, Ltd. in the amount of \$500,000. The funds for the loan were a HOME Grant from Harris County.

HCHA Sierra Meadows, LLC has negative equity of \$46 in Sierra Meadows, Ltd. at December 31, 2012. The Authority and Sierra Meadows, Ltd. have a 45-year ground lease agreement signed December 9, 2009. Under the terms of the lease, the annual lease amount for Sierra Meadows, Ltd. is seventy-five thousand (\$75,000) with all but one thousand (\$1,000) of that waived, provided that the Project is leased to tenants in accordance with all applicable Low Income Housing requirements.

**NOTE 9 – RETIREMENT PLAN**

**Plan Description**

The Authority provides retirement for all of its full-time employees through a non-traditional defined benefit pension plan in the statewide Texas County and District Retirement System (TCDRS). The Board of Trustees of TCERS is responsible for the administration of the statewide agent multiple-employer public employee retirement system consisting of 586 nontraditional defined benefit pension plans.

**HARRIS COUNTY HOUSING AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
March 31, 2013**

**NOTE 9 – RETIREMENT PLAN (CONTINUED)**

**Plan Description (continued)**

TCDRS in the aggregate issues a comprehensive annual financial report (CAFR) on a calendar year basis. The CAFR is available upon written request from the TCDRS Board of Trustees at P.O. Box 2034, Austin, Texas 78768-2034.

Under the state law governing TCDRS since 1991, the Authority has the option of selecting the plan of benefits to provide in the future, while at the same time considering the level of the employer contribution rate required to adequately finance the plan. Effective March 1, 2010, the Authority adopted an annually determined contribution rate plan, for which the employer contribution rate is actuarially determined as a part of the annual actuarial valuation. The rate, applicable for a calendar year, consists of the normal cost contribution rate plus the rate required to amortize the unfunded actuarial liability over the remainder of the plan's 20-year amortization period which began March 1, 2010 using the entry age actuarial cost method. Monthly contributions by the Authority are based on the covered payroll and the employer contribution rate in effect. The PHA's contribution rate for 2012 was 9.95%. The contribution rate for 2013 is 10.12%.

The plan provisions were adopted by the Board of Commissioners of the Authority, within the options available in the state statutes governing TCDRS (TCDRS Act). Members can retire at age 60 and above with 8 or more years of service; with 30 years of service regardless of age, or when the sum of their age and years of service equals 75 or more. Members are vested after eight years of service but must leave their accumulated contributions in the plan to receive an employer-financed benefit. Members who withdraw their personal contributions in a lump sum are not entitled to any amounts contributed by the Authority.

Benefit amounts are determined by the sum of the employee's contributions to the plan, with interest and employer-financed monetary credits. The level of these monetary credits is adopted by the Board of Commissioners, within the actuarial constraints imposed by the TCDRS Act so that the resulting benefits can be expected to be adequately financed by the employer's commitment to contribute. At retirement the benefit is calculated by converting the sum of the employee's accumulated contributions and the employer-financed monetary credits to a monthly annuity using annuity purchase rates prescribed by the TCDRS Act.

**Funding Policy**

The Authority has elected the annually determined contribution rate (ADCR) plan provisions of the TCDRS Act. The plan is funded by monthly contributions from both employee members and the Authority based on the covered payroll of employee members. Under the TCDRS Act, the contribution rate of the Authority is actuarially determined annually. The Authority contributed to the Plan using the actuarially determined rate of 10.12% for the year ended December 2013.

The contribution rate payable by the employee members for the fiscal year ended March 31, 2013 is 7% as adopted by the Board of Commissioners. The employee contribution rate and the employer contribution rate may be changed by the Board of Commissioners within the options available in the TCDRS Act.



**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2013**

**NOTE 9 – RETIREMENT PLAN (CONTINUED)**

**Annual Pension Cost**

For the calendar year ending December 31, 2012, pension plan contributions by the Authority and the contributions by its employees were \$226,532 and \$156,906, respectively. The Authority's annual required contribution was determined through an actuarial valuation performed as of December 31, 2012. The Plan uses the entry age actuarial cost method and level percent of payroll to determine required contributions. Significant actuarial assumptions used to compute the annual contribution requirement are as follows:

Valuation Date	12/31/12
Actuarial Cost Method	Entry Age
Amortization Method	20 year period as a level percent of covered payroll
Remaining Amortization Period	20 years
Asset Valuation Method	10-year recognition of the difference between the expected and the actual interest credited to the Subdivision Accumulation Fund (SAF) for each year. An additional recognition is required when, after the 10-year recognition is applied, the actuarial value of the SAF is outside the corridor of 60%-140% of the fund value. The actuarial value of the ESF is equal to its fund value.

**Economic Assumptions:**

TCDRS system-wide	
Real rate of return	4.5%
Inflation	3.5%
Long-term investment return	8.0%
Employer specific	
Growth in membership	0.0%
Payroll growth	5.4%

**Funded Status and Funding Progress**

The funded status of the Plan as of December 31, 2012, the most recent actuarial valuation date, is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	Percentage of Covered Payroll ((b-a)/c)
12/31/2012	\$ 1,144,115	\$ 1,048,680	\$ (95,435)	109.10%	\$ 2,247,543	-4.25%

For purposes of this schedule, the AAL for the Plan is determined using the entry age actuarial cost method.

**HARRIS COUNTY HOUSING AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
March 31, 2013**

**NOTE 10 – ECONOMIC DEPENDENCY**

Most of the Authority's revenues are provided by HUD grants and related revenues. The Authority is economically dependent on these HUD grant funds for their normal operations, including costs associated with administering these HUD grant programs. A significant decrease in HUD grant funding would negatively impact the Authority's ability to meet its operating and related administrative expenses under its current operating structure.

**NOTE 11 – CONTINGENCIES**

The Authority is currently the defendant and counter-plaintiff in litigation against the former Chief Executive Officer (CEO) for breach of contract. The CEO is seeking a one-time severance payment of \$137,000. The Authority has not paid the severance due to additional investigations being conducted by the U.S. Department of Housing and Urban Development and other regulatory agencies for possible mismanagement of funds by the CEO and third-party defendants. After the Texas Supreme Court denied the Authority's defense of sovereign immunity, the Authority filed an Amended Answer, Original Counterclaim and Original Third-Party Petition against four additional third-party defendants. The attorneys representing the Authority in this lawsuit will be paid on a contingency fee basis.

The Authority is currently in negotiation with HUD as the result of findings of an inspector general report related to transactions which occurred under prior management. Based on these findings, the Authority has paid \$6,773,771 to HUD and is committed to pay up to an additional \$7.7 million. Any additional amounts due will be determined as a result of negotiation with HUD.

**NOTE 12 – PRIOR PERIOD ADJUSTMENTS**

At March 31, 2012, deferred ground lease revenue was not properly recognized. The Authority received prepayments on ground leases in 2005 and recognized the entire amount as revenue instead of recognizing the lease revenue over the term of the lease on a straight-line basis. A prior period adjustment is needed to properly defer the revenue of the ground leases as of March 31, 2012.

Net position as of March 31, 2012, as previously reported	\$ 36,274,870
Adjustment for ground lease deferred revenue	<u>(1,526,740)</u>
<b>Net position - March 31, 2012, as restated</b>	<b><u>\$ 34,748,130</u></b>

This information is an integral part of the accompanying financial statements.

## SUPPLEMENTAL INFORMATION

**March 31, 2013**

Line Item #	Accounts Description	Housing Choice Vouchers	Disaster Assistance Grant	Disaster Housing Program	Disaster Voucher Program	PHAP - HRE	Moderate Rehabilitation	Section 8 Mod Rehab SVO	Estates (Business Activities)	Business Activities	Elimination	Total Enterprises Fund	Component Units	Total Reporting Entity
CURRENT ASSETS														
Cash:														
111	Unrestricted	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 707,512	707,512
112	Restricted - modernization and development	-	-	-	-	-	-	-	-	-	-	-	-	-
113	Other restricted	-	688,769	1,708,686	-	13,785	85,793	268,524	1,671,993	26,986	-	4,447,090	3,065,362	7,512,852
114	Tenant security deposits	-	-	-	-	-	-	-	-	-	-	-	-	26,986
115	Cash - restricted for current liabilities	-	-	-	-	-	-	-	-	-	-	-	-	-
100	Total cash	-	688,769	1,708,686	-	13,785	85,793	268,524	1,671,993	26,986	-	4,474,076	3,772,824	8,247,900
Accounts and notes receivable:														
121	Accounts receivable - PHA projects	88,714	-	-	-	-	-	7,598	-	-	-	88,714	-	88,714
122	HUD other projects	-	-	-	-	-	-	-	-	-	-	7,598	-	7,598
124	Other government	-	-	27,557	-	-	-	-	-	-	-	-	-	-
125	Miscellaneous	173	-	-	-	-	-	-	3,068	-	-	30,739	28,418	59,211
126	Tenants	-	-	-	-	687,824	-	6,077	-	-	-	663,901	27,668	691,799
126.1	Allowance for doubtful accounts - tenants	-	-	-	-	(689,824)	-	-	-	-	-	(689,824)	-	(689,824)
126.2	Allowance for doubtful accounts - other	-	-	-	-	-	-	-	-	-	-	-	-	-
127	Notes, loans, & mortgages receivable - current	-	-	-	-	-	-	-	-	-	-	-	-	-
128	Notes, loans, & mortgages receivable - current	17,093	-	-	-	-	-	-	-	-	-	17,093	-	17,093
129	Fraud recovery	-	-	-	-	-	-	-	-	-	-	-	-	-
129	Accrued interest receivable	-	-	-	-	-	-	-	-	-	-	1,564,860	-	1,564,860
120	Total receivables, net of allowances for uncollectibles	105,920	-	27,557	-	7,598	6,077	1,567,923	-	1,719,415	-	56,276	-	1,789,691
131	Investments - unrestricted	-	-	-	-	-	-	-	-	-	-	-	-	-
132	Investments- restricted	-	-	-	-	-	-	-	-	-	-	-	-	-
Total current investments														
142	Prepaid expenses and other assets	54,089	3,000	-	-	-	-	13,384	2,955	72,898	-	1,688,932	-	2,063,770
143	Inventories	-	-	-	-	-	-	-	-	-	-	-	-	-
143.1	Allowance for obsolete inventories	-	-	-	-	-	-	-	-	-	-	-	-	-
144	Interprogram - due from	94,764	251,649	-	-	6,648,192	-	-	2,965,999	(8,340,604)	-	-	-	-
145	Assets held for sale	-	-	-	-	-	-	-	6,500,000	-	-	5,500,000	-	6,500,000
150	Total current assets	254,773	933,418	1,736,243	-	13,785	314,971	12,108,260	(8,340,604)	12,760,729	-	5,818,082	-	19,578,811
NONCURRENT ASSETS														
Fixed assets:														
161	Land	-	-	-	-	-	-	-	-	-	-	-	-	-
162	Buildings	-	-	-	-	750,000	-	-	7,682,569	13,947,614	-	21,660,183	-	21,660,183
163	Furniture, equipment & mach. - dwellings	-	-	-	-	15,228,273	-	-	15,228,273	67,949,525	-	83,172,596	-	83,172,596
164	Furniture, equipment & mech. - admin.	-	-	-	-	-	-	-	-	-	-	-	-	-
165	Leasehold improvements	230,788	189,544	22,269	-	31,378	-	-	525,229	4,449,154	-	4,974,369	-	4,974,369
166	Accumulated depreciation	(161,341)	(833,319)	(27,205)	-	4,185	-	-	(4,076)	1,065,701	-	(1,065,701)	-	(1,065,701)
167	Construction in progress	(27,898)	(1,063,102)	(27,205)	-	(725,678)	-	-	(1,076,694)	(17,849,000)	-	(19,925,694)	-	(19,925,694)
167	Total fixed assets, net of accumulated depreciation	120,091	45,761	-	-	15,263,198	-	-	7,928,207	68,397,093	-	91,774,290	-	91,774,290
170	Notes, loans and mortgages receivable - noncurrent	-	-	-	-	-	-	-	4,496,420	-	-	4,496,420	-	4,496,420
171	Other assets	-	-	-	-	-	-	-	74,518	-	-	74,518	3,057,182	3,131,700
176	Investments in Joint Venture	-	-	-	-	-	-	-	273,940	-	-	273,940	-	273,940
180	Total noncurrent assets	120,091	45,761	-	-	15,357,656	-	-	28,722,015	71,454,275	-	99,076,290	-	99,076,290
190	TOTAL ASSETS	\$ 374,804	\$ 979,179	\$ 1,736,243	\$ -	\$ 6,646,192	\$ 13,785	\$ 93,671	\$ 15,673,627	\$ 24,906,847	\$ (8,340,604)	\$ 77,723,357	\$ -	\$ 118,155,101

**HARRIS COUNTY HOUSING AUTHORITY**  
**ENTITY-WIDE BALANCE SHEET SUMMARY**  
**March 31, 2013**

Line Item #	Accounts Description	Housing Choice Vouchers	Disaster Assistance Grant	Disaster Housing Assistance Grant	Program	DHAP - ILE	Section 8 Moderate Rehabilitation	Section 8 Mod Rehab SRO	Cypresswood Estates (Business Activities)	Business Activities	Elimination	Total Enterprise Fund	Component Units	Total Reporting Entity
<b>CURRENT LIABILITIES</b>														
311	Bank overdraft	-	-	-	-	-	-	-	-	-	-	-	-	-
312	Accounts payable <= 90 days	27,924	-	-	101	-	33	-	16,990	24,993	-	70,153	371,064	441,217
313	Accounts payable > 90 days	-	-	-	-	-	-	-	-	-	-	-	-	-
321	Accrued wage/payroll taxes payable	43,771	-	-	-	-	190	700	-	6,478	-	51,139	-	51,139
322	Accrued compensated absences - current portion	71,614	-	-	-	-	-	-	-	16,727	-	88,341	-	88,341
324	Accrued contingency liability	-	-	-	-	-	-	-	-	-	-	-	-	-
325	Accrued interest payable	-	-	-	-	-	-	-	-	-	-	-	-	-
331	Accounts payable - PHA projects	54,709	773,771	-	-	3,912,272	4,308	-	-	-	-	4,745,060	1,564,860	1,564,860
332	Accounts payable - HUD	-	-	-	-	-	-	-	-	-	-	-	-	-
341	Tenant security deposits	-	-	-	-	-	-	-	26,986	-	-	26,986	223,648	250,634
342	Deferred revenues	-	-	-	36,726	429,813	-	-	-	1,751,503	-	2,218,042	603,854	2,821,896
343	Current portion of LT debt - capital projects/ mortgage revenue	-	-	-	-	-	-	-	53,992	-	-	53,992	455,508	509,500
344	Current portion of LT debt - operating borrowings	-	-	-	-	-	-	-	-	-	-	-	-	-
345	Other current liabilities	-	11,837	-	-	-	-	-	251	-	-	12,088	-	12,088
346	Other liabilities	-	-	-	-	2,215	-	-	-	803	-	3,018	209,782	212,800
347	Interprogram (due to)	3,563,160	-	-	-	-	-	-	4,484,890	1,297,584	(9,340,604)	-	-	-
348	Loan liability - current	-	-	-	-	-	-	-	-	-	-	-	-	-
310	Total current liabilities	3,761,178	785,638	-	36,827	4,344,300	4,531	872	4,583,019	3,093,088	(9,340,604)	7,268,819	3,428,716	10,697,535
<b>NONCURRENT LIABILITIES</b>														
351	Long-term debt, net of current - capital projects/ mortgage revenue	-	-	-	-	-	-	-	3,446,008	-	-	3,446,008	43,722,941	47,168,949
352	Long-term debt, net of current - operating borrowings	-	-	-	-	-	-	-	-	-	-	-	-	-
353	Non-current liabilities - other	94,764	-	-	-	-	-	-	-	-	-	94,764	10,683,178	10,683,178
354	Accrued compensated absences - noncurrent	19,037	-	-	-	-	-	-	-	-	-	19,037	-	19,037
355	Loan liability - non current	-	-	-	-	-	-	-	-	-	-	-	-	-
350	Total noncurrent liabilities	113,801	-	-	-	-	-	-	3,446,008	-	-	3,559,809	54,311,355	57,871,164
300	Total liabilities	3,874,979	785,638	-	36,827	4,344,300	4,531	872	8,029,027	3,093,088	(9,340,604)	10,828,628	57,740,071	68,568,699
<b>EQUITY</b>														
508.1	Invested in capital assets	120,031	45,761	-	-	-	-	-	11,783,138	7,928,207	-	19,877,137	-	19,877,137
511.1	Restricted net position	3,821,760	698,769	-	1,708,686	-	13,785	85,733	268,524	1,671,993	-	8,269,250	-	8,269,250
512.1	Unrestricted net position	(7,441,966)	(550,959)	-	(9,270)	2,301,892	(4,531)	7,066	(4,408,062)	12,115,559	-	2,007,729	19,532,286	21,540,015
513	Total equity/net position	(3,500,175)	193,571	-	1,699,416	2,301,892	9,254	92,799	7,643,600	21,715,759	-	30,154,115	19,532,286	49,686,402
600	TOTAL LIABILITIES AND EQUITY/NET POSITION	374,804	979,179	-	1,736,243	6,646,192	13,785	93,671	15,672,627	24,808,847	(9,340,604)	40,982,744	77,272,357	118,255,101

**March 31, 2013**

[illegible]

**HARRIS COUNTY HOUSING AUTHORITY**  
**ENTITY-WIDE REVENUE AND EXPENSE SUMMARY**  
**March 31, 2013**

Line Item #	Accounts Description	Housing Choice Vouchers	Disaster Assistance Grant	Disaster Housing Voucher	Section 8 Moderate Rehabilitation	Section 8 New Rehab SRO	Cypresswood Estates (Business Activities)	Business Activities	Elimination	Total Enterprise Fund	Component Units	Total Reporting Entity
	<b>EXPENSES (Continued)</b>											
	General expenses:											
96200	Other general expenses	\$ -	\$ -	\$ -	751	\$ -	\$ -	\$ -	\$ -	751	1,236,626	\$ 1,237,177
96210	Compensated absences	150,129	-	-	-	-	-	37,945	-	188,074	-	188,074
96300	Payments in lieu of taxes	-	-	-	-	-	-	-	-	-	-	-
96400	Bad debt - tenant rents	-	-	-	-	-	-	-	-	-	-	-
96600	Bad debt - other	-	-	-	-	-	-	-	-	-	-	-
96800	Severance expense	-	-	-	-	-	-	-	-	-	-	-
96000	Total general expenses	150,129	-	-	751	-	-	37,945	-	188,825	1,236,626	1,425,251
96710	Interest of mortgage payable	-	-	-	-	-	-	-	-	-	728,175	728,175
96720	Interest on notes payable	-	-	-	-	-	72,127	-	-	72,127	682,984	755,111
96730	Amortization of bond issue costs	-	-	-	-	-	-	-	-	-	181,589	181,589
96700	Total interest expense and amortization cost	-	-	-	-	-	72,127	-	-	72,127	1,592,748	1,664,875
96900	Total operating expenses	3,018,225	-	17	751	25,552	545,077	1,858,301	-	5,284,451	6,798,321	12,052,772
97000	Excess of operating revenue over operating expenses	36,346,944	219,392	208	5,705	39,748	323,794	284,752	-	36,133,963	1,313,342	37,447,305
97100	Extraordinary maintenance	-	-	-	-	-	-	-	-	-	-	-
97200	Casualty losses - non capitalized	-	-	-	-	-	-	-	-	-	-	-
97300	Housing assistance payments	34,151,454	-	-	-	288,671	-	-	-	34,518,666	-	34,518,666
97350	HAP portability - in	1,854,823	-	-	-	-	-	-	-	1,854,823	-	1,854,823
97400	Depreciation expense	40,276	98,303	-	-	-	397,610	17,974	-	554,163	3,109,658	3,663,821
90000	Total expenses	39,104,778	98,303	17	751	314,173	942,887	1,676,275	-	42,182,103	9,907,979	52,090,082
10010	Other financing sources (uses):											
10020	Operating transfer in	-	-	-	-	-	-	(1,647,074)	-	(1,647,074)	-	(1,647,074)
10030	Operating transfer out	-	1,192	-	-	-	1,694,173	31,709	-	1,847,074	-	1,847,074
10100	Total other financing sources (uses)	-	1,192	-	-	-	1,614,173	(1,615,365)	-	-	-	-
10000	EXCESS (DEFICIENCY) OF REVENUE OVER (UNDER) EXPENSES	\$ 260,391	\$ 119,857	\$ 208	\$ 5,705	\$ 1,157	\$ (1,777,031)	\$ 510,811	\$ -	\$ (793,689)	\$ (1,796,316)	\$ (2,590,005)
11090	Memo Account Information											
	Beginning equity	(894,570)	73,674	1,699,188	2,296,187	8,087	9,370,631	19,863,692	-	32,474,545	21,653,100	54,127,645
11040	Prior period adjustments, equity transfers correction	(2,865,996)	-	-	-	-	-	1,339,256	-	(1,526,740)	(324,498)	(1,851,238)
11170	Administrative Fee Equity	(7,321,935)	-	-	-	-	-	-	-	(7,321,935)	-	(7,321,935)
11180	Housing Assistance Payments Equity	3,821,760	-	-	-	-	-	-	-	3,821,760	-	3,821,760
11190	Unit months available	49,881	-	-	-	960	1,056	-	-	51,897	11,400	63,297
11210	Number of unit months leased	49,173	-	-	-	935	1,031	-	-	51,139	10,732	61,871



CliftonLarsonAllen LLP  
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**Independent Auditor's Report on Internal Control over Financial  
Reporting and on Compliance and Other Matters Based on an Audit of Financial  
Statements Performed in Accordance with *Government Auditing Standards***

To the Board of Commissioners  
Harris County Housing Authority  
Houston, Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Harris County Housing Authority (the Authority), as of and for the year ended March 31, 2013, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated December 23, 2013. Our report includes a reference to other auditors who audited the financial statements of the aggregate discretely presented components units, as described in our report on the Authority's financial statements. This report includes our consideration of the results of the other auditor's testing of internal control over financial reporting and compliance and other matters that are reported on separately by those other auditors. However, this report, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and questioned costs as Item 2013-01 to be a material weakness.



### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Authority's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs as item 2013-01.

### **Harris County Housing Authority's Response to Findings**

The Authority's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The Authority's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*CliftonLarsonAllen LLP*

Baltimore, Maryland  
December 23, 2013



**Independent Auditor's Report on Compliance with Requirements that Could  
Have a Direct and Material Effect on Each Major Program and on Internal  
Control Over Compliance in Accordance with OMB Circular A-133**

The Board of Commissioners  
Harris County Housing Authority  
Houston, Texas

**Report on Compliance for Each Major Federal Program**

We have audited Harris County Housing Authority's (the Authority) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Authority's major federal programs for the year ended March 31, 2013. The Authority's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditors' Responsibility***

Our responsibility is to express an opinion on compliance for each of the Authority's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; 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 the Authority'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 on compliance for each major federal program. However, our audit does not provide a legal determination of the Authority's compliance.

***Opinion on Each Major Federal Program***

In our opinion, the Authority complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended March 31, 2013.

### **Other Matters**

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2013-02, 2013-03, and 2013-04. Our opinion on each major federal program is not modified with respect to these matters.

The Authority's response to the noncompliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The Authority's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

### **Report on Internal Control Over Compliance**

Management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Authority's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and significant deficiencies.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2013-02 to be a material weakness.

*A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2013-03 and 2013-04 to be significant deficiencies.

The Authority's responses to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The Authority's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the result of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

**Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133**

We have audited the financial statements of the enterprise fund and the aggregate discretely presented component units of the Authority as of and for the year ended March 31, 2013, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements. We issued our report thereon dated December 23, 2013, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

*CliftonLarsonAllen LLP*

Baltimore, Maryland  
December 23, 2013

**HARRIS COUNTY HOUSING AUTHORITY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Year Ended March 31, 2013**

	<u>CFDA Number</u>	<u>Federal Expenditures</u>
<b>U.S. Department of Housing and Urban Development (HUD)</b>		
Housing Choice Voucher Program	14.871	\$ 39,104,778
Disaster Voucher Program	14.871	<u>17</u>
Housing Voucher Cluster Total		<u>39,104,795</u>
 Lower Income Housing Assistance - Section 8 Moderate Rehab	 14.856	 45,119
Section 8 Rental Moderate Rehabilitation Program - SRO	14.182	<u>314,173</u>
Section 8 Project-Based Cluster Total		<u>359,292</u>
 DHAP Ike Housing Assistance Payments	 DH-IKE	 <u>751</u>
<b>TOTAL FEDERAL EXPENDITURES</b>		<b><u>\$ 39,464,838</u></b>

The accompanying notes are an integral part of this schedule.

**HARRIS COUNTY HOUSING AUTHORITY**  
**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**March 31, 2013**

**NOTE 1 – BASIS OF PRESENTATION**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Harris County Housing Authority (the Authority) and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the basic financial statements.

**NOTE 2 – NON-CASH FEDERAL ASSISTANCE**

The Authority did not receive any non-cash Federal assistance for the year ended March 31, 2013.

**HARRIS COUNTY HOUSING AUTHORITY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended March 31, 2013**

**I. Summary of Independent Auditor's Results**

**Financial Statements**

Type of auditor's report issued: Unmodified

Internal control over financial reporting:

• Material weakness(es) identified?	<u>  X  </u>	Yes	<u>      </u>	No
• Significant deficiency(ies) identified that are not considered to be material weaknesses?	<u>      </u>	Yes	<u>  X  </u>	None reported
Noncompliance material to financial statements noted?	<u>      </u>	Yes	<u>  X  </u>	No

**Federal Awards**

Internal control over major programs:

• Material weakness(es) identified?	<u>  X  </u>	Yes	<u>      </u>	No
• Significant deficiencies identified that are not considered to be material weaknesses?	<u>  X  </u>	Yes	<u>      </u>	None reported

Type of auditor's report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133?	<u>  X  </u>	Yes	<u>      </u>	No
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**Identification of Major Programs**

<u>Name of Federal Program</u>	<u>CFDA Number</u>	<u>Expenditures</u>
Housing Voucher Cluster	14.871	\$ 39,104,795

Dollar threshold used to distinguish between type A and type B programs: \$ 1,183,945

Auditee qualified as low-risk auditee?	<u>      </u>	Yes	<u>  X  </u>	No
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**HARRIS COUNTY HOUSING AUTHORITY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended March 31, 2013**

**II. Financial Statement Findings**

**Finding 2013-01 – Material Audit Adjustments**

***Condition***

Reconciliation errors in deferred ground lease revenue between the Authority and related party transactions with the component units were identified as a result of new requirements under group audit standards. Ground lease revenue was not properly reported by the Authority. The Authority received prepayments on ground leases in 2005 and recognized all amounts as revenue rather than recognizing the lease revenue over the term of the lease on a straight-line basis. A prior period adjustment of \$1,526,740 was required to properly defer the ground lease revenue as of March 31, 2012.

***Criteria***

To be properly managed, accurate and timely accounting records should be maintained. Reconciliations should be performed between the Authority and component units to ensure accounting transactions agree.

***Cause***

The Authority did not have in place an adequate system of internal controls for reviewing and monitoring its financial reporting.

***Effect***

Material misstatements that resulted in a prior period adjustment.

***Recommendation***

We recommend that management enhance its processes for reviewing, monitoring and accounting for all transactions between the Authority and the component units. In addition, management should establish procedures to ensure the identification and application of appropriate accounting standards for recording and reporting and ensure that all transactions are supported by appropriate documentation.

***Management's Response***

In Fiscal Year 2006, the Authority made a journal entry that is the subject of this finding at the direction of its then current independent financial auditors. While internal controls have certainly been at issue at the Authority under the previous management, better internal controls would not have compensated for this particular error from seven (7) years ago, nor do better internal controls generally compensate for errors made by independent auditors who are hired by and report to the Board of Commissioners. The only internal control that might have caught this error sooner is the best practice of using the same auditor for no longer than 4-5 years as HUD currently recommends. This limit on using the same auditor is the approach currently implemented by the Authority. However, this practice will only increase the likelihood that an error made by a previous independent auditor is found sooner rather than later. Despite what is suggested in the above finding, better internal controls will not generally compensate for errors made by independent auditors.

Management is pleased that the independent auditor has detected this error, and agrees that the revenue in question should have been recognized as lease revenue over the term of the lease on a straight-line basis.



**HARRIS COUNTY HOUSING AUTHORITY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended March 31, 2013**

**III. Federal Award Findings and Questioned Costs**

**Finding 2013-02 – Housing Choice Voucher Program, CFDA #14.871**

<b>Federal Agency:</b>	<b>U.S. Department of Housing and Urban Development</b>
<b>Compliance Requirement:</b>	<b>Cash Management</b>
<b>Type of Finding:</b>	<b>Noncompliance, Material Weakness</b>

***Condition***

The Authority has overspent on certain programs and utilized cash from other programs to cover the overage. The Authority should have approximately \$10,949,081 of cash on hand to cover program reserves, but as of March 31, 2013, there is only \$4,474,476 of available cash. Commingling of funds is not allowable between federal programs.

***Criteria***

HUD issued PIH Notice 2008-38 which details the Operating requirements for the DHAP-like program and states that funding under this program may not be used for other activities or costs including the HCVP or DVP program.

***Cause***

The Authority uses one sweep account to handle all cash accounts. The Authority did not maintain separate bank accounts for each program or monitor the allocation of funds.

***Effect***

The Authority is in violation of their ACC Contract and could result in civil penalties or sanctions.

***Questioned Costs***

\$6,474,605

***Recommendation***

We recommend that Management implement a process to ensure cash is properly allocated to the proper program.

***Management's Response***

The cause and source of the commingling, overspending of certain federal accounts, and funds owed back to HUD have been well documented, including partial documentation by CliftonLarsonAllen in the Authority's financial statements for Fiscal Year 2012. Since March 31, 2012, the Authority's available cash has increased by \$2,527,113, no additional DHAP funds have been spent, \$773,771 of DHAP funds have been repaid to HUD, and since October 1, 2012, all new nonfederal funds have been segregated in a separate account. Further, since October 1, 2012, all nonfederal expenses have been properly allocated to these segregated nonfederal revenues. However, until the Authority property, known as Patriots by the Lake, is sold, the Authority will not have sufficient cash to cover program reserves. This fact was reported to HUD on April 13, 2012 and has been consistently and thoroughly disclosed by management to HUD, other federal agencies, independent auditors, the Board of Commissioners and the general public from that day forward.

**HARRIS COUNTY HOUSING AUTHORITY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended March 31, 2013**

The Authority has opened separate accounts for each of its separate lines of business as of May 2013. However, because certain lines of business were significantly overdrawn due to spending that occurred under the previous management, the Authority was unable to fund those accounts until it could bring the balance in each line of business to \$0 or greater. Additionally, until HUD identified the proper Net Restricted Asset (NRA) fund amount, which occurred on June 20, 2013, and until HUD determined the final amount of monies owed back to HUD from its DHAP IKE Harris County program, which occurred by August 23, 2013, the Authority could not move forward with determining the amount owed from one Authority line of business to another.

This process is now complete, and per board approval, the appropriate journal entries have been made as of October 31, 2013. In January 2014, the Authority will fully fund separate checking accounts for its active lines of business. Within 60 days of receiving the net proceeds for the above mentioned property, the Authority is committed to completing the funding of the necessary program reserves and fully repaying any federal fund from which money was misspent.

**Finding 2013-03 – Housing Choice Voucher Program, CFDA #14.871**

<b>Federal Agency:</b>	<b>U.S. Department of Housing and Urban Development</b>
<b>Compliance Requirement:</b>	<b>Special Tests – Rent Reasonableness (Change)</b>
<b>Type of Finding:</b>	<b>Noncompliance, Significant Deficiency</b>

***Condition***

Testing of 40 Housing Choice Voucher tenant files identified 8 files where the rent determination date was after the effective date.

***Criteria***

The PHA must determine that the rent to owner is reasonable at the time of initial leasing. Also, the PHA must determine reasonable rent during the term of the contract: (a) before any increase in the rent to owner, and (b) at the HAP contract anniversary if there is a five percent decrease in the published Fair Market Rent (FMR) in effect 60 days before the HAP contract anniversary. The PHA must maintain records to document the basis for the determination that rent to owner is a reasonable rent (initially and during the term of the HAP contract). (24 CFR sections 982.4, 982.54(d)(15), 982.158(f)(7), and 982.507).

***Cause***

The Authority did not follow established procedures as documented in their Administrative Plan to ensure that rents were reasonable.

***Effect***

The Authority is not in compliance with HUD regulations.

***Questioned Costs***

Unable to determine

***Recommendation***

We recommend that management review their rent determination procedures and establish a method to ensure compliance.

**HARRIS COUNTY HOUSING AUTHORITY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended March 31, 2013**

***Management's Response***

Authority management is ultimately responsible for failing to ensure that proper quality control regarding the timely determination of reasonable rent was implemented during the transition that occurred during this fiscal year. Proper quality control is now occurring, and management has established procedures to monitor and ensure that the Administrative Plan is properly followed in a timely manner.

**Finding 2013-04 – Housing Choice Voucher Program, CFDA #14.871**

**Federal Agency**

**U.S. Department of Housing and Urban Development**

**Compliance Requirement:**

**Reporting:**

**Type of Finding:**

**Significant Deficiency**

***Condition***

The Authority submitted their unaudited REAC submission to HUD, which was due May 31, 2013 on October 22, 2013.

***Criteria***

HUD issued PIH notice 2012-21 which states that unaudited submissions are due no later than 2 months after the PHA's FYE. A PHA with a March 31 FYE needs to submit its unaudited submission to HUD no later than May 31.

***Cause***

The Authority did not meet deadlines required by HUD.

***Effect***

The Authority is not in compliance with HUD regulations.

***Questioned Costs***

Unable to determine

***Recommendation***

We recommend that Management establish procedures to ensure submissions are done timely.

***Management's Response***

Management communicated with senior staff from HUD's Real Estate Assessment Center (REAC) that the Authority's unaudited submission would be postponed until management received the Quality Assurance Division (QAD) report detailing the proper Net Restricted Asset (NRA) fund amount and was able to make the proper adjustments to ensure that these amounts were reflected as of March 31, 2013.

The Authority was faced with the option of providing HUD unaudited submissions that it knew were inaccurate or waiting to ensure that the unaudited submissions were as accurate as possible, using guidance from HUD's Quality Assurance Division, which was received on June 20, 2013. The Authority chose the route of providing the more accurate, albeit tardy, unaudited submissions. Given the journal entries approved by the Board of Commissioners and made as of October 31, 2013, the Authority will be able to provide timely submissions to REAC going forward.

**HARRIS COUNTY HOUSING AUTHORITY  
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS  
Year Ended March 31, 2013**

**Finding 2012-01 – Material Audit Adjustments**

***Condition***

The unaudited Financial Data Schedule (FDS) that was filed by the Authority had significant errors and during the course of the audit, several misstatements were identified that had a material effect on the Authority's financial statements. Several adjustments were required to properly record various transactions as follows:

- Adjustment to record Accounts Payable at year end that were not properly accrued.
- Adjustments to record accrued compensated absences at year end that were not properly accrued.
- Adjustments to accrue interest receivable on the notes receivables from component units.
- Adjustments to write off accounts receivables and uncollected tenant receivables.
- Adjustments to record activity of Cypresswood Estates.
- Adjustment to record accrued interest expense for the construction loan for Cypresswood Estates.

***Recommendation***

We recommend that management enhance its processes for reviewing, monitoring and accounting for all transactions. In addition, management should establish procedures to ensure the identification and application of appropriate accounting standards for recording and reporting and ensure that all transactions are supported by appropriate documentation.

***Status***

A similar finding was noted in the current year. See finding number 2013-01.

**Finding 2012-02 – Housing Choice Voucher Program, CFDA #14.871**

<b>Federal Agency:</b>	<b>U.S. Department of Housing and Urban Development</b>
<b>Compliance Requirement:</b>	<b>Cash Management</b>
<b>Type of Finding:</b>	<b>Noncompliance, Material Weakness</b>

***Condition***

The Authority has overspent on certain programs and utilized cash from other programs to cover the overage. The Authority should have approximately \$8,288,000 of cash on hand to cover program reserves, but as of March 31, 2012, there is only \$1,771,592 of available cash. Commingling of funds is not allowed in federal programs. It was also noted that HUD requested the Authority to return approximately \$3.9 million in DHAP-like funds. The Authority is unable to do so at this time.

***Recommendation***

We recommend that Management implement a process to ensure cash is properly allocated to the proper program.

***Status***

A similar finding was noted in the current year. See finding number 2013-02.

**HARRIS COUNTY HOUSING AUTHORITY  
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS  
Year Ended March 31, 2013**

**Finding 2012-03 – Housing Choice Voucher Program, CFDA #14.871**

<b>Federal Agency:</b>	<b>U.S. Department of Housing and Urban Development</b>
<b>Compliance Requirement:</b>	<b>Special Tests – Depository Agreement</b>
<b>Type of Finding:</b>	<b>Noncompliance, Significant Deficiency</b>

***Condition***

The Authority was unable to provide general depository agreements providing third-party rights to HUD for banks holding deposits for Housing Choice Voucher Funds using the form required by HUD.

***Recommendation***

We recommend that the Authority immediately enter into General Depository Agreements with their financial institutions in the form prescribed by HUD.

***Status***

This finding has been cleared in the current year.

**Finding 2012-04 – Housing Choice Voucher Program, CFDA #14.871**

<b>Federal Agency:</b>	<b>U.S. Department of Housing and Urban Development</b>
<b>Compliance Requirement:</b>	<b>Activities Allowed or Unallowed</b>
<b>Type of Finding:</b>	<b>Noncompliance, Significant Deficiency</b>

***Condition***

The Authority was over-leased by 142 unit months when comparing Housing Choice Voucher Occupancy Report to the ACC Contract for the 2011 calendar year.

***Recommendation***

We recommend that the Authority monitor their leasing to reduce the risk of an over-leasing situation.

***Status***

This finding has been cleared in the current year.

**Finding 2012-05 – Housing Choice Voucher Program, CFDA #14.871**

<b>Federal Agency:</b>	<b>U.S. Department of Housing and Urban Development</b>
<b>Compliance Requirement:</b>	<b>Special Tests – Rent Reasonableness (Change)</b>
<b>Type of Finding:</b>	<b>Noncompliance, Significant Deficiency</b>

***Condition***

Testing of 12 Housing Choice Voucher tenant files found exceptions in 3 files, which included the following:

- 1 file had a rent determination date after the effective date.
- 2 files had a rental request form that was not properly approved by the housing specialist.

**HARRIS COUNTY HOUSING AUTHORITY  
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS  
Year Ended March 31, 2013**

- 1 file had a rent increase that was not properly entered into the system and there was no evidence that the contract rent change occurred.
- 2 files did not have a letter to the landlord notifying them of the approved/denied rent increase request.

***Recommendation***

We recommend that management review their rent determination procedures and establish a method that ensures compliance.

***Status***

A similar finding was noted in the current year. See finding number 2013-03.

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