WATERSIDE COURT, LTD.
FINANCIAL STATEMENTS
For the years ended December 31, 2013 and 2012
with
Report of Independent Auditors

Report of Independent Auditors

To the Partners of
Waterside Court, Ltd.:

Report on the Financial Statements

We have audited the accompanying financial statements of Waterside Court, Ltd., which comprise the balance sheets as of December 31, 2013 and 2012, and the related statements of operations, changes in partners' capital, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 Partnership'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 Partnership's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Waterside Court, Ltd. as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Novogradac & Company LLP

April 21, 2014
Austin, Texas

WATERSIDE COURT, LTD.
BALANCE SHEETS
December 31, 2013 and 2012

		2013		2012
ASSETS				
Cash and cash equivalents	$	69,246	$	177,831
Restricted cash		720,113		598,730
Prepaid expenses		25,060		28,633
Fixed assets, net of accumulated depreciation		12,043,361		12,528,711
Intangible assets, net of accumulated amortization		300,422		316,829
Total assets	$	13,158,202	$	13,650,734
LIABILITIES AND PARTNERS' CAPITAL				
Liabilities				
Accounts payable	$	12,151	$	21,656
Security deposits payable		84,236		81,114
Accrued interest		200,192		173,592
Accrued expenses		40,989		28,916
Due to related party		5,608		5,531
HOME loan payable		500,000		500,000
Mortgage loan payable		4,496,571		4,567,387
Total liabilities		5,339,747		5,378,196
Partners' capital		7,818,455		8,272,538
Total liabilities and partners' capital	$	13,158,202	$	13,650,734

see accompanying notes

WATERSIDE COURT, LTD.
STATEMENTS OF OPERATIONS
For the years ended December 31, 2013 and 2012

	2013	2012
REVENUE		
Rental revenue	$ 1,261,929	$ 1,235,271
Other income	46,934	39,580
Total revenue	1,308,863	1,274,851
OPERATING EXPENSES		
General and administrative	40,217	40,453
Payroll	180,381	177,270
Utilities	138,204	129,841
Taxes and insurance	80,393	78,159
Property management fee	66,896	65,110
Repairs and maintenance	195,543	167,777
Legal and other professional fees	12,040	13,412
Land lease expense	1,000	2,000
Marketing and advertising	3,113	3,119
Total operating expenses	717,787	677,141
Operating income	591,076	597,710
OTHER INCOME AND (EXPENSES)		
Interest income	1,759	1,152
Interest expense	(357,993)	(371,564)
Depreciation and amortization	(501,757)	(584,135)
Other partnership expenses	(144,840)	(136,200)
Net other income and (expenses)	(1,002,831)	(1,090,747)
Net loss	$ (411,755)	$ (493,037)

WATERSIDE COURT, LTD.
STATEMENTS OF CHANGES IN PARTNERS' CAPITAL
For the years ended December 31, 2013 and 2012

	General Partner	Limited Partners	Total Partners' Capital
BALANCE, JANUARY 1, 2012	$ (261)	$ 8,780,472	$ 8,780,211
Capital distributions	-	(14,636)	(14,636)
Net loss	(49)	(492,988)	(493,037)
BALANCE, DECEMBER 31, 2012	(310)	8,272,848	8,272,538
Capital distributions	(24,059)	(18,269)	(42,328)
Net loss	24,018	(435,773)	(411,755)
BALANCE, DECEMBER 31, 2013	$ (351)	$ 7,818,806	$ 7,818,455

see accompanying notes

WATERSIDE COURT, LTD.
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2013 and 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (411,755)	$ (493,037)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	501,757	584,135
Net changes in operating assets and liabilities:		
Restricted cash	(15,571)	(10,044)
Prepaid expenses	3,573	(603)
Accounts payable	(9,505)	7,957
Security deposits payable	3,122	10,452
Accrued interest	26,600	26,600
Accrued expenses	12,073	(32,764)
Due to related party	77	353
Net cash provided by operating activities	110,371	93,049
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in restricted cash	(105,812)	(10,221)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments of mortgage loan payable	(70,816)	(57,245)
Capital distributions	(42,328)	(14,636)
Net cash used in financing activities	(113,144)	(71,881)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(108,585)	10,947
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	177,831	166,884
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 69,246	$ 177,831
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$ 331,393	$ 344,964

WATERSIDE COURT, LTD.
NOTES TO FINANCIAL STATEMENTS
For the years ended December 31, 2013 and 2012

1. General

Waterside Court, Ltd. (the "Partnership"), a Texas limited partnership, was formed on February 20, 2004, to acquire, construct, develop and operate a 118-unit single family home project known as Waterside Court (the "Project") in Houston, Texas. The Project is rented to low-income tenants and is operated in a manner necessary to qualify for federal low-income housing tax credits as provided under Section 42 of the Internal Revenue Code.

The general partner is HCHA Waterside, LLC (the "General Partner"). The limited partners (the "Limited Partners") are Investors Affordable Housing Group X, LLC (the "Class A Limited Partner"), Hudson SLP, LLC (the "Special Limited Partner"), and Hudson Waterside, LLC (the "Investment Limited Partner"). The Partnership will operate until December 31, 2080, or until its earlier dissolution or termination.

Profits, losses, and tax credits are allocated in accordance with the Amended and Restated Agreement of Limited Partnership of Waterside Court, Ltd., dated June 22, 2006, and as amended (the "Partnership Agreement"). Profits and losses from operations and low-income housing tax credits are allocated 99.99% to the Limited Partners and 0.01% to the General Partner.

Pursuant to the Partnership Agreement, the Investment Limited Partner is required to provide capital contributions to the Partnership totaling $11,140,928, as adjusted for any tax credit adjustments. During 2009, there was a downward adjustment of $7,404. As of December 31, 2013 and 2012, the Investment Limited Partner had provided cumulative contributions in the amount of $11,133,524. During 2013 and 2012, the Investment Limited Partner received distributions in the amounts of $18,269 and $14,636, respectively. During 2013, the General Partner received a distribution in the amount of $24,059.

2. Summary of significant accounting policies and nature of operations

Basis of accounting
The Partnership prepares its financial statements on the accrual basis of accounting consistent with accounting principles generally accepted in the United States of America.

Cash and cash equivalents
Cash and cash equivalents include all cash balances on deposit with financial institutions and highly liquid investments with a maturity of three months or less at the date of acquisition.

Restricted cash is not considered cash and cash equivalents, and includes cash held with financial institutions for refunds of tenant security deposits, funding of operating deficits, repairs or improvements to the buildings which extend their useful lives, and annual insurance and property tax payments.

2. Summary of significant accounting policies and nature of operations (continued)

Concentration of credit risk

The Partnership maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Partnership has not experienced any losses in such accounts. The Partnership believes it is not exposed to any significant credit risk on cash and cash equivalents.

Income taxes

Income taxes on partnership income are levied on the partners at the partner level. Accordingly, all profits and losses of the Partnership are recognized by each partner on its respective tax return.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the Partnership to report information regarding its exposure to various tax positions taken by the Partnership. Management has determined whether any tax positions have met the recognition threshold and has measured the Partnership's exposure to those tax positions. Management believes that the Partnership has adequately addressed all relevant tax positions and that there are no unrecorded tax liabilities. Federal and state tax authorities generally have the right to examine and audit the previous three years of tax returns filed. Any interest or penalties assessed to the Partnership are recorded in operating expenses. No interest or penalties from federal or state tax authorities were recorded in the accompanying financial statements.

Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Economic concentrations

The Partnership operates one property located in Houston, Texas. Future operations could be affected by changes in economic or other conditions in that geographical area or by changes in federal low-income housing subsidies or the demand for such housing.

Fixed assets

Fixed assets are recorded at cost. Residential rental buildings are depreciated over their estimated useful lives of 40 years using the straight-line method. Site improvements are depreciated over 15 years using the straight-line method. Personal property is depreciated over 5 years using the straight-line method. Depreciation expense during 2013 and 2012 was $485,350 and $567,728, respectively.

2. Summary of significant accounting policies and nature of operations (continued)

Fixed assets (continued)
Fixed assets consisted of the following at December 31:

	2013	2012
Buildings	$ 12,539,072	$ 12,539,072
Site improvements	2,578,104	2,578,104
Personal property	617,835	617,835
Less: accumulated depreciation	(3,691,650)	(3,206,300)
Fixed assets, net	$ 12,043,361	$ 12,528,711

Intangible assets
Intangible assets include financing fees of $357,353 and tax credit fees of $67,425, which are amortized using the straight-line method over the life of the loan and tax credit compliance period, respectively. As of December 31, 2013 and 2012, accumulated amortization was $124,356 and $107,949, respectively. Amortization expense during 2013 and 2012 was $16,407 for both years.

Impairment of long-lived assets
The Partnership reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Recoverability is measured by a comparison of the carrying amount to the future net undiscounted cash flow expected to be generated and any estimated proceeds from the eventual disposition. If a long-lived asset is considered to be impaired, the impairment to be recognized is measured at the amount by which the carrying amount exceeds the fair value as determined from an appraisal, discounted cash flows analysis, or other valuation technique. There were no impairment losses recognized during 2013 or 2012.

Revenue recognition
Rental revenue attributable to residential leases is recorded when due from residents, generally upon the first day of each month. Leases are for periods of up to one year, with rental payments due monthly. Other income results from fees earned for late payments, cleaning, damages and laundry facilities and is recorded when earned.

Marketing and advertising
Marketing and advertising costs are expensed as incurred. During 2013 and 2012, the Partnership incurred $3,113 and $3,119, respectively, in marketing and advertising costs.

2. Summary of significant accounting policies and nature of operations (continued)

Tenant receivables
An allowance for bad debts is not maintained. Accounts receivable are written off when they are determined to be uncollectible. Accounting principles generally accepted in the United States of America require that an allowance for uncollectible accounts be maintained in lieu of using the direct charge-off method; however, management has determined that such an allowance would be immaterial with respect to the financial statements taken as a whole.

Ground lease
The Partnership accounts for its ground lease as an operating lease and records expense (see Note 4) based on the average minimum yearly base lease accrual calculated over the term of the lease. The ground lease accrues at varying amounts over its term. The cumulative difference between the annual expense and the actual base lease amount has been recorded as accrued land lease expense and is included in "Accrued expenses" on the accompanying balance sheets.

Subsequent events
Subsequent events have been evaluated through April 21, 2014, which is the date the financial statements were available to be issued, and there are no subsequent events requiring disclosure.

3. Restricted cash

Security deposits
Tenant security deposits are deposited into the operating account and are generally held until termination of the leases, at which time some or all of the deposits may be returned to the lessees. As of December 31, 2013 and 2012, the security deposits balance was $84,190 and $81,114, respectively.

Tax and insurance escrows
Monthly deposits are made for the payment of Project insurance and taxes. All deposits are pledged as additional security for the Project mortgage. As of December 31, 2013 and 2012, the tax and insurance escrows balance was $58,602 and $46,107, respectively.

Operating reserve
Pursuant to the Partnership Agreement, the General Partner is required to establish an operating reserve with a minimum deposit of $100,000, to be increased to $275,000 upon funding of the HOME loan payable. The funds may be released to pay operating expenses with the approval of the Special Limited Partner. As of December 31, 2008, the operating reserve had been funded from proceeds of the HOME loan payable and the third and fourth capital contribution installments. As of December 31, 2013 and 2012, operating reserve funds are maintained in money market accounts and certificates of deposit. As of December 31, 2013 and 2012, the accounts totaled $432,841 and $356,303, respectively.

3. Restricted cash (continued)

Replacement reserve

Pursuant to the Partnership Agreement, monthly deposits equal to an annual balance of $250 per unit, increased annually by the consumer price index are required. The deposits are placed into an interest-bearing account held by Amegy Mortgage Company, L.L.C. (the “Lender”) for major repairs and improvements of the Project. Deposits to the replacement reserve account began in 2008. All deposits in the account are pledged as additional security for the Project mortgage. As of December 31, 2013 and 2012, the replacement reserve balance was $144,480 and $115,206, respectively.

Replacement reserve activity for the year ended December 31:

	2013	2012
Beginning balance	$ 115,206	$ 105,721
Monthly deposits	31,919	29,599
Disbursements	(2,645)	(20,114)
Ending balance	$ 144,480	$ 115,206

4. Related party transactions

Property management fees

Pursuant to a property management agreement, Hettig Management Corp., a related party of the Class A Limited Partner, receives property management fees in the amount of 5% of the gross effective income collected from operations, provided that payment of 20% of the property management fee is subordinated to the payment of Project debt service and other operating expenses. During 2013 and 2012, property management fees of $66,896 and $65,110, respectively, were incurred. As of December 31, 2013 and 2012, property management fees of $5,608 and $5,531, respectively, were outstanding and are included in "Due to related party" on the accompanying balance sheets.

4. Related party transactions (continued)

Incentive partnership management fee

Pursuant to the Partnership Agreement, the General Partner and Class A Limited Partner are entitled to receive an annual, non-cumulative incentive partnership management fee equal to 11% of gross effective income and payable from net cash flow available for distribution. During 2013, the Partnership achieved positive net cash flow, and based on the priority distribution there was remaining cash flow to be applied toward the incentive partnership management fee. During 2013 and 2012, an incentive partnership management fee of $140,360 and $131,720, respectively, was incurred and included in “Other partnership expenses” on the accompanying statements of operations.

Preferred return

In any year in which the General Partner receives a preferred return (the “Preferred Return”) as stated in the Partnership Agreement, the General Partner is required to receive an equivalent allocation of gross income prior to allocation of profit and losses. Preferred returns should be recorded as a distribution to the General Partner with the reduction in capital that is offset by the equivalent income allocation. During 2013, the General Partner received a Preferred Return with an equivalent income allocation of $24,059.

Ground lease

In October 2005, the Partnership entered into a 65-year ground lease agreement (the “Ground Lease”) with Harris County Housing Authority, a related party of the General Partner. Under the terms of the Ground Lease, the Partnership is required to make annual lease payments of $1,000 during the first 17 years. Beginning in year 18, the annual lease payment increases to $65,000 for the remaining term of the Ground Lease, with all but $1,000 waived, provided that the Project is leased to tenants in accordance with all applicable low income housing requirements. During 2013 and 2012, Ground Lease expense of $1,000 and $2,000, respectively, was charged to operations. As of December 31, 2013 and 2012, outstanding Ground Lease payable was $1,000 for both years and is included in "Accrued expenses" on the accompanying balance sheets.

Future minimum ground lease payment requirements over each of the next five years and thereafter are as follows:

Year ending December 31,	
2014	$ 1,000
2015	1,000
2016	1,000
2017	1,000
2018	1,000
Thereafter	51,000
Total	$ 56,000

4. Related party transactions (continued)

HOME loan payable

In June 2006, the Partnership obtained a HOME loan from Harris County Housing Authority in the total amount of $500,000. The HOME loan accrues interest on the outstanding balance at the applicable federal interest rate (AFR) of 5.32%, and matures on June 30, 2028. The HOME loan is collateralized by the Project and is subordinate to the mortgage loan payable. Interest only payments are required until maturity, at which time all outstanding principal and interest is due. As of December 31, 2013 and 2012, principal of $500,000 was outstanding for both years. As of December 31, 2013 and 2012, accrued interest of $200,192 and $173,592, respectively, was outstanding.

5. Mortgage loan payable

On June 1, 2008, the construction loan in the principal amount of $4,800,000 held with the Lender converted to permanent financing. The mortgage loan payable bears interest at 7.38% with principal and interest payments due monthly based on a thirty year amortization period. The mortgage loan payable is collateralized by the Project and matures in June 2026. As of December 31, 2013 and 2012, a principal balance of $4,496,571 and $4,567,387, respectively, was outstanding.

Future minimum principal payment requirements over each of the next five years and thereafter are as follows:

Year ending December 31,		
2014	$	67,115
2015		72,312
2016		76,967
2017		83,872
2018		90,366
Thereafter		4,105,939
Total	$	4,496,571

6. Property tax exemption

The Partnership applied for, and was granted, exemption from property tax by Harris County Appraisal District, pursuant to Section 392.005 of the Texas Local Government Code. Pursuant to the code, a multifamily residential development which is owned by a housing authority is property tax exempt.

On October 26, 2005, the Partnership entered into an agreement for payment in lieu of ad valorem taxes with the Fallbrook Utility District. The Partnership will be taxed for the use of water, sewage, drainage and other services within the Fallbrook Utility District boundaries. The Partnership was under dispute with Fallbrook Utility District for taxes owed from 2007 to 2011. The dispute has been resolved and agreements were made in late 2011 and early 2012. As of December 31, 2013 and 2012, estimated taxes of $17,616 for both years have been accrued and are included in "Accrued expenses" on the accompanying balance sheets.

7. Low-income housing tax credits

The Partnership expects to generate an aggregate of $11,541,000 of low-income housing tax credits ("Tax Credits"). The Tax Credits include an annual allocation of $1,054,000 from 2005 and an additional annual allocation of $100,100 allocated in 2008. Tax Credits are available for use by the partners pro-rata over a ten-year period that began in 2007. In order to qualify for these Tax Credits, the Project must comply with various federal and state requirements. These requirements include, but are not limited to, renting to low-income tenants at rental rates, which do not exceed specified percentages of area median gross income for the first 15 years of operation. The Partnership has also agreed to maintain and operate the Project as low-income housing for another 25 years after that period ends. Because the Tax Credits are subject to compliance with certain requirements, there can be no assurance that the aggregate amount of Tax Credits will be realized and failure to meet all such requirements or to correct noncompliance within a specified time period may result in generating a lesser amount of Tax Credits than expected in future years, and/or recapture of Tax Credit previously allocated. A reduction of future credits or recapture would require credit payments to the Investment Limited Partner under the terms of the Partnership Agreement.