

BAYBROOK PARK RETIREMENT CENTER, 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  
Baybrook Park Retirement Center, Ltd.:

*Report on financial statements*

We have audited the accompanying financial statements of Baybrook Park Retirement Center, 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 Baybrook Park Retirement Center, 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.

### *Report on Supplementary Information*

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The property tax exemption is presented for purposes of additional analysis and is not a required part of the 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 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 financial statements or to the 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 financial statements as a whole.

*Nowogrodski & Company CP*

April 29, 2014  
Austin, TX

BAYBROOK PARK RETIREMENT CENTER, LTD.  
BALANCE SHEETS  
December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash and cash equivalents	\$ 124,018	\$ 109,950
Restricted cash	183,125	151,191
Restricted cash - money market account	228,304	152,403
Prepaid expenses	18,919	22,614
Prepaid ground lease	517,566	526,726
Fixed assets, net of accumulated depreciation	4,960,574	5,192,203
Intangible assets, net of accumulated amortization	<u>83,799</u>	<u>93,592</u>
Total assets	<u><u>\$ 6,116,305</u></u>	<u><u>\$ 6,248,679</u></u>
LIABILITIES AND PARTNERS' CAPITAL		
Liabilities		
Accounts payable	\$ 3,780	\$ 6,131
Security deposits payable	27,190	26,177
Accrued interest	219,495	191,266
Accrued expenses	8,221	4,270
Accrued property management fee	3,447	3,217
HOME loan payable	625,000	625,000
Mortgage loan payable	<u>3,032,833</u>	<u>3,090,827</u>
Total liabilities	<u>3,919,966</u>	<u>3,946,888</u>
Partners' capital	<u>2,196,339</u>	<u>2,301,791</u>
Total liabilities and partners' capital	<u><u>\$ 6,116,305</u></u>	<u><u>\$ 6,248,679</u></u>

see accompanying notes

BAYBROOK PARK RETIREMENT CENTER, LTD.  
STATEMENTS OF OPERATIONS  
For the years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
REVENUE		
Rental revenue	\$ 785,889	\$ 690,215
Other income	<u>31,478</u>	<u>25,753</u>
Total revenue	817,367	715,968
OPERATING EXPENSES		
General and administrative	18,661	18,653
Payroll	131,109	125,707
Utilities	54,590	56,295
Insurance	56,059	48,178
Property management fees	41,459	36,354
Repairs and maintenance	75,840	72,275
Legal and other professional fees	16,641	15,879
Ground lease expense	10,160	11,160
Marketing and advertising	<u>11,315</u>	<u>14,219</u>
Total operating expenses	<u>415,834</u>	<u>398,720</u>
Operating income	401,533	317,248
OTHER INCOME AND (EXPENSES)		
Interest income	965	379
Interest expense	(221,764)	(221,520)
Depreciation and amortization	(241,422)	(241,423)
Other partnership expenses	<u>(41,064)</u>	<u>(21,507)</u>
Net other income and (expenses)	<u>(503,285)</u>	<u>(484,071)</u>
Net loss	<u><u>\$ (101,752)</u></u>	<u><u>\$ (166,823)</u></u>

see accompanying notes

BAYBROOK PARK RETIREMENT CENTER, LTD.  
STATEMENT 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	\$ (116)	\$ 2,470,260	\$ 2,470,144
Capital distributions	-	(1,530)	(1,530)
Net loss	<u>(17)</u>	<u>(166,806)</u>	<u>(166,823)</u>
BALANCE, DECEMBER 31, 2012	(133)	2,301,924	2,301,791
Capital distributions	-	(3,700)	(3,700)
Net loss	<u>(10)</u>	<u>(101,742)</u>	<u>(101,752)</u>
BALANCE, DECEMBER 31, 2013	<u><u>\$ (143)</u></u>	<u><u>\$ 2,196,482</u></u>	<u><u>\$ 2,196,339</u></u>

see accompanying notes

BAYBROOK PARK RETIREMENT CENTER, LTD.  
STATEMENTS OF CASH FLOWS  
For the years ended December 31, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$ (101,752)	\$ (166,823)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	241,422	241,423
Ground lease expense	9,160	9,160
Net changes in operating assets and liabilities:		
Restricted cash	(12,167)	(7,995)
Prepaid expenses	3,695	(1,674)
Accounts payable	(2,351)	1,599
Security deposits payable	1,013	1,570
Accrued interest	28,229	17,451
Accrued expenses	3,951	(4,164)
Due to related parties	230	(5,171)
Net cash provided by operating activities	<u>171,430</u>	<u>85,376</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Increase in restricted cash	(19,767)	(20,004)
Increase in restricted cash - money market account	(75,901)	(379)
Net cash used in operating activities	<u>(95,668)</u>	<u>(20,383)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Repayments of development fee payable	-	(16,704)
Repayments of mortgage loan payable	(57,994)	(47,126)
Capital distributions	(3,700)	(1,530)
Net cash used in financing activities	<u>(61,694)</u>	<u>(65,360)</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	14,068	(367)
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<u>109,950</u>	<u>110,317</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u><u>\$ 124,018</u></u>	<u><u>\$ 109,950</u></u>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid for interest	<u><u>\$ 193,535</u></u>	<u><u>\$ 204,069</u></u>

see accompanying notes

BAYBROOK PARK RETIREMENT CENTER, LTD.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2013 and 2012

1. Organization

Baybrook Park Retirement Center, Ltd. (the "Partnership"), a Texas limited partnership, was formed on February 23, 2004 to acquire, construct, develop and operate a 100-unit apartment project known as Baybrook Park Retirement Center (the "Project") in Webster, 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 Baybrook Park, LLC (the "General Partner"). The limited partners (the "Limited Partners") are Investors Affordable Housing Group V, Ltd. (the "Class A Limited Partner"), Hudson SLP, LLC (the "Special Limited Partner"), and Hudson Baybrook, LLC (the "Investment Limited Partner"). The Partnership will operate until December 31, 2079, 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 Baybrook Park Retirement Center, Ltd., dated June 21, 2005, 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 Third Amendment to the Amended and Restated Partnership Agreement, the Investment Limited Partner is required to provide capital contributions to the Partnership totaling \$4,669,879, as adjusted for any tax credit adjustments. As of December 31, 2013 and 2012, the Investment Limited Partner had provided capital contributions in the amount of \$4,626,774 for both years. As of December 31, 2013 and 2012, total distributions of \$5,230 and \$1,530, respectively, were made to the Investment Limited Partner.

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.

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 Webster, 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.

BAYBROOK PARK RETIREMENT CENTER, LTD.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2013 and 2012

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

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 payments.

The carrying amounts of cash and restricted cash approximate their fair values

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.

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, it has been determined that such an allowance would be immaterial with respect to the financial statements taken as a whole.

Fixed assets and depreciation

Fixed assets are recorded at cost. Residential rental buildings are depreciated over their estimated useful lives of 40 years using the straight-line method. Commercial space is depreciated over 39 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 \$231,629 and \$231,631, respectively.

Intangible assets and amortization

Intangible assets include permanent loan fees of \$102,741 and tax credit fees of \$44,144, which are amortized using the straight-line method over the life of the loan and 15 year tax credit compliance period, respectively. Amortization expense was \$9,793 and \$9,792 during 2013 and 2012, respectively. As of December 31, 2013 and 2012, accumulated amortization was \$63,086 and \$53,293, respectively.

BAYBROOK PARK RETIREMENT CENTER, LTD.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2013 and 2012

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

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.

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.

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.

Ground lease

The Partnership accounts for its ground lease as an operating lease and records expense (see Note 5) 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 prepaid ground lease in the accompanying balance sheets.

BAYBROOK PARK RETIREMENT CENTER, LTD.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2013 and 2012

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

Subsequent events

Subsequent events have been evaluated through April 29, 2014, which is the date the financial statements were available to be issued, and there are no subsequent events requiring disclosure.

3. Restricted cash

Operating reserve

Pursuant to the Partnership Agreement, the General Partner was required to establish a \$175,000 operating reserve account in a segregated account to fund operating deficits. The funds may be released to pay operating expenses with the approval of the Special Limited Partner. The proceeds to fund the operating reserve were deposited into an interest bearing money market account. As of December 31, 2013 and 2012, the balance of the money market account was \$228,304 and \$152,403, respectively.

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 tenant security deposits balance was \$25,911 and \$24,898, respectively.

Insurance escrow

Monthly deposits are made to Amegy Mortgage Company, L.L.C. (the "Lender") for the payment of property insurance. All deposits are pledged as additional security for the Project mortgage. As of December 31, 2013 and 2012, the insurance escrow balance was \$37,433 and \$26,279, respectively.

Replacement reserve

Pursuant to the Partnership Agreement, the Partnership is required to make monthly deposits equal to an annual balance of \$250 per unit, of which \$50 is required to be paid with funds from net cash available. The deposits to the replacement reserve are to be increased annually by changes in the consumer price index. Monthly deposits are placed into an interest-bearing account held by the Lender for major repairs and improvements of the Project. 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 \$119,781 and \$100,014, respectively.

BAYBROOK PARK RETIREMENT CENTER, LTD.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2013 and 2012

4. Fixed assets

Fixed assets consist of the following as of December 31:

	2013	2012
Buildings	\$ 5,038,127	\$ 5,038,127
Commercial space	74,031	74,031
Site improvements	1,556,649	1,556,649
Personal property	974,923	974,923
Less: accumulated depreciation	(2,683,156)	(2,451,527)
Fixed assets, net	<u>\$ 4,960,574</u>	<u>\$ 5,192,203</u>

5. Related party transactions

Ground lease

In June 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. The initial payment for the Ground Lease was \$595,427 and is recognized over the term of the lease. 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 of that waived, provided that the Project is leased to tenants in accordance with all applicable low-income housing requirements. As of December 31, 2013 and 2012, the prepaid ground lease balance was \$517,566 and \$526,726, respectively. The total ground lease expense during 2013 includes prepaid ground lease recognition of \$9,160 and a rent payment of \$1,000. The total ground lease expense during 2012 includes prepaid ground lease recognition of \$9,160 and a rent payment of \$2,000.

Future minimum lease payments over 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	<u>51,000</u>
Total	<u>\$ 56,000</u>

BAYBROOK PARK RETIREMENT CENTER, LTD.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2013 and 2012

5. Related party transactions (continued)

Property management fee

Pursuant to the property management agreement, Investors Management Group, LLC, a related party of the Class A Limited Partner, is entitled to a property management fee in the amount of 5% of the gross effective income collected from operations, provided that payment of 20% of the fee is subordinated to the payment of the Project's debt service and other operating expenses. During 2013 and 2012 the Partnership incurred a fee of \$41,459 and \$36,354, respectively. As of December 31, 2013 and 2012, accrued property management fees of \$3,447 and \$3,217, respectively, remained outstanding.

Development fee payable

Hettig Development Group XI, Ltd., a related party of the Class A Limited Partner, earned a fee of \$961,788 for services rendered in connection with the construction and development of the Project. The development fee payable bore interest at 6% per annum. Payments of principal and interest were to be made from Project cash flow and from additional capital contributions received from the Investment Limited Partner. During 2012, development fee payable was fully paid.

Operating deficit guaranty

Pursuant to the Partnership Agreement, at any time during the period beginning upon the date breakeven operations is achieved and ending on the third anniversary of such date, the General Partner must provide funds to the Partnership as is necessary to pay operating deficits. The General Partner is not obligated to provide funds in excess of \$260,000, as defined by the Partnership Agreement. Operating deficit loans bear no interest. As of December 31, 2013 and 2012, there were no guaranty amounts due or payable.

Incentive partnership management fee

Pursuant to the Partnership Agreement, the General Partner and Class A Limited Partner may 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 and 2012, incentive partnership management fees of \$32,966 and \$13,766, respectively, were paid.

Asset management fee

Pursuant to the Partnership Agreement and subject to the priority distributions of net cash flow, the Special Limited Partner may receive an annual cumulative asset management fee of \$5,000, adjusted for the change in the consumer price index in effect on the date of adjustment over the date in effect twelve months prior, for its services in monitoring the operations of the Partnership. During 2013 and 2012, \$6,098 and \$5,741 of asset management fees for were incurred, respectively, and are included in "Other partnership expenses" on the accompanying statements of operations. As of December 31, 2013 and 2012, no asset management fees were outstanding.

BAYBROOK PARK RETIREMENT CENTER, LTD.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2013 and 2012

5. Related party transactions (continued)

Home loan

In June 2005, the Partnership obtained a HOME loan (the "HOME loan") in the total amount of \$625,000 from Harris County Housing Authority. The HOME loan accrues interest on the outstanding balance at the applicable federal interest rate in place on the date of the agreement, which was 4.57%. The HOME loan matures on August 31, 2027, is collateralized by the Project, and is subordinate to the mortgage. Payments of principal and unpaid interest are required at maturity. As of December 31, 2013 and 2012, principal of \$625,000 was outstanding for both years. As of December 31, 2013 and 2012, accrued interest of \$219,495 and \$190,932, respectively, was outstanding.

6. Mortgage loan payable

On December 14, 2007, construction financing of \$3,300,000 was converted to permanent financing for the Project from the Lender. The mortgage loan payable bears interest at 6.44%, requires minimum monthly principal and interest payments of \$20,933 and is due and payable in 180 consecutive monthly installments of principal and interest, commencing in February 2008. The mortgage payable is collateralized by the Project. As of December 31, 2013 and 2012, the total outstanding principal balance was \$3,032,833 and \$3,090,827, respectively.

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

Year ending December 31,	
2014	\$ 54,017
2015	57,562
2016	60,982
2017	65,635
2018	70,052
Thereafter	<u>2,724,585</u>
Total	<u>\$ 3,032,833</u>

BAYBROOK PARK RETIREMENT CENTER, LTD.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2013 and 2012

7. Low-income housing tax credits

The Partnership expects to generate an aggregate of \$4,849,810 of low-income housing tax credits ("Tax Credits"). The Tax Credits include an annual allocation of \$445,118 from 2004 and an additional annual allocation of \$39,863 allocated in 2007. Tax Credits became available for use by the partners pro-rata over a ten-year period beginning in 2006 and 2007. The year in which the credit period begins is determined on a building-by-building basis within the Partnership. In order to qualify for these 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 an additional 40 years beyond the initial 15 year compliance period. 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 Credits previously allocated. A reduction of future credits or recapture would require credit deficit payments to the Investment Limited Partner under the terms of the Partnership Agreement.

## **SUPPLEMENTARY INFORMATION**

BAYBROOK PARK RETIREMENT CENTER, LTD.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2013 and 2012

Property tax exemption

The Partnership applied for and was granted an exemption from property tax by the Hays County Appraisal District, pursuant to Section 392.005 of the Local Government Code, which establishes a property tax exemption for property owned by a housing authority, if the property is used for public purposes. As described in Note 5, the Partnership entered into a 65-year ground lease agreement with Harris County Housing Authority, a related party of the General Partner. Harris County Housing Authority is the legal owner of the land on which the property is located.