SIERRA MEADOWS, LTD.
FINANCIAL STATEMENTS
For the year ended December 31, 2013
with
Report of Independent Auditors

Report of Independent Auditors

To the Partners of
Sierra Meadows, Ltd.:

Report on the Financial Statements

We have audited the accompanying financial statements of Sierra Meadows, Ltd. which comprise the balance sheet as of December 31, 2013, and the related statements of operations, changes in partners' deficit and cash flows for the year 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 audit. We conducted our audit 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 of 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, the financial statements referred to above present fairly, in all material respects, the financial position of Sierra Meadows, Ltd. as of December 31, 2013, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Supplemental and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Supplemental Information – 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. The information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide assurance on it.

Novogradac & Company LLP

May 29, 2014
Austin, TX

SIERRA MEADOWS, LTD.
BALANCE SHEET
December 31, 2013

ASSETS		
Cash and cash equivalents	$	77,120
Restricted cash		313,377
Accounts receivable		2,100
Due from related party		771
Prepaid expenses		34,106
Fixed assets, net of accumulated depreciation		9,914,108
Intangible assets, net of accumulated amortization		357,112
Total assets	$	10,698,694
LIABILITIES AND PARTNERS' DEFICIT		
Liabilities		
Accounts payable	$	7,623
Tenant security deposits payable		27,566
Prepaid rent		2,325
Accrued interest		12,607
Due to related parties		6,827
Development fee payable		121,943
Mortgage payable		2,439,762
Tax credit exchange program grant		7,531,441
Deferred grant income		983,212
Total liabilities		11,133,306
Partners' deficit		(434,612)
Total liabilities and partners' deficit	$	10,698,694

SIERRA MEADOWS, LTD.
STATEMENT OF OPERATIONS
For the year ended December 31, 2013

REVENUE		
Rental revenue	$	739,106
Other income		17,970
Total revenue		757,076
OPERATING EXPENSES		
General and administrative		28,489
Payroll		99,740
Utilities		99,174
Taxes and insurance		49,197
Management fees		37,301
Repairs and maintenance		57,640
Marketing and advertising		6,202
Legal and other professional fees		15,400
Ground lease		1,000
Total operating expenses		394,143
Net operating income		362,933
OTHER INCOME AND (EXPENSES)		
Exchange fund income		227,615
Interest income		98
Interest expense		(148,906)
Depreciation and amortization		(409,630)
Other partnership expenses		(4,500)
Net other income and (expenses)		(335,323)
Net income	$	27,610

SIERRA MEADOWS, LTD.
STATEMENT OF CHANGES IN PARTNERS' DEFICIT
For the year ended December 31, 2013

	General Partner	Limited Partners	Total Partners' Deficit
BALANCE, JANUARY 1, 2013	$ (46)	$ (462,176)	$ (462,222)
Net income	3	27,607	27,610
BALANCE, DECEMBER 31, 2013	$ (43)	$ (434,569)	$ (434,612)

see accompanying notes

SIERRA MEADOWS, LTD.
STATEMENT OF CASH FLOWS
For the year ended December 31, 2013

CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	$ 27,610
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	409,630
Exchange fund income	(227,615)
Changes in operating assets and liabilities:	
Restricted cash	68,694
Accounts receivable	5,250
Prepaid expenses	(544)
Accounts payable	(2,621)
Security deposits payable	1,385
Prepaid rent	(1,123)
Accrued interest	(51)
Accrued expenses	(5,939)
Net cash provided by operating activities	274,676
CASH FLOWS FROM INVESTING ACTIVITIES	
Decrease in restricted cash	11,239
Purchase of fixed assets	(3,391)
Net cash provided by investing activities	7,848
CASH FLOWS FROM FINANCING ACTIVITIES	
Increase in intangible assets	(4,744)
Increase in due to related parties	3,805
Payment of development fee payable	(325,726)
Repayment of mortgage payable	(10,238)
Net cash used in financing activities	(336,903)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(54,379)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	131,499
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 77,120
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:	
Cash paid for interest	$ 148,957

see accompanying notes

1. General

Sierra Meadows, Ltd. (the "Partnership"), a Texas Limited Partnership, was formed on February 26, 2009, to construct, develop and operate a 90-unit senior housing project known as Sierra Meadows (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 operating methods of the Project are subject to the provisions of the Tax Credit Exchange Program Subaward Agreement (the "Subaward Agreement") executed between the Partnership and Texas Department of Housing and Community Affairs ("TDHCA"), whereby TDHCA advanced the Partnership tax credit exchange program funds as a sub-award from grant funds provided under Section 1602 of the American Recovery and Reinvestment Act of 2009 ("ARRA").

The general partner is HCHA Sierra Meadows, LLC (the "General Partner"). The limited partners are Sierra Meadows Investors, LLC and Harris County Housing Authority (the "Limited Partners") and Integrated Sierra Meadows SLP, LLC (the "Special Limited Partner"). The Partnership will operate in perpetuity or until its dissolution in accordance with the provisions of the Partnership Agreement.

Profits, losses, and tax credits are allocated in accordance with the Amended and Restated Limited Partnership Agreement dated June 29, 2010 ("the Partnership Agreement"). Profits and losses from operations and low-income housing tax credits in any one year are allocated 0.01% to the General Partner, 99.98% to the Limited Partners, and 0.01% to the Special Limited Partner.

Pursuant to the Partnership Agreement, the General Partner is required to make capital contributions of $0.10, the Limited Partners are required to make capital contributions of $999.80, and the Special Limited Partner is required to make capital contributions of $0.10. For the year ended December 31, 2013, no capital contributions had been provided.

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.

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, capital replacements, and exchange program funds.

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

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.

Accounts receivable
An allowance for bad debts is not maintained. Accounts are written off when they are determined to be uncollectible. Accounting principles generally accepted in the United States of America require that the allowance method be used to recognize bad debts; however, the effect of using the direct write-off method is not materially different from the results that would have been obtained under the allowance method.

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 for late payments, cleaning, damages, and laundry facilities, and is recorded when earned.

Grants
Grants received by the Partnership are recorded as a liability and are amortized as grant income over a period of 40 years, which coincides with the depreciable life of the buildings. The grants are generally forgiven over 15 years; therefore, the carrying amount of the grants exceed the Partnership’s recapture obligation if it fails to satisfy all of the underlying compliance requirements.

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

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. The Partnership 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.

Marketing and advertising

Marketing and advertising costs are expensed as incurred. During 2013, the Partnership incurred $6,202 in marketing and advertising costs.

Fixed assets

The Partnership records all depreciable assets at cost. Residential rental buildings are depreciated over their estimated useful lives of 40 years under the straight-line method. Site improvements are depreciated over their estimated useful lives of 15 years under the straight-line method. Furniture and equipment are depreciated over their estimated useful lives of 5 years under the straight-line method. During 2013, depreciation expense was $407,902.

Fixed assets consist of the following as of December 31, 2013:

Buildings	$ 8,177,093
Site improvements	2,592,741
Personal property	243,783
Less: accumulated depreciation	(1,099,509)
Fixed assets, net	$ 9,914,108

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

Intangible assets

Intangible assets consist of financing and tax credit fees of $330,965 and $77,001, respectively. Permanent loan fees are amortized over the term of the loan. Tax credit fees are amortized using the straight line method over the tax credit compliance period of 15 years. During 2013, amortization expense was $1,728. As of December 31, 2013, accumulated amortization was $50,854.

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 of the asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount of the asset 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 of the asset 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.

Ground lease

The Partnership accounts for the ground lease as an operating lease and records expense based on the average minimum yearly base lease accrual calculated over the term of the lease (see Note 4). The cumulative difference between the annual expense and the actual base lease amount will be recorded as deferred rent in the accompanying balance sheet.

Subsequent events

Subsequent events have been evaluated through May 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

Replacement reserve

Pursuant to the Subaward Agreement, the Partnership is required to establish and maintain a replacement reserve to be funded annually commencing on the construction completion date. The reserve for replacements is to be funded at an annualized rate of $250 per apartment unit per year. Funds in the replacement reserve are to be used solely to fund capital repairs and improvements deemed necessary by the Partnership. As of December 31, 2013, the replacement reserve balance was $11,239.

3. Restricted cash (continued)

Operating lease-up reserve
Pursuant to the Subaward Agreement, the Partnership is required to establish and maintain a segregated operating lease up reserve account in an amount equivalent to six months of stabilized operating expenses and debt service payments. Funds in the account are allowed as approved by TDHCA to fund cash deficits prior to stabilization. Once six months of continuous stabilized occupancy as defined by the Subaward Agreement is achieved, withdrawals from this fund may be made by the Partnership without consent of TDHCA. As of December 31, 2013, the operating lease up reserve balance was $274,570.

Special reserve
Pursuant to the Subaward Agreement, in the event of positive net cash flow generated by the Project, assuming the replacement reserve and operating lease up reserve are fully funded, a participation percentage as designated in the Subaward Agreement of that net cash flow is to be placed in a special reserve account to assist residents with expenses associated with their tenancy. These expenses may include application costs, security deposits, or utilities for low income units as specified in the Subaward Agreement. TDHCA has prior approval rights for any disbursement of funds from this account. As of December 31, 2013, the special reserve had not been funded.

Security deposits
Tenant security deposits are placed into an account and are generally held until termination of the lease, at which time some or all deposits may be returned to the lessee. As of December 31, 2013, security deposits balance was $27,568.

4. Related party transactions

Due from related party
As of December 31, 2013, the Partnership paid for operating expenses on behalf of the property management associated with the Project. Related party receivables bear no interest and are due upon demand. As of December 31, 2013, a receivable of $771 was outstanding.

Development fee payable
The Partnership entered into a development services agreement with Integrated Housing Solutions, LLC (the "Developer"), a related party of the Special Limited Partner and Sierra Meadows Investors, LLC. The Developer earned a fee of $1,435,000 for services rendered in connection with the construction and development of the Project. Any remaining outstanding developer fees after permanent loan closing are to be paid from available net cash in accordance with the Partnership Agreement. No interest accrues on the development fee payable. As of December 31, 2013, development fee payable of $121,943 remained outstanding.

4. Related party transactions (continued)

Ground lease

In December 2009, the Partnership entered into a 45-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 $75,000 during the first 18 years with all but $1,000 waived, provided that the Project is leased to tenants in accordance with all applicable low income housing requirements. Beginning in year 18, the annual lease payment increases to $100,000 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.

December 9, 2009 to December 8, 2027	$75,000, less waived portion of $74,000 if in compliance with the ground lease requirements
December 9, 2027 to December 8, 2054	$100,000, less waived portion of $99,000 if in compliance with the ground lease requirements

The term of the Ground Lease is from December 9, 2009 to December 8, 2054. At the expiration of this lease, the Partnership will surrender the possession of the leased premises to the Harris County Housing Authority. During 2013, Ground Lease expense of $1,000 was charged to operations. As of December 31, 2013, there was no ground lease payable outstanding.

Future annual lease payments due over the next five years are as follows:

Year ending December 31,		
2014	$	1,000
2015		1,000
2016		1,000
2017		1,000
2018		1,000
Thereafter		35,000
Total	$	40,000

Property management fees

Pursuant to the property management agreement, Integrated Property Management, a related party of Special Limited Partner and Sierra Meadows Investors, LLC, receives a monthly property management fee equal to 5% of gross revenue. Additionally, during lease-up the property manager is entitled to a monthly fee of $5,000 for a period less than 11 months or 90% occupancy. For the year ended December 31, 2013, property management fees and leasing fees of $37,301 were incurred. As of December 31, 2013, property management fees and leasing fees of $6,827 remained outstanding and are included in "Due to related parties" on the accompanying balance sheet.

5. Mortgage payable

On June 29, 2010, the Partnership entered into an agreement with the Lender to obtain a construction loan in the principal amount of $3,000,000. Interest only payments at a rate of 6% are due monthly commencing on June 29, 2010. During 2013, the construction loan converted into permanent loan in the principal amount $2,450,000. The loan bears interest at 6%. Payments of principal and interest totaling $14,689 are due monthly. The mortgage payable is collateralized by the Project. The maturity date of the permanent financing will be 15 years after conversion. As of December 31, 2013, principal of $2,439,762 and accrued interest of $12,607 remained outstanding.

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

Year ending December 31,		
2014	$	30,693
2015		32,586
2016		34,595
2017		36,729
2018		38,995
Thereafter		2,266,164
Total	$	2,439,762

6. Exchange program loan and deferred grant income

Pursuant to the Subaward Agreement, the Partnership obtained exchange funds in the amount of $9,104,580 (“Exchange Funds”) from TDHCA in lieu of federal low-income housing tax credits. The Partnership is obligated to operate under the program requirements for receiving and maintaining Exchange Funds set forth in ARRA, regulations, guidelines or notices published from time to time with respect to the Exchange Program that are applicable to the Project.

The Exchange Funds are non-interest bearing and secured by a first lien on the Project. Provided no event of recapture (as defined in the Subaward Agreement) has occurred, the Exchange Funds will be forgiven at the expiration of the Compliance Period, as defined in the Subaward Agreement.

The obligation to repay the Exchange Funds is reduced on a straight-line basis over the 15 year compliance period. The Exchange Funds are recognized as income on a straight-line basis over the 40-year life of the fixed assets. For the year ended December 31, 2013, the Exchange Funds repayment obligation was reduced by $1,573,139, of which $227,615 was recognized as income and the balance of $983,212 was recorded as deferred income. As of December 31, 2013, the Exchange Funds balance was $7,531,441.

SUPPLEMENTARY INFORMATION

SIERRA MEADOWS, LTD.
SUPPLEMENTAL INFORMATION - PROPERTY TAX EXEMPTION
December 31, 2013

Property tax exemption

The Partnership applied for and was granted exemption from property tax by the Harris County Appraisal District, pursuant to Section 11.182 of the Texas Property Tax Code, which requires that the Partnership meet certain cash flow requirements by providing benefits to low and moderate-income individuals and families in the form of social, educational, or economic development services, capital improvement projects, or rent reduction. The exemption was granted in 2005 and began in the year 2007. Pursuant to Section 11.182(h)(1)(B) of the Texas Property Tax Code, the Partnership is restricted to the amount of rent it may charge for dwelling units, therefore it is exempt from certain compliance requirements that are defined in Subsections (d) and (e)(3) of Section 11.182 of the Texas Property Tax Code.