

Hoffman Homes, Inc.

Financial Statements And Independent Auditors' Report

June 30, 2017

CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	3
FINANCIAL STATEMENTS	
STATEMENT OF FINANCIAL POSITION	4
STATEMENT OF ACTIVITIES	5
STATEMENT OF FUNCTIONAL EXPENSES	6
STATEMENT OF CASH FLOWS	7
NOTES TO FINANCIAL STATEMENTS	8 - 21

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Hoffman Homes, Inc.

We have audited the accompanying Statement of Financial Position of Hoffman Homes, Inc. (a nonprofit organization) as of June 30, 2017, and the related Statements of Activities, Functional Expenses 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 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, the financial statements referred to above present fairly, in all material respects, the financial position of Hoffman Homes, Inc. as of June 30, 2017, and the changes in their net assets and their cash flows for the year then ended.

Stambaugh Ness, PC

York, Pennsylvania
October 18, 2017

A Professional Corporation

HOFFMAN HOMES, INC.
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2017

ASSETS

CURRENT ASSETS	
Cash	\$ 6,399
Accounts receivable - fee for service	1,425,312
Accounts receivable - other	30,000
Prepaid expenses	<u>116,831</u>
Total current assets	1,578,542
RESTRICTED CASH	120,195
INVESTMENTS	4,468,180
PROPERTY, PLANT AND EQUIPMENT	
Property, plant and equipment - at cost	14,921,522
Less: accumulated depreciation	<u>(11,908,625)</u>
Net property, plant and equipment	3,012,897
OTHER ASSETS	
Beneficial interest in perpetual trusts	<u>2,650,535</u>
TOTAL ASSETS	<u><u>\$ 11,830,349</u></u>

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES	
Line of credit	\$ 2,137,398
Cash overdraft	114,277
Accounts payable	131,702
Accrued payroll and related benefits	449,007
Accrued interest	1,462
Current portion of long-term debt	360,695
Current portion of capital lease	5,968
Interest rate swap liability	12,725
Escrow accounts payable	<u>1,533</u>
Total current liabilities	3,214,767
LONG-TERM LIABILITIES	
Long-term debt - net of current portion	1,577,595
Capital lease - net of current portion	13,996
Pension liability	<u>1,784,832</u>
Total long-term liabilities	<u>3,376,423</u>
TOTAL LIABILITIES	6,591,190
NET ASSETS	
Unrestricted:	
Undesignated	1,581,606
Temporarily restricted	167,126
Permanently restricted	<u>3,490,427</u>
TOTAL NET ASSETS	<u>5,239,159</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 11,830,349</u></u>

See accompanying notes.

HOFFMAN HOMES, INC.
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES AND GAINS				
Fees for services	\$ 8,956,395	\$ -	\$ -	\$ 8,956,395
Education income	2,033,154	-	-	2,033,154
Contributions	256,188	138,257	5,000	399,445
Food reimbursement	171,058	-	-	171,058
Miscellaneous income	57,332	-	-	57,332
Bequests	56,631	-	-	56,631
Investment gain	485,419	-	-	485,419
Irrevocable trust fund income	119,712	-	-	119,712
Changes in beneficial interest in perpetual trusts	-	-	121,774	121,774
Net assets released from restrictions:				
Restrictions satisfied by fulfilling purpose	156,230	(156,230)	-	-
Total revenues and gains	12,292,119	(17,973)	126,774	12,400,920
EXPENSES AND LOSSES				
Administration	1,860,250	-	-	1,860,250
Clinical services	6,005,463	-	-	6,005,463
Culinary	452,634	-	-	452,634
Development	226,730	-	-	226,730
Healthcare	1,324,374	-	-	1,324,374
Operations	844,756	-	-	844,756
Education (Hoffman Academy)	1,121,612	-	-	1,121,612
Total expenses and losses	11,835,819	-	-	11,835,819
OTHER CREDITS AND CHARGES				
Defined benefit plan changes other than net periodic pension expense	678,046	-	-	678,046
Unrealized gain on interest rate swaps	2,555	-	-	2,555
Total other credits and charges	680,601	-	-	680,601
INCREASE IN NET ASSETS	1,136,901	(17,973)	126,774	1,245,702
NET ASSETS				
Beginning of year	444,705	185,099	3,363,653	3,993,457
End of year	<u>\$ 1,581,606</u>	<u>\$ 167,126</u>	<u>\$ 3,490,427</u>	<u>\$ 5,239,159</u>

See accompanying notes.

HOFFMAN HOMES, INC.
STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED JUNE 30, 2017

	Administration	Clinical Services	Culinary	Development	Healthcare	Operations	Education (Academy)	Total
Salaries	\$ 701,923	\$ 4,621,482	\$ 86,164	\$ 122,326	\$ 636,203	\$ 241,248	\$ 861,779	\$ 7,271,125
Employee benefits*	233,513	1,262,371	32,874	34,435	176,979	59,881	165,858	1,965,911
Contracted services***	95,022	20,749	1,236	-	453,802	2,216	52,704	625,729
Depreciation expense	395,084	-	-	-	-	-	-	395,084
Utilities**	40,808	8,605	-	-	-	303,889	-	353,302
Food and food service supplies	-	-	332,310	-	-	458	-	332,768
Bad debt expense	141,304	-	-	-	-	-	-	141,304
Housekeeping & sanitation	-	1,343	-	-	2,413	104,348	-	108,104
Interest expense	105,331	-	-	-	-	-	-	105,331
Maintenance & repairs	1,070	1,581	-	-	-	81,116	504	84,271
Office supplies/equipment	7,518	17,928	50	2,757	2,009	10,014	28,327	68,603
Development	1,494	202	-	59,099	-	-	193	60,988
Medical/dental supplies & expense	-	7,728	-	-	52,573	-	-	60,301
Miscellaneous expense	39,426	16,707	-	2,197	-	-	-	58,330
Computer expenses	28,377	8,409	-	1,394	-	-	10,699	48,879
Lease expense	38,513	-	-	-	-	-	-	38,513
Staff development/recruitment	10,023	22,372	-	161	395	898	1,548	35,397
Travel/vehicle expense	487	5,208	-	50	-	20,631	-	26,376
Insurance - property and liability	-	-	-	-	-	20,057	-	20,057
Postage	19,290	570	-	13	-	-	-	19,873
Advertising	1,067	7,105	-	4,298	-	-	-	12,470
Behavior management	-	3,103	-	-	-	-	-	3,103
	<u>\$ 1,860,250</u>	<u>\$ 6,005,463</u>	<u>\$ 452,634</u>	<u>\$ 226,730</u>	<u>\$ 1,324,374</u>	<u>\$ 844,756</u>	<u>\$ 1,121,612</u>	<u>\$ 11,835,819</u>

* Includes Social Security, Unemployment Tax, Workers Compensation, Medical, Life, Dental, Pension and Employee Assistance Program.

** Includes telephone, electricity, fuel oil, water & sewer, cable TV and propane gas.

*** Includes legal, accounting, psychiatric and other professional services.

See accompanying notes.

HOFFMAN HOMES, INC.
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2017

CASH FLOWS FROM OPERATING ACTIVITIES	
Change in net assets	\$ 1,245,702
Adjustments to reconcile change in net assets to net cash from operating activities:	
Depreciation expense	395,084
Bad debt expense	141,304
Realized and unrealized loss on investments	(474,177)
Unrealized gain on interest rate swaps	(2,555)
Donated stock	(33,960)
Changes in beneficial interest in perpetual trusts	(121,774)
Defined benefit plan changes other than net periodic pension expense	(678,046)
(Increase) decrease in:	
Accounts receivable - fee for service	(208,893)
Accounts receivable - other	(27,763)
Prepaid expenses	(111,013)
Restricted cash	(21,243)
Increase (decrease) in:	
Accounts payable	(61,036)
Accrued payroll and related benefits	(9,253)
Escrow accounts payable	651
	<hr/>
Net cash from operating activities	33,028
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of property, plant and equipment	(262,727)
Purchase of investments	(1,328,321)
Proceeds from sale of investments	1,476,179
	<hr/>
Net cash from investing activities	(114,869)
CASH FLOWS FROM FINANCING ACTIVITIES	
Net change in line of credit	269,229
Net change in cash overdraft	24,134
Proceeds from capital lease	25,052
Payments on long-term debt	(236,259)
	<hr/>
Net cash from financing activities	82,156
NET CHANGE IN CASH	
	315
Cash at beginning of year	<hr/> 6,084
Cash at end of year	<hr/> <u>\$ 6,399</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION	
Cash payments for interest	<hr/> <u>\$ 105,331</u>

See accompanying notes.

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Hoffman Homes, Inc. ("Organization") is a private, not-for-profit, Pennsylvania Corporation related to the United Church of Christ.

The purpose of Hoffman Homes, Inc. is to provide comprehensive psychiatric care, treatment, and education to emotionally and behaviorally troubled children and their families. Hoffman Homes, Inc. is committed to providing services that are cost effective and responsive to the unique needs of each child, always in close cooperation with the parents/guardians, referring agencies, case management organizations, school systems, and funding sources. Hoffman Homes, Inc. grants credit to the agencies that place the youth in their facilities. The agencies that purchase services from Hoffman Homes, Inc. are located in Pennsylvania.

Hoffman Homes, Inc. also operates the Hoffman Academy ("Academy") under the Pennsylvania State Board of Academic Schools. The Academy provides differentiated instruction to meet the diverse needs of students with complex behavioral concerns. All programs are operated according to the guidelines established by PDE. Students have their needs assessed and then receive instruction designed specifically to their academic level.

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 certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Basis of Accounting

The financial statements of Hoffman Homes, Inc. have been prepared on the accrual basis of accounting and, accordingly, reflect all significant receivables, payables and other liabilities.

Basis of Presentation

Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Accounting Standards Codification 958, *Financial Statements of Not-for-Profit Organizations*. Under ASC 958, Hoffman Homes, Inc. is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets.

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - continued

Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, Hoffman Homes, Inc. considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents. There were no cash equivalents as of June 30, 2017.

Restricted Cash

These amounts represent cash that has been restricted by donors, as well as by Board designation.

Accounts Receivable

Accounts receivable balances are reviewed by management monthly. Any account over sixty days past due based on contractual terms is analyzed. Management believes that at June 30, 2017, no allowance is necessary as all accounts are deemed collectible. Account balances generally are written off when management judges such balances uncollectible.

Donated Assets

Donated marketable securities and other non-cash donations are recorded as contributions at their estimated fair values at the date of donation.

Promises to Give

Unconditional promises to give are recognized as revenues or gains in the period the promise is made. Conditional promises to give are recognized when the conditions on which they depend on are substantially met.

Restricted and Unrestricted Revenue and Support

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support, depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when the purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restrictions.

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - continued

Beneficial Interest in Perpetual Trusts

Hoffman Homes, Inc. recognizes its interests in irrevocable perpetual trust agreements of which it has been named an income beneficiary. The assets reported in the Statement of Financial Position represent Hoffman Homes, Inc.'s beneficial interest in the fair market value of the irrevocable perpetual trusts. Upon Hoffman Homes, Inc. being named an income beneficiary of an irrevocable perpetual trust, the initial interest is recognized as permanently restricted bequest income. Hoffman Homes, Inc. also recognizes changes in the fair market value of its beneficial interests in perpetual trusts in the permanently restricted section of the Statement of Activities.

Income Tax Status

Hoffman Homes, Inc. is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. Section 501(c)(3) defines the exempt organization as being "organized and operated for religious, charitable, scientific, testing for public safety, literacy or educational purposes, or for the prevention of cruelty to children or animals." In addition, Hoffman Homes, Inc. qualifies for the charitable contribution deduction under Section 170(b)(1)(a) and has been classified as an organization that is not a private foundation under Section 509(a)(2). Accordingly, no provision for federal or state income taxes has been recorded in the financial statements. Adjustments, if any, for uncertain tax positions would be recorded as a liability. The Organization is no longer subject to tax examinations by tax authorities for years before 2013.

The Organization would also recognize accruals for interest and penalties related to uncertain tax positions in its interest expense.

Allocation of Functional Expenses

Expenses reported on Hoffman Homes, Inc.'s Statement of Functional Expenses are allocated directly to their functional categories.

Concentrations of Credit Risk

The financial instruments that potentially subject Hoffman Homes, Inc. to credit risk consist primarily of cash, investments and accounts receivable that represent amounts due for per diem fees from managed care organizations, government agencies, and private pay clients. Hoffman Homes, Inc. maintains its cash deposits and investments with various financial institutions where the account balances may at times exceed FDIC insured limits.

At June 30, 2017, accounts receivable from two managed care organizations and one school district accounted for 84% of total accounts receivable. These organizations provided 89% of total fee for service and education income revenue during the year ended June 30, 2017.

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - continued

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs totaled \$12,470 for the year ended June 30, 2017.

Fair Value of Financial Instruments

Accounting Standards Codification 820, *Fair Value Measurements*, provides a framework for measuring fair value under accounting principles generally accepted in the United States of America. Accounting Standards Codification 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Accounting Standards Codification 820 requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs.

Accounting Standards Codification 820 also establishes a fair value hierarchy, which prioritizes the valuation inputs into three broad levels. Financial assets and liabilities valued using Level 1 inputs are based on unadjusted quoted market prices within active markets. Financial assets and liabilities valued using Level 2 inputs are based primarily on quoted prices for similar assets or liabilities in active or inactive markets. Financial assets and liabilities using Level 3 inputs are primarily valued using management's assumptions about the assumptions market participants would utilize in pricing the asset or liability.

The estimated fair values of the Organization's financial instruments for the fiscal year ended June 30, 2017 are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash	\$ 103,948	\$ -	\$ -	\$ 103,948
Mutual funds	2,549,019	-	-	2,549,019
Mutual funds - fixed income	1,257,218	-	-	1,257,218
Common stock	429,944	-	-	429,944
Real estate investment trusts	-	-	128,051	128,051
Beneficial interests in perpetual trusts	-	-	2,650,535	2,650,535
Derivative instruments - swap	-	(12,725)	-	(12,725)
	<u>\$4,340,129</u>	<u>\$(12,725)</u>	<u>\$2,778,586</u>	<u>\$7,105,990</u>

The change in Level 3 fair value inputs is as follows:

Beginning balance	\$2,693,305
Unrealized gain	<u>85,281</u>
Ending balance	<u>\$2,778,586</u>

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE A - SIGNIFICANT ACCOUNTING POLICIES - continued

Property, Plant and Equipment

Hoffman Homes, Inc. capitalizes all expenditures for property and equipment with a useful life greater than one year and a cost in excess of \$1,000. Purchased property and equipment are carried at cost. Depreciation is computed using primarily the straight-line method over the estimated useful lives of the respective assets.

Equipment, new construction costs, furnishings, building improvements, land, and vehicles are stated at cost. Expenditures for renewals and improvements that significantly add to productive capacity or extend the useful life of the asset are capitalized. Maintenance and repairs are charged to expense as incurred. When depreciable property is retired or otherwise disposed of, the cost and related accumulated depreciation are eliminated from the accounts, and the resulting gain or loss is reflected in the Statement of Activities.

Donations of property and equipment are recorded as contributions at their estimated fair value on the date received. Hoffman Homes, Inc. does not imply time restrictions with respect to donated property and equipment.

Compensated Absences

Employees of Hoffman Homes, Inc. are entitled to paid time off and sick bank days. It is Hoffman Homes, Inc.'s policy to pay accrued paid time off when an employee resigns with proper notice. Sick bank days are only available for use during an extended illness and are not paid out upon separation of employment. The liability resulting from these policies has been recorded in the financial statements.

Revenue Recognition

Grant revenue which is determined to be an exchange transaction, is classified as unrestricted revenue or deferred revenue, as appropriate, when received or receivable. Such grant revenue is not deemed to be a contribution, since the proceeds thereof are used to pursue objectives of the grantor.

Grant revenue which is deemed to be a contribution, is classified as temporarily restricted revenue when received or receivable. Such grant revenue is not in respect of exchange transactions, since the proceeds are non-reciprocal, unconditional and voluntary.

All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts received which are restricted for future periods or restricted by the donor for specific purposes, are reported as temporarily restricted or permanently restricted support that increases those net asset classes. However, if a restriction is fulfilled in the same time period in which the contribution is received, Hoffman Homes, Inc. reports the support as unrestricted.

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE B - IRREVOCABLE TRUST FUND INCOME

Hoffman Homes, Inc. receives income from several irrevocable trusts. The following provides income distributions from the listed trusts that are attributed to the year ended June 30, 2017:

<u>Trustee</u>	<u>Trust</u>	<u>Trust Income</u>
Fulton Financial Advisors	John L Gerber	\$ 31,052
BB&T Jesse Park	Lola Crawford	21,174
PNC	Katherine H Glatfelter	13,190
BB&T Jesse Park	Francis A. Crawford	12,029
James and Sharon Franklin	Frances C. Mowery	11,156
Wilmington Trust	Howard W. Sheeler	10,131
Wilmington Trust	Florence & Stewart Bortner	8,678
Fulton Financial Advisors	Ammon & Dorothy Patrick	2,461
PNC	Emma M Duttera	2,175
Trust Corp America	Estella Yingling	1,959
Iventrust	Various Customer	1,764
M&T	Mamie B Bush	1,430
Wilmington Trust	Elmira Quickel	1,124
Wilmington Trust	Jacob Schnader	677
Merrill Lynch	Paul & Margie Smith	403
Wilmington Trust	Jessie S Omwake	197
Wilmington Trust	Ervin & Lottie Spangler	<u>112</u>
		<u>\$119,712</u>

NOTE C - PROPERTY, PLANT AND EQUIPMENT

Below is a summary of the activity in the property, plant and equipment accounts as of June 30, 2017:

	<u>July 1, 2016</u>	<u>Additions (Deletions)</u>	<u>June 30, 2017</u>
Buildings	\$ 10,211,956	\$ 40,815	\$ 10,252,771
Furniture and fixtures	1,694,225	49,030	1,743,255
Equipment	1,258,372	125,149	1,383,521
Vehicles	238,507	-	238,507
Land improvements	907,840	47,735	955,575
Water tower	103,893	-	103,893
Sewage treatment plants	<u>244,000</u>	<u>-</u>	<u>244,000</u>
	14,658,793	262,729	14,921,522
Less: accumulated depreciation	<u>(11,513,539)</u>	<u>(395,086)</u>	<u>(11,908,625)</u>
Net property, plant and equipment	<u>\$ 3,145,254</u>	<u>\$ (132,357)</u>	<u>\$ 3,012,897</u>

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE D - TEMPORARILY RESTRICTED NET ASSETS

As of June 30, 2017, temporarily restricted net assets are available as follows:

Purpose restrictions:	
Building/equipment repairs	\$123,949
Music therapy	9,523
Recreation center	5,000
Housing construction or upgrades	3,545
Other	<u>5,805</u>
Total purpose restrictions	147,822
Time restrictions:	
Bequest to be held in trust for 50 years	<u>19,304</u>
Total time restrictions	<u>19,304</u>
	<u>\$167,126</u>

NOTE E - PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets consist of the beneficial interest in perpetual trusts and bequests received by Hoffman Homes, Inc. in which the donor has restricted the use of the principal portion of the gift.

As of June 30, 2017, permanently restricted net assets are restricted to investment in perpetuity, the income from which is expendable to support:

Scholarships	\$ 7,785
Unrestricted uses	<u>3,482,642</u>
	<u>\$ 3,490,427</u>

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE F - OPERATING LEASES

Hoffman Homes, Inc. leases equipment and vehicles under numerous operating leases with various expiration dates.

Minimum future rental payments under non-cancelable operating leases having remaining terms in excess of one year as of June 30, 2017, are as follows:

<u>June 30,</u>	
2018	\$ 39,828
2019	39,828
2020	39,828
2021	39,828
2022	<u>9,310</u>
	<u>\$ 168,622</u>

Rental expense amounted to \$38,513 in 2017.

NOTE G - CAPITAL LEASE

In August 2016 the Organization entered into a capital lease for equipment requiring monthly payments of \$607 for 48 months and containing a purchase option at the end of the lease for \$1. Related accumulated amortization totaled \$5,219 as of June 30, 2017. Amortization is included with depreciation expense on the Statement of Functional Expenses.

Following are the future minimum payments on the above lease as well as the interest component:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 5,968	\$1,321	\$ 7,289
2019	6,441	848	7,289
2020	6,952	337	7,289
2021	<u>603</u>	<u>4</u>	<u>607</u>
	<u>\$19,964</u>	<u>\$2,510</u>	<u>\$22,474</u>

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE H - INVESTMENTS

Investments consist of the following as of June 30, 2017:

Cash	\$ 103,948
Common stock	429,944
Mutual funds and alternative investments	2,549,019
Mutual funds - fixed income	1,257,218
Real estate investment trusts	<u>128,051</u>
	<u>\$ 4,468,180</u>

The following is a schedule of the components of investment gain as shown in the Statement of Activities for the year ended June 30, 2017:

Interest and dividends (net of fees)	\$ 136,492
Unrealized gain	387,904
Realized loss	<u>(38,977)</u>
	<u>\$ 485,419</u>

NOTE I - ESCROW ACCOUNTS PAYABLE

The youths' individual account balances are maintained by the Hoffman Homes, Inc.'s business office. This money may be withdrawn for personal needs during a youth's stay. At the time of discharge, the total amount held in escrow for the youth is returned to the youth, along with interest accrued on the deposit. As of June 30, 2017, escrow accounts payable was \$1,533.

NOTE J - LINE OF CREDIT

Hoffman Homes, Inc. has a \$3,000,000 line of credit with PNC Bank, of which \$2,137,398 was used as of June 30, 2017. The bank advances on the line of credit are due on demand and carry an interest rate of 30 Day LIBOR + 1.75%, which was 2.97% at June 30, 2017. The line of credit is secured by all assets of Hoffman Homes, Inc.

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE K - LONG-TERM DEBT

Long-term debt consisted of the following at June 30, 2017:

Term note payable to bank of \$1,232,948, payable in monthly principal installments of approximately \$20,000, plus interest at LIBOR plus 1.85% or 2.30% at June 30, 2017, due in March 2022, secured as outlined in the "Security" and "Pledge" agreements in the related debt documents.

Term note payable to bank of \$700,000 with maturity of August 2017 was refinanced and is payable in monthly principal installments (starting in September 2017) of \$11,667 plus interest at LIBOR plus 2.25% through maturity of August 31, 2022, secured by all business assets.

Term note payable to bank of \$5,342 in monthly principal and interest payments of \$330, due in March 2022, secured by Ford F-250.

Total term debt outstanding	\$ 1,938,290
Less current portion	<u>(360,695)</u>
Long-term portion	<u>\$ 1,577,595</u>

Future maturities of long-term debt are as follows as of June 30, 2017:

2018	\$ 360,695
2019	392,156
2020	400,525
2021	400,525
2022	361,055
Thereafter	<u>23,334</u>
	<u>\$ 1,938,290</u>

Terms of the Organization's loan agreements provide for certain financial covenants. The Organization met these covenants for the year ending June 30, 2017.

NOTE L - CONTINGENT LIABILITIES

Hoffman Homes, Inc. participates in several grant programs with funding from federal and state sources. These programs are subject to compliance audits by the grantors or their representatives. The audits of some of these programs for and including the year ended June 30, 2017, have not yet been conducted. Accordingly, Hoffman Homes, Inc.'s compliance with applicable grant requirements will be established at some future date. The amount, if any, of expenditures which may be disallowed by the grantor agencies cannot be determined at this time.

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE M - RETIREMENT PLANS

Tax Deferred Annuity Plan

Hoffman Homes, Inc. maintains a tax deferred annuity plan under Internal Revenue Code Section 403(b), covering eligible full-time employees.

Defined Benefit Plan

Hoffman Homes, Inc. has a defined benefit pension plan covering substantially all of its employees that were employed as of June 30, 2003. The benefits are based on years of service and the employee's compensation during the last year of employment. Hoffman Homes, Inc.'s funding policy is to contribute the minimum required deposit, as defined in Section 412 of the Internal Revenue Code, throughout the plan year which will keep the Plan from developing an accumulated funding deficiency.

Hoffman Homes, Inc. adopted a plan amendment which suspended all future benefit accruals in the defined benefit plan as of June 30, 2003. Hoffman Homes, Inc. established a defined contribution 403(b) plan for employee and employer contributions to be made after June 30, 2003.

Periodic benefit cost included in the Statement of Activities for 2017 include the following components:

Interest cost on the projected benefit obligation	\$273,349
Expected return on assets held in the plan	(366,597)
Recognized net actuarial loss	<u>166,387</u>
	<u>\$ 73,139</u>

Other disclosure information:

Measurement date	<u>June 30, 2017</u>
Projected benefit obligation	\$ 7,579,566
Accumulated benefit obligation	7,579,566
Fair value of plan assets	5,794,734
Funded status	(1,784,832)
Contributions	-
Benefits paid	281,857

Pension plan assets are carried at fair value based upon quoted market prices, a Level 1 fair value input and are made up of equity securities (\$1,836,930), mutual funds (\$3,853,499) and cash/money funds (\$104,305).

Contributions to the plan expected to be made during fiscal year ending June 30, 2018: \$ -

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE M - RETIREMENT PLANS - continued

Defined Benefit Plan - continued

Components of expected net periodic pension cost for fiscal year ending June 30, 2018:

Interest cost	\$273,349
Return on assets	(366,597)
Amortization of net loss or (gain) from earlier periods	<u>119,428</u>
	<u>\$ 26,180</u>

Total expense for June 30, 2017 was \$141,912, comprised of \$73,139 of net periodic pension expense, \$14,625 for professional actuarial services and \$54,148 for Pension Benefit Guaranty Corporation (PBGC) premiums.

Items not recognized as a component of net periodic pension cost:

Net gain	\$678,046
----------	-----------

Assumptions:

Weighted average discount rate	3.80%
Weighted average compensation increase	0.00%
Expected long-term rate of return on assets	7.00%

Change in pension liability:

Net gain	\$ 844,433
Amortization of loss	<u>(166,387)</u>
	<u>\$ 678,046</u>

Estimated future fiscal year benefit payments:

2018	\$ 301,868
2019	302,370
2020	326,120
2021	346,032
2022	365,519
2023 - 2027	2,044,516

Allocation of plan assets at fair value:

Equity	67%
Fixed income	32%
Other	1%

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE M - RETIREMENT PLANS - continued

Defined Benefit Plan - continued

Investment policies and strategies:

The investment policy for plans sponsored by Hoffman Homes, Inc. is based on ERISA standards for prudent investing. This policy seeks to maximize return while limiting risk, which is achieved through a balanced portfolio of equity and fixed income investments, as well as alternative asset classes. Within each asset class, a diversified mix of individual securities and bonds is selected. Equity allocations are targeted between 50% and 75% of the portfolio, with the remainder in fixed income investments and a small portion in alternative asset classes such as real estate. Asset manager performance is reviewed at least once every six months and benchmarked against the peer universe for the given investment style.

Determination of expected long-term rate of return on assets:

Hoffman Homes, Inc. has examined the historical benchmarks for returns in each asset class in its portfolio and, based on the target asset mix, has developed a weighted average expected return for the portfolio as a whole, taking into consideration forecasts of long-term expected inflation rates of 2.0% - 3.5%.

NOTE N - DERIVATIVE INSTRUMENTS

During the fiscal year ending June 30, 2012, Hoffman Homes, Inc. entered into a forward start interest rate swap to hedge the interest rate risk associated with a loan in the amount of \$2,350,000 at a fixed-rate. The loan was issued during the year ending June 30, 2012. The swap was effective on March 9, 2012, and terminates on March 9, 2022.

Hoffman Homes, Inc. is paying interest related to the swap agreement. The swap is issued at market terms so that it had no fair value at its inception. The carrying amount of the swap has been adjusted to the fair value at the end of the year. The swap agreement had a negative fair value of \$(12,725) at June 30, 2017. This amount is included in liabilities on the Statement of Financial Position and the change in fair value shown as an unrealized gain on the Statement of Activities, affecting the changes in unrestricted net assets.

The fair market value of Hoffman Homes, Inc.'s financial assets and liabilities is determined using forecasted levels of LIBOR and the notional value noted above, and is considered a Level 2 input in accordance with Accounting Standards Codification 820, *Fair Value Measurements*. Level 2 inputs are based on quoted market prices for similar assets or liabilities within active markets. Management determined that the carrying value of the swap was materially consistent with the fair market value at June 30, 2017.

HOFFMAN HOMES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017

NOTE O - SUBSEQUENT EVENTS

Management has evaluated subsequent events through the date of the Independent Auditors' Report, the date the financial statements were available to be issued.

On August 9, 2017, Hoffman Homes, Inc. entered into a term loan in the amount of \$1,500,000, which was used to pay down their line of credit. The interest rate on the loan is LIBOR plus 1.75%. Interest only payments will be made monthly starting September 30, 2017 through August 31, 2019, on which date all outstanding principal and accrued interest shall be due and payable in full.