

**RURAL COMMUNITIES HOUSING
DEVELOPMENT CORPORATION**

Annual Financial Report

October 31, 2011



FENTRESS & BARNES

| certified public accountants |

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RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
MISSION and LEADERSHIP
October 31, 2011

Rural Communities Housing Development Corporation (“RCHDC”) is a California not-for-profit corporation which was incorporated in November 1975. RCHDC’s mission is to provide decent, affordable housing to low and moderate income persons. The mission is accomplished through its self-help home ownership program and developing and managing multi-family low-income housing for the elderly and families.

BOARD OF DIRECTORS

<u>Name</u>	<u>Date Seated</u>	<u>Term Expires</u>
William Thompson, Chairperson	March 11, 2005	November 2013
Peter Klein, Vice Chairperson	July 28, 2008	November 2015
Charlotte Watkins, Secretary	October 25, 2010	November 2015
Gary Mirata, Treasurer	August 31, 2009	November 2013
Marlene Ruiz	October 26, 2009	November 2015
Raymond Hall	September 28, 2009	November 2015
Mark Rohloff	February 28, 2011	November 2013
Tom MonPere	February 27, 2012	November 2013

ADMINISTRATION

Lois Goforth – Chief Executive Officer
Chuck Lange – Fiscal Officer

ADDRESS OF CORPORATE OFFICE

499 Leslie Street
Ukiah, California 95482

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
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Independent Auditors' Report

To the Board of Directors of
Rural Communities Housing Development Corporation
Ukiah, California

We have audited the accompanying consolidated statement of financial position of Rural Communities Housing Development Corporation and Affiliates ("Corporation"), as of October 31, 2011 and the related consolidated statements of activities and changes in net assets (deficit) and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Rural Communities Housing Development Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, the evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Rural Communities Housing Development Corporation and Affiliates of October 31, 2011, and the results of their operations and changes in net assets, and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 16, the October 31, 2010 consolidated financial statements have been restated to correct accounting, notes receivable valuation, acquisition of partnership interest, net asset classification, and accounting for nonconsolidated interest in partnerships. Additionally, the financial statements have a change in accounting for grant lien classification.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 30, 2012, on our consideration of Rural Communities Housing Development Corporation and Affiliates' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements. The consolidating schedules of financial information on pages 42 through 49 are presented for purposes of additional analysis and are not a required part of the financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated 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 relations to the basic consolidated financial statements as a whole.

Fentress & Barnes

Fentress & Barnes
Certified Public Accountants
Columbus, Ohio
April 30, 2012

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
STATEMENT of FINANCIAL POSITION
October 31, 2011

ASSETS	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Totals</u>
Current Assets:				
Cash and cash equivalents	\$ 1,084,036	\$ -	\$ 286,691	\$ 1,370,727
Net tenant accounts receivable	36,669	-	-	36,669
Tenant assistance accounts receivable	863	-	-	863
Other accounts receivable	5,834	-	-	5,834
Due from related parties	1,575,824	-	-	1,575,824
Prepaid expenses	<u>44,578</u>	<u>-</u>	<u>-</u>	<u>44,578</u>
Total Current Assets	<u>2,747,804</u>	<u>-</u>	<u>286,691</u>	<u>3,034,495</u>
Deposits:				
Tenant security deposits held in trust	175,333	-	-	175,333
Self-Help construction deposits held in trust	1,300	-	-	1,300
Tax and insurance impounds	248,884	-	-	248,884
Replacement reserves	2,185,117	-	-	2,185,117
Other required reserves	933,346	-	-	933,346
Residual receipts reserves	585,951	-	-	585,951
Cash restricted for pension plan	13,670	-	-	13,670
Cash restricted for self-insurance plan	<u>48,119</u>	<u>-</u>	<u>-</u>	<u>48,119</u>
Total Deposits	<u>4,191,720</u>	<u>-</u>	<u>-</u>	<u>4,191,720</u>
Fixed Assets, net of Accumulated Depreciation	<u>21,361,038</u>	<u>9,782,400</u>	<u>584,000</u>	<u>31,727,438</u>
Other Assets:				
Long-term notes receivable	139,948	205,000	708,881	1,053,829
Advances and investments in nonconsolidated affiliates	292,785	-	269,800	562,585
Land held for development	1,571,725	726,092	-	2,297,817
Development costs	<u>3,335,359</u>	<u>2,190,614</u>	<u>400,000</u>	<u>5,925,973</u>
Total Other Assets	<u>5,339,817</u>	<u>3,121,706</u>	<u>1,378,681</u>	<u>9,840,204</u>
Total Assets	<u>\$ 33,640,379</u>	<u>\$ 12,904,106</u>	<u>\$ 2,249,372</u>	<u>\$ 48,793,857</u>

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

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
STATEMENT of FINANCIAL POSITION - Continued
October 31, 2011

LIABILITIES & NET ASSETS (DEFICIT)	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Totals</u>
Current Liabilities:				
Accounts payable and accrued liabilities	\$ 625,298	\$ -	\$ -	\$ 625,298
Accrued interest payable	82,348	-	-	82,348
Current portion mortgages and notes payable	3,221,986	-	-	3,221,986
Deferred revenue	<u>69,761</u>	<u>-</u>	<u>-</u>	<u>69,761</u>
Total Current Liabilities	<u>3,999,393</u>	<u>-</u>	<u>-</u>	<u>3,999,393</u>
Long-Term Liabilities:				
Tenant security deposits	177,340	-	-	177,340
Self-Help construction deposits	1,300	-	-	1,300
Accrued interest payable	1,835,048	-	-	1,835,048
Mortgages and notes payable, net	<u>28,703,936</u>	<u>-</u>	<u>-</u>	<u>28,703,936</u>
Total Long-Term Liabilities	<u>30,717,624</u>	<u>-</u>	<u>-</u>	<u>30,717,624</u>
Total Liabilities	<u>34,717,017</u>	<u>-</u>	<u>-</u>	<u>34,717,017</u>
Net Assets (Deficit)	<u>(1,076,638)</u>	<u>12,904,106</u>	<u>2,249,372</u>	<u>14,076,840</u>
Total Liabilities & Net Assets (Deficit)	<u>\$ 33,640,379</u>	<u>\$ 12,904,106</u>	<u>\$ 2,249,372</u>	<u>\$ 48,793,857</u>

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

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
STATEMENT of ACTIVITIES and CHANGES in NET ASSETS (DEFICIT)
Year ended October 31, 2011

REVENUES	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Net tenant rents	\$ 1,899,476	\$ -	\$ -	\$ 1,899,476
Tenant assistance payments	3,396,140	-	-	3,396,140
Other rents	118,690	-	-	118,690
Grant income	460,231	-	240,947	701,178
Interest income	32,992	-	-	32,992
Management fees and reimbursements	212,542	-	-	212,542
Operational revenue	833,412	-	-	833,412
Gain on sale of development properties	172,645	-	-	172,645
Other revenue	72,338	-	-	72,338
Total Revenues	<u>7,198,466</u>	<u>-</u>	<u>240,947</u>	<u>7,439,413</u>
EXPENSES				
Administrative services	1,830,679	-	-	1,830,679
Utilities	748,431	-	-	748,431
Operating and maintenance				
Operating accounts	883,613	-	-	883,613
Replacement reserve and residual receipt expenditures	294,983	-	-	294,983
Taxes and insurance	738,445	-	-	738,445
Interest expense	1,290,308	-	-	1,290,308
Development costs	736,285	-	-	736,285
Unrealized loss on land development and notes receivable	1,243,560	-	-	1,243,560
Depreciation	1,213,531	-	-	1,213,531
Total Expenses	<u>8,979,835</u>	<u>-</u>	<u>-</u>	<u>8,979,835</u>
Change in Net Assets (Deficit)	(1,781,369)	-	240,947	(1,540,422)
New grant liens during year, net of forgiven grant liens for temporarily restricted net assets	-	364,177	-	364,177
Net assets released from restriction	363,500	-	(363,500)	-
Net Asset (Deficit) at the Beginning of the Year, as previously reported	<u>2,028,988</u>	<u>290,000</u>	<u>2,622,575</u>	<u>4,941,563</u>
Prior Period Adjustments:				
Correct net asset classification	200,650	50,000	(250,650)	-
Cost method for nonconsolidated interests in partnerships	(53,022)	-	-	(53,022)
Notes receivable net present value and reserves	(1,137,329)	-	-	(1,137,329)
Fixed assets and investment in consolidated affiliates	(698,056)	-	-	(698,056)
Grant liens to temporarily restricted net assets	-	12,199,929	-	12,199,929
Net Asset (Deficit), Beginning, restated	<u>341,231</u>	<u>12,539,929</u>	<u>2,371,925</u>	<u>15,253,085</u>
Net Assets (Deficit) at the End of the Year	<u>\$ (1,076,638)</u>	<u>\$ 12,904,106</u>	<u>\$ 2,249,372</u>	<u>\$ 14,076,840</u>

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

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
STATEMENT of CASH FLOWS
Year ended October 31, 2011

CASH FLOWS FROM OPERATING ACTIVITIES

Change in Total Net Assets from Operations	\$ (1,540,422)
Adjustments to Reconcile Changes in Net Assets to Net cash Provided by (Used in) Operating Activities:	
Net present value of notes receivable	(17,046)
Increase in long-term accrued interest	129,718
Depreciation	1,213,531
Forgiveness of grant liens	(241,096)
Unrealized loss on land development and notes receivable	1,053,944
Gain on sale of development properties	(172,645)
Decrease (Increase) in:	
Net tenant accounts receivable	(26,496)
Tenant assistance accounts receivable	19,636
Other accounts receivable	2,197
Prepaid expenses	93,289
Increase (Decrease) in:	
Accounts payable and accrued liabilities	(507,347)
Accrued interest payable	(29,270)
Deferred revenue	<u>35,923</u>
Net Cash Provided by (Used in) Operating Activities	<u>13,916</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Decrease (Increase) in:	
Tenant deposits held in trust	22,050
Tax and insurance impounds	41,242
Replacement reserve	(236,990)
Other reserves	(4,639)
Residual receipts reserve	33,054
Cash restricted for pension plan	(9,701)
Cash restricted for self-insurance plan	(8,029)
Purchase of fixed assets	(233,876)
Decrease in due from related parties	517,321
Advances and Investment in nonconsolidated affiliates	(151,200)
Proceeds on sale of developed lots	659,967
Development costs	<u>(472,042)</u>
Net Cash Provided by (Used in) Investing Activities	<u>6,260</u>

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

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
STATEMENT of CASH FLOWS – Continued
Year ended October 31, 2011

CASH FLOWS FROM FINANCING ACTIVITIES

Proceeds from mortgages and notes payable	\$ 1,131,046
Proceeds from grant liens	620,273
Increase (Decrease) in due to related parties	(107)
Principal payments on mortgages and notes payable	<u>(1,059,966)</u>

Net Cash Provided by (Used in) Financing Activities 691,246

Net Increase (Decrease) in Cash and Cash Equivalents 711,422

Cash and Cash Equivalents, Beginning 659,305

Cash and Cash Equivalents, Ending \$ 1,370,727

SUPPLEMENTAL DISCLOSURES

Amounts Paid for Interest	<u>\$ 1,319,578</u>
Amounts Paid for Income Tax	<u>\$ 1,781</u>

NON CASH INVESTING AND FINANCING ACTIVITIES

Capitalized accrued interest payable	<u>\$ 91,393</u>
Prior period adjustment for notes receivable net present value and allowance for doubtful accounts	<u>\$ 1,137,329</u>
Prior period adjustment for fixed assets and investment in consolidated affiliates	<u>\$ (474,749)</u>
Prior period adjustment for grant liens recorded as temporarily restricted net assets	<u>\$ 12,199,929</u>

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

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS
Year ended October 31, 2011

Note 1. Organization and Summary of Significant Accounting Policies

Organization

RCHDC is a California not-for-profit corporation that was incorporated in November 1975. The primary purpose of RCHDC is to develop, own and manage low-cost housing through the use of government financing, subsidies and other available resources to alleviate housing problems affecting low and moderate income families and to promote the welfare of the elderly and handicapped.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of RCHDC and its affiliates, as described below. Significant intercompany accounts and transactions have been eliminated in consolidation, as presented in the respective consolidating schedules. Intercompany transactions include management fees, accounting fees, and receivables and payables between related parties.

These consolidated financial statements include Funds 10, 20, 21, 22, 23, 70 and 90 of RCHDC, its owned housing projects, controlled housing projects, and investments in partnerships. All but one of the controlled housing projects are owned by separate corporations, which share the same board of directors as RCHDC. One of the controlled housing projects is owned by a limited partnership in which both the general partner and the limited partner are not-for-profit corporations, which share the same board of directors as RCHDC. The controlled entities, other than housing projects, are generally corporations or limited liability companies, which share the same board of directors as RCHDC. Three of these controlled entities were formed to serve as general partners in limited partnerships, which own housing projects that are not consolidated in the financial statements. RCHDC also manages other housing projects with unrelated ownership that are not consolidated in these financial statements.

Financial data used for the consolidation of CC Seabreeze, LLC and CC Seagull Villa, LLC is as of October 31, 2011. There were no events or transactions either excluded or included that would have a significant effect on the consolidated financial statements.

Nonconsolidated Interests in Partnerships

RCHDC, through its controlled entities, holds 0.01% general partner interests in four limited partnerships which operate seven low income housing projects. Based on various provisions in the partnership agreements, the general partner does not have control, therefore, the general partner interests are accounted for under the cost method of accounting. In previous years, RCHDC recorded these interests using the equity method. See Note 16 for the effect of changing to the cost method as a prior period adjustment. Additionally, see footnote 5 for disclosures regarding potential unanticipated obligations of RCHDC or its consolidated affiliates related to these partnerships. At October 31, 2011, RCHDC's investment in the four limited partnerships totaled \$243,385 and is classified as "Advances and investment in nonconsolidated affiliates" in the consolidated statement of financial position.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 1. Organization and Summary of Significant Accounting Policies – (Continued)

The following summarizes the funds, owned entities and controlled entities that are included in these consolidated financial statements:

RCHDC Funds	Fund Number
Corporate Fund	Fund 10
Administrative Fund	Fund 20
Revolving Development Fund	Fund 21
Property Management	Fund 22
First Time Home Buyer	Fund 23
Self-Help Technical Assistance Grant	Fund 70
Self-Help Construction Trust Fund	Fund 90

RCHDC Owned Housing Projects	Project Operations Included
Creekside Village	McCarty Manor
Cypress Ridge	McCloud Motel Apartments
Highlands Village	Oak Hill Apartments
Holden Street	Sunshine Manor
Holly Heights I	Walnut Village
Holly Heights II	Gibson Court 4 Apartments*

Controlled Entities	Project Operations Included
Pine Gardens I, Inc.	
CC Seabreeze, LLC	
CC Seagull Villa, LLC	
Redwood Court Property Corporation	
Redwood Court Property, A California Limited Partnership	Redwood Court Apartments
Bevins Court Housing Corporation	Bevins Court Apartments
Clearlake Housing Corporation	North Shore Village
Gibson Court Housing Corporation	Gibson Court Apartments*
Lakeview Housing Incorporated	Lakeview Apartments
Low Gap Housing Corporation	Jack Simpson School View Apartments
North Pine Street Senior Housing Corporation	North Pine Street Apartments
Red Bluff Senior Housing Corporation	Oak Park Manor
Siskiyou Gardens Incorporated	Siskiyou Garden Apartments
Washington Court Senior Housing Corporation	Washington Court Apartments
Willits Senior Housing Corporation	Lenore Street Senior Housing

* Gibson Court Housing Corporation was only able to obtain funding to support 12 of the 16 units at Gibson Court Apartments. RCHDC provided the funding for the remaining 4 units.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 1. Organization and Summary of Significant Accounting Policies – (Continued)

Description of Funds

RCHDC maintains separate funds for each low-income housing project it owns and for each federal grant it administers. In addition to these funds, RCHDC maintains corporate, administrative and trust funds. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Resources are allocated to, and accounted for, in individual funds based upon the purposes for which they are intended. The corporate, administrative, operating and trust funds are grouped into categories as follows:

Corporate Fund (Fund 10)

Assets, such as land, buildings, computer equipment and other assets, used by RCHDC to manage its housing projects and funds are recorded in Fund 10. Sources of revenue for Fund 10 include interest earned on bank accounts and other miscellaneous revenues. Fund 10 is charged with depreciation for the fixed assets discussed above.

Administrative Fund (Fund 20)

Sources of revenue for Fund 20 generally include rental income from commercial real estate owned by RCHDC, accounting fees charged to some of the housing projects where appropriate, laundry revenue from contracts with many of the housing projects managed by RCHDC, and expendable grant income where appropriate. All administrative costs of managing RCHDC and its related entities as well as costs specifically related to the production of revenue discussed above are charged to Fund 20.

Revolving Development Fund (Fund 21)

Fund 21 is used to acquire and develop land for proposed Self-Help projects and for low-income family and elderly housing projects. Revenues for Fund 21 generally include grant income designated for specific projects or developer fees associated with the completion and lease-up of new or rehabilitated low-income housing projects.

Property Management Fund (Fund 22)

Revenues for Fund 22 generally include property management fees from both affiliated and unaffiliated low-income housing projects that are managed by RCHDC. All direct costs of property management are charged to Fund 22.

First Time Home Buyer Fund (Fund 23)

All direct costs associated with the Home Ownership Center are charged to Fund 23. Revenues for Fund 23 generally include nominal charges to participants in the home ownership classes as well as grant income as appropriate.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 1. Organization and Summary of Significant Accounting Policies – (Continued)

Description of Funds - continued

Self-Help Technical Assistance Grant (Fund 70)

Fund 70 administers the USDA and HCD Technical Assistance grant funds to support the Self-Help families. Therefore, all costs associated with the oversight and management of the Self-Help program are charged to Fund 70.

Self-Help Construction Trust Fund (Fund 90)

Fund 90 is a trust account used to account for the Self-Help construction costs for each family. Costs incurred in excess of budget are charged to the individual family responsible for the cost overrun. Although RCHDC manages the assets and liabilities in Fund 90 on behalf of the families building their homes these assets and liabilities do not accrue to RCHDC, and therefore are not consolidated in the financial statements.

Basis of Accounting

RCHDC uses the accrual basis of accounting. Under the accrual basis of accounting revenues are recognized when earned and expenses are recognized when incurred. Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenditures are reported as decreases in unrestricted net assets.

Net Asset Classifications

Unrestricted Net Assets are those currently available for use of the organization, as determined by the management and board of directors as appropriate.

Temporarily Restricted Net Assets are those received with donor stipulations that limit the use of the donated assets. Once the donor stipulations have been met, these net assets are reclassified as unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Permanently Restricted Net Assets are those contributed with donor stipulations that permanently limit the use of the donated assets for the purpose intended by the donor.

Cash and Cash Equivalents

For purposes of the statements of cash flows, RCHDC considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. There were no cash equivalents as of October 31, 2011.

Cash balances in banks are insured up to \$250,000 from October 3, 2008 through December 31, 2013 by the Federal Deposit Insurance Corporation (FDIC). As of October 31, 2011, RCHDC's Funds, Owned Projects and Controlled Entities held cash in banks in excess of amounts insured by the FDIC totaled \$699,366.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 1. Organization and Summary of Significant Accounting Policies – (Continued)

Tenant Receivable and Bad Debt Policy

Tenant receivables are charged to bad debt expense when they are determined to be uncollectible based upon a periodic review of the accounts by management. 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. Included in expenses are bad debts of \$54,921 for the year ended October 31, 2011.

Tenant Deposits Held in Trust

Tenant security deposits are segregated and held in trust in a separate bank account in the name of the respective housing project.

Fixed Assets

Fixed assets are valued at acquisition cost. Major additions are capitalized as they are placed in service, and minor improvements, which do not extend the useful life of the asset, are expensed in the period incurred. Depreciation is provided using the straight-line method over the estimated useful lives of the related assets, which range from five to forty years.

Reserves

The low-cost housing projects obtain federal, state and local funding which require certain reserves to be maintained in separate federally insured bank accounts. These accounts include tax and insurance impounds, replacement reserves, other required reserves and residual receipts reserves. Use of these funds are restricted as defined in the corporate, partnership, debt and regulatory agreements and therefore, have been excluded from cash in the accompanying consolidated Statement of Financial Position and Consolidated Statement of Cash Flows.

Grants

RCHDC receives various grants to assist with the development of specific projects and programs. Capital grants and expendable grants are received from NeighborWorks America, a sponsoring organization of RCHDC. These funds are used to assist with the development of affordable housing projects, improvements in management and planning of new programs and projects for the benefit of low-income families and seniors. The NeighborWorks America grant receipts and related expenditures are reported in Note 8 to these consolidated financial statements.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 1. Organization and Summary of Significant Accounting Policies – (Continued)

Grant Liens

RCHDC regularly receives funds from various governmental or non-profit agencies in the form of non-interest bearing mortgages secured by deeds of trust related to the development of affordable housing, subject to regulatory agreements or other restrictions that require the properties to remain affordable to low-income residents for extended periods of time. RCHDC records such advances as temporarily restricted net assets. These were previously reported as long-term liabilities at their face amounts until the affordability restrictions were fully satisfied. See Note 16 for the effect of the change in accounting. Upon full satisfaction of the affordability restrictions and the reconveyance of the deeds of trust by the granting agencies, the face amount of these liens are reported as grant income.

Notes Receivable

As described in Note 2, RCHDC obtains funding from various external and internal sources to loan funds to individuals that qualify for self-help programs to purchase homes. The notes receivable agreements are subordinate to the first mortgage and other third party financing that has priority. The payment terms vary from 1) fully forgiven providing the buyers continue to reside in the homes for 20 to 30 years, 2) deferred for 5 or more years with payment of principal and interest 3) deferred until the first mortgage is paid in full. Effective October 31, 2010, as described in Note 16, RCHDC corrected its accounting for these loans by reserving 100% of the outstanding notes receivable balance for forgivable loans and reduced the notes receivable balances to their net present value using the applicable federal rates and the note terms for each agreement. The effect of the prior period adjustment is summarized in Note 16. At October 31, 2011, RCHDC has a reserve for forgivable loans of \$569,731 and net present value reserve of \$804,748.

Management reviews its note receivable balances for collectability, based on payment history and review of the underlying real estate. At October 31, 2011, no allowance for doubtful accounts is deemed necessary.

Development Costs and Revenue Recognition

Development costs are recorded on a site-specific basis. Development costs include all expenditures necessary to complete a project including but not limited to the purchase price of land, escrow and closing costs, predevelopment costs, legal and other consulting fees, architecture and engineering costs, entitlement costs, governmental fees and permits, construction and supervision costs, and interest costs during the development process. Development costs are capitalized as construction in process until the completed project is placed in service, at which time construction in process is reclassified to land and buildings subject to depreciation, for reporting purposes.

Development costs are capitalized and proportionately allocated at sale. Developments which experience lot sales in more than one fiscal period reflect lower development costs when the first lots are sold and higher development costs as the last lots are sold.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 1. Organization and Summary of Significant Accounting Policies – (Continued)

Fixed Asset, Land Held for Development, and Development Costs Impairment

RCHDC reviews its investment in real estate for impairment whenever events or changes in circumstances indicate that the carrying value of such property may not be recoverable. Recoverability is measured by a comparison of the carrying amount of the real estate to the future net undiscounted cash flow expected to be generated by the estimated proceeds from the eventual disposition of the real estate or recent appraisals. If the real estate is considered to be impaired, the impairment to be recognized is measured at the amount by which the carrying amount of the real estate exceeds the fair value of such property. For the year ended October 31, 2011, RCHDC recorded an impairment loss of \$1,053,944. However, RCHDC may in the future sell certain real estate for less than the carrying value or determine that future events would indicate additional impairment.

Income Taxes

RCHDC and the majority of its controlled corporations are exempt from Federal and California income taxes because they are organized as a not-for-profit corporations exempt under Federal and California Code Sections 501(c)(3) and 23701(d), respectively. Redwood Court Properties, A California Limited Partnership; CC Seabreeze, LLC and CC Seagull Villa, LLC are pass-through entities with not-for-profit general partners and managing members, and are treated as exempt organizations for Federal and California income tax purposes per IRS ruling.

RCHDC and affiliates account for uncertainty in income taxes in accordance with Accounting Standards Codification (“ASC”) 740 Income Taxes. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

RCHDC’s previously filed income tax returns for the tax years 2007, 2008, and 2009 remain subject to examination by a taxing authority. RCHDC’s income tax returns for the tax year 2010 have not been filed and remain subject to examination by a taxing authority.

See Note 14 for tax notices received from the Internal Revenue Service (“IRS”).

Fair Value of Financial Instruments

RCHDC considers the recorded value of its financial assets and liabilities, which consist primarily of cash, accounts receivable, and account payable, to approximate the fair value of the respective assets and liabilities at October 31, 2011 based upon the short-term nature of the assets and liabilities.

Notes receivable are recorded at their net realizable value using the applicable federal rate as of the date of the note agreement and the term period.

There has been no significant change in interest rates available to RCHDC. Therefore, the fair value of mortgages and notes payable approximates book value.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 1. Organization and Summary of Significant Accounting Policies – (Continued)

Fair Value Measurements of Assets and Liabilities

The accounting guidance for “Fair Value Measurements and Disclosures” establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Where observable inputs are available for substantially the full term of the asset or liability, the instrument is categorized in Level 2. When quoted market prices are not available, pricing may be completed using comparable securities, dealer values, operating data and general market conditions to determine Fair value. Valuation models utilize various inputs such as commodity, interest rate and, to a lesser degree, volatility or credit that include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, market corroborated inputs (i.e. inputs derived principally from, or correlated to, observable market data) and other observable inputs for the asset or liability.

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. Actual results could differ from these estimates.

Subsequent Events

The consolidated financial statements and related disclosures include evaluation of events up through and including April 30, 2012, which is the date the consolidated financial statements were available to be issued.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 2. Notes Receivable

In assisting eligible individuals and facilitating the development or rehabilitation of low-income multifamily housing, RCHDC has provided assistance in the form of purchase money loans, which are secured by junior deeds of trust on real estate. Terms vary, but generally fall into one of the following categories:

Fund 21:

1. Loans are for a period of 30 years accruing interest at 4% per annum and do not require repayment until they mature or the homeowner sells the property.
2. Loans are for a period of 30 years accruing interest at 4% to 5% per annum. Monthly interest and principal payments are required beginning in the sixth year until the loan is fully amortized at the end of the 30 year term or prepaid in accordance with its terms.
3. Fund 21 has \$70,000 of notes receivable due from CC Seabreeze, L.P. as well as \$85,000 of notes receivable due from CC Seagull Villas, L.P. The funds were loaned to these two partnerships for the rehabilitation of three low-income housing apartments in Crescent City. The loans are secured and do not accrue interest and are due on May 31, 2066, and September 30, 2066, respectively.

Fund 10:

1. Loans with 30 year terms were made to homeowners from Fund 10. The loans bear no interest during the first ten years and accrue 3% simple interest thereafter for the next twenty years. Monthly payments of principal and interest commence in the sixteenth year such that all outstanding principal and accrued interest is fully amortized by the end of the 30 year term. The loans are secured by trust deeds on the properties.
2. Loans with 30 year terms were made to homeowners from Fund 10. The terms of these loans give RCHDC a share in the appreciation of the affordable housing that they help finance. The loans do not bear interest and require no payments unless the properties subject to the liens are sold prior to their maturity dates. The loans are secured by trust deeds on the properties. RCHDC's share of appreciation is reduced by 5% per year beginning in the eleventh year of each loan such that there shall be no amounts due to RCHDC provided the properties are held for the full 30 year terms of the loans. RCHDC's policy is to provide a valuation allowance equal to the face amount on these notes since the present value of the notes cannot be readily determined.

Due to the long-term nature of these loans, minimal principal payments are expected during the year ended October 31, 2012.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 3. Fixed Assets

Fixed assets, net of accumulated depreciation, consists of the following at October 31, 2011:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Ending Balance</u>
Fixed Assets:				
Land and Improvements	\$ 2,839,048	\$ -	\$ -	\$ 2,839,048
Building and Improvements	45,637,509	207,977	-	45,845,486
Office Furniture and Equipment	<u>951,397</u>	<u>25,899</u>	<u>-</u>	<u>977,296</u>
Total Fixed Assets	49,427,954	233,876	-	49,661,830
Accumulated Depreciation	<u>(16,720,861)</u>	<u>(1,213,531)</u>	<u>-</u>	<u>(17,934,392)</u>
Fixed Assets, Net	<u>\$ 32,707,093</u>	<u>\$ (979,655)</u>	<u>\$ -</u>	<u>\$ 31,727,438</u>

Note 4. Long-Term Debt

Long-term debt consists of the following at October 31, 2011:

FUNDS

Corporate Fund (Fund 10)

United States Department of Agriculture, Rural Development Mortgage for \$750,000 at 4.375% annual interest secured by RCHDC's principal offices on Leslie Street in Ukiah. Payments of principal and interest of \$3,315 monthly for forty years, due May 18, 2044. As of October 31, 2011, accrued interest totaled \$2,595. \$ 689,075

Revolving Development Fund (Fund 21)

Redevelopment Agency, City of Ukiah loan to be repaid when primary financing is obtained. This note is unsecured and is non-interest bearing. 18,000

Redevelopment Agency, City of Ukiah loan requiring an annual payment of \$500, payable through September 1, 2032. This note is unsecured and is non-interest bearing. 20,500

City of Ukiah loan originally due on December 31, 1999, including simple interest at 3%. This note is unsecured. This note has been extended by the City until called. As of October 31, 2011, accrued interest totaled \$66,138. 115,200

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 4. Long-Term Debt – (Continued)

<p>Redevelopment Agency, City of Ukiah loan originally due on September 26, 1999, including simple interest at 3%. This note is unsecured. This note has been extended by the City until called. As of October 31, 2011, accrued interest totaled \$15,421.</p>	36,500
<p>Local Initiatives Support Corporation (LISC) advance in the amount of \$300,000 at 6% interest for RCHDC to use for Clara Court, LP pursuant to a Line of Credit Agreement dated May 2, 2011. Accrued interest is due and payable quarterly. This advance together with accrued interest is to be repaid upon the earlier payment of developer fees from Clara Court, LP or receipt of funds from State of California Department of Housing and Community Development. This note is secured by deed of trust.</p>	200,000
<p>Savings Bank of Mendocino County loan for land development costs associated with the Lake Mendocino Drive Self-Help property in the maximum amount of \$1,500,000 at 7% interest. Interest is payable on the loan monthly in arrears and all unpaid principal interest was originally due on or before July 21, 2009. This note is secured. This note has been extended until January 15, 2014.</p>	1,032,000
<p>California Department of Housing and Community Development note through the Joe Serna, Jr. grant program dated October 21, 2009. The note is non-interest bearing and principal payments are to be repaid upon the sale of a lot in increments of \$19,455.</p>	233,455
<p>California Department of Housing and Community Development loan of \$800,000 secured by property on North State Street (Contract #03-PDL-34), originally due June 30, 2008, bearing interest at 3%. This note is secured by a deed of trust. The note has been extended to August 31, 2012. As of October 31, 2011, accrued interest totaled \$172,000.</p>	800,000
<p>Savings Bank of Mendocino County \$1,829,520 promissory note secured by property at Brush Street originally due October 1, 2007. Interest is fixed at 5.75% and is payable monthly. \$482,935 was paid down during the fiscal year ended October 31, 2008, from the \$500,000 NeighborWorks Loan. As of October 31, 2011, accrued interest totaled \$172,000.</p>	1,334,585
<p>NeighborWorks Capital Corporation loan in the amount of \$500,000 for Orr Creek Commons (Brush Street property) with interest at 5% per annum payable interest only at the end of each quarter in arrears. All unpaid principal and interest is due on or before April 8, 2012. This note is secured.</p>	500,000
<p>California Department of Housing and Community Development unsecured note dated August 11, 2008, in the amount of \$100,000 (Contract #07-PDL-69) for predevelopment costs related to Orr Creek Commons in the City of Ukiah. The note accrues simple interest of 3% and is repayable on or before July 31, 2012. As of October 31, 2011, accrued interest totaled \$9,317.</p>	100,000

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 4. Long-Term Debt – (Continued)

Rural Community Assistance Corporation (“RCAC”) promissory note, not to exceed \$500,000 bearing 5% interest with principal and accrued interest originally due on September 1, 2008. This note has been extended until March 1, 2012, and the interest rate has been increased to 6.25% from March 1, 2011 to March 1, 2012. This note is secured. As of October 31, 2011, the entire balance of the loan has been drawn and interest only payments are paid monthly. RCHDC is currently working with RCAC on an extension for this promissory note.

500,000

Redevelopment Agency, City of Ukiah loan dated April 20, 2010. The note is unsecured and non-interest bearing. Payments of principal must be made from residual receipts as required by the Agency under the terms of the Regulatory Agreement.

15,000

\$ 5,594,315

OWNED PROJECTS

Creekside Village is financed with a mortgage note of \$1,952,900 with the United States Department of Housing and Urban Development (HUD), under Section 202 of the National Housing Act of 1959. The mortgage note bears interest of \$15,441 payable through January 1, 2024. This note is secured. As of October 31, 2011, accrued interest totaled \$10,447.

\$ 1,355,265

Cypress Ridge is financed with two mortgage notes of \$1,500,000 and \$50,000, totaling \$1,550,000, with the United States Department of Agriculture, Farmers Home Administration (FmHA) under Section 515 of the National Housing Act of 1959. The mortgage note bears interest at the rate of 9.0% per annum, payable in 588 equal monthly installments (49 years) of principal and interest of \$11,780 through November 12, 2029. The mortgage note is secured by the apartment project. In addition, there is an interest subsidy from Rural Development associated with these mortgages that reduces the effective interest rate to 7.0%. The subsidy is not recorded on the Project’s books as income or expense and reduces the actual monthly payments by RCHDC to \$9,362. As of October 31, 2011, interest subsidy totaled \$18,288 and accrued interest totaled \$6,600.

1,131,458

Cypress Ridge rehabilitation is financed with a note from the City of Fort Bragg for \$225,000 that accrues interest at 3% per annum and requires repayment from residual receipts, as defined by the regulatory agreement. Principal and interest shall be due and payable on or before March 1, 2065. The note is secured by the assignments or rents and revenues. As of October 31, 2011, accrued interest totaled \$17,688.

225,000

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 4. Long-Term Debt – (Continued)

<p>Cypress Ridge rehabilitation is also financed with a mortgage note from the California Department of Housing and Community Development (“HCD”) under the Home Investment Partnership’s (“HOME”) Program, dated July 14, 2004 for a maximum amount of \$983,026 (Contract #03-HOME-0687). The note accrues simple interest of 3% per annum and requires repayment from residual receipts, as defined in the regulatory agreement, commencing the last day of the initial operating year following the completion of rehabilitation. The unpaid principal and accrued interest are due in full on or before the 55th anniversary of the note. The note is secured by a Deed of Trust against the Project. As of October 31, 2011, accrued interest totaled \$85,272.</p>	908,215
<p>Highlands Village is financed with a mortgage note of \$1,675,900 with HUD, under Section 202 of the National Housing Act of 1959. The mortgage note bears interest at the rate of 8.5% per annum and is being repaid in 480 equal monthly installments of principal and interest of \$12,285 payable through June 1, 2021. The mortgage is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$6,828.</p>	969,628
<p>Holden Street is financed with a mortgage note of \$293,000 with HUD, under Section 202 of the National Act of 1959. The mortgage note bears interest at the rate of 9.25% per annum and is being repaid in 454 equal monthly installments of principal and interest of \$2,334 payable through October 1, 2020. The mortgage note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$1,306.</p>	169,399
<p>Holly Heights I is financed with two mortgage notes of \$125,000 and \$670,000, totaling \$795,000, with FmHA under Section 515 of the National Housing Act of 1959. The mortgage notes bear interest at the rate of 8.0% per annum, payable in 468 equal monthly installments (39 years) of principal and interest of \$5,550 through October 1, 2007. In addition, there is an interest subsidy from RD associated with these mortgages that reduces the effective interest rate to 6.0%. The subsidy is not recorded on the Project’s books as income or expense and reduces the actual monthly payments by the Project to \$4,405. The interest subsidy is deducted monthly by RD directly from the contract payments and is estimated at \$4,324 for the year ended October 31, 2011. As of October 31, 2011, accrued interest totaled \$1,027.</p>	201,099
<p>Holy Heights I received additional financing with a mortgage note of \$238,736 with the Department of Housing & Community Development for new construction and rehabilitation projects under the HOME Program. The mortgage note accrues simple interest at the rate of 3% per annum. The mortgage note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$57,709.</p>	238,636

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 4. Long-Term Debt – (Continued)

Holly Heights II is financed with two mortgages notes of \$644,632 and \$105,726, totaling \$770,358, with FmHA under Section 515 of the National Housing Act of 1959. The mortgage note contracts bear interest at the rate of 11.875% per annum, payable in 548 equal monthly installments of principal and interest of \$7,658 through November 2034. In addition, there is an interest subsidy from RD associated with these mortgages that reduces the effective interest rate to 1.0%. The subsidy is not recorded on the Project's books as income or expense and reduces the actual monthly payments by the Project to \$1,752. The interest subsidy is deducted monthly by RD directly from the contract payments and for the years ended October 31, 2011 amount to \$70,022. As of October 31, 2011, accrued interest totaled. 722,829

Holly Heights II received additional financing with a mortgage note of \$178,928 with the Department of Housing & Community Development for new construction and rehabilitation projects under the HOME Program. The mortgage note contract bears simple interest at the rate of 3% per annum. The mortgage note is secured by the project. As of October 31, 2011, accrued interest totaled \$43,609. 178,928

McCarty Manor is financed with a mortgage note of \$1,708,500 with FmHA under Section 515 of the National Housing Act of 1959. The mortgage note contract bears interest at the rate of 10.75% per annum, payable in 588 equal monthly installments (49 years) of principal and interest of \$15,378 through October 1, 2032. The mortgage note is secured by the apartment project. In addition, there is an interest subsidy from RD associated with this mortgage that reduces the effective interest rate to 9.75%. The subsidy is not recorded on the Project's books as income or expense and reduces the actual monthly payments by the Project to \$14,010. The interest subsidy is deducted monthly by RD directly from the contract payments and is estimated to be \$6,486 for the year ended October 31, 2011. As of October 31, 2011, accrued interest totaled \$9,106. 1,120,715

Sunshine Manor is financed with a mortgage note of \$1,112,400 with HUD, under Section 202 of the National Housing Act of 1959, as amended. The mortgage note bears interest at the rate of 6.875% per annum and is being repaid in 480 equal monthly installments of principal and interest of \$6,812 payable through October 1, 2019. The mortgage note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$2,876. 501,926

Walnut Village is financed with a mortgage note of \$1,395,100 with HUD, under Section 202 of the National Housing Act of 1959. The mortgage note bears interest at the rate of 6.875% per annum and is being repaid in 480 equal monthly installments of principal and interest of \$8,543 payable through September 1, 2019. The mortgage note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$4,965. 624,559

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 4. Long-Term Debt – (Continued)

McCloud Motel Apartments is financed with a promissory note from the Housing Assistance Council. The note accrues interest at 5%. The entire balance of principal and accrued interest is due and payable on December 31, 2011. The note has been extended until December 31, 2012. The note is secured by a First Deed of Trust. As of October 31, 2011, accrued interest totaled \$117,120. 799,785

Oak Hill Apartments is financed with three mortgage notes originated on October 28, 2004, in the original amounts of \$2,500,000, \$1,100,000 and \$400,000 with RD under Section 514 Labor Housing of the Title V of the Housing Act of 1949. The mortgage notes bear interest at the rate of 1% per annum and payable in monthly installments of \$13,205 of principal and interest over the over the thirty-three year term of the loans through October 28, 2037. The note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$3,025. 3,629,597

Oak Hill Apartments was also financed with a note, secured by a deed of trust, originated on June 1, 2005, in the original amount of \$3,442,000 from the Home Investment Partnerships Program ("HCD-HOME") through the California Department of Housing and Community Development. The note calls for simple interest at the rate of 3% per annum to accrue on the unpaid principal amount of the note. Payments are required pursuant to the terms of the mortgage note equal to residual receipts after the Development Fee Note has been paid in full as well as Asset Management Fees not to exceed \$12,000 per year. Thereafter, all unpaid principal and interest are payable at the maturity date for this mortgage note June 1, 2060. As of October 31, 2011, there were no payments made under the terms of this mortgage note. As of October 31, 2011, accrued interest totaled \$674,768. 3,442,000

\$ 16,219,039

CONTROLLED ENTITIES

Bevins Court is financed with a promissory note of \$100,000 from the County of Lake. The note matures in January 2044 and bears interest on unpaid principal of 2%. Interest is deferred from January 15, 2003, and will be repaid in 37 equal installments of \$4,236 beginning January 15, 2008. Annual payments of interest and principal shall be made from "residual receipts" as determined by HUD, or from the Project's own funds. No payments of principal are due before 2012. The promissory note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$7,041. \$ 100,000

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 4. Long-Term Debt – (Continued)

North Shore Villas is financed with a mortgage note of \$1,488,800 with HUD, under Section 202 of the National Housing Act of 1959. The mortgage note bears interest at the rate of 8.375% per annum and is being repaid in 480 equal monthly installments of principal and interest of \$10,773 payable through October 1, 2031. The mortgage note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$8,743. 1,252,776

Gibson Court is also financed with a promissory note from HOME through the California Department of Housing and Community Development Program. The note is for \$758,824, matures in May 2031 and bears annual interest of 3%. Annual payments of interest and principal shall be made only from "residual receipts" approved by HUD for any particular year. All other terms and conditions of the note default to the provisions of HUD Section 811. The promissory note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$125,947. 758,824

Lakeview Apts. is financed with a mortgage note of \$1,656,000 with HUD, under Section 202 of the National Housing Act of 1959. The mortgage note bears interest at the rate of 9.25% per annum and is being repaid in 480 equal monthly installments of principal and interest of \$13,093 payable through October 1, 2028. The mortgage note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$10,359. 1,343,865

Jack Simpson Apts. is financed with a mortgage note of \$1,619,200 with HUD, under Section 202 of the National Housing Act of 1959. The mortgage note bears interest at the rate of 9.0% per annum and is being repaid in 480 equal monthly installments of principal and interest of \$12,490 payable through August 1, 2032. The mortgage note is secured by the apartment project. As of October 31, 2011, accrued interest totaled \$10,561. 1,408,137

Siskiyou Garden Apts. is financed with a mortgage note of \$485,580 with Berkodia Mortgage Company. The mortgage note bears interest at the rate of 7% per annum and is being repaid in 190 equal monthly installments of principal and interest of \$4,007 payable through September 30, 2013. The mortgage note is secured by the apartment project. In addition, there is an interest subsidy from HUD associated with the mortgage that reduces the effective interest rate to .45%. The interest subsidy is deducted monthly by the finance company directly from the contract payments. The total interest subsidy for the year ended October 31, 2011 amounted to \$28,938. 99,828

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 4. Long-Term Debt – (Continued)

Washington Court is financed with a promissory note from California Department of Housing and Community Development HOME. The original note was for \$202,720, matures in August 2031 and bears annual interest of 3%. Annual payments of interest and principal shall be made only from "residual receipts" approved by HUD for any particular year. No payments shall be required from this promissory note in the absence of residual receipts. The promissory note is secured by the apartment project. All other terms and conditions of the note default to the provisions of HUD Section 202. As of October 31, 2011, accrued interest totaled \$60,770.

202,720

Redwood Court is financed with a mortgage note of \$1,854,944, with FmHA under Section 515 of the National Housing Act of 1949. The mortgage note bears interest at the rate of 9.0% per annum, payable in 600 equal monthly installments (50 years) of principal and interest of \$14,072 through July 2, 2037. The mortgage note is secured by the apartment. In addition, there is an interest subsidy from RD associated with this mortgage that reduces the effective interest rate to 1%. The subsidy is recorded on the Partnership's books as income and expense and reduces the actual monthly payments by the Partnership to \$4,098. The interest subsidy is deducted monthly by RD directly from the contract payments. For the year ended October 31, 2011, interest subsidy totaled \$121,525. As of October 31, 2011, accrued interest totaled \$2,537.

1,688,454

Redwood Court is also financed with a second mortgage note of \$76,923 with FmHA on January 23, 1992 for the purpose of landscaping and installing playground equipment. The mortgage note bears interest at the rate of 8.25% and is payable in 600 equal monthly installments (50 years) of principal and interest of \$538 through February 1, 2042. The mortgage note is secured by the equipment. As of October 31, 2011, accrued interest totaled \$119.

70,407

Redwood Court is also financed with a mortgage note secured by a Deed of Trust on the apartment project from the California Department of Housing and Community Development HOME Program in the amount of \$2,987,557. The full amount of this loan funded in favor of the Partnership on September 15, 2008. The note bears interest at the rate of 3% per annum, and is repayable in 35 years. As of October 31, 2011, accrued interest totaled \$146,344.

2,987,557

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 4. Long-Term Debt – (Continued)

Redwood Court is also financed with a mortgage note secured by a deed of trust from the Fortuna Redevelopment Agency pursuant to a Promissory Note and Loan Agreement in the amount of \$200,000. This Promissory Note bears interest at the rate of 3% per annum, simple interest, and is payable in full together with accrued and unpaid interest at its maturity on September 1, 2063. The terms of this loan include an affordability restriction on the units within the property by which the loan is secured that runs the full 55 year term of the loan. The proceeds from this loan were advanced to Pine Gardens I, Inc. so that Pine Gardens I, Inc. could acquire the limited partnership interest in the Partnership from Beech Villa Ltd. effective August 29, 2008. As of October 31, 2011, accrued interest totaled \$20,071.

200,000
\$ 10,112,568

Changes in long-term debt for the year ended October 31, 2011 is as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Funds	\$ 5,753,724	\$ 259,307	\$ 418,716	\$ 5,594,315
Owned Projects	16,700,511	6,932	488,404	16,219,039
Controlled Entities	<u>9,385,607</u>	<u>864,807</u>	<u>137,846</u>	<u>10,112,568</u>
Totals	<u>\$ 31,839,842</u>	<u>\$ 1,131,046</u>	<u>\$ 1,044,966</u>	<u>\$ 31,925,922</u>

Aggregate maturities required on the mortgages payable at October 31, 2011 is as follows:

<u>For the Year Ended October 31:</u>	<u>Funds</u>	<u>Owned</u>	<u>Controlled</u>	<u>Total</u>
2012	\$ 1,761,272	\$ 1,319,840	\$ 140,874	\$ 3,221,986
2013	510,267	554,410	160,845	1,225,522
2014	1,042,725	591,739	145,934	1,780,398
2015	11,204	632,158	137,658	781,020
2016	1,384,789	640,074	150,070	2,174,933
Thereafter	<u>884,058</u>	<u>12,480,818</u>	<u>9,377,187</u>	<u>22,742,063</u>
	<u>\$ 5,594,315</u>	<u>\$ 16,219,039</u>	<u>\$ 10,112,568</u>	<u>\$ 31,925,922</u>

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 5. Commitments and Contingencies

As described in Note 1, RCHDC controls the General Partner (“GP”) interest in four Limited Partnerships, which own a total of seven low-income apartment developments.

These controlled entities have certain ongoing obligations, with respect to the partnerships in which they are involved, as follows:

A) Pine Gardens I, Inc. has the following ongoing obligations related to Clara Court, L.P. (“Clara”):

- i) During the construction phase of Clara, Pine Gardens I, Inc. has guaranteed a September 30, 2011 completion date, is required to pay any development deficits and shall cause rental achievement to occur by June 1, 2012. Management expects a September 30, 2011 completion date to be extended by the limited partner. Completion of Clara was delivered in December 2011 and management believes that the GP will not have to pay the limited partner for any short fall in tax credit delivery.
- ii) Pine Gardens I, Inc. is required to establish a separate Operating Reserve Account in the amount of \$105,000 for Clara. This is expected to be funded out of presently committed invested equity funding sources for Clara.
- iii) Pine Gardens I, Inc. has pledged to lend Clara any operating loans to fund operating deficits incurred by Clara during the period commencing at rental achievement and expiring 60 months thereafter.
- iv) Pine Gardens I, Inc. is required to make capital contributions to Clara to compensate the limited partner for any ongoing shortfall in the tax credits which are hereinafter expected to accrue for the benefit of the limited partner.

Pine Gardens I, Inc. is required to make capital contributions for the portion of the Development Fee Note that remains unpaid by the thirteenth anniversary of the completion of the construction of Clara.

- vi) Pine Gardens I, Inc. is required to purchase the limited partner's interest in Clara for the total amount of capital contributions contributed by the limited partner plus any expenses incurred by the limited partner, based upon the occurrence of various specified events related to the failure of Clara to achieve the anticipated results. The management of Clara believes that it is highly unlikely that the GP will have any liability related to this obligation.

B) Pine Gardens I, Inc. has the following ongoing obligations related to Orchard River Associates, L.P. (“Orchard”) and the three apartment projects it owns:

- i) Pine Gardens I, Inc. together with RCHDC, is required to maintain an aggregate net worth of not less than \$500,000.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 5. Commitments and Contingencies – (Continued)

- ii) Pine Gardens I, Inc. is required to establish segregated Operating Reserve Accounts for each project as follows:

Orchard Manor Apts.	\$80,250
Orchard Village Apts.	\$70,500
River Gardens Apts.	\$67,000

To date these segregated Operating Reserve Accounts have not yet been established. The GP expects to fund these reserves with funds from the investor equity installments, yet to be received.

- iii) Pine Gardens I, Inc. has guaranteed to fund the operating deficits of each project until each project has achieved a Debt Service Coverage Ratio of 1.15 to 1.00, and then for an additional sixty (60) consecutive months up to an aggregate amount of \$788,925 after the segregated Operating Reserve Accounts have been exhausted.
- iv) Pine Gardens I, Inc. is required to make capital contributions to the partnership to compensate the limited partner for any ongoing shortfall in the tax credits which are hereinafter expected to accrue for the benefit of the limited partnership.
- v) Pine Gardens I, Inc. is required to make a capital contribution for the portion of the Developer Fee Note for each project that remains unpaid as of the end of the twelfth year following the completion of the rehabilitation of each project.
- vi) Pine Gardens I, Inc. is required to purchase the limited partner's interest in Orchard for the total amount of capital contributions contributed by the limited partner plus any expenses incurred by the Limited Partner, based upon the occurrence of various specified events related to the failure of the projects to achieve the anticipated results. The management of Orchard believes that it is highly unlikely that they GP will have any liability related to this obligation.

- C) CC Seabreeze, LLC (“Seabreeze”) and CC Seagull Villa, LLC (“Seagull”) have the following ongoing obligations related to the respective partnerships in which they have an interest and the related projects that these partnerships own:

- i) Seabreeze and Seagull have guaranteed to fund the operating deficits of each project until each project has achieved a Debt Service Coverage Ratio of 1.10 to 1.00, and then for an additional three (3) consecutive years up to the following total amounts:

Seabreeze Apts. and Totem Villa Apts.	\$314,594
Seagull Villa Apts.	\$154,262

These obligations are required only after the Operating Reserve Target Amounts have been exhausted.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 5. Commitments and Contingencies – (Continued)

- ii) Seabreeze and Seagull are required to make capital contributions to the partnerships to compensate the limited partners for any ongoing shortfall in the tax credits which are hereinafter expected to accrue for the benefit of the limited partners.
- iii) Seabreeze and Seagull are required to make capital contributions for the portion of the Developer Fee Note for each project that remain unpaid as of the end of the twelfth year following the completion of the rehabilitation of each project.
- iv) Seabreeze and Seagull are required to purchase the limited partners' interests in the partnerships for the total amount of capital contributions contributed by the limited partners plus \$50,000 plus any expenses incurred by the limited partners, based upon the occurrence of various specified events related to the failure of the projects to achieve the anticipated results. The management of the partnerships believe that it is highly unlikely that the GP will have any liability related to this obligation.

Note 6. Gain (Loss) on Sale of Development Properties

RCHDC develops real estate for sale to Self-Help families. During the year ended October 31, 2011, RCHDC reported the following gains from the sale of development properties:

	<u>Lakewood</u>
Selling Price	\$ 659,967
Cost of Development Properties:	
Land held for development	69,655
Development cost	<u>417,667</u>
Gain on Sale of Development Properties	<u>\$ 172,645</u>

Note 7. Functional Allocation of Expenses

Expenditures incurred in connection with RCHDC operations and expenditures made for corporate purposes have been summarized on functional basis, as administrative services, in the accompanying consolidated Statement of Activities.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 8. NeighborWorks America Grants

During the year ended October 31, 2011, RCHDC received grant funds from NeighborWorks America. The grants have been recognized in multiple funds and related corporations. The following provides a listing of the grants received:

<u>Grant Type</u>	<u>Amount Received</u>
Permanently Restricted	\$ 150,000
Expendable	<u>70,500</u>
Total NeighborWorks America Grants Received	<u>\$ 150,000</u>

The following represents the components of permanently restricted net assets as it relates to cumulative capital grants provided to RCHDC from NeighborWorks America:

	<u>Fixed Assets</u>	<u>Notes Receivable</u>	<u>Advances to Affiliates</u>	<u>Development Costs</u>	<u>Total</u>
Beginning of the year, as previously reported	\$ 794,000	\$ 285,000	\$ 269,800	\$ 200,000	\$ 1,548,800
Reclassification per NeighborWorks	-	50,000	-	(50,000)	-
Permanent restriction release, transferred to unrestricted net assets	(153,500)	(210,000)	-	-	(363,500)
Grants	<u>-</u>	<u>-</u>	<u>150,000</u>	<u>-</u>	<u>150,000</u>
End of the year	<u>\$ 640,500</u>	<u>\$ 125,000</u>	<u>\$ 419,800</u>	<u>\$ 150,000</u>	<u>\$ 1,335,300</u>

During the year ended October 31, 2011, NeighborWorks America authorized the release of \$363,500 from permanently restricted to unrestricted net assets.

Note 9. Self-Insurance

RCHDC's dental and vision insurance plans are funded through a restricted bank account established to provide medical benefits for eligible employees and their dependents. When necessary RCHDC makes a monthly contribution to the account to cover expected expenses. At October 31, 2011, RCHDC has \$48,119 in cash restricted for the self-insurance plan and accounts payable for amounts that were available to fund outstanding claims.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 10. Defined Contribution Pension Plan

RCHDC has a 403(b) defined contribution pension plan covering all employees working 20 hours per week or more. RCHDC may make a discretionary matching contribution to the plan each year, not to exceed 5% of the contributing employees' regular pay. For an employee to be eligible to receive the match, they must be employed on October 31st of the respective year. RCHDC reserves the contribution monthly and makes the deposit to the plan in the following fiscal year. Total contributions accumulated for the year ended October 31, 2011 to be deposited to the plan totaled \$13,670.

Note 11. Temporarily Restricted Net Assets

Temporarily restricted net assets consisted of the following at October 31, 2011:

Fair market value of land of \$135,000 purchased from the County of Lake for \$1 for use by Bevins Court Housing Corporation. The land is restricted for affordable housing in Lake County for a period of 40 years from the date of grant.	\$ 135,000
Crescent City granted to RCHDC \$70,000 and \$85,000 during the years ended October 31, 2006 and 2008, respectively, to be used for rehabilitation of three low income housing apartments in Crescent City, California. The housing projects must remain affordable for 55 years from the dates of the grants.	155,000
Revolving Development Fund (Fund 21) grant liens	2,916,706
Owned Projects grant liens	3,300,500
Controlled Entities grant liens	6,346,900
Notes receivable with funds obtained from Redevelopment Agency of Mendocino	<u>50,000</u>
Total Temporarily Restricted Net Assets	<u>\$ 12,904,106</u>

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 11. Temporarily Restricted Net Assets – (Continued)

The following is a summary of the grant liens at October 31, 2011:

REVOLVING DEVELOPMENT FUND (FUND 21)

<p>California Department of Housing and Community Development secured by deed of trust on the Lake Mendocino Drive property. The note is in the amount of \$560,000 originally due November 30, 2009. The note has been extended to November 30, 2013. The note bears interest at 3% until forgiven incrementally as individual lots are sold. RCHDC pays \$18,667 toward principal per lot sold. The note converts to a grant upon sale of lots to families. As of October 31, 2011 accrued interest totaled \$45,152.</p>	\$ 149,333
<p>California Department of Housing and Community Development, CalHOME predevelopment loans secured by deed of trust on the Lake Mendocino Drive property. The notes are in the amount of \$427,500 at 0% interest originally due February 25, 2005. The notes have been extended to lot sale dates. The notes convert to grants upon sale of lots to families. As of October 31, 2011, accrued interest totaled \$179,521.</p>	90,053
<p>Housing Assistance Council notes in the aggregate amount of \$1,493,647 on Lake Mendocino Drive Self-Help property at interest rates of 0% and 5% with a range of maturity dates. Notes are forgiven incrementally as individual lots are sold. The notes are secured by the properties. As of October 31, 2011, accrued interest totaled \$134,369.</p>	1,343,647
<p>Redevelopment Agency, County of Mendocino \$100,000 note dated January 20, 2009. Note bears interest at 1% until forgiven incrementally as individual lots are sold. This note is secured by the property.</p>	50,000
<p>County of Mendocino loan sponsored by Community Development Commission in the amount of \$496,000 which is forgiven incrementally as individual lots are sold. This note is secured by the property.</p>	217,888
<p>Lake County Redevelopment Agency note dated November 1, 2004, not to exceed \$250,000, secured by deed of trust on Collier Street property. Note balance increased by \$998,000 in 2009 to maximum balance of \$1,248,000. The note accrues simple interest at 2%. No payments or interest are due as long as the maker is not in default of an affordable housing covenant. After 10 years and each succeeding 5 years, 10% of the principal shall be reduced until the end of the 55 year term of the note. Lake County Redevelopment Agency has notified RCHDC that the remaining available funds will not be disbursed.</p>	618,785
<p>Ukiah Redevelopment Agency loan of \$447,000, dated April 1, 2011. The loan is unsecured and non-interest bearing. No payments are due provided RCHDC has remained in continuous compliance with the Regulatory Agreement.</p>	<u>447,000</u>
	<u>\$ 2,916,706</u>

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 11. Temporarily Restricted Net Assets – (Continued)

OWNED PROJECTS

Gibson Court 4 is financed with an Affordable Housing Program Direct Subsidy. The Agreement requires no payments or interest as long as the Project remains affordable for households with income at or below 50% of average median income. Provided the Project remains in compliance with the AHP conditions for the term of the lien, then repayment of these funds is not required. This note is secured by the apartment project. \$ 20,000

Oak Hill Apartments obtained a Grant Lien secured by a Deed of Trust which originated on January 30, 2002 in the total amount of \$2,988,000 from the Department of Housing and Community Development, Joe Serna Jr. Farmworker Housing Grant Program ("HCD-Joe Serna"). Provided that the Project remains in compliance with all of the covenants in the Grant Lien and Regulatory Agreement for the full 40 year term of the lien until January 30, 2042, no interest will accrue and no payments will be required pursuant to this Grant Lien. 2,988,000

Oak Hill Apartments obtained a Grant Lien secured by a Deed of Trust which originated on December 16, 2004 in the total amount of \$292,500 from the National Bank of the Redwoods pursuant to an Affordable Housing Program ("AHP") Award through the Federal Home Loan Bank of San Francisco ("FHLBSF"). Provided that the Project remains in compliance with FHLBSF – AHP requirements until July 26, 2022 (15 years from the date of issuance of the certificate of occupancy for the Project) no interest will accrue and no payments will ever be required pursuant to this Grant Lien. 292,500

\$ 3,300,500

CONTROLLED PROJECTS

Bevins Court is financed with a \$68,800 Affordable Housing Program Direct Subsidy. The Agreement requires no payments or interest as long as the Project remains affordable for households with income at or below 50% of average median income. The note payable is secured by the apartment project. \$ 68,800

Bevins Court is also financed with a mortgage note of \$1,104,100 from HUD, under Section 202 of the National Housing Act of 1959. The mortgage note bears no interest and repayment is not required as long as the housing remains available for qualifying persons with disabilities. The note matures May 1, 2041 and may not be prepaid without prior written approval of HUD. Provided that the Project remains available and Bevins Court Housing Corporation has not defaulted on the terms of the Note, Mortgage, or Regulatory Agreement, HUD will deem the note paid in full at the maturity date. The mortgage note is secured by the apartment project. 1,104,100

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 11. Temporarily Restricted Net Assets – (Continued)

Gibson Court is financed with a \$60,000 Affordable Housing Program Direct Subsidy. The Agreement requires no payments of principal or interest as long as the Project remains affordable for households with income at or below 50% of average median income. The note payable is secured by the apartment project. 60,000

Gibson Court is also financed with a Capital Advance Mortgage note of \$752,400 from HUD, under Section 811. The mortgage note bears no interest and repayment is not required as long as the housing remains available for qualifying persons with disabilities. The note matures May 1, 2041 and may not be prepaid without prior written approval of HUD. Provided that the Project remains available for disabled persons until the maturity date, and that Gibson Court Housing Corporation has not defaulted under the terms of the note, Mortgage, or Regulatory Agreement, HUD will deem the note paid in full at the maturity date. The mortgage note is secured by the apartment project. 752,400

North Pine St. Apts. is financed with a Capital Advance Mortgage note of \$706,000 with HUD under Section 202 of the National Housing Act of 1959, where HUD agreed to advance a maximum of \$706,000 to the project. The capital advance bears no interest and will not be repaid to HUD as long as the Project remains available to qualifying low income persons for a period of 40 years. If the Project becomes non-compliant within term, the advance becomes immediately due and payable. The note is secured by the project. 706,000

North Pine St. Apts. is also financed through a \$47,500 Affordable Housing Program Direct Subsidy. The Agreement requires no payments or interest as long as the Project remains affordable for households with income at or below 50% of average median income. The note payable is secured by the apartment project. 47,500

Oak Park Manor is financed with a mortgage note of \$1,733,300 with HUD, under Section 202 of the National Housing Act of 1959. The mortgage note bears no interest and repayment is not required as long as the housing remains available for low-income seniors. The note matures August 1, 2033 and may not be prepaid without prior written approval of the HUD. Provided that the Project remains available for low-income seniors until the maturity date, and that Red Bluff Senior Housing Corporation has not defaulted on the terms of the note, Mortgage, or Regulatory Agreement, HUD will deem the note paid in full at the maturity date. The mortgage note is secured by the apartment project. 1,733,300

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 11. Temporarily Restricted Net Assets – (Continued)

Washington Court is financed with a \$55,000 Affordable Housing Program Direct Subsidy. The Agreement requires no payments of principal or interest as long as the Project remains affordable for households with income at or below 50% of average median income. The note payable is secured by the apartment project. 55,000

Washington Court is also financed with a Capital Advance Mortgage note in the amount of \$924,000 with HUD under Section 202 of the National Housing Act of 1959. The capital advance bears no interest and will not be repaid to HUD as long as the Project remains available to qualifying low income persons for a period of 40 years. If the Project becomes non-compliant within the term, the advance becomes immediately due and payable. The note is secured by the apartment project. 924,000

Lenore Street is financed with a \$60,000 Affordable Housing Program Direct Subsidy. The agreement requires no payments of principal or interest as long as the Project remains affordable for households with income at or below 50% of average median income. The note payable is secured by the apartment project. 60,000

Lenore Street is also financed with a Capital Advance Mortgage note of \$835,800 with HUD under Section 202 of the National Housing Act of 1959. The mortgage note bears no interest and repayment is not required as long as the housing remains available for low-income seniors. The note matures March 15, 2041 and may not be prepaid without prior written approval of HUD. Provided that the Project remains available for low-income seniors until the maturity date, and WSHC has not defaulted under the terms of the note, Mortgage or Regulatory Agreement, HUD will deem the note paid in full at the maturity date. The note payable is secured by the apartment project. 835,800

\$ 6,346,900

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 12. Permanently Restricted Net Assets

Permanently restricted net assets at October 31, 2011 have been restricted for the following purpose:

Self-Help notes receivable	\$ 845,572
Fixed assets	584,000
Advances to or investment in affiliates	419,800
Development costs	<u>400,000</u>
Total Permanently Restricted Net Assets	<u>\$ 2,249,372</u>

Note 13. Business Conditions – Oak Hill Apartments

During the year ended October 31, 2011, Oak Hill generated positive cash flow from operations and incurred a use of cash of \$5,667. The Project funded \$10,460 to the replacement reserve during the year ended October 31, 2011, but the replacement reserve remains underfunded by \$145,987. At October 31, 2011, the Project owes RCHDC a total of \$398,042. Therefore, the continued viability of this Project is dependent upon successful future operations. Effective November 1, 2011, Oak Hill received approval from RD to increase rents and received approval for the four unsubsidized units to reduce rents to market which management believes will result in reducing vacancies. However, it should be noted that as turnover continues to be higher than originally anticipated, the fact that the replacement reserves are underfunded is likely to further impact negative cash flow from operations attributable to the inability to draw upon the replacement reserves for unusual or unexpected turnover costs.

Note 14. Tax Exempt Notices

Subsequent to year-end, RCHDC obtained notices for six of its controlled entities from the IRS stating that these entities had lost their tax-exempt status due to failure to file proper tax returns. These entities have been included in the consolidated tax-exempt tax return for RCHDC, which includes its funds, owned projects and certain of its controlled entities that are organized as tax-exempt entities. While these six entities were included in the consolidated return, it is the position of the IRS that the consolidated return was not properly filed in accordance with the regulations for consolidated tax-exempt returns, therefore, these entities must apply for tax-exempt status and file tax returns for certain years. RCHDC is currently working with the IRS to resolve this matter and believes that there will be no change in the tax-exempt status for these entities, therefore, no provision has been made for federal, state or local income taxes. While the ultimate outcome cannot be determined at this time, management believes that it is more likely than not that these entities will be determined to be tax-exempt organizations.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
 Year ended October 31, 2011

Note 15. Fair Value Measurements

The guidance requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

- Level 1: Quoted market prices in active markets for identical assets or liabilities.
- Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data:
- Level 3: Unobservable inputs that are not corroborated by market data.

In determining the appropriate levels, RCHDC performs a detailed analysis of the assets and liabilities that are subject to fair value measurements. For the year ended October 31, 2011, the application of fair value techniques applied to similar assets and liabilities has been consistent. The following is a description of the valuation methodologies used for instruments measured at fair value.

Investment in Land Held for Development and Development Costs: The fair value of real estate is the market value of real estate based on recent appraisals, estimated future net undiscounted cash flows from the eventful disposition of the property and other real estate market condition factors.

The table below presents the balances of assets measured at fair value by level within that hierarchy at October 31, 2011.

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Land held for development and developments costs	<u>\$ 8,223,790</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,223,790</u>

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 16. Prior Period Adjustments and Change in Accounting

Effective October 31, 2010, the consolidated financial statements have been restated for the following:

Change in Accounting

- A. RCHDC enters into grant liens and liens convertible to grants which provide that these debt agreements will convert to grant income if certain requirements are maintained. These requirements align with RCHDC's core mission to develop, own and manage low-cost housing. Therefore, the more appropriate presentation for these grant liens and liens convertible to grants, which were previously reported as long-term liabilities, is temporarily restricted net assets due to either purpose and/or time requirements.

Prior Period Adjustments

- A. RCHDC assists eligible buyers for low-cost housing with loans from various external and internal funding sources. The note agreements, as described in Note 2 to these consolidated financial statements, have long terms which require payment after certain first and other mortgages are paid by the buyers. Additionally, certain of the loans have provisions that the notes receivable are forgiven over a period of time. Due to the long-term nature of the notes receivable, accounting principles generally accepted in the United States of America require that these loans be presented at their net present value using applicable discount rates over the term of the notes receivable agreements, therefore, the notes receivable balances have been reduced to their net present value. Additionally, certain of the forgivable loans were not reserved in accordance with RCHDC's policy, therefore, the allowance was restated.
- B. RCHDC controls two not-for profit entities as summarized in Note 1 in the consolidated financial statements which are Redwood Court Property Corporation and Pine Gardens I, Inc. which are the general partner and limited partner, respectively, of Redwood Court Property, A California Limited Partnership whose sole asset is Redwood Court Apartments. The acquisition of the partnership interests were purchased in 2006 and 2008, respectively. The purchase of the partnership interests were previously reflected using purchase accounting which included adjusting the basis of fixed assets. The effect of using purchase accounting has been restated.
- C. RCHDC corrected net asset classification for notes receivable which reduced permanently restricted net assets by \$250,650. Based on the funding sources for these notes receivable and their agreements, temporarily restricted net assets increased by \$50,000 and unrestricted net assets increased by \$200,650.
- D. RCHDC owns .01% general partner interest in four limited partnerships which were previously reported using the equity method. Accounting principles generally accepted in the United States of America requires that these be recorded using the cost method. The effect of using the equity method of accounting has been restated.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 16. Prior Period Adjustments and Change in Accounting – (Continued)

The following summarizes the effect on beginning net assets as of October 31, 2010 and the statement of changes in net assets for the year ended October 31, 2010 for net asset restriction:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Totals</u>
Net Assets, October 31, 2010, as previously reported	\$ 2,028,988	\$ 290,000	\$ 2,622,575	\$ 4,941,563
Correct notes receivable classification as permanently restricted to proper classification	200,650	50,000	(250,650)	-
Cost method for consolidated interests in partnerships	(53,022)			(53,022)
Self-Help Family notes receivable adjustments for net present value and allowance for forgiveable loans	(1,137,329)			(1,137,329)
Correct fixed assets and investment in consolidated affiliates	(698,056)	-	-	(698,056)
Correct grant liens net asset classification	<u>-</u>	<u>12,199,929</u>	<u>-</u>	<u>12,199,929</u>
Net Assets (Deficit), October 31, 2010, restated	<u>\$ 341,231</u>	<u>\$ 12,539,929</u>	<u>\$ 2,371,925</u>	<u>\$ 15,253,085</u>
Change in Net Assets (Deficit) for the year ended October 31, 2010, as previously reported	\$ (42,423)	\$ -	\$ 286,000	\$ 243,577
Income from nonconsolidated limited partnerships	(57,529)	-	-	(57,529)
Self-Help Family notes receivable adjustments for net present value and allowance for forgiveable loans	(166,000)	-	-	(166,000)
Correct fixed assets and investment in consolidated affiliates	<u>(2,845)</u>	<u>-</u>	<u>-</u>	<u>(2,845)</u>
Change in Net Assets (Deficit) for the year ended October 31, 2010, restated	<u>\$ (268,797)</u>	<u>\$ -</u>	<u>\$ 286,000</u>	<u>\$ 17,203</u>

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
NOTES to the CONSOLIDATED FINANCIAL STATEMENTS – Continued
Year ended October 31, 2011

Note 16. Prior Period Adjustments and Change in Accounting – (Continued)

The following summarizes the effect on beginning net assets as of October 31, 2010 and the statement of changes in net assets for the year ended October 31, 2010 by groupings as presented in the supplemental information section:

	Funds	Owned Projects	Controlled Entities	Consolidating Entries	Totals
Net Assets (Deficit), October 31, 2010, as previously reported	\$ 5,956,370	\$ (760,204)	\$ (16,973)	\$ (237,630)	\$ 4,941,563
Cost method for consolidated interests in partnerships	-	-	(53,022)	-	(53,022)
Self-Help Family notes receivable adjustments for net present value and allowance for forgivable loans	(1,137,329)	-	-	-	(1,137,329)
Correct fixed assets and investment in consolidated affiliates	-	-	(474,749)	(223,307)	(698,056)
Correct grant liens net asset classification	2,552,529	3,300,500	6,346,900	-	12,199,929
Net Assets (Deficit), October 31, 2010, restated	<u>\$ 7,371,570</u>	<u>\$ 2,540,296</u>	<u>\$ 5,802,156</u>	<u>\$ (460,937)</u>	<u>\$ 15,253,085</u>
Change in Net Assets (Deficit) for the year ended October 31, 2010, as previously reported	\$ 578,960	\$ (89,788)	\$ (245,595)	\$ -	\$ 243,577
Income from nonconsolidated limited partnerships	-	-	(57,529)	-	(57,529)
Self-Help Family notes receivable adjustments for net present value and allowance for forgivable loans	(166,000)	-	-	-	(166,000)
Correct fixed assets and investment in consolidated affiliates	-	-	(2,845)	-	(2,845)
Change in Net Assets (Deficit) for the year ended October 31, 2010, restated	<u>\$ 412,960</u>	<u>\$ (89,788)</u>	<u>\$ (305,969)</u>	<u>\$ -</u>	<u>\$ 17,203</u>

Note 17. Current Concentration Due to Certain Conditions

RCHDC, through its Funds, Owned Properties and Controlled Entities, operations are concentrated in the low cost housing real estate including developing, owning and managing affordable housing which is a heavily regulated environment. The operations of the Owned Properties and Controlled Entities are subject to administrative directives, rules and regulations of federal and state regulatory agencies, including but not limited to RD, HUD, IRS and State Housing Agencies. The Funds rely on federal and state affordable housing programs to fund their purposes. Such administrative directives, rules and regulations are subject to change by an act of Congress or administrative change mandated by federal and state agencies. Such changes may occur with little notice or inadequate funding to pay for the related cost, including the additional administrative burden, to comply with a change.

SUPPLEMENTAL INFORMATION

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
CONSOLIDATING SCHEDULE of FINANCIAL POSITION
October 31, 2011

ASSETS	Funds	Owned Projects	Controlled Entities	Consolidating Entries	Totals
Current Assets:					
Cash and cash equivalents	\$ 705,664	\$ 530,255	\$ 134,808	\$ -	\$ 1,370,727
Net tenant accounts receivable	1,700	22,122	12,847	-	36,669
Tenant assistance accounts receivable	-	415	448	-	863
Other accounts receivable	5,834	-	-	-	5,834
Due from funds	-	52	-	(52)	-
Due from owned projects	441,275	-	-	(441,275)	-
Due from controlled entities	202,835	-	-	(202,835)	-
Due from related parties	1,327,979	-	247,845	-	1,575,824
Prepaid expenses	35,033	4,742	4,803	-	44,578
Total Current Assets	2,720,320	557,586	400,751	(644,162)	3,034,495
Deposits:					
Tenant deposits held in trust	7,293	100,423	67,617	-	175,333
Amounts held for self-help families	1,300	-	-	-	1,300
Tax and insurance impounds	-	138,380	110,504	-	248,884
Replacement reserves	-	1,365,916	819,201	-	2,185,117
Other required reserves	-	838,073	95,273	-	933,346
Residual receipts reserves	-	215,315	370,636	-	585,951
Cash restricted for pension plan	13,670	-	-	-	13,670
Cash restricted for self-insurance plan	48,119	-	-	-	48,119
Total Deposits	70,382	2,658,107	1,463,231	-	4,191,720
Fixed Assets, net of Accumulated Depreciation	789,870	17,010,928	13,926,640	-	31,727,438
Other Assets:					
Long-term notes receivable	1,053,829	-	-	-	1,053,829
Advances and investments in consolidated affiliates	128,000	-	332,937	(460,937)	-
Advances and investment in nonconsolidated affiliates	319,200	-	243,385	-	562,585
Land held for development	2,297,817	-	-	-	2,297,817
Development costs	5,900,996	24,977	-	-	5,925,973
Total Other Assets	9,699,842	24,977	576,322	(460,937)	9,840,204
Total Assets	\$ 13,280,414	\$ 20,251,598	\$ 16,366,944	\$ (1,105,099)	\$ 48,793,857

See Independent Auditors' Report.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
CONSOLIDATING SCHEDULE of FINANCIAL POSITION – Continued
October 31, 2011

LIABILITIES & NET ASSETS (DEFICIT)	<u>Funds</u>	<u>Owned Projects</u>	<u>Controlled Entities</u>	<u>Consolidating Entries</u>	<u>Totals</u>
Current Liabilities:					
Accounts payable and accrued liabilities	\$ 504,664	\$ 64,628	\$ 56,006	\$ -	\$ 625,298
Accrued interest payable	2,595	47,467	32,286	-	82,348
Due to funds	-	441,275	202,835	(644,110)	-
Due to owned properties	52	-	-	(52)	-
Current portion mortgages and notes payable, net	1,761,272	1,319,840	140,874	-	3,221,986
Deferred revenue	46,167	19,750	3,844	-	69,761
Total Current Liabilities	<u>2,314,750</u>	<u>1,892,960</u>	<u>435,845</u>	<u>(644,162)</u>	<u>3,999,393</u>
Long-Term Liabilities:					
Tenant deposits held in trust	7,293	102,430	67,617	-	177,340
Amounts held for self-help families	1,300	-	-	-	1,300
Accrued interest payable	478,716	996,126	360,206	-	1,835,048
Mortgages and notes payable, net	3,833,043	14,899,199	9,971,694	-	28,703,936
Total Long-Term Liabilities	<u>4,320,352</u>	<u>15,997,755</u>	<u>10,399,517</u>	<u>-</u>	<u>30,717,624</u>
Total Liabilities	<u>6,635,102</u>	<u>17,890,715</u>	<u>10,835,362</u>	<u>(644,162)</u>	<u>34,717,017</u>
Net Assets (Deficit):					
Unrestricted (Deficit)	1,914,734	(1,196,117)	(1,334,318)	(460,937)	(1,076,638)
Temporarily restricted	3,121,706	3,300,500	6,481,900	-	12,904,106
Permanently restricted	1,608,872	256,500	384,000	-	2,249,372
Total Net Assets (Deficit)	<u>6,645,312</u>	<u>2,360,883</u>	<u>5,531,582</u>	<u>(460,937)</u>	<u>14,076,840</u>
Total Liabilities & Net Asset (Deficit)	<u>\$ 13,280,414</u>	<u>\$ 20,251,598</u>	<u>\$ 16,366,944</u>	<u>\$ (1,105,099)</u>	<u>\$ 48,793,857</u>

See Independent Auditors' Report.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
CONSOLIDATING SCHEDULE of ACTIVITIES and CHANGES in NET ASSETS (DEFICIT)
Year ended October 31, 2011

REVENUES	Funds	Owned Projects	Controlled Entities	Consolidating Entries	Totals
Net tenant rents	\$ -	\$ 979,670	\$ 919,806	\$ -	\$ 1,899,476
Tenant assistance payments	-	2,215,681	1,180,459	-	3,396,140
Other rents	89,752	-	28,938	-	118,690
Grant income	701,178	-	-	-	701,178
Interest income	22,125	8,871	1,996	-	32,992
Management fees and reimbursements	668,911	-	64,716	(521,085)	212,542
Operational revenue	810,662	11,679	11,071	-	833,412
Gain on sale of development properties	172,645	-	-	-	172,645
Other revenue	59,076	9,478	3,784	-	72,338
Total Revenues	<u>2,524,349</u>	<u>3,225,379</u>	<u>2,210,770</u>	<u>(521,085)</u>	<u>7,439,413</u>
EXPENSES					
Administrative services	1,052,221	427,238	351,220	-	1,830,679
Management fees	27,735	252,668	193,688	(474,091)	-
Bookkeeping and accounting fees	-	19,016	27,978	(46,994)	-
Utilities	-	386,953	361,478	-	748,431
Operating and maintenance:					
Operating accounts	189,971	434,057	259,585	-	883,613
Replacement reserve & residual receipts accounts	-	197,261	97,722	-	294,983
Taxes and insurance	295,159	255,096	188,190	-	738,445
Interest expense	31,427	735,895	522,986	-	1,290,308
Development costs	736,285	-	-	-	736,285
Unrealized loss on land development & notes receivable	1,243,560	-	-	-	1,243,560
Depreciation	38,426	696,608	478,497	-	1,213,531
Total Expenses	<u>3,614,784</u>	<u>3,404,792</u>	<u>2,481,344</u>	<u>(521,085)</u>	<u>8,979,835</u>
Change in Net Assets (Deficit)	(1,090,435)	(179,413)	(270,574)	-	(1,540,422)
New grant liens during year, net of forgiven grant liens for temporarily restricted net assets	364,177	-	-	-	364,177
Net Assets (Deficit) Beginning, as previously reported	5,956,370	(760,204)	(16,973)	(237,630)	4,941,563
Prior Period Adjustments:					
Cost method for nonconsolidated interest in partnerships	-	-	(53,022)	-	(53,022)
Notes receivable net present value and reserves	(1,137,329)	-	-	-	(1,137,329)
Fixed assets and investment in consolidated affiliates	-	-	(474,749)	(223,307)	(698,056)
Grant liens to temporarily restricted net assets	2,552,529	3,300,500	6,346,900	-	12,199,929
Net Asset (Deficit), Beginning, restated	<u>7,371,570</u>	<u>2,540,296</u>	<u>5,802,156</u>	<u>(460,937)</u>	<u>15,253,085</u>
Net Assets (Deficit), Ending	<u>\$ 6,645,312</u>	<u>\$ 2,360,883</u>	<u>\$ 5,531,582</u>	<u>\$ (460,937)</u>	<u>\$ 14,076,840</u>

See Independent Auditors' Report.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
CONSOLIDATING SCHEDULE of CASH FLOWS
Year ended October 31, 2011

CASH FLOWS FROM OPERATING ACTIVITIES	<u>Funds</u>	<u>Owned Projects</u>	<u>Controlled Entities</u>	<u>Consolidating Entries</u>	<u>Total</u>
Change in Total Net Assets from Operations	\$ (1,090,435)	\$ (179,413)	\$ (270,574)	\$ -	\$ (1,540,422)
Adjustments to Reconcile Changes in Net Asset to Net cash Provided by (Used in) Operating Activities:					
Net present value of notes receivable	(17,046)	-	-	-	(17,046)
Increase in long-term accrued interest	-	129,718	-	-	129,718
Depreciation	38,426	696,608	478,497	-	1,213,531
Forgiveness of grant liens	(241,096)	-	-	-	(241,096)
Unrealized loss on land development & notes receivable	1,053,944	-	-	-	1,053,944
Allowance for doubtful accounts	-	-	-	-	-
Gain on sale of development properties	(172,645)	-	-	-	(172,645)
Decrease (Increase) in:					
Net tenant accounts receivable	(1,700)	(18,077)	(6,719)	-	(26,496)
Tenant assistance accounts receivable	-	15,801	3,835	-	19,636
Other accounts receivable	(3,019)	2,860	2,356	-	2,197
Due from funds	-	144,757	103	(144,860)	-
Due from owned properties	67,611	-	-	(67,611)	-
Due from controlled entities	78,175	-	-	(78,175)	-
Prepaid expenses	(1,276)	62,949	31,616	-	93,289
Increase (Decrease) in:					
Accounts payable and accrued liabilities	214,802	12,116	(734,265)	-	(507,347)
Accrued interest payable	-	(31,299)	2,029	-	(29,270)
Due to funds	-	(67,611)	(78,175)	145,786	-
Due to owned properties	(144,757)	-	-	144,757	-
Due to controlled entities	(103)	-	-	103	-
Deferred revenue	23,648	14,230	(1,955)	-	35,923
Net Cash Provided by (Used in) Operating Activities	<u>(195,471)</u>	<u>782,639</u>	<u>(573,252)</u>	<u>-</u>	<u>13,916</u>
CASH FLOWS FROM INVESTING ACTIVITIES					
Decrease (Increase) in:					
Tenant deposits held in trust	(200)	2,007	20,243	-	22,050
Tax and insurance impounds	-	24,299	16,943	-	41,242
Replacement reserve	-	(31,662)	(205,328)	-	(236,990)
Other reserves	-	(1,878)	(2,761)	-	(4,639)
Residual receipts reserve	-	(50,674)	83,728	-	33,054
Cash restricted for pension plan	(9,701)	-	-	-	(9,701)
Cash restricted for self-insurance plan	(8,029)	-	-	-	(8,029)
Purchase of fixed assets	-	(152,900)	(80,976)	-	(233,876)
Decrease (Increase) in due from related parties	524,607	-	(7,286)	-	517,321
Increase in long-term notes receivable	(150,897)	-	-	-	(150,897)
Advance to nonconsolidated affiliates	(151,200)	-	-	-	(151,200)
Proceeds on sale of developed lots	659,967	-	-	-	659,967
Development costs	(472,042)	-	-	-	(472,042)
Net Cash Provided by (Used in) Investing Activities	<u>392,505</u>	<u>(210,808)</u>	<u>(175,437)</u>	<u>-</u>	<u>6,260</u>

See Independent Auditors' Report.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
CONSOLIDATING SCHEDULE of CASH FLOWS – Continued
Year ended October 31, 2011

CASH FLOWS FROM FINANCING ACTIVITIES	Funds	Owned Projects	Controlled Entities	Consolidating Entries	Total
Proceeds from mortgages and notes payable	\$ 259,307	\$ 6,932	\$ 864,807	\$ -	\$ 1,131,046
Proceeds from grant liens	620,273	-	-	-	620,273
Increase (Decrease) in due to related parties	(107)	-	-	-	(107)
Principal payments on mortgages and notes payable	<u>(433,716)</u>	<u>(488,404)</u>	<u>(137,846)</u>	<u>-</u>	<u>(1,059,966)</u>
Net Cash Provided by (Used in) Financing Activities	<u>445,757</u>	<u>(481,472)</u>	<u>726,961</u>	<u>-</u>	<u>691,246</u>
Net Increase (Decrease) in Cash and Cash Equivalents	642,791	90,359	(21,728)	-	711,422
Cash and Cash Equivalents, Beginning	<u>62,873</u>	<u>439,896</u>	<u>156,536</u>	<u>-</u>	<u>659,305</u>
Cash and Cash Equivalents, Ending	<u>\$ 705,664</u>	<u>\$ 530,255</u>	<u>\$ 134,808</u>	<u>\$ -</u>	<u>\$ 1,370,727</u>
SUPPLEMENTAL DISCLOSURES					
Amounts Paid for Interest	<u>\$ 31,427</u>	<u>\$ 767,194</u>	<u>\$ 520,957</u>	<u>\$ -</u>	<u>\$ 1,319,578</u>
Amounts Paid for Income Tax	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,781</u>	<u>\$ -</u>	<u>\$ 1,781</u>
NON CASH INVESTING AND FINANCING ACTIVITIES					
Capitalized accrued interest payable	<u>\$ 91,393</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 91,393</u>
Prior period adjustment for notes receivable net present value and allowance for doubtful accounts	<u>\$ 1,137,329</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,137,329</u>
Prior period adjustment for fixed assets and investment in consolidated affiliates	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (474,749)</u>	<u>\$ -</u>	<u>\$ (474,749)</u>
Prior period adjustment for grant liens recorded as temporarily restricted net assets	<u>\$ 2,552,529</u>	<u>\$ 3,300,500</u>	<u>\$ 6,346,900</u>	<u>\$ -</u>	<u>\$ 12,199,929</u>

See Independent Auditors' Report.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
CONSOLIDATING FUND SCHEDULE OF FINANCIAL POSITION
October 31, 2011

ASSETS	Funds						Consolidating Entries	Totals
	10	20	21	22	23	70		
Current Assets:								
Cash and cash equivalents	\$ -	\$ 4,704	\$ 457,870	\$ 243,090	\$ -	\$ -	\$ -	\$ 705,664
Net tenant accounts receivable	-	1,700	-	-	-	-	-	1,700
Other accounts receivable	-	5,834	-	-	-	-	-	5,834
Due from funds	-	16,240	1,702,230	1,404,256	-	-	(3,122,726)	-
Due from owned projects	20,000	34,100	378,107	9,068	-	-	-	441,275
Due from controlled entities	53,630	98,170	31,110	19,925	-	-	-	202,835
Due from related parties	-	28,335	1,290,596	9,048	-	-	-	1,327,979
Prepaid expenses	-	13,158	4,646	679	60	16,490	-	35,033
Total Current Assets	73,630	202,241	3,864,559	1,686,066	60	16,490	(3,122,726)	2,720,320
Deposits:								
Tenant deposits held in trust	7,293	-	-	-	-	-	-	7,293
Amounts held for self-help families	-	-	-	-	-	-	1,300	1,300
Cash restricted for pension plan	13,670	-	-	-	-	-	-	13,670
Cash restricted for self-insurance plan	48,119	-	-	-	-	-	-	48,119
Total Deposits	69,082	-	-	-	-	-	-	70,382
Fixed Assets, net of Accumulated Depreciation	789,870	-	-	-	-	-	-	789,870
Other Assets:								
Long-term notes receivable	261,977	-	791,852	-	-	-	-	1,053,829
Advance to consolidated affiliates	128,000	-	-	-	-	-	-	128,000
Advance to nonconsolidated affiliate	319,200	-	-	-	-	-	-	319,200
Land held for development	-	-	2,297,817	-	-	-	-	2,297,817
Development costs	-	-	5,900,996	-	-	-	-	5,900,996
Total Other Assets	709,177	-	8,990,665	-	-	-	-	9,699,842
Total Assets	\$ 1,641,759	\$ 202,241	\$ 12,855,224	\$ 1,686,066	\$ 60	\$ 16,490	\$ (3,122,726)	\$ 13,280,414
LIABILITIES & NET ASSETS (DEFICIT)								
Current Liabilities:								
Accounts payable and accrued liabilities	\$ 68,782	\$ 133,046	\$ 272,523	\$ 20,760	\$ 695	\$ 8,858	\$ -	\$ 504,664
Accrued interest payable	-	2,595	-	-	-	-	-	2,595
Due to funds	228,613	2,151,538	3,985	4,873	214,939	518,778	(3,122,726)	-
Due to owned properties	-	-	-	52	-	-	-	52
Current portion mortgages and notes payable	9,572	-	1,751,700	-	-	-	-	1,761,272
Deferred revenue	2,337	-	43,830	-	-	-	-	46,167
Total Current Liabilities	309,304	2,287,179	2,072,038	25,685	215,634	527,636	(3,122,726)	2,314,750
Long-Term Liabilities								
Tenant deposits held in trust	7,293	-	-	-	-	-	-	7,293
Amounts held for self-help families	-	-	-	-	-	-	1,300	1,300
Accrued interest payable	-	-	478,716	-	-	-	-	478,716
Mortgages and notes payable	679,503	-	3,153,540	-	-	-	-	3,833,043
Total Long-Term Liabilities	686,796	-	3,632,256	-	-	-	1,300	4,320,352
Total Liabilities	996,100	2,287,179	5,704,294	25,685	215,634	527,636	1,300	6,635,102
Net Assets (Deficit):								
Unrestricted	450,859	(2,084,938)	2,615,152	1,660,381	(215,574)	(511,146)	-	1,914,734
Temporarily restricted	-	-	3,121,706	-	-	-	-	3,121,706
Permanently restricted	194,800	-	1,414,072	-	-	-	-	1,608,872
Total Net Assets (Deficit)	645,659	(2,084,938)	7,150,930	1,660,381	(215,574)	(511,146)	-	6,645,312
Total Liabilities & Net Assets (Deficit)	\$ 1,641,759	\$ 202,241	\$ 12,855,224	\$ 1,686,066	\$ 60	\$ 16,490	\$ (3,122,726)	\$ 13,280,414

See Independent Auditors' Report.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
CONSOLIDATING FUND SCHEDULE of ACTIVITIES and CHANGES in NET ASSETS (DEFICIT)
Year ended October 31, 2011

REVENUES	Funds						Consolidating Entries	Totals
	10	20	21	22	23	70		
Other rents	\$ -	\$ 89,752	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 89,752
Grant income	-	87,089	350,947	-	-	263,142	-	701,178
Interest income	12,623	11,540	(2,038)	-	-	-	-	22,125
Management fees and reimbursements	-	45,886	-	623,025	-	-	-	668,911
Operational revenue	-	82,302	727,500	-	860	-	-	810,662
Gain on sale of development properties	-	-	172,645	-	-	-	-	172,645
Other revenue	-	34,068	25,008	-	-	-	-	59,076
Total Revenues	12,623	350,637	1,274,062	623,025	860	263,142	-	2,524,349
EXPENSES								
Administrative services	-	591,570	165,784	219,488	15,573	59,806	-	1,052,221
Utilities	-	27,735	-	-	-	-	-	27,735
Operating & Maintenance								
Operating accounts	-	67,457	440	23	1,321	120,730	-	189,971
Taxes & Insurance	-	125,577	21,914	45,813	2,460	99,395	-	295,159
Interest expense	-	30,371	1,056	-	-	-	-	31,427
Development costs	-	-	736,285	-	-	-	-	736,285
Unrealized loss on land development & notes receivable	-	-	1,243,560	-	-	-	-	1,243,560
Depreciation	38,426	-	-	-	-	-	-	38,426
Total Expenses	38,426	842,710	2,169,039	265,324	19,354	279,931	-	3,614,784
Change in Net Assets (Deficit)	(25,803)	(492,073)	(894,977)	357,701	(18,494)	(16,789)	-	(1,090,435)
New grant liens during year, net of forgiven grant liens for temporarily restricted net assets	-	-	364,177	-	-	-	-	364,177
Net Asset (Deficit), Beginning, as previously reported	1,245,006	(1,592,865)	5,692,986	1,302,680	(197,080)	(494,357)	-	5,956,370
Prior Period Adjustments:								
Notes receivable net present value and reserves	(573,544)	-	(563,785)	-	-	-	-	(1,137,329)
Grant liens to temporarily restricted net assets	-	-	2,552,529	-	-	-	-	2,552,529
Net Asset (Deficit), Beginning, restated	671,462	(1,592,865)	7,681,730	1,302,680	(197,080)	(494,357)	-	7,371,570
Net Assets (Deficit), Ending	\$ 645,659	\$ (2,084,938)	\$ 7,150,930	\$ 1,660,381	\$ (215,574)	\$ (511,146)	\$ -	\$ 6,645,312

See Independent Auditors' Report.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
CONSOLIDATING FUND SCHEDULE of CASH FLOWS
Year ended October 31, 2011

CASH FLOWS FROM OPERATING ACTIVITIES	Funds						Consolidating Entries	Totals
	10	20	21	22	23	70		
Change in Total Net Assets from Operations	\$ (25,803)	\$ (492,073)	\$ (894,977)	\$ 357,701	\$ (18,494)	\$ (16,789)	\$ -	\$ (1,090,435)
Adjustments to Reconcile Changes in Net Asset to Net cash Provided by (Used in) Operating Activities:								
Net present value of notes receivable	(12,623)	-	(4,423)	-	-	-	-	(17,046)
Depreciation and amortization	38,426	-	-	-	-	-	-	38,426
Forgiveness of grant liens	-	-	(241,096)	-	-	-	-	(241,096)
Unrealized loss on land development & notes receivable	-	-	1,053,944	-	-	-	-	1,053,944
Allowance for doubtful accounts	(106,000)	-	106,000	-	-	-	-	-
Gain on sale of development properties	-	-	(172,645)	-	-	-	-	(172,645)
Decrease (Increase) in:								
Net tenant accounts receivable	-	(1,700)	-	-	-	-	-	(1,700)
Other accounts receivable	-	(3,193)	-	164	-	10	-	(3,019)
Due from funds	30,265	(2,008)	(728,680)	(153,965)	-	-	854,388	-
Due from owned projects	-	68,010	55	(454)	-	-	-	67,611
Due from controlled entities	-	22,488	51,501	4,186	-	-	-	78,175
Prepaid expenses	-	(2,185)	(3,605)	8,222	(60)	(3,648)	-	(1,276)
Increase (Decrease) in:								
Accounts payable and accrued liabilities	25,223	(39,877)	227,665	(2,624)	148	4,267	-	214,802
Due to funds	228,313	589,413	2,618	(472)	18,406	16,110	(854,388)	-
Due to owned properties	-	(137,280)	(7,477)	-	-	-	-	(144,757)
Due to controlled entities	-	-	-	(103)	-	-	-	(103)
Deferred revenue	-	(182)	23,830	-	-	-	-	23,648
Net Cash Provided by (Used in) Operating Activities	177,801	1,413	(587,290)	212,655	-	(50)	-	(195,471)
CASH FLOWS FROM INVESTING ACTIVITIES								
Decrease (Increase) in:								
Tenant deposits held in trust	(200)	-	-	-	-	-	-	(200)
Cash restricted for pension plan	(9,701)	-	-	-	-	-	-	(9,701)
Cash restricted for self-insurance plan	(8,029)	-	-	-	-	-	-	(8,029)
Decrease (Increase) in due from related parties	-	(1,430)	526,077	(40)	-	-	-	524,607
Long-term notes receivable	-	-	(150,947)	-	-	50	-	(150,897)
Advance to nonconsolidated affiliates	(151,200)	-	-	-	-	-	-	(151,200)
Proceeds on sale of developed lots	-	-	659,967	-	-	-	-	659,967
Development costs	-	-	(472,042)	-	-	-	-	(472,042)
Net Cash Provided by (Used in) Investing Activities	(169,130)	(1,430)	563,055	(40)	-	50	-	392,505
CASH FLOWS FROM FINANCING ACTIVITIES								
Proceeds from mortgages and notes payable	-	-	259,307	-	-	-	-	259,307
Proceeds from grant liens	-	-	620,273	-	-	-	-	620,273
Increase (Decrease) in due to related parties	-	-	-	(107)	-	-	-	(107)
Principal payments on mortgages, notes payable and grant liens	(9,409)	-	(424,307)	-	-	-	-	(433,716)
Net Cash Provided by (Used in) Financing Activities	(9,409)	-	455,273	(107)	-	-	-	445,757
Net Increase (Decrease) in Cash and Cash Equivalents	(738)	(17)	431,038	212,508	-	-	-	642,791
Cash and Cash Equivalents, Beginning	738	4,721	26,832	30,582	-	-	-	62,873
Cash and Cash Equivalents, Ending	\$ -	\$ 4,704	\$ 457,870	\$ 243,090	\$ -	\$ -	\$ -	\$ 705,664
SUPPLEMENTAL DISCLOSURES								
Amounts Paid for Interest	\$ -	\$ 30,371	\$ 1,056	\$ -	\$ -	\$ -	\$ -	\$ 31,427
Amounts Paid for Income Tax	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
NON CASH INVESTING AND FINANCING ACTIVITIES								
Capitalized accrued interest payable	\$ -	\$ -	\$ 91,393	\$ -	\$ -	\$ -	\$ -	\$ 91,393
Prior period adjustment for notes receivable net present value and allowance for doubtful accounts	\$ 573,544	\$ -	\$ 563,785	\$ -	\$ -	\$ -	\$ -	\$ 1,137,329
Prior period adjustment for grant liens recorded as temporarily restricted net assets	\$ -	\$ -	\$ 2,552,529	\$ -	\$ -	\$ -	\$ -	\$ 2,552,529

See Independent Auditors' Report.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
SCHEDULE of EXPENDITURES of FEDERAL AWARDS
Year ended October 31, 2011

Federal Programs:		Funds	Owned Projects	Controlled Entities	Total
U.S Department of Agriculture:					
Farm Labor Housing Loans and Grants	10.405	\$ -	\$ 3,629,597	\$ -	\$ 3,629,597
Rural Rental Housing Loans (Section 515 and 521)	10.415	-	3,275,222	1,758,861	5,034,083
Rural Self-Help Housing Technical Assistance (Section 523)	10.420	150,000	-	-	150,000
Rural Rental Assistance Payments	10.427	-	232,383	2,091	234,474
Community Facilities Loans and Grants	10.766	<u>689,075</u>	<u>-</u>	<u>-</u>	<u>689,075</u>
Total U.S Department of Agriculture		<u>839,075</u>	<u>7,137,202</u>	<u>1,760,952</u>	<u>9,737,229</u>
U.S. Department of Housing and Urban Development:					
Mortgage Insurance For The Purchase or Refinancing of Existing Multifamily Housing Projects (Section 223(f)/207)	14.155	-	-	128,766	128,766
Supportive Housing For the Elderly (Section 202)	14.157	-	3,620,777	10,060,378	13,681,155
Supportive Housing for Person with Disabilities (Section 811)	14.181	-	752,400	-	752,400
Section 8 Housing Assistance Payments Program (Pass-Through Contract Administrator)	14.195	-	1,955,339	1,123,809	3,079,148
Home Investment Partnership Program (HOME) (Pass-Through California Department of Housing & Community Dev)	14.239	159,317	5,526,603	4,118,171	9,804,091
Self Help Homeownership Opportunity Program	14.247	622,888	-	-	622,888
Section 4 Capacity Building for Community Development and Affordable Housing	14.252	<u>16,588</u>	<u>-</u>	<u>-</u>	<u>16,588</u>
Total U.S. Department of Housing and Urban Development		<u>798,793</u>	<u>11,855,119</u>	<u>15,431,124</u>	<u>28,085,036</u>
NeighborWorks America:					
Expendable Grants	21.000	70,500	-	-	70,500
Capital Loan	21.000	<u>500,000</u>	<u>-</u>	<u>-</u>	<u>500,000</u>
Total NeighborWorks America		<u>570,500</u>	<u>-</u>	<u>-</u>	<u>570,500</u>
TOTAL FEDERAL AWARDS EXPENDED		<u>\$ 2,208,368</u>	<u>\$ 18,992,321</u>	<u>\$ 17,192,076</u>	<u>\$ 38,392,765</u>

Note 1. Basis of Presentation

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

See Independent Auditors' Report.

**Report on Internal Control Over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

To the Board of Directors of
Rural Communities Housing Development Corporation
Ukiah, California

We have audited the consolidated financial statements of Rural Communities Housing Development Corporation and Affiliates as of and for the year ended October 31, 2011, and have issued our report thereon dated April 30, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Rural Communities Housing Development Corporation and Affiliates internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Rural Communities Housing Development Corporation and Affiliates' consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Audit Findings and Questioned Costs as items 2011-2 and 2011-3.

We noted certain other matters that we reported to management of Rural Communities Housing Development Corporation in a letter dated April 30, 2012.

Rural Communities Housing Development Corporation's response to the findings identified in our audit the described in the accompanying Schedule of Findings and Questioned Costs. We did not audit Rural Communities Housing Corporation's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the board of directors, the audit committee, others within the Corporation, the United States Department of Agriculture, Rural Development, and the United States Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

Fentress & Barnes

Fentress & Barnes
Certified Public Accountants
Columbus, Ohio
April 30, 2012

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

To the Board of Directors of
Rural Communities Housing Development Corporation
Ukiah, California

Compliance

We have audited Rural Communities Housing Development Corporation and Affiliates' compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Rural Communities Housing Development Corporation and Affiliates' major federal programs for the year ended October 31, 2011. Rural Communities Housing Development Corporation's major federal programs are identified in the Summary of Audit Results section of the accompanying Schedule of Audit Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal programs is the responsibility of the Corporation's management. Our responsibility is to express an opinion on Rural Communities Housing Development Corporation and Affiliates' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Rural Communities Housing Development Corporation and Affiliates' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Rural Communities Housing Development Corporation and Affiliates' compliance with those requirements.

In our opinion, Rural Communities Housing Development Corporation and Affiliates complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended October 31, 2011.

Internal Control Over Compliance

Management of Rural Communities Housing Development Corporation and Affiliates are responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Rural Communities Housing Development Corporation and Affiliates' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Rural Communities Housing Development Corporation and Affiliates' internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the board of directors, the audit committee, others within the Corporation, the United States Department of Agriculture, Rural Development, and the United States Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

Fentress & Barnes

Fentress & Barnes
Certified Public Accountants
Columbus, Ohio
April 30, 2012

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
 SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS
 Year ended October 31, 2011

SECTION I - SUMMARY OF AUDIT RESULTS

Financial Statements

Type of auditor's report issued:	<u>unqualified</u>		
Internal control over financial reporting:			
Material weakness identified?	Yes	<u>X</u>	No
Control deficiency identified not considered to be material weaknesses?	<u>X</u>	Yes	None
Noncompliance material to financial statements noted?	Yes	<u>X</u>	None

Federal Awards

Type of auditor's report issued on compliance for major programs:	<u>unqualified</u>		
Internal control over financial reporting:			
Material weakness identified?	Yes	<u>X</u>	No
Control deficiency identified not considered to be material weaknesses?	Yes	<u>X</u>	None
Any audit findings disclosed that reported in accordance with Circular A-133, Section .510(a)	<u>X</u>	Yes	None

Identification of major program:

CFDA Number	Name of Federal Program or Cluster
<u>10.405</u>	<u>Farm Labor Housing Loans and Grants</u>
<u>10.415</u>	<u>Rural Rental Housing Loans</u>
<u>14.157</u>	<u>Supportive Housing For the Elderly</u>
<u>14.195</u>	<u>Section 8 Housing Assistance Payments Program</u>
<u>14.239</u>	<u>Home Investment Partnerships Program (HOME)</u>

Dollar threshold used to distinguish between Type A and Type B programs:	<u>\$300,000</u>		
Auditee qualified as low-risk auditee?	Yes	<u>X</u>	No

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS - Continued
Year ended October 31, 2011

SECTION II - FINANCIAL STATEMENT FINDINGS

Restatement of prior year financial statements

2011-1

Management identified numerous prior period adjustments effective October 31, 2010 which included 1) recording grant liens and liens convertible to grants as temporarily restricted net assets instead of debt 2) recording notes receivable as their net present value and recording a reserve for all of the notes receivable that are forgivable under the terms of their agreements 3) reversing the effect of purchase accounting for the acquisition of partnership interest 4) correcting net asset classification for notes receivable and 5) recording .01% general partnership interest using the cost method versus the equity method of accounting. These prior period adjustments were the result of certain control deficiencies in the accounting and reporting process due primarily to understaffing in the accounting and finance functions in previous years.

SECTION III FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Failure to Fund the Replacement Reserve – Oak Hill Apartments

2011-2

Condition

Oak Hill Apartments, a controlled entity, failed to set aside the required Reserves for Replacements for the year ended October 31, 2011.

Effect

The Replacement Reserve Bank Account was underfunded by \$145,987 pursuant to the Rural Development Regulatory Agreement.

Cause

Due to the excessive vacancies of the Project, cash flow from operations was inadequate to set aside the required Reserves for Replacements during the first four years of operations ended October 31, 2011.

Criteria

The Regulatory Agreements from Rural Development, HCD-HOME and HCD-Joe Serna that affect this Project together with HB-2-3560, Chapter 4, paragraph 4.3(C) require that a predetermined amount of Reserves for Replacements be transferred from operations on a monthly basis and deposited into a properly designated Replacement Reserve Bank Account.

Recommendation

The Replacement Reserve Bank Account should be fully funded with \$145,987 as soon as possible. As a possible alternative, the Project Owner may negotiate written waivers from Rural Development and HCD-HOME.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS - Continued
Year ended October 31, 2011

SECTION III FEDERAL AWARD FINDINGS AND QUESTIONED COSTS – (Continued)

Failure to Fund the Replacement Reserve – Redwood Court Property, a California Limited Partnership

2011-3

Condition

Redwood Court Property, a controlled entity, failed to set aside the required Reserves for Replacements for the year ended December 31, 2011.

Effect

The Replacement Reserve Bank Account was underfunded by \$29,192 pursuant to the Rural Development Regulatory Agreement.

Cause

Due to the excessive vacancies of the Project, cash flow from operations was inadequate to set aside the required Reserves for Replacements during the year ended December 31, 2011.

Criteria

The Regulatory Agreements from Rural Development (“RD”), require that a predetermined amount of Reserves for Replacements be transferred from operations on a monthly basis and deposited into a properly designated Replacement Reserve Bank Account.

Recommendation

Increase monthly funding of the reserve in accordance with its workout agreement with RD.

Oak Hill and Redwood Court Property, a California Limited Partnership Project Response and Action Plan

Although Oak Hill Apartments and Redwood Court Property, a California Limited Partnership did not generate sufficient cash flow from operations to fund certain of their funding requirements to their Replacement Reserves. The Project’s have obtained rent increases for subsidized apartments, received approval from RD to reduce rent for four unsubsidized units which will increase occupancy and continue to keep costs reduced. Management believes these approvals will help to maints.

RURAL COMMUNITIES HOUSING DEVELOPMENT CORPORATION
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
Year ended October 31, 2011

<u>Finding / Recommendation</u>	<u>Current Status</u>	<u>Project Explanation If Not Implemented</u>
<p>Oak Hill Apartments failed to set aside the full amount of required Reserves for Replacements into a separate Replacement Reserve Bank Account for the fiscal year ended October 31, 2010. The Replacement Reserve Bank Account should be funded with \$114,715 as soon as possible. As a possible alternative, the Project's Owner may negotiate written waivers from Rural Development and HCD-HOME.</p>	Repeated	See recommendation 2011-2
<p>Redwood Court Property failed to set aside the full amount of required Reserves for Replacements into a separate Replacement Reserve Bank Account for the fiscal year ended December 31, 2010. The Replacement Reserve Bank Account should be funded with \$19,336 as soon as possible. As a possible alternative, the Project's Owner may negotiate written waivers from Rural Development.</p>	Repeated	See recommendation 2011-3