

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
BEREA, KENTUCKY

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AUDITED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT
FOR THE YEARS ENDED
JUNE 30, 2016 AND 2015



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TABLE OF CONTENTS

	PAGE
INDEPENDENT AUDITOR'S REPORT	1 - 2
FINANCIAL STATEMENTS	
Consolidated Statements of Financial Position	3-4
Consolidated Statements of Activities	5-6
Consolidated Statements of Cash Flows	7
Notes to Financial Statements	8-25
SUPPLEMENTAL INFORMATION	
Schedule of Expenditures of Federal Awards	26
Notes to Schedule of Expenditures of Federal Awards	27
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	28-29
Independent Auditor's Report on Compliance for Each Major Federal Program and on Internal Control Over Compliance Required by the Uniform Guidance	30-31
Schedule of Findings and Questioned Costs	32
Statements of Functional Expenses	33-34
Statements of Financial Position - NeighborWorks America Capital Fund	35
Statements of Activities - NeighborWorks America Capital Fund	36
Computation of Adjusted Net Worth for Approval of Nonsupervised Mortgagees Other Than Loan Correspondents	37

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Federation of Appalachian Housing Enterprises, Inc.
Berea, Kentucky

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Federation of Appalachian Housing Enterprises, Inc. (a non-profit organization), which comprise the consolidated statements of financial position as of June 30, 2016 and 2015, and the related consolidated statements of activities and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Federation of Appalachian Housing Enterprises, Inc., as of June 30, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The schedules of functional expenses on pages 33 and 34, the statements of financial position – NeighborWorks America Capital Fund on page 35, the statements of

activities – NeighborWorks America Capital Fund on page 36 and the Computation of Adjusted Net Worth for Approval of Non-Supervised Mortgagees Other Than Loan Correspondents on page 37 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 on page 27, as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the 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 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 relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued a report dated September 8, 2016 on our consideration of Federation of Appalachian Housing Enterprises, Inc. internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Federation of Appalachian Housing Enterprises, Inc.'s internal control over financial reporting and compliance.

Craft, Noble & Company, PLLC

Craft, Noble & Company, PLLC
Richmond, Kentucky
September 8, 2016

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
JUNE 30, 2016

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<u>Assets</u>				
Current assets				
Cash and cash equivalents	\$ 7,318,696	\$ 1,030,476	\$ 51,900	\$ 8,401,072
Accounts receivable	187,065	166,800	-	353,865
Grants receivable	75,000	181,500	-	256,500
Accrued interest receivable	108,405	11,658	3,873	123,936
Deposits	335	-	-	335
Prepaid expenses	124,739	-	-	124,739
Interfund balances	(271,224)	235,421	35,803	-
Current notes receivable	8,810,940	10,427	-	8,821,367
Current mortgage notes receivable	776,297	1,438,684	28,911	2,243,892
Total current assets	<u>17,130,253</u>	<u>3,074,966</u>	<u>120,487</u>	<u>20,325,706</u>
Noncurrent assets				
Notes receivable, net	5,841,582	603,667	67,964	6,513,213
Bankruptcy arrearages	7,715	969	-	8,684
Mortgage notes receivable, net	15,549,236	6,288,067	1,262,306	23,099,609
Property held for sale, net	431,352	171,949	123	603,424
Investments	130,193	-	-	130,193
Property and equipment, net	3,438,332	-	-	3,438,332
Intangible assets, net	114,390	-	-	114,390
Deferred compensation	91,508	-	-	91,508
Total noncurrent assets	<u>25,604,308</u>	<u>7,064,652</u>	<u>1,330,393</u>	<u>33,999,353</u>
Total Assets	<u>\$ 42,734,561</u>	<u>\$ 10,139,618</u>	<u>\$ 1,450,880</u>	<u>\$ 54,325,059</u>
<u>Liabilities & Net Assets</u>				
<u>Liabilities</u>				
Current liabilities				
Accounts payable	\$ 198,832	\$ -	\$ -	\$ 198,832
Client advances and deposits	2,088,621	-	-	2,088,621
Accrued interest payable	75,245	-	-	75,245
Accrued expenses	320,892	-	-	320,892
Current portion of deferred revenue	9,000	-	-	9,000
Current portion of notes payable	5,275,103	-	-	5,275,103
Total current assets	<u>7,967,693</u>	<u>-</u>	<u>-</u>	<u>7,967,693</u>
Noncurrent liabilities				
Deferred revenue	960,931	-	-	960,931
Long-term portion of notes payable	18,234,872	-	-	18,234,872
Deferred compensation	91,508	-	-	91,508
Total noncurrent liabilities	<u>19,287,311</u>	<u>-</u>	<u>-</u>	<u>19,287,311</u>
Other Liabilities				
Equity equivalent	<u>2,000,000</u>	<u>-</u>	<u>-</u>	<u>2,000,000</u>
Total Liabilities	<u>29,255,004</u>	<u>-</u>	<u>-</u>	<u>29,255,004</u>
<u>Net Assets</u>				
Net assets	12,879,557	10,139,618	1,450,880	24,470,055
Net assets, board designated	<u>600,000</u>	<u>-</u>	<u>-</u>	<u>600,000</u>
Total Net Assets	<u>13,479,557</u>	<u>10,139,618</u>	<u>1,450,880</u>	<u>25,070,055</u>
Total Liabilities & Net Assets	<u>\$ 42,734,561</u>	<u>\$ 10,139,618</u>	<u>\$ 1,450,880</u>	<u>\$ 54,325,059</u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
JUNE 30, 2015

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<u>Assets</u>				
Current assets				
Cash and cash equivalents	\$ 10,410,173	\$ 1,668,557	\$ 128,767	\$ 12,207,497
Accounts receivable	375,395	-	-	375,395
Grants receivable	112,413	183,801	-	296,214
Accrued interest receivable	120,291	6,081	-	126,372
Deposits	435	-	-	435
Prepaid expenses	112,486	-	-	112,486
Interfund balances	(149,441)	113,609	35,832	-
Current notes receivable	8,536,105	351,077	-	8,887,182
Current mortgage notes receivable	595,517	1,220,279	29,026	1,844,822
Total current assets	<u>20,113,374</u>	<u>3,543,404</u>	<u>193,625</u>	<u>23,850,403</u>
Noncurrent assets				
Notes receivable, net	3,672,540	789,621	-	4,462,161
Bankruptcy arrearages	1,833	3,486	-	5,319
Mortgage notes receivable, net	14,287,197	6,389,171	1,119,975	21,796,343
Property held for sale, net	604,055	99,746	-	703,801
Investments	122,338	-	-	122,338
Property and equipment, net	3,577,460	-	-	3,577,460
Intangible assets, net	-	-	-	-
Deferred compensation	76,906	-	-	76,906
Total noncurrent assets	<u>22,342,329</u>	<u>7,282,024</u>	<u>1,119,975</u>	<u>30,744,328</u>
Total Assets	<u>\$ 42,455,703</u>	<u>\$ 10,825,428</u>	<u>\$ 1,313,600</u>	<u>\$ 54,594,731</u>
<u>Liabilities & Net Assets</u>				
<u>Liabilities</u>				
Current liabilities				
Accounts payable	\$ 228,923	\$ -	\$ -	\$ 228,923
Client advances and deposits	1,613,443	-	-	1,613,443
Accrued interest payable	84,099	3,376	-	87,475
Accrued expenses	268,835	-	-	268,835
Current portion of deferred revenue	-	-	-	-
Current portion of notes payable	1,551,027	27,043	-	1,578,070
Total current liabilities	<u>3,746,327</u>	<u>30,419</u>	<u>-</u>	<u>3,776,746</u>
Noncurrent liabilities				
Deferred revenue	1,329,792	18,000	-	1,347,792
Long-term portion of notes payable	22,727,685	452,503	-	23,180,188
Deferred compensation	76,906	-	-	76,906
Total noncurrent liabilities	<u>24,134,383</u>	<u>470,503</u>	<u>-</u>	<u>24,604,886</u>
Other Liabilities				
Equity equivalent	2,000,000	-	-	2,000,000
Total Liabilities	<u>29,880,710</u>	<u>500,922</u>	<u>-</u>	<u>30,381,632</u>
<u>Net Assets</u>				
Net assets	11,974,993	10,324,506	1,313,600	23,613,099
Net assets, board designated	600,000	-	-	600,000
Total Net Assets	<u>12,574,993</u>	<u>10,324,506</u>	<u>1,313,600</u>	<u>24,213,099</u>
Total Liabilities & Net Assets	<u>\$ 42,455,703</u>	<u>\$ 10,825,428</u>	<u>\$ 1,313,600</u>	<u>\$ 54,594,731</u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.

CONSOLIDATED STATEMENT OF ACTIVITIES

YEAR ENDING JUNE 30, 2016

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<u>Revenue</u>				
Mortgage and note interest	\$ 1,131,786	\$ 91,325	\$ -	\$ 1,223,111
Contributions, grants	1,244,311	225,000	-	1,469,311
State grants	-	-	-	-
Pass-through grants	494,670	24,500	-	519,170
Federal grants	457,000	503,417	500,000	1,460,417
Rental income	-	-	-	-
Realized gain (loss) on investments	19,771	-	-	19,771
Unrealized gain (loss) on investments	7,855	-	-	7,855
Interest income	10,632	-	-	10,632
Administration income	28,150	-	-	28,150
Gain on acquisition of assets	646,893	753	-	647,646
Fees and service charges	1,467,045	-	-	1,467,045
Miscellaneous income	2,467	-	-	2,467
Net assets released from restrictions				
Satisfaction of program restrictions	1,392,603	(1,029,883)	(362,720)	-
Total Revenue	6,903,183	(184,888)	137,280	6,855,575
<u>Expenses</u>				
Program services	4,167,036	-	-	4,167,036
General and administrative	216,842	-	-	216,842
Fundraising	383,338	-	-	383,338
Membership	1,231,403	-	-	1,231,403
Total Expenses	5,998,619	-	-	5,998,619
Increase (decrease) in net assets	904,564	(184,888)	137,280	856,956
Net Assets at Beginning of Period	12,574,993	10,324,506	1,313,600	24,213,099
Net Assets at End of Period	<u>\$ 13,479,557</u>	<u>\$ 10,139,618</u>	<u>\$ 1,450,880</u>	<u>\$ 25,070,055</u>

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

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.

CONSOLIDATED STATEMENT OF ACTIVITIES

YEAR ENDING JUNE 30, 2015

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<u>Revenue</u>				
Mortgage and note interest	\$ 1,014,863	\$ 70,088	\$ -	\$ 1,084,951
Contributions, grants	99,513	605,040	-	704,553
State grants	3,574	331,091	-	334,665
Pass-through grants	1,190,728	32,500	-	1,223,228
Federal grants	2,391,650	3,000	500,000	2,894,650
Rental income	(700)	-	-	(700)
Realized gain (loss) on investments	7,473	-	-	7,473
Unrealized gain (loss) on investments	6,549	-	-	6,549
Interest income	11,049	-	-	11,049
Administration income	28,088	-	-	28,088
Gain on acquisition of assets	1,041,369	10,133	-	1,051,502
Fees and service charges	1,355,676	73	-	1,355,749
Miscellaneous income	203	-	-	203
Net assets released from restrictions				
Satisfaction of program restrictions	2,418,234	(1,904,334)	(613,900)	(100,000)
Total Revenue	9,568,269	(852,409)	(113,900)	8,601,960
<u>Expenses</u>				
Program services	5,010,013	-	-	5,010,013
General and administrative	192,976	-	-	192,976
Fundraising	320,493	-	-	320,493
Membership	1,756,338	-	-	1,756,338
Total Expenses	7,279,820	-	-	7,279,820
Increase (decrease) in net assets	2,288,449	(852,409)	(113,900)	1,322,140
Net Assets at Beginning of Period	10,286,544	11,176,915	1,427,500	22,890,959
Net Assets at End of Period	\$ 12,574,993	\$ 10,324,506	\$ 1,313,600	\$ 24,213,099

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

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDING JUNE 30, 2016 AND 2015

CASH FLOWS FROM OPERATING ACTIVITIES	<u>2016</u>	<u>2015</u>
Changes in Net Assets	\$ 856,956	\$ 1,322,140
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Depreciation and amortization	187,439	207,816
Loss on disposal of assets	109,494	365,293
Provision for loan losses	608,955	1,391,070
(Gain) Loss on investments using equity method	(7,855)	9,912
Gain on purchase of loan portfolio	(647,646)	(1,027,394)
(Increase) decrease in operating assets		
Accounts receivable	21,530	214,450
Grants receivable	39,714	15,553
Accrued interest receivable	2,436	22,606
Prepaid expenses	(12,253)	27,596
Deferred compensation	(14,602)	(14,057)
Deposits	100	1,410
Increase (decrease) in operating liabilities		
Accounts payable	(30,091)	(481,706)
Client advances and deposits	475,178	288,275
Accrued interest payable	(12,230)	1,175
Accrued expenses	52,057	31,544
Deferred revenue	(377,861)	(446,548)
Deferred compensation	14,602	14,057
	<u>1,265,923</u>	<u>1,943,192</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>1,265,923</u>	<u>1,943,192</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(45,744)	(623,771)
Proceeds from sale of property and equipment	201,749	204,770
Purchase of loan portfolio	(1,121,027)	(898,859)
Purchase of investment property	(1,337)	-
Purchase of intangible assets	(116,956)	-
Payments received on notes receivable	15,256,385	43,787,673
Disbursement of loans receivable funds	(17,997,136)	(43,850,969)
	<u>(3,824,066)</u>	<u>(1,381,156)</u>
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	<u>(3,824,066)</u>	<u>(1,381,156)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt borrowings	4,410,739	3,482,228
Payments on long-term debt	(5,659,021)	(2,339,790)
	<u>(1,248,282)</u>	<u>1,142,438</u>
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	<u>(1,248,282)</u>	<u>1,142,438</u>
NET INCREASE (DECREASE) IN CASH	<u>(3,806,425)</u>	<u>1,704,474</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>12,207,497</u>	<u>10,503,023</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 8,401,072</u>	<u>\$ 12,207,497</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	<u>\$ 571,650</u>	<u>\$ 566,175</u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 1 – Organization

Federation of Appalachian Housing Enterprises, Inc. (Fahe or the Organization) is a nonprofit organization that was founded in 1980 to serve Appalachia via a Network of nonprofits. Fahe’s mission is to eliminate persistent poverty in Appalachia. Our unique collaborative model connects a Network of local, regional, and national leaders, all working together to uplift our nation’s rural places. Working with our 50+ nonprofits across the Appalachian portion of Kentucky, Tennessee, West Virginia, Virginia, Alabama, and Maryland, we use our expertise in finance, collaboration, innovation, advocacy, and communication to achieve a more prosperous Appalachian region.

For over three decades, Fahe has increased the scale and reach of our Network's interventions by:

- Identifying and supporting the development of local leaders who are committed to delivering interventions that result in safe, well-designed homes that are affordable; and
- Providing those leaders with access to the expertise, capital, subsidy, training, and other resources that support and catalyze positive opportunities for the communities and people they serve.

In this way, we positively change the lives of over 68,000 families annually. In our 35-year history, the Fahe Network has served more than 300,000 Appalachians with housing, made over \$536 million in direct investment, and achieved a total cumulative financial impact of over a billion dollars in Appalachia. We bring hope to our region at scale through collaboration across the nonprofit and profit worlds and across party lines.

Fahe is a designated Community Development Financial Institution (CDFI) by the US Treasury. As a CDFI, Fahe offers two clusters of loan products, one for nonprofit corporations who serve low-income populations and the other for low-income populations directly for home purchase.

Specifically, Fahe’s principal services include Mortgage Lending, Community Lending Services (CLS), Consulting, Membership, and Loan Servicing, as described below:

- Mortgage Lending—JustChoice Lending (JCL) is a full service mortgage lender that strengthens communities by creating successful homeowners. JustChoice is the only nonprofit third party originator for Freedom and has been instrumental in creating a national nonprofit packaging system for USDA RD 502 Direct loans.
- Loan Servicing—Fahe Loan Servicing emphasizes quality customer care and personalized account management on the mortgages we service for Fahe, our partners, and our borrowers. During FY16, Fahe serviced 6,328 loans in 12 different states.
 - Both JCL and Loan Servicing are licensed to conduct business in Kentucky, Tennessee, Indiana, Florida, Mississippi, Virginia, West Virginia, Michigan, and Alabama.
- Community Lending Services—Fahe couples a Community Loan Fund with outstanding lending expertise to facilitate the flow of impactful private and public investments into housing and community development projects across the region.
- Consulting—Fahe Consulting connects different organizations to specialized resources that will help to expand their projects and improve the quality of life in their communities.
- Membership—The Membership team strengthens our Network by connecting the Members to each other and to Fahe’s expertise and services. Fahe’s 50+ Members in the Appalachian portion of Kentucky, Tennessee, West Virginia, Virginia, Alabama, and Maryland get access to specialized training, information sharing, financial resources, and a stronger combined political voice that supports positive change in their communities.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 2 – Summary of Significant Accounting Policies

Principles of Consolidation

The financial statements include the consolidated statements of the Organization and its subsidiaries, Fahe Capital Corporation I, Fahe Consulting, LLC and Fahe TN, LLC. Accordingly, all significant inter-company balances and transactions have been eliminated.

Fahe Capital Corporation I, a wholly-owned subsidiary of Fahe, was formed in 2000 to syndicate private investments from corporations, generating a market rate return delivered through a federal tax credit. Investments raised through Low Income Housing Tax Credit Equity Funds managed by Fahe Capital Corporation I and a partner, Virginia Community Development Corporation, facilitated the creation/preservation of affordable rental housing.

Fahe Consulting, LLC, a wholly-owned subsidiary of Fahe, was formed in 2006 to help communities connect to opportunities by providing turn-key consulting services to nonprofits, municipalities, and others who wish to accomplish community development outcomes but who lack the technical expertise or personnel to achieve their desired outcomes. Fahe Consulting assists with filing applications for federal, state and local funding by overseeing the development process, securing construction and permanent financing, facilitating and tracking construction progress and preparing any and all required project reports.

In 2011 Fahe established Fahe TN, LLC. This entity is domiciled in Tennessee and was created to provide access to investments through Tennessee's Community Investment Tax Credit Program.

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

- Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.
- Temporarily restricted net assets – Net assets subject to donor-imposed stipulations on the original and/or revolving proceeds that may or will be met, either by actions of the Organization and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restriction.
- Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Organization. Generally, the donors of these assets permit the Organization to use all or part of the income earned on any related investments for general or specific purposes.

Cash and Cash Equivalents

For purposes of the Statements of Financial Position and the Statements of Cash Flows, the Organization considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents unless held by investment managers as part of the investment portfolio. As required by grant and servicing agreements Fahe does hold cash in separate bank accounts.

Fahe maintains an \$800,000 compensating balance arrangement with Commercial Bank against a \$6 million line of credit.

Cash received from grants and held with temporary restrictions at June 30, 2016 and 2015 was \$1,030,476 and \$1,668,557, respectively. Cash permanently restricted for loans to clients at June 30, 2016 and 2015 was \$51,900 and \$128,767, respectively.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 2 – Summary of Significant Accounting Policies (Continued)

Investments

The organization carries investments in equity securities with readily determinable fair market values and all investments in debt securities at their fair values in the Statement of Financial Position. Unrealized gains and losses are included in the change in net assets in the accompanying Statement of Activities. The Organization holds two investments that are recorded using the equity method, due to no fair value or equivalent being readily determinable.

Mortgage Notes Receivable

Mortgage and Notes receivable are stated at the outstanding principal balance, less an allowance for loan losses. The allowance for loan losses is increased by charges to the change in net assets and decreased by charge-offs (net of recoveries).

Since the interest rate charged to the borrowers corresponds with the customary rates applicable to the low-income housing industry, the Organization considers these rates to be reasonable and has not made any adjustment for imputed interest that would be applicable to higher interest rate conventional housing loans.

Allowance for Loan Losses

It is the policy of the Organization to provide valuation allowances for estimated loan losses. The allowance for loan losses represents management's best estimate of future bad debts. Additions to the allowance are charged to earnings. Accounts written off are charged against the allowance. Recoveries are credited to the allowance reserve.

Fixed Assets and Intangible Assets

The Organization capitalizes all expenditures for fixed asset acquisitions in excess of \$500. Fixed assets are carried at cost or, if donated, at the approximate fair value at the date of donation. Depreciation is computed on a straight-line basis over the useful lives of the assets generally as follows:

Building and improvements	39 years
Computers and data handling equipment	3 years
Vehicles and equipment	5 years

During the years ended June 30, 2016 and 2015, depreciation expense was \$184,873 and \$207,816, respectively.

During the year ended June 30, 2016, the Organization amortized costs associated with the issuance of the CDFI Bond Guarantee Program, of which Fahe was allocated \$15,000,000. These costs will be expensed during the life of the bond program. Amortization expense for the year ended June 30, 2016 was \$2,566.

A summary of property and equipment and intangible assets at June 30 is as follows on the next page.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 2 – Summary of Significant Accounting Policies (Continued)

Fixed Assets (Continued)

	<u>2016</u>	<u>2015</u>
Land	\$ 130,133	\$ 130,133
Building	3,234,380	3,245,162
Equipment and Vehicles	<u>847,790</u>	<u>791,264</u>
Subtotal	4,212,303	4,166,559
Accumulated Depreciation	<u>(773,971)</u>	<u>(589,099)</u>
Property and Equipment, net	<u>\$ 3,438,332</u>	<u>\$ 3,577,460</u>
Intangible Assets	116,956	-
Accumulated Amortization	<u>(2,566)</u>	<u>-</u>
Intangible Assets, net	<u>\$ 114,390</u>	<u>\$ -</u>

Revenue Recognition

Contributions received are recorded as increases in unrestricted, temporarily restricted, or permanently restricted net assets, depending on the existence and/or nature of any donor imposed restrictions. All donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is satisfied), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

Income Tax Status

The organization is recognized as a tax-exempt organization under code Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for federal income tax has been made. In addition, the Organization has been classified as an Organization that is not a private foundation under Section 509(a).

The Organization is not aware of any unrelated business income as of June 30, 2016. In Accounting Standards Codification (ASC) 740-10-50, Income Taxes, (formerly FIN 48, Accounting for Uncertainty in Income Taxes) the Financial Accounting Standards Board (FASB) requires entities to disclose known or anticipated positions of income tax uncertainty. The Organization is not aware of any uncertain tax positions that would require adjustment to the financial statements. The Organization files income tax returns in the U.S. federal jurisdiction. Generally, the Organization is no longer subject to income tax examination by the U.S. federal, state or local tax authorities for years before 2013.

Compensated Absences

The Organization revised its personnel policies regarding employee vacation and sick time beginning calendar year 2010. Previously, upon separation of service, employees could be paid up to a maximum of 80 accrued sick hours and 160 accrued vacation hours. As of January 1, 2010, employees will not receive pay for accrued sick time upon separation of service with the exception of sick hours earned and not spent as of December 31, 2009. However, accrued vacation time can now be paid out up to a maximum of 352 hours. The employee earns accrued time based on job classification, length of service, and other factors. The liability accrued for compensated absences is limited to the actual amount that would be payable to the employee in the event of separation from employment. The amount is calculated based on multiplying the representative hourly wage by the number of accrued hours.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 2 – Summary of Significant Accounting Policies (Continued)

Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Functional Allocation of Expenses

The costs of providing various programs and other activities have been summarized on a functional basis in the statement of activities and detailed in the statement of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Note 3 – Investments and Fair Value Measurements

Investments held by the Organization consisted of the following as of June 30, 2016:

	<u>Cost</u>	<u>Market Value</u>	<u>Unrealized Appreciation</u>
KYNWA Alliance investment	\$ 1,000	\$ 1,000	\$ -
Scenic States investment	-	40,693	40,693
FHLB stock	88,500	88,500	-
Balance, June 30, 2016	<u>\$ 89,500</u>	<u>\$ 130,193</u>	40,693
Balance, June 30, 2015	<u>\$ 89,500</u>	<u>\$ 122,338</u>	32,838
Unrealized gain (loss) on investments			<u>\$ 7,855</u>

The Organization has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The hierarchy gives the highest priority to unadjusted quoted prices in an active market for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded on the statement of financial position are categorized based on the inputs to the valuation techniques as follows:

Level 1 – Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Organization has the ability to access.

Level 2 – Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable whether directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in non-active markets;
- Pricing models whose inputs are observable for substantially the full term of the asset or liability; and
- Pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset or liability.

Level 3 – Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 3 – Investments and Fair Value Measurements (Continued)

The Organization's fair value of securities available for sale measured on a recurring basis at June 30, 2016 and 2015 is as follows:

	<u>Fair Value</u>	<u>Fair Value Measurements at Reporting Date Using</u>		
		<u>Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
<u>June 30, 2016</u>				
KY NWA Alliance investment	\$ 1,000	\$ -	\$ -	\$ 1,000
Scenic States investment	40,693	-	-	40,693
FHLB Stock	88,500	-	88,500	-
	<u>\$ 130,193</u>	<u>\$ -</u>	<u>\$ 88,500</u>	<u>\$ 41,693</u>
<u>June 30, 2015</u>				
KY NWA Alliance investment	\$ 1,000	\$ -	\$ -	\$ 1,000
Scenic States investment	32,838	-	-	32,838
FHLB Stock	88,500	-	88,500	-
	<u>\$ 122,338</u>	<u>\$ -</u>	<u>\$ 88,500</u>	<u>\$ 33,838</u>

Available-for-sale securities measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	<u>KYNWA Alliance</u>	<u>Scenic States</u>
July 1, 2014	\$ 17,461	\$ 26,289
Distribution	\$ (23,934)	
Total gains and losses - unrealized Included in earnings	<u>7,473</u>	<u>6,549</u>
June 30, 2015	<u>1,000</u>	<u>32,838</u>
Total gains and losses - unrealized Included in earnings	<u>-</u>	<u>7,855</u>
June 30, 2016	<u>\$ 1,000</u>	<u>\$ 40,693</u>

Fair value for investments is determined by reference to quoted market prices and other relevant information generated by market transactions. There have been no changes in valuation techniques and related inputs.

Note 4 – Grant Funds Receivable

Unconditional promises to give amounted to \$256,500 and \$296,214 as of June 30, 2016 and 2015, respectively. These funds will be received in fiscal year 2017 and were received in fiscal year 2016, respectively.

Note 5 – Property Held for Resale

Property held for resale consists of foreclosure properties (REO). REO property is recorded at the lower of cost or market when recovered from the foreclosure proceedings or by a deed-in-lieu of foreclosure. The properties are recorded at book value less an adjustment of 25% to create an allowance for loan loss. FAHE has adopted a conservative approach to the valuation of foreclosures lacking an appraisal. Gains or losses from the sale of properties are recorded in the statement of activities as either gains or losses on disposal of property.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 5 – Property Held for Resale (Continued)

Property held for resale also consists of property preservation advances. The Organization advances funds for expenses for property preservation to protect the value of their collateral related to mortgages receivable. These expenses are shown as receivables from the borrower unless the Organization takes the property back. At June 30, 2016 and 2015, the organization held \$504,755 and \$360,711, respectively in REO property and \$82,962 and \$79,240, respectively in property preservation. The related allowances recorded as of June 30, 2016 and 2015 were \$198,130 and \$136,193, respectively for REO property. There were no allowances recorded for property preservation advances.

During the fiscal year 2016, the Organization sold their former office building. A second property, which was purchased in order to use a portion of the land for the Organization's new office building, is still held in Property Held for Sale. Also during fiscal year 2016, the Organization purchased a small tract of land to meet funder requirements of a grant. This land will be developed into a house in partnership with a Fahe member. These properties are being recorded at their fair market value which is \$213,837 as of June 30, 2016. These balance are held as Investment Property and are not depreciated.

During the fiscal year 2015, the Organization actively began pursuing buyers for two properties that had been included in fixed assets in the prior audit periods. One property is the Organization's former office building and the second property was purchased in order to use a portion of the land for the Organization's new office building. These properties are being recorded at their fair market value which is \$400,043 as of June 30, 2015. These balances are held as Investment Property and are no longer depreciated.

Note 6 – Mortgage Notes Receivable

Fahe makes loans to individual borrowers for home purchase and rehabilitation of existing homes. Fahe is an approved FHA and USDA lender offering a combination of loans held on balance sheet, loans sold off balance sheet, and loans packaged to USDA Rural Development and brokered to State Housing Finance Agencies. In addition to traditional mortgage products, Fahe provides subordinated loans to low-income homebuyers to ensure affordability. The subordinated finance can be in the form of an amortized loan or as a soft second for down payment assistance. Mortgage lending funds are made available from several different sources. These sources include federal and state grants awarded to the Organization, borrowings of lower interest funds made available by state housing agencies, grants from foundations, and revolved funds in the Organization's various lending portfolios. Loans are made in accordance with the restrictions imposed by the various funding sources.

The Organization has a programmatic loan balance of \$1,999,043 and \$1,540,734 as of June 30, 2016 and 2015, respectively. The Organization has determined these loans do not meet the definition of a security and therefore does not elect to report them using the "Fair Value Option." These loans are considered conditional promises to give and are reported at amortized cost. The expense of forgiving a portion of a loan is recorded as a programmatic expense as the conditions are met. The Organization changed it's loan loss reserve policy in fiscal year 2015 to fully reserve the entirety of the programmatic loan balance due to their intent to never collect these loans. The balance of the programmatic loans nets to zero in the Mortgage Receivables line of the Statement of Financial Position.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 6 – Mortgage Notes Receivable (Continued)

Mortgage notes receivable as of June 30, 2016 consist of the following balances in each fund:

Kentucky Home Loan Fund	\$ 4,379,996
AHTF Fund	95,960
HOME Program of Kentucky	7,263,096
Virginia Home Loan Fund	3,827,349
NHPR Kentucky	73,358
HOME Program of Virginia	2,147,444
West Virginia Home Loan Fund	792,187
Tennessee Home Loan Fund	1,848,416
Chase/NHSA	371,496
FAHE Other States	<u>7,085,780</u>
Total	27,885,082
Less: Allowance for Loan Losses	<u>(2,541,581)</u>
Mortgage Notes Receivable, Net of Allowance	<u>\$ 25,343,501</u>

Mortgage notes receivable as of June 30, 2015 consist of the following balances in each fund:

Kentucky Home Loan Fund	\$ 4,419,320
AHTF Fund	99,112
HOME Program of Kentucky	7,090,800
Virginia Home Loan Fund	4,033,343
NHPR Kentucky	78,163
HOME Program of Virginia	2,197,740
West Virginia Home Loan Fund	866,978
Tennessee Home Loan Fund	1,489,496
Chase/NHSA	379,204
FAHE Other States	<u>4,981,057</u>
Total	25,635,213
Less: Allowance for Loan Losses	<u>(1,994,048)</u>
Mortgage Notes Receivable, Net of Allowance	<u>\$ 23,641,165</u>

The Organization has loan covenants with certain foundations that require the Organization to maintain certain levels of allowances to cover potential loan losses. In lieu of charging the full amount of the requirements to earnings, the Organization's Board of Directors has chosen to voluntarily designate a portion of its net assets for this purpose. The balance of the Board Designated Net Assets as of June 30, 2016 and 2015, is \$600,000. This provides aggregate loan loss coverage of no less than 4.0% on the Fahe loan portfolio. Based on actual, historical delinquency trends, the Organization's management does not expect to incur any charges against this designation.

Note 7 – Notes Receivable

The Organization makes loans to Corporations. Financial products provided to members and partner Community Development Corporations (CDCs) include: 1) affordable housing development loans for single-family construction, 2) affordable housing development loans for multi-family construction, and 3) working capital loans or business loans. The target market end user of these loans is the low-income targeted population or low-income communities. Combined borrower balances of the Organization's community loan portfolio as of June 30, 2016 and 2015 are presented on the following page(s):

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 7 – Notes Receivable (Continued)

	<u>2016</u>	<u>2015</u>
Aid to Distressed Families of Appalachian Countries	\$ 23,650	\$ -
Almost Heaven Habitat for Humanity	193,482	178,620
Appalachia Habitat For Humanity	445,090	424,227
Beattyville Housing Development	263,119	276,130
Bedford Lofts, LLC	-	1,299,327
Burchwood Homes of Berea Ltd	-	36,720
Chattanooga Neighborhood Enterprises	683,660	628,735
Clinch Valley Community	-	13,310
COAP	-	54,248
Community Action Partnership of North Alabama	1,493,745	-
Eastern Eight CDC	1,223,220	764,603
Frontier Housing, Inc.	1,177,905	713,173
Hale County Habitat for Humanity	63,105	66,609
Hazard/Perry County Community Ministries	19,497	19,497
HERO	252,202	46,119
Homeownership Center	-	12,432
HOMES, Inc.	387,665	423,632
HOPE Inc.	436,635	235,204
Housing Authority of Mingo County	244,893	257,085
Housing Development Alliance	297,474	350,332
Housing Development Foundation, Inc.	380,707	391,863
Housing Equity Fund of KY III	-	1,760,473
Kentucky Highlands Investment	-	62,700
Kentucky Mountain Housing Corporation	198,226	282,901
Kentucky River Community Care	55,090	55,090
Knox Housing Partners, Inc.	71,892	160,219
Lil Britches Child Care Center	46,243	50,267
Long Run Apartments	2,278,479	2,058,720
Mackey	226,827	234,947
Midway School Apartments	247,384	250,938
Montgomery County Habitat for Humanity	-	40,354
Mountain Cap, Inc.	-	227,630
Mt. Sterling- Main Cross, LLC	184,500	184,500
Mulberry Housing LLP	45,000	45,000
Neighborhood Housing Services of Birmingham	255,606	105,241
New Directions Housing Corporation	31,380	25,688
Next Step Network	-	10,000
Partnership Housing, Inc.	-	85,000
People Inc. Financial Services	340,078	353,390
Randolph County Housing Authority	454,367	477,842
Safe Housing & Economic Development	6,211	19,037
Scott-Morgan CDC	65,121	67,486
Southern Appalachian Labor School	68,381	73,585

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 7 – Notes Receivable (Continued)

	<u>2016</u>	<u>2015</u>
Sterling Housing, Inc.	909,599	98,247
Sutton School Apartments	1,211,081	-
The Housing Partnership, Inc.	70,067	245,616
Warrior Creek Development Holdings	150,528	-
Washington County VA Habitat for Humanity	93,055	-
Wolfe Co High School, LLP	824,486	425,920
Woodlands Development Group	69,823	99,972
	<u>15,489,473</u>	<u>13,692,629</u>
Total Notes Receivable		
Less: Allowance for Loan Loss	(154,893)	(343,286)
Notes Receivable, Net of Allowance	<u>\$ 15,334,580</u>	<u>\$ 13,349,343</u>

Note 8 – Allowance for Loan Losses

Fahe has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in Fahe’s portfolio. For purposes of determining the allowance for loan losses, Fahe segments certain loans in its portfolio by product type. Fahe’s loans are segmented as follows: Community Loans or notes to corporations and Mortgages for single-family purchase and rehabilitation. These segments are then broken down into classes determined by length of delinquency. The Community Loans lending segment is also broken down into IRP and non-IRP classes because in order to be compliant, Fahe must maintain a loan loss reserve of at least 6% of the IRP fund, resulting in an additional loan loss calculation for that fund. The percentages have been determined based upon historical data for the Organization’s loan collections and delinquencies, and also to remain in compliance with related debt covenants. The loan loss set up for each length of delinquency is as follows:

Days Delinquent	Reserve Percentage
0-29 days	1%
30-59 days	2%
60-89 days	3%
90-179 days	5%
180+ days	25%

In addition, based on Fahe’s analysis of lending trends, Fahe has applied additional loss multipliers to the loan balances. Currently, Fahe has applied additional loss estimations to ensure that purchased loan portfolios are performing and that gains shown on those purchases are conservative. As the portfolio is cured, reserve is released either through writing off nonperforming loans or due to good performance of loans.

Fahe has also taken into account any properties conveyed back to the Organization via foreclosure or deed in lieu as an additional component of the allowance for loan losses. It is the Organization’s policy to immediately reserve 25% of the value of the note until a better estimate of property value can be acquired and the property can be written down to fair market value.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 8 – Allowance for Loan Losses (Continued)

2016 Allowance for Loan Losses				
	Mortgage Lending	Community Lending – IRP	Community Lending – Non-IRP	Total
Beg. Balance	\$ 1,994,048	\$ 24,977	\$ 318,309	\$ 2,337,334
Charge-Offs	(77,006)	-	(227,630)	(304,636)
Recoveries	4,821	-	50,000	54,821
Provision	619,718	(24,977)	14,214	608,955
Ending Balance	<u>\$ 2,541,581</u>	<u>\$ -</u>	<u>\$ 154,893</u>	<u>\$ 2,696,474</u>

2015 Allowance for Loan Losses				
	Mortgage Lending	Community Lending – IRP	Community Lending – Non-IRP	Total
Beg. Balance	\$ 645,421	\$ 27,844	\$ 407,495	\$ 1,080,760
Charge-Offs	(138,841)	-	-	(138,841)
Recoveries	4,345	-	-	4,345
Provision	1,483,123	(2,867)	(89,186)	1,391,070
Ending Balance	<u>\$ 1,994,048</u>	<u>\$ 24,977</u>	<u>\$ 318,309</u>	<u>\$ 2,337,334</u>

Credit Quality Information

Fahe determines credit quality of its existing portfolio by examining delinquency monthly. The following tables present performing and nonperforming real estate loans based on payment activity for the years ended June 30, 2016 and 2015. Payment activity is reviewed by management on a monthly basis to determine credit quality of the loans. Loans are considered to be nonperforming when days delinquent is greater than 30 days in the previous month. The Organization has found that it is in its best interest to consider loans past this date nonperforming instead of the traditional single-family mortgage standard of 90 days. Fahe's Loan Servicing Department has found it has the best chances of collection if contact is made with the borrower during the first month of delinquency.

Nonperforming loans also include certain loans that have been modified in troubled debt restructurings where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from Fahe's loss mitigation activities and could include loan modification by way of reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain troubled debt restructurings are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. Management believes the likelihood of loss for nonperforming loans is increased in this current period due to the persisting weak economy and the growth of performing loans transferred to nonperforming status upon modification in a troubled debt restructuring. The Organization also classifies its non-acrual loans as nonperforming.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 8 - Allowance for Loan Losses (Continued)

2016 Performing vs. Nonperforming Loans				
	Mortgage Lending	Community Lending IRP	Community Lending	Mortgage Conveyances
Performing	\$ 26,127,275	\$ -	\$ 15,044,383	\$ -
TDR	196,119	-	445,090	-
Non-accrual	-	-	-	-
Nonperforming	1,452,512	-	-	109,176
Total	<u>\$ 27,775,906</u>	<u>\$ -</u>	<u>\$ 15,489,473</u>	<u>\$ 109,176</u>

2015 Performing vs. Nonperforming Loans				
	Mortgage Lending	Community Lending IRP	Community Lending	Mortgage Conveyances
Performing	\$ 24,493,230	\$ 416,306	\$ 12,750,832	\$ -
TDR	293,727	-	-	-
Non-accrual	-	-	505,994	-
Nonperforming	349,109	-	19,497	499,147
Total	<u>\$ 25,136,066</u>	<u>\$ 416,306</u>	<u>\$ 13,276,323</u>	<u>\$ 499,147</u>

Age Analysis of Past Due Financing Receivables by Class

The table below includes an aging analysis of the recorded investment of past due financing receivables as of June 30, 2016 and 2015. Also included are loans that are 90 days or more past due as to interest and principal and still accruing, because they are (a) well-secured and in the process of collection or (b) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual.

Age Analysis of Past Due Financing Receivables by Class						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Financing Receivables
2016						
Mortgage Lending	\$ 408,908	\$ 331,773	\$ 711,831	\$ 1,452,512	\$ 26,323,394	\$ 27,775,906
Mortgage Conveyances	-	-	109,176	109,176	-	109,176
Community - IRP	-	-	-	-	-	-
Community - Non-IRP	-	-	-	-	15,489,473	15,489,473
Total	<u>\$ 408,908</u>	<u>\$ 331,773</u>	<u>\$ 821,007</u>	<u>\$ 1,561,688</u>	<u>\$ 41,812,867</u>	<u>\$ 43,374,555</u>
2015						
Mortgage Lending	\$ 162,247	\$ 96,558	\$ 257,203	\$ 516,008	\$ 24,620,058	\$ 25,136,066
Mortgage Conveyances	-	-	499,147	499,147	-	499,147
Community - IRP	-	-	-	-	416,306	416,306
Community - Non-IRP	-	19,497	227,630	247,127	13,029,196	13,276,323
Total	<u>\$ 162,247</u>	<u>\$ 116,055</u>	<u>\$ 983,980</u>	<u>\$ 1,262,282</u>	<u>\$ 38,065,560</u>	<u>\$ 39,327,842</u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 8 - Allowance for Loan Losses (Continued)

Impaired Loans

Fahe considers a loan to be impaired when, based on current information and events, Fahe determines that it will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, Fahe uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of the discounted cash flows. If Fahe determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), Fahe recognizes impairment through an allowance estimate or a charge-off to the allowance. Fahe determines impairment based on a 60-day default period for mortgages and makes a credit decision for community loans. Loans classified as troubled debt restructurings are also considered impaired

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to the principal, under the cost recovery method. When the ultimate collectability of the total principal of any impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

The table below includes the recorded investment and unpaid principal balances for impaired financing receivables with the associated allowance amount, if applicable. Fahe determined the specific allowance based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the remaining source of repayment for the loan is the operation or liquidation of the collateral. In those cases, the current fair value of the collateral, less selling costs was used to determine the specific allowance recorded.

The Organization uses the grouping Mortgage Conveyances to pull out loans for which title is being actively sought as collection is no longer effective. These are homes which have either been determined to be vacant or the borrower is deceased.

Interest recognized on impaired loans during fiscal year 2016 was \$21,845. The average investment in impaired loans at the end of FY 2016 was \$101,861. The organization had one troubled debt restructuring loan default in the fiscal year ended June 30, 2016. The total investment on this was \$29,891.

Impaired Loans			
	Unpaid Principal Balance	Related Allowance	Net Recorded Investment
2016			
Mortgage Lending	\$ 583,442	\$ (91,469)	\$ 491,973
Mortgage Conveyances	109,176	(31,741)	77,435
Community – IRP	-	-	-
Community – Non IRP	<u>529,707</u>	<u>(5,297)</u>	<u>524,410</u>
Total	<u>\$ 1,222,325</u>	<u>\$ (128,507)</u>	<u>\$ 1,093,818</u>
2015			
Mortgage Lending	\$ 426,603	\$ (68,618)	\$ 357,985
Mortgage Conveyances	499,148	(124,787)	374,361
Community – IRP	-	-	-
Community – Non IRP	<u>505,994</u>	<u>(187,191)</u>	<u>318,803</u>
Total	<u>\$ 1,431,745</u>	<u>\$ (380,596)</u>	<u>\$ 1,051,149</u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 8 - Allowance for Loan Losses (Continued)

Nonaccrual loans

In the Community Lending fund, Fahe generally places a loan on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, during which period staff work out a mitigation strategy with the borrower, and no restructuring has occurred. In the Mortgage Lending segment, loans at 0% interest are not considered nonaccrual because they were underwritten or designed with that intent and funded from a grant resource. Loans on nonaccrual status and their respective classes are as follows:

Nonaccrual Loans		
	2016	2015
Mortgage Lending	\$ -	\$ -
Mortgage Conveyances	-	-
Community Lending - IRP	-	-
Community Lending - Non IRP	-	505,994
	-	505,994
Total	\$ -	\$ 505,994

When Fahe places a loan on nonaccrual status, Fahe reverses the accrued unpaid interest receivable against interest income and accounts for the loan on the cash or cost recovery method, until it qualifies to return to accrual status. Generally, Fahe returns a loan to accrual status when (a) all delinquent interest and principal become current under the terms of the loan agreement or (b) the loan is both well-secured and in the process of collection and collectability is no longer doubtful.

Fahe has determined that the entire balance of a loan is contractually delinquent for all classes if the minimum payment is not received by the specified due date on the member's statement. Interest and fees continue to accrue on past due loans until the date the loan goes into nonaccrual status, if applicable.

Note 9 – Notes Payable

Notes payable at June 30, 2016 and 2015 consists of notes payable to governmental agencies, banks, non-profit organizations and individuals as detailed below and on the following page(s):

	Rate	Term	Maturity	Balance	
				2016	2015
Kentucky Housing Corporation					
Kentucky Home Loan Fund/AHTF					
Special Contract #6	1.00%	20 Years	July 1, 2015	\$ -	\$ 20,750
Special Contract #7	1.00%	20 Years	July 1, 2016	21,002	42,006
Special Contract #8	3.00%	20 Years	October 1, 2035	378,760	392,559
Affordable Housing Trust Fund	1.00%	30 Years	July 1, 2033	41,937	44,053
NHPL, NHRL, NHPR					
NHPL 1999-2000	1.00%	20 Years	July 1, 2019	96,504	125,868
NHPR 2000-2001	1.00%	20 Years	July 1, 2020	158,062	189,675
NHPR 2001-2002	1.00%	20 Years	July 1, 2022	160,425	187,163
NHPR 2002-2003	1.00%	20 Years	July 1, 2023	235,739	269,301
NHPR 2003-2004	1.00%	20 Years	July 1, 2024	242,700	273,038
NHPR 2004-2005	1.00%	20 Years	July 1, 2025	208,575	231,750
NHPR 2005-2006	1.00%	20 Years	July 1, 2026	214,720	234,240
NHPR 2006-2007	1.00%	20 Years	January 1, 2027	95,700	104,400
NHPR 2007-2008	1.00%	20 Years	September 1, 2028	148,306	160,665
NHPR 2009	1.00%	20 Years	February 1, 2030	170,335	182,993

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 9 – Notes Payable (Continued)

	Rate	Term	Maturity	Balance	
				<u>2016</u>	<u>2015</u>
Virginia Housing Development Authority					
Housing Fund #1	3.00%	30 Years	July 5, 2028	\$ 1,085	\$ 6,821
VHPRF Phase I & II	3.00%	20 Years	November 5, 2026	76,667	81,752
Housing Fund #2	3.00%	30 Years	December 5, 2018	155,688	162,870
Housing Fund #3	2.00%	30 Years	March 1, 2034	411,018	429,565
2004 Line of Credit	2.00%	30 Years	September 1, 2026	570,599	594,122
2005 Line of Credit	2.00%	30 Years	February 1, 2037	501,814	521,372
2007 Reach	3.00%	30 Years	April 1, 2038	245,568	253,481
2009 Reach	3.00%	30 Years	May 1, 2039	156,234	160,961
2010 Reach	3.00%	30 Years	July 1, 2040	361,107	371,456
2011 Reach	3.00%	30 Years	June 1, 2042	325,699	333,893
2012 Reach	3.00%	30 Years	June 1, 2043	41,077	42,055
Commercial Bank					
Ten Year Note - FAHE TN, LLC	3.25%	10 Years	April 10, 2023	500,000	500,000
Two Year Note	2.75%	2 Years	April 30, 2017	3,650,000	450,000
Various Lenders					
Wells Fargo Bank	2.00%	3 Years	April 1, 2023	2,000,000	2,000,000
PNC Bank National Association	3.00%	4 Years	June 1, 2017	-	1,490,000
PNC Bank National Association	3.00%	3 Years	June 1, 2017	-	1,500,000
Federal Home Loan Bank of Cincinnati	0.00%	2 Years	October 30, 2015	-	100,000
Central Bank	3.48%	5 Years	November 15, 2020	1,500,000	2,286,926
MACED	3.25%	1.5 Years	December 17, 2015	-	500,000
F.B. Heron Foundation	3.00%	6 Years	September 30, 2016	400,000	450,000
Linda Miller & Robert Adelberg	2.50%	3 Years	December 20, 2017	50,000	50,000
Woodlands Investment Management	3.00%	4 Years	September 30, 2015	-	100,000
Richard S. Chapel	2.50%	3 Years	December 20, 2017	25,000	25,000
Glenmary Home Missioners	2.00%	3 Years	October 28, 2016	25,000	25,000
Kentucky Housing Corporation	1.00%	20 Years	November 1, 2031	259,686	275,188
U.S. Department of Agriculture	1.00%	30 Years	October 16, 2031	-	479,546
Cg of the Sisters of the Incarnate World	2.00%	5 Years	November 17, 2016	250,000	250,000
Kentucky Housing Corporation	3.00%	23 Years	July 1, 2016	172,251	186,811
Peoples Self Help Housing	2.25%	2 Years	January 5, 2018	500,000	500,000
CDFI Fund	1.25%	20 Years	September 10, 2019	930,000	930,000
Domestic & Foreign Missionary Society	3.63%	5 Years	March 31, 2021	500,000	-
Opportunity Finance Network	3.00%	10 Years	November 30, 2019	2,500,000	2,500,000
Seton Enablement Fund	3.00%	5 Years	April 1, 2020	100,000	100,000
Mercy Investment Services	2.00%	5 Years	July 15, 2020	500,000	300,000
Episcopal, Diocese of Iowa	2.50%	3 Years	March 31, 2018	25,000	25,000
Byron Stookey	3.00%	5 Years	September 30, 2020	50,000	25,000
Lee Stookey	3.00%	5 Years	November 15, 2015	-	25,000
US Department of Treasury – SBLF	2.00%	8 Years	September 15, 2019	2,063,000	2,063,000
Mary Reynolds Babcock Foundation	2.50%	6 Years	August 1, 2017	400,000	500,000
Emma C. Trevor	1.50%	3 Years	December 31, 2018	2,500	2,500
Eric Haralson	1.00%	2 Years	March 31, 2017	10,000	10,000
Jones Family Farm	1.00%	1 Year	May 31, 2017	35,960	35,603
Jones Family Farm	1.50%	2 Years	May 31, 2017	25,757	25,375
Perls Foundation	2.50%	1 Year	July 1, 2017	100,000	100,000
Phyllis J. Hatfield	2.50%	1 Year	July 1, 2017	50,000	50,000

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 9 – Notes Payable (Continued)

Various Lenders (Continued)	Rate	Term	Maturity	Balance	
				<u>2016</u>	<u>2015</u>
Nazareth Literary & Benevolent Institution	0.50%	3 Years	December 30, 2017	\$ 100,000	\$ 100,000
Fay Chandler Trust	2.00%	3 Years	August 31, 2017	-	100,000
Deutsche Bank	2.00%	5 Years	August 2, 2019	500,000	500,000
HEAD Corporation	2.50%	3 Years	January 15, 2018	300,000	300,000
Thomas Benningson	2.50%	3 Years	January 16, 2018	80,000	80,000
Virginia Organizing	2.50%	2 Years	March 20, 2017	100,000	100,000
Virginia Organizing	1.50%	2 Years	January 20, 2018	200,000	-
Slyvia Jones	1.50%	2 Years	March 31, 2017	1,500	1,500
Donna Wardenaar	2.50%	5 Years	May 15, 2019	50,000	50,000
RCIF	2.50%	5 Years	June 15, 2020	250,000	250,000
Edith Allen	3.00%	5 Years	September 30, 2020	100,000	-
James DeWolf Perry V	2.50%	4 Years	December 30, 2019	25,000	-
John and Sara Morgan	1.00%	3 Years	June 30, 2019	10,000	-
Larry Withers	2.00%	2 Years	July 2, 2017	150,000	-
Total Notes Payable				<u>\$ 23,509,975</u>	<u>\$ 24,758,258</u>

The principal repayment requirements at June 30, 2016 and 2015, relating to the above notes payable are as follows:

	<u>2016</u>	<u>2015</u>
2016	\$ -	\$ 1,578,069
2017	5,275,103	2,906,966
2018	2,366,377	3,579,795
2019	564,045	8,751,101
2020	6,782,770	3,337
2021	2,602,489	-
Later Years	5,919,191	7,938,990
	<u>\$ 23,509,975</u>	<u>\$ 24,758,258</u>

At June 30, 2016 and 2015 approximately \$15 million and \$18 million notes payable, respectively, are unsecured and represent private investments by individuals and groups.

During fiscal year 2016 and 2015 the Organization held a line of credit with Commercial Bank secured by pledged notes receivable. At June 30, 2016 and 2015 the balance of the line was \$3,650,000 and \$450,000, respectively. The Organization also had a \$500,000, undrawn line of credit with Central Bank at both June 30, 2016 and 2015, secured by real estate. The Organization has a construction line of credit with Central Bank secured by the new building and cash for \$3,000,000. The balance of this line was \$1,500,000 and \$2,286,926 at June 30, 2016 and 2015, respectively.

At June 30, 2016 and 2015 the organization had available balances on lines of credit with Commercial Bank of \$2.35 million and \$5.55 million and Central Bank of \$500,000 and \$500,000, respectively.

The Organization has receivables totaling \$3,827,349 pledged as collateral against loans with VHDA, \$800,000 compensating balance and \$4,150,000 receivables pledged as collateral to Commercial Bank, and \$625,000 receivables pledged to Peoples Self Help Housing.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 10 - Other Liabilities

The Organization shows EQ2 notes under Other Liabilities on the statements of financial position in order to represent more clearly the nature of the payable and to adhere to industry practices. The EQ2 is defined by having six attributes as follows (1) the EQ2 investment is carried as an investment on the investor's balance sheet in accordance with GAAP. (2) the EQ2 investment is a general obligation of Fahe that is not secured by any of Fahe's assets; (3) the EQ2 investment is fully subordinated to the right of repayment of all Fahe's other creditors; (4) the EQ2 investment does not give the investor the right to accelerate payment unless Fahe ceases its normal operations; (5) the EQ2 investment carries an interest rate that is not tied to any income received by Fahe; and (6) the EQ2 investment has a rolling term, and therefore, an indeterminate maturity (also known as an evergreen provision).

In fiscal year 2013, the Organization received another EQ2 investment from Pinnacle Bank. This is a ten-year note, that beginning on the seventh anniversary of the maturity date and on each anniversary thereafter, unless the Organization ceases to be financially sound or ceases to carry out a community development mission, the maturity date is automatically extended by one year. This investment is to be used for single-family housing in Knoxville, Tennessee, allowing Pinnacle Bank to qualify for a CITC tax credit. This note had an outstanding balance of \$2.00 million as of June 30, 2016 and 2015, respectively.

Fahe also holds notes payable to the U.S. Department of Treasury (\$2,063,000) and Wells Fargo (\$2,000,000) which uses verbiage consistent with EQ2 funding, but does not meet requirement 6, having an evergreen provision. Fahe decided to take the conservative stance and report these notes as noncurrent notes payable on the statements of financial position.

Note 11 – Commitments and Contingencies

The Organization receives federal and state grant funds that are subject to review by the granting agencies. If an agency finds that the funds are considered not to have been used in accordance with the purposes of the grant, the grantor may request a refund of such funds. The amount of future potential refunds, if any, is not expected to be significant.

The Organization has an agreement with the Tennessee Housing Development Agency (THDA) to guarantee and service New Start loans to individuals, as well as guaranteeing and servicing member loan agreements with THDA. The Organization entered into the agreements to facilitate THDA working with the Organization's members located in Tennessee. Although management of the Organization feels these loans will be repaid and are fully secured by real estate, the Organization has a contingent liability of \$17,090,316 and \$19,479,737 as of June 30, 2016 and 2015, respectively. To further clarify, Fahe is the first guarantor on \$837,309 and \$873,901 and takes the position of second guarantor on the remaining member loan agreements as of June 30, 2016 and 2015, respectively. Historically, there has not been a significant loss on these loans since inception in 2003.

During fiscal year 2011, the Organization entered into an agreement with the Department of Local Governments of the Commonwealth of Kentucky to implement a Neighborhood Stabilization Program (NSP) in the amount of \$632,000. Five notes were written on Fahe paper, using NSP grant funding.

At June 30, 2016, Fahe had committed, but undisbursed credit lines totaling \$5,141,969.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2016 AND 2015

Note 12 – Concentrations of Credit Risk

Financial instruments that potentially subject the Organization to a concentration of credit risk consist principally of cash and cash equivalents and notes receivable. The Organization maintains cash balances in various financial institutions. The cash accounts are insured by the Federal Deposit Insurance Corporation up to \$250,000 per depositor, per insured bank, for each ownership category. The Organization manages the cash position to mitigate and or eliminate any associated risk. The Organization maintains a sweep account agreement to ensure that all balances above the FDIC limits are insured, in addition to holding a letter of credit from the FHLB to cover all accounts not eligible to earn interest.

The Organization provides mortgage loans primarily to low- and moderate-income individuals. Mortgage notes totaling \$27,885,082 and \$25,635,213 at June 30, 2016 and 2015, respectively, are secured by the property purchased or improved except as noted. These mortgage receivables are a concentration of credit risk. The Organization provides loans to groups to support the growth of low-income housing opportunities in its service area. Notes receivable totaling \$15,489,473 and \$13,692,629 at June 30, 2016 and 2015, respectively, are secured by the assets of the Organization with the exception of the unsecured amount as noted. At June 30, 2016 and 2015, \$140,144 and \$115,848, respectively, were unsecured.

Note 13 – Portfolios Purchased

Fahe purchased three portfolios from different organizations during fiscal year 2016. The portfolios were recorded at the outstanding principal balance. The gain on sale is recorded through Gain on Acquisition of Assets on the statement of activities. Interest income on these portfolios is recognized when earned. No future revenue has been recorded. The total purchase amount was \$1,121,027 and the gain on purchase of the portfolios recognized was \$647,646, for a total portfolio purchase of \$1,768,673.

Note 14 – Related Party Transactions

At June 30, 2016 three employees of Fahe were on the Board of Directors of Sterling Housing, Inc. This organization is a non-profit organization that provides single-family residential rental property to low income individuals in Berea, KY. Sterling Housing, Inc. pays a management fee to Fahe in the amount of 20% of the rent collected. This fee is paid to cover the cost of maintaining the accounting records of Sterling Housing, Inc. and provide oversight of the operations of the properties. In addition, Sterling Housing, Inc. is a borrower of Fahe. At June 30, 2016 Fahe had two notes receivable from Sterling Housing, Inc. totaling \$909,599.

Note 15 – Reclassifications

During fiscal year 2016, the Organization changed to a Classified Balance Sheet presentation with current and noncurrent balances of assets and liabilities. This resulted in the addition of current portions of notes and mortgages receivable in both fiscal years ending 2015 and 2016. Fahe had the information available to accurately represent the number for both fiscal years. To better clarify interest income this line was added to the statement of activities for both fiscal years.

Note 16 – Subsequent Events

Management of the Organization has considered subsequent events through September 8, 2016, the date this report became available for issuance.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2016

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CDFA Number</u>	<u>Pass-Through Grantor's Number</u>	<u>Expenditures</u>
<u>U.S. Department of Treasury</u>			
NeighborWorks America	21.000*		\$ 1,263,600
<u>Department of Housing & Urban Development</u>			
Passed through Kentucky Housing Corporation (KHC)			
Home Investment Partnership Program (HOME)	14.239*	HB13-0201-01	39,647
Home Investment Partnership Program (HOME)	14.239*	HB15-0201-01	278,300
Subtotal passed through KHC			<u>317,947</u>
Passed through Virginia Department of Housing & Community Development (VDHCD)			
Home Investment Partnership Program (HOME)	14.239	2014 DPA	<u>23,000</u>
Passed through Local Initiatives Support Corporation			
HUD Section 4	14.252	45314-0003	11,458
HUD Section 4	14.252	45314-0004	40,970
HUD Section 4	14.252	45314-0005	42,500
HUD Section 4	14.252	45314-0007	7,629
Subtotal passed through Local Initiatives Support Corporation			<u>102,557</u>
Passed through Department for Local Government			
Neighborhood Stabilization Program	14.228	11N-045	<u>15,220</u>
Total Department of Housing & Urban Development			<u>458,724</u>
<u>Appalachian Regional Commission</u>			
Passed through Kentucky Housing Corporation			
Appalachian Regional Development	23.001	KY-16798-C3-302-15	54,452
Total Appalachian Regional Commission			<u>54,452</u>
TOTAL FEDERAL AWARDS			<u>\$ 1,776,776</u>

* Major Program OMB Circular

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2016

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Federation of Appalachian Housing Enterprises, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in, the preparation of the financial statements.

NOTE B – INSURANCE

The Organization carried insurance coverage during the entire year in amounts sufficient to or in excess of required levels, including coverage for general and professional liability, real and personal property, workers' compensation and fidelity bonding of employees who have access to funds.

INDEPENDENT AUDITOR'S 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
Federation of Appalachian Housing Enterprises, Inc.
Berea, Kentucky

We have audited, in accordance with the 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, the consolidated financial statements of Federation of Appalachian Housing Enterprises, Inc. (a non-profit organization), which comprise the consolidated statements of financial position as of June 30, 2016, and the related statements of activities, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated September 8, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Federation of Appalachian Housing Enterprises, Inc.'s internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances 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 Federation of Appalachian Housing Enterprises, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of Federation of Appalachian Housing Enterprises, Inc.'s internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters



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As part of obtaining reasonable assurance about whether Federation of Appalachian Housing Enterprises, Inc.'s 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 statement 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Craft, Noble & Company, PLLC

Craft, Noble & Company, PLLC
Richmond, Kentucky
September 8, 2016

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

To the Board of Directors
Federation of Appalachian Housing Enterprises, Inc.
Berea, Kentucky

Report on Compliance for Each Major Federal Program

We have audited Federation of Appalachian Housing Enterprises, Inc.'s compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Federation of Appalachian Housing Enterprises, Inc.'s major federal programs for the year ended June 30, 2016. Federation of Appalachian Housing Enterprises, Inc.'s major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Federation of Appalachian Housing Enterprises, Inc.'s major federal programs based on our audit of the types of compliance requirements referred to above. 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 audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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 Federation of Appalachian Housing Enterprises, Inc.'s 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 on compliance for each major federal program. However, our audit does not provide a legal determination of Federation of Appalachian Housing Enterprises, Inc.'s compliance.

Opinion on Each Major Federal Program



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In our opinion, Federation of Appalachian Housing Enterprises, Inc. complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2016.

Report on Internal Control Over Compliance

Management of Federation of Appalachian Housing Enterprises, Inc. is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Federation of Appalachian Housing Enterprises, Inc.'s internal control over compliance

with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Federation of Appalachian Housing Enterprises, Inc.'s 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. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Craft, Noble & Company, PLLC

Craft, Noble & Company, PLLC
Richmond, Kentucky
September 8, 2016

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2016

SUMMARY OF AUDITOR'S RESULTS

1. The auditor's report expresses an unqualified opinion on the financial statements of Federation of Appalachian Housing Enterprises, Inc.
2. Our report on the financial statements disclosed no significant deficiencies in the internal control structure.
3. No instances of noncompliance material to the financial statements of Federation of Appalachian Housing Enterprises, Inc. were disclosed during our audit.
4. The auditor's report on compliance for the major federal awards programs for Federation of Appalachian Housing Enterprises, Inc. expresses an unqualified opinion on all major federal programs.
5. Our audit report disclosed no audit finding required to be reported in accordance with 2 CFR 200.516(a).
6. The programs tested as major programs included:

NeighborWorks America CFDA #21.000 Type A.
Home Investment Partnership Program CFDA #14.239 Type B.
7. The threshold to determine Type A: \$750,000.
8. Federation of Appalachian Housing Enterprises, Inc. was determined to be a low-risk auditee.
9. In connection with tests of internal control and compliance with laws and regulations, no material weaknesses were noted in internal control, and the Organization was in substantial compliance with laws and regulations.
10. There were no questioned costs with respect to major programs selected for compliance tests.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2016

Expenses	General &			Program Services						Total Program	
	Administrative	Membership	Fundraising	Home Lending	Community Development	Loan Servicing	FAHE Consulting	FAHE Capital	Loan Portfolios	Services	Total
Personnel Expenses	\$ 140,766	\$ 383,065	\$ 274,599	\$421,667	\$ 341,686	\$448,759	\$447,408	\$ 70,380	\$ 288,481	\$ 2,018,381	\$ 2,816,811
Travel Expenses	7,173	39,698	9,822	12,762	17,685	11,987	14,657	5,464	8,827	71,382	128,075
Board & Committee Meetings	47	103	-	159	199	199	40	40	79	716	866
Conferences & Workshops	1,074	32,401	2,296	2,320	2,726	3,101	6,470	289	566	15,472	51,243
Occupancy Expense	4,175	4,175	4,175	4,175	4,175	4,175	4,175	4,174	8,350	29,224	41,749
REO Expense	-	-	-	-	-	-	-	-	42,178	42,178	42,178
Supplies & Publications	2,108	2,670	2,098	2,101	2,279	2,937	2,211	1,943	4,448	15,919	22,795
Postage & Shipping	146	166	200	5,825	458	53,826	640	59	11,826	72,634	73,146
Communications	3,917	8,728	4,856	6,406	7,094	4,367	5,189	3,860	7,355	34,271	51,772
Equipment & Maintenance	4,013	4,033	4,013	4,013	4,013	4,013	4,013	4,013	8,026	28,091	40,150
Subscriptions	178	505	536	178	178	178	178	139	276	1,127	2,346
Licenses, Fees & Permits	39	349	43	26,183	165	168	438	205	69	27,228	27,659
Employee Education	510	782	878	2,280	599	647	487	273	723	5,009	7,179
Memberships	711	15,243	2,510	1,210	646	724	648	39	461	3,728	22,192
Marketing & Advertising	2,026	4,028	4,751	2,215	2,156	2,155	3,284	1,982	417	12,209	23,014
Liability & Property Insurance	4,468	4,468	4,468	4,468	4,468	4,468	4,468	4,468	8,936	31,276	44,680
Service Charges	2,379	893	2,644	3,096	2,363	46,778	1,038	367	30,758	84,400	90,316
Depreciation & Amortization	18,744	1,874	-	13,121	13,121	37,488	7,498	1,874	93,719	166,821	187,439
Organizational Expenses	81	81	-	322	403	403	81	81	161	1,451	1,613
Contributions	31	2,244	79	18,637	186	186	651	-	-	19,660	22,014
Software Lease	1,696	1,202	3,616	3,825	1,512	13,926	1,328	1,104	8,061	29,756	36,270
Legal Fees	3,893	4,321	-	15,716	20,336	19,985	4,463	3,893	7,681	72,074	80,288
Audit & Review	1,874	187	-	1,312	1,312	3,748	750	187	9,370	16,679	18,740
Contract Services	13,085	42,179	61,629	41,026	16,057	17,503	29,628	13,357	14,251	131,822	248,715
Loan Processing Expense	1	-	-	8,845	550	3,785	-	-	5	13,185	13,186
Loan Servicing Expense	82	82	-	328	(105)	57,893	82	82	8,193	66,473	66,637
Pass Thru Grants	-	673,925	-	-	-	-	-	-	-	-	673,925
Administration	-	-	-	-	-	-	-	-	28,150	28,150	28,150
Bad Debt Expense	-	-	-	-	-	-	-	-	399,332	399,332	399,332
Interest Expense	3,542	3,531	-	14,126	17,655	17,672	3,534	3,531	487,074	543,592	550,665
Loans Forgiven	-	-	-	-	-	-	-	-	184,323	184,323	184,323
Miscellaneous Expense	83	470	125	135	117	130	(6)	22	75	473	1,151
Total Expenses	\$ 216,842	\$1,231,403	\$ 383,338	\$616,451	\$ 462,034	\$761,201	\$543,353	\$121,826	\$1,662,171	\$ 4,167,036	\$ 5,998,619

See Independent Auditor's Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2015

Expenses	General &			Program Services						Total Program	
	Administrative	Membership	Fundraising	Home Lending	Community Development	Loan Servicing	FAHE Consulting	FAHE Capital	Loan Porfolios	Services	Total
Personnel Expenses	\$ 106,561	\$ 264,384	\$ 144,331	\$ 515,951	\$ 295,180	\$ 541,989	\$ 466,785	\$ 185,740	\$ 41,950	\$ 2,047,595	\$ 2,562,871
Travel Expenses	9,321	21,746	13,966	22,528	22,003	18,666	16,773	19,890	2,932	102,792	147,825
Board & Committee Meetings	35	75	88	35	35	35	35	13	-	153	351
Conferences & Workshops	2,969	8,874	6,930	6,138	6,170	4,425	4,340	3,337	234	24,644	43,417
Occupancy Expense	5,424	6,554	-	10,622	6,580	13,787	7,433	3,290	2,059	43,771	55,749
REO Expense	-	-	-	-	-	-	-	-	129,564	129,564	129,564
Supplies & Publications	1,972	2,827	732	3,639	2,583	5,146	2,645	1,149	634	15,796	21,327
Postage & Shipping	220	357	197	5,203	429	66,720	891	190	73	73,506	74,280
Communications	3,174	4,352	331	9,437	9,049	10,254	4,513	4,262	3,812	41,327	49,184
Equipment & Maintenance	4,040	5,456	136	11,490	9,845	12,778	5,746	4,909	4,395	49,163	58,795
Subscriptions	280	552	711	353	582	402	310	87	27	1,761	3,304
Licenses, Fees & Permits	70	117	80	26,132	136	159	103	373	48	26,951	27,218
Employee Education	333	478	156	4,035	415	1,070	434	183	117	6,254	7,221
Memberships	2,266	4,050	5,465	3,018	2,302	2,387	2,296	4,223	27	14,253	26,034
Marketing & Advertising	2,308	4,422	5,503	2,645	2,563	2,709	2,588	2,232	36	12,773	25,006
Liability & Property Insurance	3,976	4,772	-	8,118	4,507	9,941	5,434	2,253	1,325	31,578	40,326
Service Charges	2,063	2,492	2,063	3,934	2,411	79,589	2,799	1,193	669	90,595	97,213
Depreciation & Amortization	20,782	24,938	-	39,485	23,552	51,954	28,402	11,776	6,927	162,096	207,816
Organizational Expenses	97	145	-	388	388	387	145	194	194	1,696	1,938
Contributions	-	8,050	-	-	-	-	-	-	-	-	8,050
Software Lease	929	1,347	3,261	4,087	1,840	14,153	1,264	867	737	22,948	28,485
Professional Fees	6,510	9,161	19	20,021	18,229	21,493	9,435	8,754	8,062	85,994	101,684
Contract Services	18,824	43,473	136,378	44,387	21,320	23,040	25,479	16,125	928	131,279	329,954
Loan Processing Expense	751	901	-	16,566	683	1,878	1,026	426	250	20,829	22,481
Loan Servicing Expense	-	-	-	-	-	104,765	-	-	-	104,765	104,765
Pass Thru Grants	-	1,308,578	-	-	-	-	-	-	-	-	1,308,578
Administration	-	28,088	-	-	-	-	-	-	-	-	28,088
Bad Debt Expense	-	-	-	-	-	-	-	-	1,067,616	1,067,616	1,067,616
Interest Expense	-	-	-	-	-	-	-	-	547,592	547,592	547,592
Loans Forgiven	-	-	-	-	-	-	-	-	152,278	152,278	152,278
Miscellaneous Expense	71	149	146	85	79	89	161	21	9	444	810
Total Expenses	\$ 192,976	\$ 1,756,338	\$ 320,493	\$ 758,297	\$ 430,881	\$ 987,816	\$ 589,037	\$ 271,487	\$ 1,972,495	\$ 5,010,013	\$ 7,279,820

See Independent Auditor's Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
 STATEMENTS OF FINANCIAL POSITION - NEIGHBORWORKS AMERICA CAPITAL FUND
 JUNE 30, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Cash and cash equivalents	\$ 87,703	\$ 164,599
Mortgages receivable	1,363,177	1,149,001
Property held for sale	<u>-</u>	<u>-</u>
TOTAL ASSETS	<u>\$ 1,450,880</u>	<u>\$ 1,313,600</u>
NET ASSETS		
Temporarily restricted	\$ -	\$ -
Permanently restricted	<u>1,450,880</u>	<u>1,313,600</u>
TOTAL NET ASSETS	<u>\$ 1,450,880</u>	<u>\$ 1,313,600</u>

See Independent Auditor's Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
STATEMENTS OF ACTIVITIES - NEIGHBORWORKS AMERICA CAPITAL FUND
FOR THE YEARS ENDED JUNE 30, 2016 AND 2015

	<u>2016</u>	<u>2015</u>
TEMPORARILY RESTRICTED NET ASSETS		
Restrictions released from temporarily restricted net assets	\$ -	\$ -
DECREASE IN TEMPORARILY RESTRICTED NET ASSETS	<u>-</u>	<u>-</u>
PERMANENTLY RESTRICTED NET ASSETS		
Capital Grant-NeighborWorks America	500,000	500,000
Net assets released from restriction	<u>(362,720)</u>	<u>(613,900)</u>
INCREASE (DECREASE) IN PERMANENTLY RESTRICTED NET ASSETS	137,280	(113,900)
CHANGE IN NET ASSETS	137,280	(113,900)
NET ASSETS AT BEGINNING OF YEAR	<u>1,313,600</u>	<u>1,427,500</u>
NET ASSETS AT END OF YEAR	<u>\$ 1,450,880</u>	<u>\$ 1,313,600</u>

See Independent Auditor's Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
 COMPUTATION OF ADJUSTED NET WORTH FOR APPROVAL OF NONSUPERVISED
 MORTGAGEES OTHER THAN LOAN CORRESPONDENTS
 FOR THE YEAR ENDING JUNE 30, 2016

Minimum net worth required		<u>\$ 1,000,000</u>
Stockholders equity (net worth)		
Per balance sheet	\$ 25,070,055	
Less unacceptable assets	<u>\$ 8,716,739</u>	
Adjusted net worth for HUD		
Requirement purposes		<u>\$ 16,353,316</u>
Adjusted net worth above amount		
Required		<u>\$ 15,353,316</u>
Adjusted net worth below amount		
Required		<u>\$ -</u>

See Independent Auditor's Report.