

Mercy Housing, Inc.

**Consolidated Financial Statements
(With Supplementary Information)
and Independent Auditor's Report**

December 31, 2017 and 2016

Mercy Housing, Inc.

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Independent Auditor's Report

Board of Directors
Mercy Housing, Inc.

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Mercy Housing, Inc., which comprise the consolidated statements of financial position as of December 31, 2017 and 2016, and the related consolidated statements of activities and changes in net assets 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 controls relevant to the preparation and fair presentation of consolidated 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 financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Mercy Housing, Inc. as of December 31, 2017 and 2016, and the consolidated 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.

Other Matters

Other Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary information on pages 46 through 264 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 accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. Code of Federal Requirements (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 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 audits 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 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 our report dated April 19, 2018, on our consideration of Mercy Housing, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Mercy Housing, Inc.'s 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 Mercy Housing, Inc.'s internal control over financial reporting and compliance.



Charlotte, North Carolina
April 19, 2018

Mercy Housing, Inc.

**Consolidated Statements of Financial Position
December 31, 2017 and 2016**

	2017	2016
Assets		
Current assets		
Cash and cash equivalents	\$ 56,927,747	\$ 53,514,147
Cash, tenant security deposits	8,978,915	7,811,575
Cash, restricted	43,582,657	41,660,928
Investments	12,807,861	8,970,000
Investments, restricted	9,378	98,756
Accounts receivable, net	13,902,320	10,566,407
Pledges receivable, net	6,310,779	2,034,219
Grants receivable	469,079	767,177
Current portion of notes and interest receivable	14,162,543	11,863,219
Prepaid expenses and other assets	2,697,685	2,715,912
Assets held for sale	-	723,160
	159,848,964	140,725,500
Property and equipment, net	2,384,735,051	2,141,078,112
Other long-term assets		
Restricted property reserves	191,725,809	143,243,653
Long-term investments	14,441,179	12,050,000
Long-term investments, restricted	2,215,000	850,000
Pledges receivable, net	22,424,382	907,178
Investments in unconsolidated entities, net	1,752,824	2,158,757
Notes and interest receivable, net	38,075,385	28,367,655
Other assets, net	21,712,107	21,367,679
	292,346,686	208,944,922
Total other long-term assets	292,346,686	208,944,922
Total assets	\$ 2,836,930,701	\$ 2,490,748,534

Mercy Housing, Inc.

**Consolidated Statements of Financial Position
December 31, 2017 and 2016**

	2017	2016
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	\$ 85,211,873	\$ 81,417,779
Accrued interest	5,366,324	4,771,742
Current portion of notes payable	203,119,864	115,854,857
Deferred revenue and other liabilities	3,264,945	3,885,272
Tenant security deposits	8,880,341	7,760,322
	305,843,347	213,689,972
Long-term liabilities		
Accrued interest	107,238,626	101,702,052
Notes payable, less current portion, net	1,466,599,896	1,327,200,000
Deferred revenue and other liabilities	31,395,018	34,256,073
	1,605,233,540	1,463,158,125
Total liabilities	1,911,076,887	1,676,848,097
Commitments	-	-
Net assets		
Unrestricted net assets, controlling	61,423,626	49,442,720
Unrestricted net assets, noncontrolling	599,092,048	539,616,947
	660,515,674	589,059,667
Temporarily restricted net assets	261,936,140	221,438,770
Permanently restricted net assets	3,402,000	3,402,000
	925,853,814	813,900,437
Total net assets	925,853,814	813,900,437
Total liabilities and net assets	\$ 2,836,930,701	\$ 2,490,748,534

See Notes to Consolidated Financial Statements.

Mercy Housing, Inc.

Consolidated Statements of Activities Year Ended December 31, 2017

	Programs					Total	Unrestricted	Temporarily Restricted	Permanently Restricted
	Property Operations & Management	Resident Services	Housing Development	Mercy Loan Fund	Corporate Operations				
Revenues									
Rent - net of vacancies	\$ 220,484,542	\$ -	\$ -	\$ -	\$ -	\$ 220,484,542	\$ 220,484,542	\$ -	\$ -
Developer fees	-	-	18,334,803	-	-	18,334,803	18,334,803	-	-
Services fees	1,170,463	223,760	52,337	-	15,156	1,461,716	1,461,716	-	-
Philanthropy	401,679	6,235,475	34,294,872	3,602,054	2,260,730	46,794,810	6,304,739	40,490,071	-
Capital grants	837,316	-	3,265,695	-	10,000	4,113,011	4,113,011	-	-
Consulting	2,070	223,795	464,245	-	-	690,110	690,110	-	-
Interest	1,195,047	5,646	455,933	2,152,338	187,757	3,996,721	3,996,721	-	-
Other	20,797,790	57,476	783,867	435,972	1,577,361	23,652,466	23,652,466	-	-
Release of restricted assets	-	-	-	-	-	-	21,930,624	(21,930,624)	-
Total revenues	244,888,907	6,746,152	57,651,752	6,190,364	4,051,004	319,528,179	300,968,732	18,559,447	-
Expenses and losses									
Compensation	60,927,165	10,374,874	9,075,101	929,686	11,554,281	92,861,107	92,861,107	-	-
Administrative	9,842,114	1,609,161	1,921,904	68,871	6,960,875	20,402,925	20,402,925	-	-
Professional services	6,076,163	806,023	951,122	66,973	1,300,961	9,201,242	9,201,242	-	-
Depreciation and amortization	107,086,898	-	122,713	-	27,715	107,237,326	107,237,326	-	-
Grants	6,398	39,377	1,172,242	-	73,000	1,291,017	1,291,017	-	-
Facility	73,031,788	35,355	772,751	-	4,897,771	78,737,665	78,737,665	-	-
Interest and fees	41,107,283	403	84,036	949,839	786,979	42,928,540	42,928,540	-	-
Bad debts	1,342,336	108,167	165,328	54,269	459,473	2,129,573	2,129,573	-	-
Project expenses	-	-	2,049,723	-	-	2,049,723	2,049,723	-	-
Allocation	2,890,469	5,132,121	1,940,418	333,911	(10,296,919)	-	-	-	-
(Gain)/loss on sale of assets	(585,143)	-	(29,351)	-	-	(614,494)	(614,494)	-	-
(Gain)/loss on investment in unconsolidated entities, net	-	-	379,087	-	309	379,396	379,396	-	-
Total expenses and losses	301,725,471	18,105,481	18,605,074	2,403,549	15,764,445	356,604,020	356,604,020	-	-
Change in net assets									
Consolidated	(56,836,564)	(11,359,329)	39,046,678	3,786,815	(11,713,441)	(37,075,841)	(55,635,288)	18,559,447	-
Attributable to non-controlling interest	(78,702,782)	-	(360)	-	-	(78,703,142)	(78,703,142)	-	-
Change in net assets attributable to Mercy Housing, Inc.	\$ 21,866,218	\$ (11,359,329)	\$ 39,047,038	\$ 3,786,815	\$ (11,713,441)	\$ 41,627,301	\$ 23,067,854	\$ 18,559,447	\$ -

Mercy Housing, Inc.

Consolidated Statements of Activities Year Ended December 31, 2016

	Programs						Total	Unrestricted	Temporarily Restricted	Permanently Restricted
	Property Operations & Management	Resident Services	Housing Development	Mercy Loan Fund	Neighborhood Stabilization	Corporate Operations				
Revenues										
Rent - net of vacancies	\$ 178,075,769	\$ -	\$ 219,543	\$ -	\$ -	\$ -	\$ 178,295,312	\$ 178,295,312	\$ -	\$ -
Developer fees	-	-	18,495,563	-	-	-	18,495,563	18,495,563	-	-
Services fees	2,061,972	321,978	214,716	-	-	3,134	2,601,800	2,601,800	-	-
Philanthropy	308,873	5,773,543	6,341,050	1,971,017	-	1,558,341	15,952,824	3,938,508	12,014,316	-
Capital grants	892,478	-	28,710	-	-	-	921,188	815,125	106,063	-
Consulting	2,040	98,064	365,622	-	82,495	-	548,221	548,221	-	-
Interest	1,603,212	5,233	129,872	2,273,972	-	194,236	4,206,525	4,194,536	11,989	-
Other	10,344,585	111,833	8,477,792	1,073,299	363,672	6,251,747	26,622,928	26,622,928	-	-
Release of restricted assets	-	-	-	-	-	-	-	16,639,566	(16,639,566)	-
Total revenues	193,288,929	6,310,651	34,272,868	5,318,288	446,167	8,007,458	247,644,361	252,151,559	(4,507,198)	-
Expenses and losses										
Compensation	51,766,303	8,691,265	8,650,802	881,509	173,655	11,047,400	81,210,934	81,210,934	-	-
Administrative	10,880,706	1,330,707	1,699,886	82,797	13,645	2,521,928	16,529,669	16,529,669	-	-
Professional services	4,204,502	831,000	852,692	90,374	16,635	1,559,621	7,554,824	7,554,824	-	-
Depreciation and amortization	90,555,944	-	407,003	-	-	23,409	90,986,356	90,986,356	-	-
Grants	211,245	116,183	197,641	-	-	17,000	542,069	542,069	-	-
Facility	59,742,757	-	820,170	-	-	4,288,283	64,851,210	64,851,210	-	-
Interest and fees	32,814,533	344	308,485	938,115	-	967,859	35,029,336	35,029,336	-	-
Bad debts	770,392	-	20	-	-	-	770,412	770,412	-	-
Provision for impaired assets	-	-	9,621	847,968	-	-	857,589	857,589	-	-
Project expenses	2,036,163	-	986,384	-	-	-	3,022,547	3,022,547	-	-
Allocation	3,088,257	4,570,902	1,741,240	327,038	65,555	(9,792,992)	-	-	-	-
(Gain)/loss on sale of assets	481,711	-	168,899	-	544,775	-	1,195,385	1,195,385	-	-
(Gain)/loss on investment in unconsolidated entities, net	-	-	(94,580)	-	-	21,749	(72,831)	(72,831)	-	-
Total expenses and losses	256,552,513	15,540,401	15,748,263	3,167,801	814,265	10,654,257	302,477,500	302,477,500	-	-
Change in net assets										
Consolidated	(63,263,584)	(9,229,750)	18,524,605	2,150,487	(368,098)	(2,646,799)	(54,833,139)	(50,325,941)	(4,507,198)	-
Attributable to non-controlling interest	(60,475,954)	-	(5,216)	-	-	-	(60,481,170)	(60,481,170)	-	-
Change in net assets attributable to Mercy Housing, Inc.	\$ (2,787,630)	\$ (9,229,750)	\$ 18,529,821	\$ 2,150,487	\$ (368,098)	\$ (2,646,799)	\$ 5,648,031	\$ 10,155,229	\$ (4,507,198)	\$ -

See Notes to Consolidated Financial Statements.

Mercy Housing, Inc.

**Consolidated Statements of Changes In Net Assets
Years Ended December 31, 2017 and 2016**

	Unrestricted Net Assets			Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total Net Assets
	Controlling	Noncontrolling	Total			
Balance, January 1, 2016	\$ 32,320,306	\$ 520,367,923	\$ 552,688,229	\$ 216,354,465	\$ 3,402,000	\$ 772,444,694
Contributions	-	85,533,950	85,533,950	-	-	85,533,950
Distributions	-	(568,469)	(568,469)	-	-	(568,469)
Syndication	(1,001,331)	(1,102,766)	(2,104,097)	-	-	(2,104,097)
Other transfers	7,968,516	(4,132,521)	3,835,995	9,591,503	-	13,427,498
Excess (deficiency) of revenues over expenses	<u>10,155,229</u>	<u>(60,481,170)</u>	<u>(50,325,941)</u>	<u>(4,507,198)</u>	<u>-</u>	<u>(54,833,139)</u>
Balance, December 31, 2016	49,442,720	539,616,947	589,059,667	221,438,770	3,402,000	813,900,437
Contributions	-	137,710,310	137,710,310	-	-	137,710,310
Distributions	(228,397)	(580,043)	(808,440)	-	-	(808,440)
Syndication	(534,727)	(1,117,434)	(1,652,161)	-	-	(1,652,161)
Other transfers	(10,323,824)	2,165,410	(8,158,414)	21,937,923	-	13,779,509
Excess (deficiency) of revenues over expenses	<u>23,067,854</u>	<u>(78,703,142)</u>	<u>(55,635,288)</u>	<u>18,559,447</u>	<u>-</u>	<u>(37,075,841)</u>
Balance, December 31, 2017	<u>\$ 61,423,626</u>	<u>\$ 599,092,048</u>	<u>\$ 660,515,674</u>	<u>\$ 261,936,140</u>	<u>\$ 3,402,000</u>	<u>\$ 925,853,814</u>

See Notes to Consolidated Financial Statements.

Mercy Housing, Inc.

**Consolidated Statements of Cash Flows
Years Ended December 31, 2017 and 2016**

	2017	2016
Operating activities		
Changes in net assets	\$ (37,075,841)	\$ (54,833,139)
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Forgiveness of debt	(2,621,114)	(561,570)
(Gain) loss on sale of assets	(614,494)	1,195,385
Depreciation and amortization	107,237,326	90,986,356
Amortization of debt issuance costs	2,150,974	1,537,658
Provisions for loan losses and impaired assets	54,269	857,589
(Gain) loss from investments in partnerships	379,396	(72,831)
(Gain) loss on interest rate swap contracts	(509,400)	(745,532)
Amortization of prepaid ground lease	129,133	75,607
Net changes in current assets and liabilities that provided (used) cash		
Cash, tenant security deposits	(1,167,340)	(636,530)
Accounts receivable, net	(3,335,913)	(2,905,503)
Grants receivable	298,098	5,649,701
Pledges receivable	(25,793,764)	(1,002,487)
Prepaid expenses and other assets	10,623	252,195
Inventory	-	70,385
Accounts payable	(37,330,521)	(16,113,146)
Accrued interest payable	6,131,156	9,467,790
Deferred revenue	(3,481,382)	(4,800,659)
Tenant security deposits liability	1,120,019	604,389
	5,581,225	29,025,658
Investing activities		
Net change in restricted cash and reserves	(50,403,885)	(26,029,725)
Net change in investments	(7,504,662)	(13,712,952)
Sale of stock	134,100	-
Purchases of property and equipment	(214,526,709)	(275,488,517)
Net change in investments in partnerships	26,537	(1,180,833)
Net change in notes receivable	(12,061,323)	3,918,991
Payment of tax credit fees	(1,134,665)	(580,579)
Payments on prepaid land lease	-	(2,744,958)
	(285,470,607)	(315,818,573)

Mercy Housing, Inc.

**Consolidated Statements of Cash Flows
Years Ended December 31, 2017 and 2016**

	2017	2016
Financing activities		
Proceeds from notes payable	315,096,670	314,107,361
Principal payments on notes payable	(160,394,617)	(89,190,223)
Debt issuance costs	(6,648,780)	(5,243,336)
Capital contributions from investor partners	137,710,310	85,533,950
Distributions paid to investor limited partners	(808,440)	(568,469)
Syndication costs	(1,652,161)	(2,104,097)
Other changes in net assets		
	<u>283,302,982</u>	<u>302,535,186</u>
Net cash provided by financing activities		
Net increase in cash and cash equivalents	3,413,600	15,742,271
Cash and cash equivalents at beginning of year	<u>53,514,147</u>	<u>37,771,876</u>
Cash and cash equivalents at end of year	<u>\$ 56,927,747</u>	<u>\$ 53,514,147</u>
Cash paid for interest, net of amounts capitalized of \$4,294,444 and \$2,720,613, respectively	<u>\$ 25,536,622</u>	<u>\$ 18,487,652</u>

Mercy Housing, Inc.

Consolidated Statements of Cash Flows
Years Ended December 31, 2017 and 2016

	2017	2016
Noncash investing and financing activities:		
Net noncash net assets of transferred entities to (from) MHI	\$ (13,779,509)	\$ (13,427,498)
Transfers of net assets of non-controlling interests	2,165,410	(4,132,521)
Property and equipment and other assets transferred to MHI	11,614,099	17,560,019
(Increase) decrease in property and equipment in payables	62,217,441	40,646,929
Increase (decrease) in accounts payable from property equipment purchases (disposals)	(62,217,441)	(40,646,929)
Increase in property and equipment from notes payable	(1,318,260)	(899,722)
Increase in notes payable from property and equipment	1,318,260	899,722
Increase in property and equipment from capitalized amortization	879,295	(882,800)
Capitalized amortization in property and equipment	(879,295)	882,800
Increase in other assets from prepaid expenses	134,586	(390,987)
Decrease in prepaid expenses from other assets	(134,586)	390,987
Increase in accounts payable from financing fees	477,686	-
Increase in financing fees in accounts payable	(477,686)	-
Decrease in notes payable from accrued interest	(325,687)	-
Increase in accrued interest from notes payable	325,687	-
Increase in unrestricted net assets	21,937,923	16,639,566
Release of temporarily and permanently restricted net assets	(21,937,923)	(16,639,566)
	(21,937,923)	(16,639,566)
Total noncash investing and financing activities	\$ -	\$ -

See Notes to Consolidated Financial Statements.

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Note 1 - Organization and summary of significant accounting policies

Mercy Housing, Inc. (MHI or the Company) is a nonprofit Nebraska corporation formed in 1981 by eight congregations of women religious. MHI's mission is to create vibrant and healthy communities by developing, financing and operating affordable, program-enriched housing for families, seniors and people with special needs who lack the economic resources to access quality, safe housing opportunities. These activities are considered to comprise the major programs of the Company. Accordingly, the consolidated statements of activities include five separate programs and corporate operations, as follows: property operations and management; resident services; housing development; neighborhood stabilization and Mercy Loan Fund (MLF).

MHI and its affiliates receive significant funding from federal, state, and local government subsidies in various forms, including low-income housing tax credits, low-interest rate loans, grants, and rent subsidies for qualifying very low, low and moderate-income tenants.

MLF has been certified by the U.S. Treasury's Community Development Financial Institutions Fund (CDFI Fund) as a Community Development Entity (CDE) and has entered into an allocation agreement with the CDFI Fund as an Allocatee under Section 45D of the Internal Revenue Code.

Mercy Portfolio Services (MPS) was formed in 2009 as a response to the nation's foreclosure crisis. MPS is addressing the crises through two major programs: 1) Management of Neighborhood Stabilization Program (NSP) funds provided by the federal government to states and municipalities. NSP funds are used to acquire, rehabilitate and reoccupy foreclosed homes; and 2) Participation in the Mortgage Resolution Fund (MRF), a partnership with Enterprise Community Partners, Housing Partnership Network, and National Community Stabilization Trust whose mission is also neighborhood stabilization. MRF seeks to purchase delinquent mortgages from lenders and restructure the mortgages, enabling families to save their homes from foreclosure or transition to suitable housing. At December 31, 2015, pursuant to the applicable agreements, MPS ceased its NSP management activities, excluding only record retention obligations set forth in those agreements. MRF, and its subsidiaries, have ceased purchasing loans, and are in the process of disposing of their remaining assets comprised primarily of REO properties.

The Company, through a subsidiary, holds an investment in Housing Partnership Equity Trust LLC (HPET). HPET was formed by twelve mission focused non-profit organizations and is operated by Housing Partnership Network. HPET is a social-purpose Real Estate Investment Trust that provides a ready source of long-term capital enabling its members and partners to quickly and efficiently acquire affordable multifamily properties. The Company and HPET jointly own 2000 Illinois, a 128-unit multifamily project in Aurora, Illinois serving working class families and individuals.

Principles of consolidation

The accompanying consolidated financial statements include the accounts of MHI and all of its controlled affiliates. This includes corporations, limited partnerships and limited liability companies in which MHI has a controlling interest. These entities are included in the consolidation according to generally accepted accounting principles (GAAP) which require that partnership accounts be consolidated for all limited partnerships or limited liability companies which are deemed to be controlled by the Company. All intercompany transactions have been eliminated in consolidation.

The following entities are included in the consolidated financial statements of MHI:

Mercy Housing, Inc.
Mercy Loan Fund (MLF)

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

Mercy Housing Management Group (MHM)
Mercy Housing Mountain Plains
Holly Park Community Center, LLC
Stapleton II Mercy, LLC
Bluff Mercy, LLC (Bluff Lake)
Mercy Housing Colorado GP, LLC
Mercy Housing Colorado III, LTD. (Springfield Court)
MHMP GP, LLC
Mercy Housing Colorado VI, LTD. (Merced de las Animas)
Mercy Housing Colorado VII, LP (Holly Park West)
MHMP CO GP, Inc.
Mercy Bond Properties Colorado I (Franconia LLC)
MHMP 12 Holly Park East and West LP (Holly Park)
MHMP 12 Holly Park East and West GP
Mercy Housing Midwest
Mercy House
Mercy Bond Properties Nebraska I (Mercy Timbercreek, LLC)
Mercy Village Joplin, Inc.
Mercy Housing Midwest Nebraska, LLC
Northglen, LP
Mercy Crestview Village Housing, LP
Western Manor, LP
Mercy Housing Southwest (MHSW)
Avondale Senior Village
Camelot Casitas
Casa de Merced
Casa de Shanti, Inc.
Decatur Place
El Mirage Senior Village
Mercy Holly Park East
Mesa Senior Meadows
Guadalupe Senior Village
Peoria Place
Plazas de Merced
Vista Alegre
Willow Street Apartments
Mercy Housing California (MHC)
Affordable Housing Initiatives
All Hallows Community
Marin Homes for Independent Living (Camino Alto)
Cantebria Senior Homes
Mercy Senior Housing Oxnard (Casa Merced)
Francis of Assisi Community
Gault Street Senior Housing
John W. King Senior Community
Maria B. Freitas Senior Housing Corporation
Marin Housing Corporation (Martinelli House)
Mercy Family Plaza Limited Partnership (Mercy Family Plaza)
Mercy Gardens
Notre Dame Senior Housing Corporation
Oceana Senior Housing Corporation (Oceana Terrace)

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
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Presentation Senior Housing Community
Russell Manor
Tierra Del Sol, Inc.
Garden Park Apartment Community
Mercy Oaks Village
Mercy Commercial California
MPCAL, LLC
MCC 1360 LLC
Central Coast Housing
Mercy Housing California 58, LP (Neary Lagoon Apts.)
Sycamore Street Consolidated
Mercy Housing California Family Properties
Mercy Housing California 51, LP (Bill Sorro Community)
Mercy Housing California Special Needs
Mercy Housing California 57, LP (1500 Page)
Mercy Midtown Inc.
Florin Housing Corporation GP
Mercy Housing California 77, LP (Crossroad Gardens)
Sunnydale Block 6 Housing Partnership, LP
Mercy Housing California Senior Properties (MHCSP)
 Bennett House, LP
 Dorothy Day Community, LP
 Junipero Serra, LP
 Monsignor Lyne, LP
 St. Andrew Community, LP
 Villa Columba Mercy Riverside, LP
Mercy Housing Calwest (MHCW)
 Mercy Housing California XXXIX, LP (Gleason Park)
 Mercy Housing California XL, LP (Arlington Hotel)
 Mercy Housing California XXXVIII, LP (East Leland Courts)
 Mercy Housing California XLII, LP (Boulevard Court)
 Mercy Housing California XLIV, LP (1000 Fourth Street)
 Third and LeConte Associates LP (Bayview Hill Gardens)
 Caroline Severance LLC
 Mercy Housing California XLIII, LP (Caroline Severance Manor)
 7th & H GP, LLC
 Mercy Housing California 47, LP (7th & H Street)
 Madonna Senior Housing LLC
 Mercy Housing California 53, LP (Madonna Residences)
 Mercy Housing California 52, LP (School House Station-Vista Grande)
 1100 Ocean Avenue Limited Partnership (1100 Ocean Avenue Apts.)
 55 Laguna, LP (Open House Community at 55 Laguna)
 Esparto Family Apartments, LLC
 Mercy Housing California 54, LP (Esperanza Crossing)
 Sunset Lane Apartments LLC
 Mercy Housing California 55, LP (Trailside Terrace)
 Mercy Housing California 56, LP (Jefferson Park Terrace)
 Mercy Housing California II, LP (Columbia Park)
 Coastside Senior Housing Limited Partners, LP
 El Monte Veterans Apartments LLC
 El Monte Veterans Apartments, LP

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**Notes to Consolidated Financial Statements
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1028 Howard Street, LLC
Mercy Housing California 60, LP (Quinn Cottages)
Mercy Housing California XI, LP (Madison Place)
Mercy Eden House LLC
Eden House, L.P.
Crossroad Gardens LLC
Transbay Block 6, LLC
Mercy Housing California 62, LP (280 Beale)
Sunset Valley Duplexes, LLC
Mercy Housing California 63, LP (Sunset Valley Duplexes)
345 Arguello, LP
Land Park Woods, LLC
Mercy Housing California 68, LP (Land Park Woods)
1800 Pine, LP
Transbay Block 7, LLC
Mercy Housing California 64, LP (Transbay Block 7)
Mercy Mather Veterans, LLC
Mercy Housing California 61, LP (Mather Veterans Village)
Mercy Housing California 65, LLC
Mercy Housing California 65, LP (15888 Hesperion)
Plaza Maria, LLC
Mercy Laguna LLC, GP
Laguna Senior Housing, LP (95 Laguna)
JFK Tower, LP
2698 California, LP
Mercy Housing California 66, LP (Colma Veterans Village)
455 Fell, LP (Parcel O)
Mercy Housing California 67, LP (Columbia Park)
St. Mary's Tower
Historic Live Oak (Odd Fellows)
Mercy Housing Camino, LLC
Mercy Housing La Cienega GP, LLC
New Dana Strand IV, LP (Camino Del Mar)
St Mary's Tower, LLC
Mercy Housing California 71, LP (St Mary's Tower)
Francis of Assisi, LLC
Mercy Housing California 69, LP (Francis of Assisi)
Mercy Housing California 59, LP (Casa de la Mission)
0623 Vernon, LLC
Mercy Housing California 48, LP (Roseville)
Esperanza Crossing II, LLC
Mercy Housing California 76, LP (Esperanza Crossing Phase II)
Mercy Transformation, LLC
Sunnydale Parcel Q Housing Partners, LP

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Candlestick Pointe 11a, a California Limited Partnership (Candlestick)
20 North Cottonwood LLC
Mercy New Hope, LP (Woodland/180 West Beamer)
Mercy Housing California 74, LP (Britton Street)
Pico Robertson LLC, GP
Mercy Housing California 73, LP (Pico Robertson)
Baldwin Rose LLC, GP
Baldwin Rose LP
Mercy Properties California
Foster Youth*
The Haven*
Leland House*
Osocales (McIntosh Mobile Homes)*
Richmond Hills*
Sycamore Center (Red Bluff)*
Sierra Vista*
San Juan Housing Corporation
Kennedy Estates Housing Associates, LP (Kennedy Estates)
Tahoe Valley Townhomes Associates, LP (Tahoe Valley Townhomes)
Mercy Housing Northwest-Idaho, Inc.
Eagle Senior Village, Inc.
Mercy Southeast Idaho, Inc. (Hamilton Court)
Mercy Moscow, Inc. (Hawthorne)
Independence Hill, Inc.
Boise Senior 202 GP, LLC
Boise Senior 202 Owner, LP (12th Street Senior)
MHNW-ID GP, LLC
Mercy Housing Lakefront (MHLF)
Laverne Courts, LLC
Washington Courts, LLC
Whitmore Apartments, LLC
111th & Wentworth Apartment Corporation
111th and Wentworth Limited Partnership (Wentworth Commons)
Belray Apartments Corporation
Belray Limited Partnership (Belray Apartments)
Harold Washington Apartments Corporation
Magnolia Limited Partnership (Carlton Apartments)
Red Door Limited Partnership (Major Jenkins Apartments)
4707 Malden Limited Partnership (Miriam Apartments)
Roseland Apartments Corporation
Roseland Limited Partnership (Holland Apartments)
South Loop Apartments Corporation
South Loop Limited Partnership (South Loop Apartments)
Winthrop Apartments Corporation
5042 Winthrop Apartments Limited Partnership (Delmar Apartments)
Near North Apartments Corporation, NFP
Near North Limited Partnership (Schiff Residences)
Malden Arms Corp. II, NFP

*Not a legal entity but is included as a separate column in Supplementary Information.

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**Notes to Consolidated Financial Statements
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Malden Limited Partnership II (Malden Arms II)
Englewood Apartments, NFP
901 West 63rd Limited Partnership (Englewood Apartments)
Countryside Seniors, LLC
Countryside Seniors Apartments, LP (Countryside Apartments)
Johnston Center MM, LLC
Johnston Center Re-Use, LLC
HWA-850 Eastwood GP Corp., NFP
HWA-850 Eastwood Limited Partnership
Belvidere Place Corp. I, NFP
Grayslake Senior Housing Limited Partnership
104th Street MM, LLC
104th Street Limited Partnership (Pullman Wheelworks)
MHL Holdings, LLC
MHL Keating MM, LLC
The Keating Building Little Village LLC
2000 Illinois Aurora MM, LLC
2000 Illinois Aurora, LLC
St. Catherine Residence, Inc.
SC Residence MM, LLC
SC Residence, LLC (McAuley Apartments)
Roseland Place Inc., NFP
Roseland Place Limited Partnership
Mercy River West Commons Elgin LLC
Danville Veterans Housing MM, LLC
Danville Veterans Housing, LLC
Greenwich Park Apartments MM, LLC
Greenwich Park Apartments, LLC
Mercy Sterling NFP
New Sterling Park MM, LLC
New Sterling Park, LLC
Kankakee Station Senior Housing MM GP, LLC
Kankakee Station Street Senior Housing, LLC
Roseland Village
Mercy Housing South East
Mercy Place Belmont, Inc.
Mercy Housing Pembroke, Inc. (McFadden Place)
Mercy Housing Georgia Holdings, LLC (1826 Florance Street)
Marshside Village, Inc.
Allegre Point Senior Residences, Inc.
MHSE Adamsville Green Senior Partners, LLC
Adamsville Green Limited Partnership
Dublin Manor, Inc.
McAuley Manor, Inc.
Mercy Manor, Inc.
Riverview - St. Mary's Inc. (St. Mary's Riverview I)
St. Mary's Villa at Riverview II, Inc. (St. Mary's Riverview II)
St. Mary's Villa, Inc.
Sacred Heart Village I, Inc.
Sacred Heart Village II, Inc.
Sacred Heart Village III, Inc.

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St. Theresa Village, Inc.
Siena Springs (Siena Springs I)
Siena Springs II
Charles Meadows Corporation
Charles Crest Corporation (Charles Crest I)
Charles Crest II, Corporation
Savannah Gardens Senior Residences, Inc.
MHSE Mauldin Center Apartments, LLC
Mercy Community Housing Georgia, Inc. (MCHGa)
 Mercy Housing Georgia I, L.L.L.P. (Heritage Place Apartments)
 Mercy Housing Georgia IV, L.P. (Heritage Corner/Heritage Row)
 Mercy Housing Georgia V, L.P. (Chamblee Senior)
 Mercy Housing Georgia VI, L.P. (The Atrium at College Town)
 MCHG Partners, Inc.
 Acquisition Properties Georgia I, LP (Magnolia Village)
 Mercy Housing Georgia X, L.P. (Savannah Gardens I)
 Mercy Lithonia Park View, Inc.
 Mercy Housing Georgia VIII L.P. (Terraces at Park View)
 MPI Highland Place, LLC
 MPI Highland Place Apartments, LP (The Hills at Fairington Apartments)
 Antioch II, LLC
 Antioch Villas, L.P.
 Mercy Housing Georgia XI GP, LLC
 Mercy Housing Georgia XI, LP (Etowah Terrace)
 MHSE Arbors, LLC
 The Arbors at Ellington, Ltd.
 MHSE Savannah Gardens Phase III GP, LLC
 Mercy Housing Georgia 12, LP (Savannah Gardens Phase III)
 MHSE Reynoldstown Senior GP, LLC
 MHSE Reynoldstown Senior, LP
 MHSE Savannah Gardens Phase IV GP, LLC
 MHSE Savannah Gardens Phase V GP, LLC
 Mercy Housing Georgia 13, LP (Savannah Gardens Phase IV)
 Mercy Housing Georgia 14, LP (Savannah Gardens Phase V)
 MHSE Renaissance Apartments, LLC
 MHSE Mercy Park GP, LLC
 Mercy Park Chamblee
Mercy Housing Northwest
 Intercommunity Housing Ferndale
 Sterling Senior Housing
 Appian Way Manager LLC
 Appian Way Mercy, LLC (Appian Way Apartments)
 New Tacoma Phase I GP LLC
 New Tacoma Phase I Owner, LP (New Tacoma Phase I)
 New Tacoma Phase II Mercy LLC
 New Tacoma Condominium Association
 Evergreen Vista 1 GP LLC
 Evergreen Vista 1 Owner, LP
 Rainer Vista Block 43 GP, LLC
 Rainer Vista Block 43 Owner, LP (Columbia City Station Apts.)
 Cobble Knoll I Mercy LLC

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Allegre Mercy Redevelopment LLLP
Villa Kathleen Redevelopment LLLP
Impact Family Village GP LLC
Impact Family Village Limited Partnership (Emerald City Commons)
Family Tree & Lincoln Way GP, LLC
Family Tree & Lincoln Way LLLP
MHNW Othello Commercial, LLC
MHNW 9 Othello East GP, LLC
MHNW 9 Othello East, LP (Mercy Othello Plaza East)
MHNW 10 Othello West GP, LLC
MHNW 10 Othello West, LP (Mercy Othello Plaza West)
MHNW 12 Eleanor Apartments GP LLC
MHNW 12 Eleanor Apartments LLLP (Eleanor Apartments)
MHNW 11 Woodlakes LLC
MHNW 11 Woodlakes LLLP
MHNW 13 Building 9 South GP, LLC
MHNW 13 Building 9 South LP
MHNW 14 Building 9 North GP, LLC
MHNW 14 Building 9 North LP
MHNW 16 Family Housing GP LLC
MHNW 16 Family Housing LLLP (Mount Baker)
Mercy Properties Washington
 Mercy Housing Washington VIII, LP (Hillside Gardens)
 Mercy Housing Washington VI, LP (Lincoln Way II)
 Mercy Housing Washington V, LP (Sterling Meadows)
 Mercy Housing Washington VII, LP (Eliza McCabe Townhomes)
 Mercy Housing Washington IX, LP (Evergreen Vista II)
 Mercy Housing Washington X, LLC (Catalina Apartments)
Mercy Housing Ohio, Inc.
Mercy Properties Washington III, LLC (Cobble Knoll I)
Mercy Properties Washington II, LLC (Cobble Knoll II)
Padre Apartments Community
Mercy Properties, Inc. (MPI)
 111 Jones Street Associates, LP (111 Jones Street Apts.)
 Britton Street Associates, LP (Britton Street Apts.)
 Mercy Housing California VII, LP (Casa San Juan)
 Mercy Housing Colorado VIII, LP (Valle de Merced)
 Mercy Housing Colorado I, LTD (Grace)
 Marlton Affordable Housing Associates (Marlton Manor)
 Mercy Housing California V, LP (Mercy Village Folsom)
 Park Terrace Apartments, LP
 Mercy Housing California X, LP (The Rose Hotel)
 San Felipe Homes, LP
 2220 10th Avenue Associates, LP (Santana Apts.)
 Mercy Housing Iowa II, LP (Sherwood Place Apts.)
 Mercy Housing California I, LP (St. Francis Terrace)
 Mercy Housing Georgia II, LLLP (Orchard Grove Apts.)
 Mercy Housing Colorado IX, LLLP (Parkside Apartments)
 Mercy Housing Arizona II, LP (Page Commons)
 Parkside Terrace Apartments, LLC
 Parkside Terraces Limited Partnership

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Mulberry Court LLC
Mercy Housing South Carolina I, LP (Mulberry Court Apts)
Savannah Rose of Sharon, LLC
Mercy Housing Georgia III, LP (Rose of Sharon)
Mercy Housing South Dakota I, LLC (Driftwood Estates)
Mercy Housing South Dakota II, LLC (Northern Heights)
Mercy Housing Colorado XI, LLC (Pinon Terrace)
Commons on Main GP, LLC
Aromor Mercy, LLC (Aromor Apts)
Mercy Galewood SLF, Inc.
FHD Holdings LLC
Franciscan Homes III, LP
Franciscan Homes IV, LP
Mercy Properties II, Inc.
 Mercy Housing Utah I, LP (Francis Peak View)
 Mercy Housing Idaho V, LP (Sisters Villa)
2101 Telegraph Avenue Housing, Inc.
 2101 Telegraph Avenue Associates, LP (Hamilton Apts.)
McDermott Place
 Bishop's Block, LP
South of Market Mercy Housing
 1101 Howard Street Associates, LP (1101 Howard St. Apts.)
 Mercy Housing California VI, LP (205 Jones Street Apts.)
 1475 167th Avenue Associates, LP (Bermuda Gardens)
 Centro Partners, LP (El Centro Residential)
 Riverside/Leibrandt Partners, LP (La Playa Residential)
 West 28th Street, LP (Montclair/Tolton Court)
 16th & Church Street Associates, LP (Padre Palou)
 Mercy Housing California IX, LP (Sycamore St. Commons)
Visitation Valley Affordable Housing Corporation
 Visitation Valley Family Housing Associates (Heritage Homes)
Mercy Housing West
 Mercy Housing California XIV, LP (10th & Mission Apartments)
 Mercy Housing California XV, LP (Nueva Vista)
 Mercy Housing California XVII, LP (Derek Silva Community)
 Mercy Housing California XXIV, LP (Carter Terrace Apartments)
 Mercy Housing California XVIII, LP (Polk Street Senior Community)
 Mercy Housing California XIII, LP (Linbrook Court)
 Mercy Housing California XX, LP (Mission Creek Sr.)
 Mercy Housing California XVI, LP (Villa Madera)
 Mercy Housing California XII, LP (Villa Amador)
 Village Park Housing Associates (Village Park Apts.)
 Mercy Housing California XXI, LP (White Rock Village)
 Mercy Housing California XIX, LP (Grand & Venice)
 Mercy Housing California XXV, LP (Casa Alegre)
 Pinewood Court Apartments, LP (Terracina Pinewood Court)
 Mercy Housing California XXII, LP (The Dudley)
 Mercy Housing California XXVI, LP (Martin Luther King Village)
 Mercy Housing California XLI, LP (Westbrook Plaza)
 Mercy Housing California XXXIV, LP (Edith Witt Sr Community)
 Mercy Housing California XXVII, LP (Serna Village)

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Mercy Housing California XXVIII, LP (The Vineyard Townhomes)
Mercy Terrace, LLC
Mercy Housing California XXIX, LP (Grizzly Hollow Phase III)
New Dana Strand Townhomes, LP (New Dana Strand Townhomes)
Mercy Housing California XXXII, LP (Creekview Manor)
Mercy Housing California XXXVI, LP (Kent Gardens)
Mercy Housing California XXXI, LP (Martinelli House)
Mercy Housing California XXXV, LP (Ardenaire Apartments)
Mercy Housing California XXXIII, LP (Casa Verde)
Mercy Housing California XXXVII, LP (Ross Ranch)
Colonia San Martin Associates, LP
Mercy Housing California 50, LP (Vera Haile Senior Housing)
Mercy Housing California 49, LP (McAuley Meadows)
Affordable Housing Corp.
Mercy Housing Washington III, L.P. (Tahoma View)
Mercy Housing Wheaton
Clare of Assisi Homes - Westminster, Inc.
Clare Gardens, Inc.
Francis Heights, Inc.
Villa Maria, Inc.
Paducah Ministries 1, Inc. (Loan Oak Manor)
Princeton Ministries 4, Inc. (Princeton Manor)
Assisi Homes of Illinois, Inc.
Mercy Housing Franciscan Campus, Inc. (Day Spring Villa)
Brandywine, Inc.
Lake Wale Ministries, Inc. (Lake Wales Gardens)
Assisi Homes – Batavia Apartments, Inc.
Assisi Homes – Constitution House, Inc.
Assisi Homes – Colony Park, Inc.
Assisi Homes – Jefferson Court, Inc. (Jefferson Court Apartments)
Assisi Homes – Kenosha, Inc.
Assisi Homes – La Salle Manor, Inc.
Assisi Homes of Gurnee, Inc.
Assisi Homes of Neenah, Inc.
Canticle Place, Inc.
Marian Housing Center, Inc.
Marian Park, Inc.
Alexandria Ministries, Inc. (Alexandria Manor)
Effingham Ministries, Inc. (Colonnade Apartments)
Indianapolis Ministries 1, Inc. (Cedar Commons)
Indianapolis Ministries 2, Inc. (Spruce Manor)
Kokomo Ministries, Inc. (Kokomo Manor)
Moline Ministries 1, Inc. (Highland Manor)
Moline Ministries 2, Inc. (Sanders Apartments)
Pendleton Ministries, Inc. (Edgewood Square Apartments)
Tucson Ministries, Inc. (Western Winds)

Revenue recognition

Rental income, principally from short-term leases on apartment units and commercial space, is recognized as the rentals become due.

Mercy Housing, Inc.

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MHI recognizes gifts of cash and other assets as unrestricted revenue unless they are received with donor restrictions. Gifts with restrictions are reported as restricted revenue. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Consolidated Statements of Activities as net assets released from restrictions. Gifts of long-lived assets with restrictions and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted revenue and are reclassified to unrestricted net assets ratably over the useful life (typically 27.5 to 40 years) of the related long-lived asset.

Unconditional and substantiated promises to give are recorded as revenue at estimated net realizable value. Conditional promises to give are not included as revenue until the conditions are substantially met or unless the possibility that the condition will not be met is remote. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted revenue in the period of receipt. Unconditional promises to give with payments due in future periods are discounted to present value and reported as temporarily restricted revenue.

Special event revenues are recognized when the event is held. Contributions received at or related to a special event are recorded as philanthropy in the Consolidated Statements of Activities.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, demand deposits, deposits in money market accounts and certificates of deposit. All highly liquid instruments with maturities of three months or less when purchased are considered to be cash equivalents. All significant balances are insured by the Federal Deposit Insurance Corporation (FDIC).

Restricted cash

The Company is subject to restrictions on certain funds received by MHI and certain subsidiaries. These funds are included in the restricted cash balance.

Many of the MHI subsidiaries are required to make monthly deposits for replacement of project assets, which are controlled by the Department of Housing and Urban Development (HUD) or other financing authorities. These subsidiaries are also required to make yearly deposits of surplus cash, if any, to residual receipts accounts. Use of residual receipt funds is contingent upon the prior written approval of HUD.

Many of the MHI subsidiaries are required to make monthly escrow deposits for taxes and insurance in a separate account held by the project. The mortgagor for the subsidiary controls these escrow deposits. These funds are included in the restricted cash balance.

Amounts received by MHI subsidiaries from HUD and other financing authorities for construction of low-income housing projects are included in the restricted cash balance.

Investments

MHI invests cash in individual certificates of deposits, treasury instruments and government agency notes. Securities with maturities greater than 90 days are recorded as investments. Debt instruments are recorded at fair value, and realized and unrealized gains and losses are recorded as unrestricted operating income or loss. MHI's intention is to hold the investments to maturity.

Accounts receivable and bad debts

Tenant receivables are charged to bad debt expense when they are determined to be uncollectible based upon a periodic review of the accounts by management. GAAP requires that the allowance

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

method be used to recognize bad debts; however, the effect of using the direct write-off method is not materially different from the results that would have been obtained under the allowance method. Non-tenant receivables are reported net of an allowance for doubtful accounts.

Property and equipment

Property and equipment have been stated at cost. The provision for depreciation is computed using the straight-line method based on estimated useful lives of the related assets. Buildings and improvements are depreciated over 27.5 to 40 years, equipment is depreciated over 3 to 10 years, and land improvements are depreciated over 15 to 20 years.

Impairment of long-lived assets

In accordance with GAAP, management continually monitors events and changes in circumstances, which could indicate that the carrying value of real estate may not be recoverable. If events or changes in circumstances are present, management assesses the recoverability of real estate by determining whether the carrying value will be recovered through the undiscounted future cash flows expected to be generated from its uses and eventual disposition. If the carrying amount of the real estate exceeds its estimated undiscounted cash flows, the impairment to be recognized is measured by the amount of its carrying value of the real estate that exceeds its fair value. No amount of impairment loss has been recognized for the years ended December 31, 2017 and 2016, respectively. Losses, when recognized, are included in the provision for impaired assets line in the Consolidated Statements of Activities.

Predevelopment project costs

The Company incurs costs in connection with properties it is considering for development as well as costs associated with properties in the initial stages of development. These costs include such items as market and environmental studies, purchase options, and legal and accounting costs. Predevelopment costs are capitalized until such time as the project is either abandoned or becomes an approved project with independent funding sources. Predevelopment project costs are charged to operations at the time a potential project is no longer considered desirable or feasible.

Allowance for loan losses

The Company maintains an allowance for loans, notes receivable and accrued interest that may not be ultimately collected. The balance maintained is based upon prior experience and management's assessment of the collectability of existing specific loans. Individual loans are written off against the allowance when they are deemed uncollectible, and increases to the allowance are charged to provision for loan losses.

Debt issuance costs

Debt issuance costs, net of accumulated amortization, are reported as a direct deduction from the face amount of the mortgage and notes payable to which such costs relate. Amortization of debt issuance costs is reported as a component of interest expense and is computed using an imputed interest rate on the related loan.

Tax credit fees and related amortization

Tax credit monitoring fees are being amortized using the straight-line method over the fifteen-year tax credit compliance period.

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Amortization expense for the years ended December 31, 2017 and 2016 was \$669,194 and \$583,727, respectively. Estimated amortization expense for each of the ensuing years through December 31, 2022 is as follows:

2018	\$	666,146
2019		662,112
2020		641,525
2021		601,967
2022		534,198

Investment in unconsolidated entities

MHI and its subsidiaries hold investments in limited partnerships and other entities that are not consolidated. The ownership interests range from .005 percent to 50 percent and are not consolidated as they are not controlled by the Company. For the years ended December 31, 2017 and 2016, the investment balance was \$1,752,824 and \$2,158,757, respectively. See Note 7 for additional information.

Basis of presentation and net assets

GAAP requires the organization to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. Furthermore, program service expenses must be segregated from management and general expenses. Contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support. Unrestricted net assets are those that have no external restrictions. Temporarily restricted net assets are those net assets for which use is limited by donors to a specific time period and/or purpose. Permanently restricted net assets are those net assets for which use is restricted in perpetuity by donors.

Non-controlling interest in limited partnerships

This represents the aggregate balance of third party Limited Partner or Investor Member equity interests in the limited partnerships or limited liability companies that are included in the consolidated financial statements. The aggregate negative balances, if any, of Limited Partner or Investor Member interests prior to January 1, 2010 remain in MHI's net assets.

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Transfers of net assets

During the year ended December 31, 2017, 22 entities were added and one entity was removed from the consolidated financial statements. During the year ended December 31, 2016, nine entities were added and one entity was removed from the consolidated financial statements. The net effect of the changes to beginning net assets for the years ended December 31, 2017 and 2016 were increases of \$13,779,509 and \$13,427,498, respectively. The following is a summary of the changes for the year ended December 31, 2017:

Addition of entities:	
Roseland Village	\$ (55,073)
Lake Wale Ministries, Inc. (Lake Wales Gardens)	794,785
Assisi Homes - Batavia Apartments, Inc.	(674,338)
Assisi Homes - Constitution House Inc.	648,515
Assisi Homes - Colony Park, Inc.	(4,635,091)
Assisi Homes - Jefferson Court, Inc. (Jefferson Court Apartments)	(1,504,966)
Assisi Homes - Kenosha, Inc.	2,423,334
Assisi Homes - La Salle Manor, Inc.	1,080,006
Assisi Homes of Gurnee, Inc.	3,205,037
Assisi Homes of Neenah, Inc.	999,078
Canticle Place, Inc.	1,940,821
Marian Housing Center, Inc.	(472,548)
Marian Park, Inc.	(5,914,939)
Alexandria Ministries, Inc. (Alexandria Manor)	2,041,768
Effingham Ministries, Inc. (Colonnade Apartments)	1,603,232
Indianapolis Ministries 1, Inc. (Cedar Commons)	404,353
Indianapolis Ministries 2, Inc. (Spruce Manor)	1,407,831
Kokomo Ministries, Inc. (Kokomo Manor)	3,893,392
Moline Ministries 1, Inc. (Highland Manor)	2,090,794
Moline Ministries 2, Inc. (Sanders Apartments)	693,021
Pendleton Ministries, Inc. (Edgewood Square Apartments)	1,716,409
Tucson Ministries	1,974,439
Transfer of entities:	
Mercy Southeast Idaho, Inc. (Hamilton Court)	8,255
Transfer of eliminations	<u>111,394</u>
Total	<u><u>\$ 13,779,509</u></u>

Mercy Housing, Inc.

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The following is a summary of the changes for the year ended December 31, 2016:

Addition of entities:	
Historic Live Oak (Odd Fellows)	\$ 596,183
Clare of Assisi Homes - Westminster, Inc.	2,692,613
Clare Gardens, Inc.	(3,466,857)
Francis Heights, Inc.	6,264,880
Villa Maria, Inc.	2,001,508
Paducah Ministries 1, Inc. (Loan Oak Manor)	2,442,837
Princeton Ministries 4, Inc.	2,428,472
Assisi Homes of Illinois, Inc.	1,959,652
Brandywine, Inc.	332,042
Transfer of entities:	
Commons on Main, LP	(976,098)
Transfer of eliminations	
	<u>(847,734)</u>
Total	<u><u>\$ 13,427,498</u></u>

Strategic health care partnerships

Throughout MHI's history, many strategic partners have pledged contributions for up to five years. MHI has eight Strategic Health Care Partners (Strategic Partners) as follows:

Ascension Health
Bon Secours Health System
Catholic Health Initiatives
Mercy Health Partners
Dignity Health
Presence Health
St. Joseph Health System
Trinity Health Corporation

As of December 31, 2017 and 2016, the Company had recorded pledges receivable of \$700,000 and \$1,600,000 respectively, from Catholic Health Initiatives (CHI), Ascension Health, Dignity Health (DH) and St. Joseph's Health System. As of December 31, 2017, future pledge payments from Strategic Partners are as follows:

For the years ending December 31,	
2018	\$ 400,000
2019	300,000
2020	-
2021	-
2022	-
Total	<u><u>\$ 700,000</u></u>

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Notes to Consolidated Financial Statements December 31, 2017 and 2016

CHI and DH provided MHI with a \$5,000,000 non-interest bearing loan and a \$3,000,000, 3 percent interest bearing loan, respectively. The loans provide working capital to support MHI's mission.

Bon Secours Health System, CHI, St. Joseph Health System, DH and Trinity Health Corporation provided MLF with loans ranging from \$1,000,000 to \$4,800,000. Proceeds from these loans are invested in communities supported by MLF. Interest rates range from 2 to 2.5 percent.

Developer and consulting fees

Developer and consulting fees are recognized during the construction period based on the percentage of construction complete. Any payments received during the construction period are recorded as deferred revenue until earned. Amounts not received by the completion date are recorded as a receivable. Developer fees that are earned during construction and paid for with investor equity or project debt are capitalized. The deferred developer fees paid from property operations are eliminated in consolidation.

Tenant subsidy payments

A portion of the rental income is in the form of subsidy payments from HUD under Section 8 of the National Housing Act. Tenants are subsidized based upon their level of income. Rent increases require HUD approval. Tenants also receive subsidy payments from US Department of Agriculture, Rural Development.

Income taxes

MHI and its consolidated nonprofit corporations are exempt from federal and state income taxes under Section 501(c)(3) of the Internal Revenue Code and comparable state statutes. MHI did not have any unrelated business income for the years ended December 31, 2017 and 2016. All nonprofit corporations are required to file tax returns with the IRS and other taxing authorities. Accordingly, these financial statements do not reflect a provision for income taxes and there are no other tax positions which must be considered for disclosure. For the years ended December 31, 2017 and 2016, the Company did not identify any uncertain tax positions that qualify for either recognition or disclosure in the financial statements.

The following entities are corporate subsidiaries of MHI that are not exempt from federal and state taxes:

- 104th Street MM, LLC
- 111th & Wentworth Apartments Corporation
- Affordable Housing Corporation
- Affordable Housing Initiatives
- Antioch II, LLC
- Belray Apartments Corporation
- Belvidere Place Corporation I, NFP
- Countryside Seniors LLC
- Danville Veterans Housing MM LLC
- Englewood Apartments, NFP
- Esperanza Crossing II, LLC
- Greenwich Park Apartments MM, LLC
- Harold Washington Apartments Corporation
- HWA-850 Eastwood GP Corporation NFP
- Impact Family Village Condominium Association
- Impact Family Village GP, LLC
- Kankakee Station Street Senior Housing MM LLC

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Malden Arms Corp. II, NFP
McDermott Place
MCHG Partners, Inc.
Mercy Affordable Housing, Inc.
Mercy Commercial California
Mercy Eden House, LLC
Mercy Galewood SLF, Inc.
Mercy Housing Georgia XI GP, LLC
Mercy Lithonia Park View, Inc.
Mercy Sterling NFP
MHL Keating MM, LLC
MHMP 12 Holly Park East and West GP
MHMP CO GP, Inc.
MHSE Adamsville Green Senior Partners, LLC
MHSE Arbors LLC
MHSE Mercy Park GP LLC
MHSE Savannah Gardens IV GP
MHSE Savannah Gardens Phase III GP, LLC
MHSE Savannah Gardens V GP
MPI Highland Place LLC
Near North Apartments Corp., NFP
New Sterling Park MM, LLC
Roseland Apartments Corporation
Savannah Rose of Sharon LLC
South Loop Apartments Corporation
Stapleton II Mercy, LLC
Winthrop Apartments Corporation
New Tacoma Condominium Association

The Company accounts for income taxes related to the taxable corporate subsidiaries under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined on the basis of the differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

The limited partnerships and limited liability companies in which the Company has a partnership interest have elected to be treated as a pass-through entity for income tax purposes and, as such, are not subject to income taxes. Rather, all items of taxable income, deductions and tax credits are passed through to and are reported by its owners on their respective income tax returns. The partnerships' federal tax statuses are based on their legal status as a partnership. Accordingly, the partnerships are not required to take any tax positions in order to qualify as a pass-through entity. The partnerships are required to file and do file tax returns with the Internal Revenue Service and other taxing authorities. Accordingly, these financial statements do not reflect a provision for income taxes and the partnerships have no other tax positions which must be considered for disclosure. Income tax returns filed by the entities are subject to examination by the Internal Revenue Service for a period of three years. While no income tax returns are currently being examined by the Internal Revenue Service, tax years since 2014 remain open.

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Fair value

The carrying amounts of the Company's cash and cash equivalents, receivables, payables and accrued expenses approximate fair value due to the short-term nature of these instruments. The fair value of the Company's long-term notes receivable and notes payable is assessed by management based on analysis of underlying investments and historical trends. It is impracticable to estimate the fair value of the Company's financial guarantees because there are no quoted market prices for transactions that are similar in nature. See Note 12.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in these financial statements and the accompanying notes. Actual results could differ from those estimates.

Derivative instruments and hedging activities

During the years ended December 31, 2017 and 2016, the Company had eight interest rate swap contracts outstanding that were used to mitigate the economic impact of changes in interest rates. The swaps are designated as cash flow hedges and are being used to offset the risk of changes in cash flows associated with benchmark interest payments on its variable rate mortgage loans. MHI reassesses the hedge on an ongoing basis to determine if it continues to be effective. Changes in the fair value of the interest rate swap contracts are recorded in the Consolidated Statement of Activities. As of December 31, 2017 and 2016, there was no hedge ineffectiveness. The swaps are reported in notes payable at fair value on the Consolidated Statements of Financial Position. See Note 12 for additional information on derivative instruments and hedging activities.

Reclassifications

Reclassifications have been made to the prior year balances to conform to the current year presentation.

Note 2 - Cash and investments

Cash and investments are categorized as unrestricted, which include board-designated amounts for a specific purpose, or restricted. Unrestricted cash held by the properties is generally not available for corporate purposes but is instead limited for use within the individual properties.

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

At December 31, 2017 and 2016, cash and investments were as follows:

	2017	2016
Unrestricted Cash - Properties	\$ 43,318,966	\$ 33,754,230
Unrestricted Cash/Investments - MLF	1,052,096	6,952,560
Unrestricted Cash - Board Designated	175,392	9,351,301
Unrestricted ST investments	2,150,000	-
Unrestricted LT investments	7,475,000	-
Unrestricted Cash/Investments - Corporate Operating Entities	12,381,293	11,631,056
Unrestricted Investments - Board Designated, Current	10,657,861	6,370,000
Unrestricted Investments - Board Designated, Non-Current	6,966,179	6,475,000
 Total Unrestricted and Designated Cash/Investments	 84,176,787	 74,534,147
 Restricted Cash - Tenant Security Deposits	 8,978,915	 7,811,575
Restricted Cash/Investments - Corporate Entities (including MLF)	18,583,084	18,785,949
Restricted Cash - Properties	27,223,951	23,823,735
Restricted Cash - LT Restricted Property Reserves, Board Designated	3,048,281	3,220,943
Restricted Cash - LT Restricted Property Reserves	188,677,528	140,022,710
 Total cash and investments	 \$ 330,688,546	 \$ 268,199,059

MHI invests in certificates of deposit which are carried at par value as they are held to maturity. Realized and unrealized gains and losses are recorded in the Consolidated Statements of Activities as unrestricted operating income or loss. Maturity dates range from January 2018 to September 2023. The approximate market value of the investments was \$85,043,427 and \$84,554,574 as of December 31, 2017 and 2016 as follows:

	2017	2016
Certificates of deposit	\$ 72,098,722	\$ 67,374,922
Money market accounts	12,935,327	17,165,850
Equities	9,378	13,802
 Total certificates of deposit, money market accounts, and equities	 \$ 85,043,427	 \$ 84,554,574

MHI recorded investment income of \$1,844,379 and \$1,932,548 during the years ended December 31, 2017 and 2016, respectively.

Note 3 - Pledges

Pledges and unconditional promises to give are recorded as revenue at estimated net realizable value based on historical trends. Pledges with payments due in future periods are discounted to present value and are reported as temporarily restricted revenue.

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

As of December 31, 2017, future pledge payments are as follows:

For the year ending December 31,	
2018	\$ 6,310,779
2019	10,645,833
2020	12,500,000
2021	-
2022	-
Total pledges receivable	<u>29,456,612</u>
Allowance and discount	<u>(721,451)</u>
Total pledges receivable, net of allowance and discount	<u><u>\$ 28,735,161</u></u>

The amount of pledges written off was \$1,304 and \$1,052 for the years ended December 31, 2017 and 2016, respectively.

Note 4 - Grants receivable

Grants receivable consist of amounts due under grant awards for which the revenue has been recognized either as unrestricted or temporarily restricted.

The amount due as of December 31, 2017 was \$469,079. Of this, \$231,442 relates to a Local Operating Subsidy Program Grant at Mission Creek Senior.

The amount due as of December 31, 2016 was \$767,177. Of this \$336,883 relates to two Department of Commerce and Economic Opportunity grants for Mercy Housing Lakefront that were received in February 2017.

Note 5 - Notes and interest receivable

Notes and interest receivable consists of notes due from various unaffiliated organizations and individuals. Interest rates on the notes receivable range from 0 percent to 7.5 percent. Maturity dates range from 2018 to 2041. At December 31, 2017 and 2016, substantially all of the notes and interest receivable are collateralized by real estate.

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

Total allowances at December 31, 2017 and 2016 consisted of the following:

	<u>MLF</u>	<u>MHSW</u>	<u>MHC</u>	<u>CCH</u>	<u>MPI</u>	<u>MHI</u>	<u>Total</u>
Balance at January 1, 2016	\$ 2,103,983	\$ 611,711	\$ 21,976	\$ 80,706	\$ 419,047	\$ 34,147	\$ 3,271,570
Increase/Decrease to allowance charged to:							
Provision for impaired assets	847,969	-	-	-	9,620	-	857,589
Loans charged off	(286,984)	(55,104)	-	-	-	-	(342,088)
Recoveries of loans charged off	(691,500)	-	-	-	-	-	(691,500)
Balance at December 31, 2016	<u>1,973,468</u>	<u>556,607</u>	<u>21,976</u>	<u>80,706</u>	<u>428,667</u>	<u>34,147</u>	<u>3,095,571</u>
Increase/Decrease to allowance charged to:							
Provision for impaired assets	54,269	-	-	-	-	-	54,269
Loans charged off	-	(55,104)	-	-	-	-	(55,104)
Recoveries of loans charged off	-	-	-	-	-	-	-
Balance at December 31, 2017	<u><u>\$ 2,027,737</u></u>	<u><u>\$ 501,503</u></u>	<u><u>\$ 21,976</u></u>	<u><u>\$ 80,706</u></u>	<u><u>\$ 428,667</u></u>	<u><u>\$ 34,147</u></u>	<u><u>\$ 3,094,736</u></u>

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

Note 6 - Property and equipment and assets held for sale

Property and equipment

Property and equipment at December 31, 2017 and 2016 consisted of the following:

	2017	2016
Land and land improvements	\$ 331,799,693	\$ 296,221,451
Buildings	2,674,827,427	2,342,976,884
Furniture and equipment	100,907,212	81,302,027
Predevelopment project costs	6,869,507	14,789,642
Construction in progress	190,534,665	192,264,042
Total property and equipment	3,304,938,504	2,927,554,046
Less accumulated depreciation	(920,203,453)	(786,475,934)
Property and equipment, net	\$ 2,384,735,051	\$ 2,141,078,112

For the years ended December 31, 2017 and 2016, depreciation expense was \$106,568,132 and \$90,402,629, respectively.

In 2016, the Company entered into an agreement with Wheaton Franciscan Services Inc. and Franciscan Ministries Inc. (collectively referred to as Franciscan Ministries) for the transfer of ownership of 33 entities comprising 3,601 apartment units (the FMI Transfer). The transfer of each asset is contingent upon the receipt of all required federal and state approvals. In addition, Franciscan Ministries agreed to provide MHI with a \$6,000,000 unrestricted cash gift, subject to the completion of pre-determined activities related to the above transfer. As of December 31, 2017 and 2016, MHI had received \$6,000,000 and \$4,500,000, respectively, of cash related to this unrestricted cash gift.

During 2017, the ownership of twenty-one entities was transferred to the Company. In conjunction with this transfer, property and equipment increased by \$80,046,584 and assumed property mortgages increased by \$76,113,814. During 2016, the ownership of nine entities was transferred to the Company. In conjunction with this transfer, property and equipment increased by \$29,502,468 and assumed property mortgages increased by \$12,807,926. See Note 18 for additional details.

Assets held for sale

In accordance with GAAP, the results of operations for properties classified as held for sale at the end of the current period are required to be classified as held for sale in the current and prior periods. Real estate assets held for sale are measured at the lower of the carrying amount or the fair value less costs to sell. Once an asset is classified as held for sale no further depreciation is recorded. At December 31, 2017, the Company does have any held for sale assets. At December 31, 2016, the Company considered the assets of Mercy Housing Southeast Idaho, Inc. (Hamilton Court) and Franciscan Homes IV, LTD as held for sale. Management believes that the fair value less costs to sell exceeds the carrying amount of these projects, therefore no loss has been charged to operations for 2016.

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

Following is summarized information regarding assets classified as held for sale:

	2017	2016
Total assets	\$ -	\$ 883,676
Total liabilities	-	5,028,675
Discontinued operations	-	(195,478)

Note 7 - Investments in unconsolidated entities

MHI and its subsidiaries hold investments in limited partnerships and other entities that are not consolidated. As of December 31, 2017 and 2016, MHI is invested in the following non-consolidating entities:

- Housing Partnership Equity Trust, LLC
- Housing Partnership Network, Inc.
- Mercy Loan Fund Sub-CDE 1, LLC
- Sunnydale Development Company LLC
- Galewood SLF Associates, LP
- Brentwood Green Valley Apartments, Inc.
- Truckee Riverview Housing Associates

The Company's investment in the projects shown above is as follows:

Investment in unconsolidated entities as of January 1, 2016	\$	905,093
Capital contributed		1,340,638
Other transfers		(159,805)
Equity in project earnings (loss)		72,831
Investment in unconsolidated entities as of December 31, 2016		2,158,757
Capital contributed		-
Distributions from cash flow		(26,537)
Equity in project earnings (loss)		(379,396)
Investment in unconsolidated entities as of December 31, 2017	\$	1,752,824

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

Note 8 - Notes payable

Notes payable as of December 31, 2017 and 2016 include both secured and unsecured borrowings and consist of the following:

	2017	2016
Unsecured Corporate Operating and Predevelopment Loans:		
US Bank - Revolving loan bearing interest at thirty day LIBOR plus 3.00% as of December 31, 2017 and thirday day LIBOR plus 2.70% as of December 31, 2016, payable monthly. The allowable borrowing under this line is \$7,500,000. The rate at December 31, 2017 and 2016 is 4.57% and 3.47%, respectively. Commitment expires December 31, 2020. ⁽¹⁾	\$ -	\$ -
California Bank & Trust - Revolving predevelopment line of credit agreement with ZB, N.A. dba California Bank & Trust. The agreement provides for borrowing up to \$8,000,000 at thirty day LIBOR plus 2.10%, payable monthly. The rate at December 31, 2017 is 3.66%. The maturity date of the line of credit is December 31, 2019. Initial proceeds from this loan were used to retire the remaining balance of the JP Morgan Chase loan.	5,190,334	-
JP Morgan Chase - Revolving predevelopment loan bearing interest at thirty day LIBOR plus 2.50% payable monthly. For the year ended December 31, 2016, credit line was available to fund predevelopment expenses up to a total of \$2,593,000. The rate as of December 31, 2016 was 3.13%. Commitment was paid and loan was closed in February 2017 and was replaced with the California Bank & Trust credit agreement.	-	2,593,000
Investor Loans to Mercy Loan Fund. Notes bearing interest from 0% to 5% and maturing through 2027. Available balances under these notes were \$13,560,482 and \$10,398,107 as of December 31, 2017 and 2016, respectively.	42,019,843	42,407,081
Other Notes Payable, bearing interest from 0% to 3% and maturing through October 2023. Available balances were \$1,500,000 as of December 31, 2017 and 2016.	17,559,418	18,597,257
Subtotal - Unsecured Corporate Operating and Predevelopment Loans	64,769,595	63,597,338

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

	2017	2016
Loans secured by the respective properties:		
Construction loans, bearing interest from 0% to 4.75%, with both fixed and variable interest rates, to be repaid in full or converted to permanent loans through 2019. Available balances are \$411,095,637 and \$255,001,583 as of December 31, 2017 and 2016, respectively.	462,818,058	375,822,282
Permanent loans, bearing interest from 0% to 9.25%, generally with principal and interest due monthly, to be repaid in full through 2076. All funds available under these notes are fully drawn as of December 31, 2017 and 2016, respectively.	1,173,939,240	1,029,245,691
Total debt	1,701,526,893	1,468,665,311
Less debt issuance costs, net attributable to construction loans	(11,777,764)	(6,572,514)
Less debt issuance costs, net attributable to permanent loans	(20,029,369)	(19,037,940)
Total	1,669,719,760	1,443,054,857
Less current portion	(203,119,864)	(115,854,857)
Non-current portion	\$ 1,466,599,896	\$ 1,327,200,000

(1) As of December 31, 2017 and 2016, the Company had standby Letters of Credit of \$250,000 and \$3,850,000, respectively, issued under the operating sub-limit. Effective March 31, 2017, the Company entered into an agreement with US Bank to modify and extend the revolving facility. Under the agreement, allowable borrowing was reduced to \$7,500,000 and the rate was increased to one-month LIBOR plus 3.00%. Effective December 31, 2017, the Company entered into an amendment and extended the commitment expiration date to December 31, 2020.

For the years ended December 31, 2017 and 2016, \$38,102,407 and \$30,057,568 of interest expense was incurred and is included in interest and fees on the consolidated statement of activities.

Future minimum principal maturities of notes payable are as follows:

For the year ending December 31, 2018	\$ 203,119,864
2019	58,054,492
2020	31,565,632
2021	28,626,939
2022	48,326,908
Thereafter	1,331,833,058
Total maturities	\$ 1,701,526,893

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Included in current maturities as of December 31, 2017 and 2016 is construction debt totaling \$189,114,548 and \$88,395,456, respectively, that has committed sources of repayment including proceeds from permanent debt and/or low income housing tax credit equity.

Note 9 - Lease commitments

The Company leases land, office space and equipment under non-cancelable operating lease agreements that expire through 2118. Future minimum lease payments are as follows:

	Office and Leases	Property Leases	Total Leases
For the year ending December 31,			
2018	\$ 1,691,990	\$ 617,643	\$ 2,309,633
2019	867,631	622,613	1,490,244
2020	841,735	638,871	1,480,606
2021	684,872	717,359	1,402,231
2022	526,416	718,692	1,245,108
Thereafter	3,432,712	30,226,295	33,659,007
Total future minimum lease payments	<u>\$ 8,045,356</u>	<u>\$ 33,541,473</u>	<u>\$ 41,586,829</u>

Lease expense for operating leases was approximately \$2,045,274 and \$2,917,594 for the years ended December 31, 2017 and 2016, respectively, and is included in facilities expense. Ground leases at eleven and nine projects, respectively, have been prepaid and are amortizing over the related lives through 2115. Prepaid lease expense as of December 31, 2017 and 2016 was \$16,157,780 and \$15,207,882, respectively, and is included in prepaid expenses and other assets, net on the statements of financial position.

Note 10 - Related party transactions

The Company has significant related party transactions with affiliates. It provides a considerable amount of funding in connection with the development of projects. It also provides development services, fund raising assistance, property management, resident services and administrative services. In certain cases, the Company pays operating expenses on behalf of and provides management services to affiliates. These costs are reimbursed to the Company on a monthly basis. In certain instances, such as when individual properties may be experiencing cash flow difficulties, repayment may be delayed, providing the property with an informal source of funds.

Notes and interest receivable, affiliates

The amounts loaned by the Company primarily represent predevelopment and development loans to consolidated affiliates. These loans are generally collateralized with real estate of the funded property. Many of these loans do not require payments until after the scheduled maturity of the related first mortgages. The loans with subsidiaries are eliminated in consolidation. Interest payments generally are subject to available cash flow. In some cases, loans are required to be repaid earlier. This usually occurs in situations where the underlying source of the loan is required to be repaid earlier as well.

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Development fee income

Generally, all development fee income is earned in connection with affiliated entities. Development fees which are paid from operating cash flows from affiliated entities are eliminated in consolidation. Many of these fees are required to be deferred and paid from cash flows of the related property.

Other fee income

Substantially all of the property management, data processing, and bookkeeping fee income earned by MHM is related to services provided to consolidated affiliates. In addition, the general partners earn partnership management fees for oversight of the properties. Property management fees, data processing fees, bookkeeping fees, and partnership management fees associated with controlled entities are eliminated in consolidation. Such fee income is included in service fees. The elimination of these fees is allocated to the controlling interest.

Note 11 - Guarantees

MHI has entered into various agreements with certain limited partnerships or their affiliated general partners whereby the Company guarantees to loan funds to the partnerships in the event that the partnerships incur operating deficits as defined in the respective partnership agreements or fail to meet their current financial obligations. These agreements expire at various times from 2018 through the terms of the underlying partnership or debt agreements. Loans made pursuant to these guarantees are generally interest-free and unsecured. The maximum potential amount of future payments under these guarantees is equal to the amount guaranteed to the partnerships under the tax indemnification agreements discussed below.

MHI has entered into various agreements with certain limited partnerships and limited liability companies or their affiliated general partners or members whereby MHI offers tax indemnification in the event of low-income housing tax credit recapture. MHI's potential liability under these agreements is dependent upon IRS audits and final letters of determination of the limited partnerships' qualified basis in tax credit properties. Similarly, MHI has entered into agreements with state and local governments who have provided loans to certain limited partnerships for the development of affordable housing whereby MHI has guaranteed any recapture of the loans resulting from non-compliance with affordable housing requirements. Management is not aware of any known liability for tax credit or loan recapture. The maximum potential liability under these guarantees as of December 31, 2017 is \$991,568,452 relating to 110 limited partnerships. MHI has not been required to fund any amounts under these guarantees and has not recorded any liabilities associated with these guarantees.

MHI provides guarantees to certain lenders who provide financing for the acquisition and construction of low-income housing projects developed by certain limited partnerships. Under these guarantees, MHI provides assurance of project completion and provides repayment guarantees for the associated loans. The guarantees terminate when construction is complete and permanent financing repays the construction loans. As of December 31, 2017, MHI had provided guarantees on 29 acquisition and construction loans of \$619,037,320 of which \$324,953,789 was outstanding. As of December 31, 2016, MHI had provided guarantees on 27 acquisition and construction loans of \$496,671,198 of which \$241,807,657 was outstanding.

The Company has also issued other guarantees in order to secure financing on various projects. As of December 31, 2017, \$6,305,247 was outstanding. MHI has not been required to fund any amounts under these guarantees.

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

The Company also guarantees certain surety bonds covering construction and utilities deposits. As of December 31, 2017, \$2,834,973 was outstanding.

Note 12 - Fair value

The accounting standard for fair value measurement and disclosures defines fair value, establishes a framework for measuring fair value, and provides for expanded disclosure about fair value measurements. Fair value is defined by the accounting standard for fair value measurement and disclosures as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. It also establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three levels. The following summarizes the three levels of inputs and hierarchy of fair value the Company uses when measuring fair value:

- Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access;
- Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as interest rates and yield curves that are observable at commonly quoted intervals; and
- Level 3 inputs are unobservable inputs for the asset or liability that are typically based on an entity's own assumptions as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the fair value measurement will fall within the lowest level input that is significant to the fair value measurement in its entirety.

The net unrealized gain/(loss) on the interest rate swap contracts during 2017 and 2016 of \$509,400 and \$745,532 respectively, is classified within level 2 of the fair value hierarchy. The unrealized gain/(loss) on certificates of deposit during 2017 and 2016 of \$(341,278) and \$134,922, respectively, is classified within level 1 of the fair value hierarchy. No other assets or liabilities are measured at fair value as of December 31, 2017 and 2016.

The following table presents the financial assets and liabilities that the Company measured at fair value on a recurring basis as of December 31, 2017:

	Level 1	Level 2	Level 3	Total
Net interest rate swap-asset/(liability)	\$ -	\$ (2,630,178)	\$ -	\$ (2,630,178)
Certificates of deposit	72,098,722	-	-	72,098,722
Money market accounts	12,935,327	-	-	12,935,327
Equities	9,378	-	-	9,378

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

The following table presents the financial assets and liabilities that the Company measured at fair value on a recurring basis as of December 31, 2016:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Net interest rate swap-asset/(liability)	\$ -	\$ (3,139,578)	\$ -	\$ (3,139,578)
Certificates of deposit	67,374,922	-	-	67,374,922
Money market accounts	17,165,850	-	-	17,165,850
Equities	13,802	-	-	13,802

On a recurring basis, the Company measures its interest rate swap contracts at their estimated fair value. In determining the fair value of the interest rate swap contracts, the Company uses the present value of expected cash flows based on market observable interest rate yield curve commensurate with the term of the instrument. In determining the fair value of the certificates of deposit, the Company uses quoted market prices and other relevant information generated by market transactions. See "Derivative Instruments and Hedging Activities" in Note 1 for additional information regarding the swaps.

Note 13 - Employee retirement plan

The Company has a defined contribution employee 403(b) retirement plan covering eligible employees. Generally, employee contributions to the plan consist of a percentage based on eligible employees' compensation. Through December 31, 2017, MHI matched dollar for dollar an employee's contribution up to 2 percent commencing on the employee's second year of service. As of January 1, 2018 MHI matches dollar for dollar an employee's contribution up to 4 percent commencing on the employee's second year of service. Additionally, at the completion of three and seven years of service, MHI makes additional contributions equal to 1 percent and 1 percent, respectively, of the employee's gross earnings regardless of whether or not the employee participates in the plan. Contribution costs of property site staff are passed through to the managed projects. The Company contributed \$1,591,249 and \$1,385,823 for the years ended December 31, 2017 and 2016, respectively.

Note 14 - Insurance

The Company uses a combination of insurance and risk retention to manage a number of risks, including, but not limited to, general liability, property and the Company's obligation for employee-related health care benefits. Liabilities relating to these claims associated with these risks are estimated by considering historical claims experience, including frequency, severity, demographic factors, and other actuarial assumptions. In estimating the liability for such claims, the Company periodically analyzes historical trends, including loss development, and applies appropriate loss development factors to the incurred costs associated with the claims. Additionally, the Company retains some of the risk related to workers compensation.

Aggregated reserves relating to retained risk were \$5,925,541 and \$3,791,664 as of December 31, 2017 and 2016, respectively. As of December 31, 2017 and 2016, \$5,229,542 and \$3,075,664, respectively are outstanding and included in accounts payable and accrued expenses. As of December 31, 2017 and 2016, \$1,411,701 and \$276,507, respectively, of these aggregated reserves and accounts payable are payable to affiliated entities. The increase primarily relates to aged claims within the Company's workers compensation program.

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

The Company maintains a restricted cash balance to pay future claims related to all areas of retained risk. As of December 31, 2017 and 2016, the Company held \$8,584,652 and \$6,257,204, respectively, in restricted cash to pay future insurance claims.

Note 15 - Special event

MHI hosted a 35th anniversary celebration in October 2017 to promote the Company's activities, recognize its supporters and raise funds. All contributions and associated expenses relating to the event have been shown in the consolidated statements of activities. Contributions of \$1,903,817 during 2017 are included in philanthropy. Expenses related to the event of \$152,135 and are included in administrative expenses.

Note 16 - Commitments and contingencies

Property management agreements

MHM, a subsidiary corporation of MHI, serves under contract as the management agent for several affiliated corporations and partnerships of MHI. In addition, MHM provides management services to unaffiliated affordable housing projects at competitive rates.

Grant and property use restrictions

Many of the properties owned and operated by MHI and its subsidiaries were developed using monies provided by grants and restrictive, low interest rate loans. The terms of these loans restrict the use of the property and generally require it be rented to qualified low-income tenants for the period of the grant or related loan term. MHI and its subsidiaries also receive grants with restrictions other than property use. Failure to comply with the terms of the grant or the loans would result in a requirement to repay a portion or all of the proceeds received.

Rental assistance contracts

Many of the properties owned by or affiliated with the Company have entered into rental assistance contracts with HUD. These contracts have various terms and require the affiliate projects to operate as low-income housing properties and to obtain HUD approval of all rent increases.

Construction contracts

The Company has entered into construction contracts with various third party contractors to construct and rehabilitate projects in the original amount of \$654,142,309 and \$429,657,688 as of December 31, 2017 and 2016, respectively. During 2017 and 2016, change orders totaled \$38,828,573 and \$24,969,461, respectively. As of December 31, 2017 and 2016, \$39,232,026 and \$40,380,034 remains payable, respectively, which includes retainage payable of \$15,769,158 and \$18,081,243, respectively, and is included in accounts payable and accrued expenses.

Surplus cash and residual receipts

Many of the properties owned by MHI and its subsidiaries are subject to HUD regulatory agreements, which restrict the use of the property and limit the use of project cash. Under these regulatory agreements, many of the subsidiaries are precluded from receiving any distributions of operating cash. A surplus cash calculation is required to be prepared annually and any surplus cash, as defined, is required to be deposited in a residual receipts account controlled by HUD.

Letters of credit

In connection with certain project developments, MHI is contingently liable on several letters of credit, expiring on various dates (see Note 8).

Mercy Housing, Inc.

Notes to Consolidated Financial Statements December 31, 2017 and 2016

Litigation

MHI and its subsidiaries are named in claims and legal actions in the normal course of its business. Based upon the opinion of counsel, management believes the outcome of such matters will not have a material adverse effect on the financial position or changes in the net assets of the Company.

Other

As general partners in various partnerships, the Company and other consolidated entities may be subject to other liabilities, should an affected partnership's assets become insufficient to meet its obligations.

Note 17 - Risks and uncertainties

The following important factors could adversely impact the Company. These factors could cause actual results to differ materially from any forward-looking and other statements that were made in periodic reports, news releases, annual reports and other written reports or communication.

MHI obtains and employs substantial capital and operating subsidies from various federal, state and local governmental agencies, including the federal departments of HUD, USDA and the Veterans Administration. The new administration and congressional leadership have expressed an interest in reducing spending for these federal agencies. Legislative or regulatory changes in the operations or funding of federal, state and local programs could have a material impact on future results. In addition, MHI obtains funding from private equity groups including national, state and local banks and financial institutions. This funding is also based on a number of government programs, including the Low Income Housing Tax Credit (LIHTC) and the Community Reinvestment Act (CRA). Legislative changes (including changes to Federal Income Tax laws) could impact the level of funding received from these groups and could have a material impact on future results. Management continues to employ diversification strategies to offset any concentration with any one specific lending institution or government agency. Changes in the current economic and credit market (e.g., a rise in inflation and/or interest rates) environment could increase the cost of capital or limit the ability to access capital. Failure to comply with covenants and conditions imposed by the agreements governing the Company's indebtedness could restrict future borrowing or cause debt to become immediately due and payable. Failure to renew existing loans could impact working capital, capital expenditures, acquisitions, debt service or other business needs.

The Company and its subsidiaries invested assets consisting of Bank Certificates of Deposits (CDs) and money market funds which invest in CDs, commercial paper, US Treasury bills, US Agency bonds, notes, and repurchase agreements. Investment policy and guidelines are established by the Finance Committee of the board of trustees. These investments are exposed to various risks, such as interest rate, market and credit. Due to the level of uncertainty related to changes in interest rates, market volatility and credit risks, it is at least reasonably possible that changes in these risks could materially affect the fair value of investments reported in the consolidated statements of financial position as of December 31, 2017. The investment policy and guidelines consider liquidity and risk for each entity and each pool of assets and attempt to diversify asset classes to mitigate risks over the applicable time horizons.

Increased development costs, supply and labor shortages, entitlement delays, uninsured losses from natural disasters and other factors may negatively affect the future results of the Company. Property operations and development is subject to warranty and liability claims that can be significant.

Mercy Housing, Inc.

**Notes to Consolidated Financial Statements
December 31, 2017 and 2016**

Note 18 - Subsequent events

Events that occur after the statement of financial position date but before the consolidated financial statements were available to be issued must be evaluated for recognition or disclosure. The effects of subsequent events that provide evidence about conditions that existed at the statement of financial position date are recognized in the accompanying consolidated financial statements. Subsequent events which provide evidence about conditions that existed after the statement of financial position date require disclosure in the accompanying notes. Management evaluated the activity of the Company through April 19, 2018 (the date the consolidated financial statements were available to be issued) and concluded that the following subsequent events have occurred that would require disclosure in the notes to the consolidated financial statements.

In connection with the FMI Transfer discussed in Note 6, the Company expects the transfer of ownership of three additional entities to occur in 2018.

On February 28, 2018, the Company entered into a 13-year lease agreement with LBA Realty Fund 11-WBP IV, LLC for approximately 36,341 square feet of office space in Denver, Colorado. The initial term of the lease is estimated to commence on January 1, 2019. Estimated lease payments are approximately \$1,000,000 annually, which includes a pro rata share of certain real property taxes, operating expenses and common area maintenance expenses. Pursuant to the lease, within 12 months of the expiration of the initial term, the Company has the option to extend the lease for one additional five-year term.

Supplementary Information

Mercy Housing, Inc.

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Mercy Housing, Inc.

**Schedule of Expenditures of Federal Awards
Year Ended December 31, 2017**

Grantor and Program Title	Federal CFDA Number	Pass-Through Identifying Number	Direct Federal Expenditures	Pass Through Expenditures
<u>United States Department of Agriculture (USDA)</u>				
Direct				
Intermediary Relending Program	10.767		\$ 790,336	\$ -
Rural Rental Assistance Payments	10.427		2,546,776	
Rural Rental Housing Loans	10.415		24,168,976	
Supplemental Nutrition Assistance Program	10.551		1,278	
			<u>27,507,366</u>	<u>-</u>
<u>United States Department of Energy</u>				
Pass Through				
King County Weatherization	81.042			750,000
			<u>-</u>	<u>750,000</u>
<u>United States Department of Health and Human Services</u>				
Pass Through				
ACA – State Innovation Models: Funding for Model Design and Model Testing Assistance	93.624	002810005		11,332
Amador-Toulumne Community Action Agency / CDBG Technical Assistance Program	93.757	2016-00000179		12,000
Substance Abuse & Mental Health Services Projects of Regional & National Significance	93.243	00-HM-430 / 00-HM-430-731		376,915
Teen Afterschool Prevention (TAP)	93.558			52,732
			<u>-</u>	<u>452,979</u>
<u>United States Department of Housing & Urban Development (HUD)</u>				
Direct				
HUD Community Development Block Grant Entitlement Grant	14.218	95-F765446-00	26,806	
HUD Community Development Block Grant Entitlement Grant	14.218		3,501	
HOME Investment Partnership Program	14.239		1,196,467	
Continuum of Care Program	14.267		150,869	
Continuum of Care Program	14.267	SC-103530	10,400	
Grant Capital Advance Section 202	14.157		185,132,494	
Grant Capital Advance Section 202	14.195		21,113	
Grant Capital Advance Section 202	14.195		19,187,718	
Grant Capital Advance Section 202	14.197		7,700,000	
Grant Capital Advance Section 202	14.258		1,400,000	
HOME Investment Partnership Program	14.239		953,717	
Housing Assistance Payments (HAP) Section 8	14.195		1,688,454	
Housing Assistance Payments (HAP) Section 8	14.195		1,259,480	
Housing Assistance Payments (HAP) Section 8	14.195		18,908,512	
Interest Reduction Payments Section 236	14.103		85,374	
Mortgage Insurance for the Purchase Section 223 (a) (7)	14.155		84,060,974	
Multifamily Services Coordinator Grant	14.191		1,513,531	
Preservation of Affordable Housing	14.187		11,414,014	
Project Rental Assistance Contract (PRAC) Section 202	14.157		10,194,693	
Project Rental Assistance Contract (PRAC) Section 811	14.181		693,851	
Supportive Housing for Persons with Disabilities-Capital Advance Section 811	14.181		8,242,823	
Supportive Housing for the Elderly Direct Loan Section 202	14.157		6,479,282	
Supportive Housing Program-Capital Advance	14.157		5,449,100	
Supportive Housing Program-Capital Advance	14.235		7,551,766	
Pass Through				
ACA – State Innovation Models: Funding for Model Design and Model Testing Assistance	14.218			16,433
Amador-Toulumne Community Action Agency / CDBG Technical Assistance Program	14.227			63,932
Amador-Toulumne Community Action Agency / CDBG Technical Assistance Program	14.239	00-HM-430 / 00-HM-430-731		300,000
Califotnia/TCAP	14.258			24,705,821
Boise Housing Authority / HOME Investment Partnership Program / HAP Section 8	14.195			15,865
California Housing Finance Agency (CHFA) / County of Alameda Housing and Community Development / HOME Investment Partnership Program	14.239			2,912,230
California Housing Finance Agency (CHFA) / Risk Sharing Loans	14.188	92-012-N		1,956,438
California Housing Finance Agency (CHFA) / Risk Sharing Loans	14.188	97-033N; 97022-N		1,716,312
California State Department of Housing and Community Development / HOME Investment Partnership Program	14.239	02-HOME-0633		1,371,859
California State Department of Housing and Community Development / HOME Investment Partnership Program	14.239			4,415,279
Chicago Housing Authority / HAP Section 8	14.195			693,115
City and County of San Francisco / HOME Investment Partnership Program	14.239			3,491,951
City and County of Denver / CDBG State Program	14.228			275,000
City and County of Denver / HOME Investment Partnership Program	14.239			277,240
City and County of San Francisco / CDBG State Program	14.218	95-F765446-00		9,543,469
City and County of San Francisco / CDBG State Program	14.228			4,142,575
City and County of San Francisco / HOME Program Loan Agreement	14.239			8,868,942

Mercy Housing, Inc.

Schedule of Expenditures of Federal Awards Year Ended December 31, 2017

Grantor and Program Title	Federal CFDA Number	Pass-Through Identifying Number	Direct Federal Expenditures	Pass Through Expenditures
United States Department of Housing & Urban Development (HUD)				
City and County of San Francisco / Mayor's Office of Housing / CDBG State Program	14.228	95-F765446-00		3,715,507
City and County of San Francisco / Mayor's Office of Housing / HAP Program Section 8	14.195			1,276,974
City and County of San Francisco / Mayor's Office of Housing / HOME Investment Partnership Program	14.239			650,351
City and County of San Francisco Housing Opportunities for Persons with Aids	14.241			800,000
City and County of San Francisco/HOME Investment Partnership Program	14.239			15,673,772
City of Bakersfield / HOME Investment Partnership Program	14.239	98-284		230,000
City of Bellingham / HOME Investment Partnership Program / HAP Section 8	14.239	00-HM-430 / 00-HM-430-731		7,080
City of Bellingham / HOME Investment Partnership Program / HAP Section 8	14.239			200,450
City of Chicago / Chicago Department of Housing / CDBG Entitlement Grant	14.218			105,558
City of Chicago / Department of Housing / CDBG Multi-family Loan State Program	14.228			2,320
City of Chicago / Department of Housing / CDBG State Program / HAP Section 8	14.195			250,615
City of Chicago / Department of Housing / CDBG State Program Entitlement / HAP Section 8	14.195			390,967
City of Chicago / Department of Housing / HOME Investment Partnership Program	14.239			17,895,190
City of Chicago / Department of Housing / HOME Investment Partnership Program / HAP Section 8	14.195			1,027,173
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	II0102L5T101407		253,254
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	IL0102L5T101508		8,805
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	IL0131L5T101407		103,316
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	IL0131L5T101508		91,114
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	IL0166L5T101407		53,643
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	IL0166L5T101508		32,302
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	IL0188L5T101508		134,331
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	IL0206L5T101306		388,128
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	WI0056L5I011508		141,519
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	WI0113L5I011403		16,680
City of Chicago / Department of Human Services (DHS) / Chicago Housing for Health Partnership / Office of Community Planning and Development / Supportive Housing Program	14.235	WI0113L5I011504		17,161
City of Chicago / Department of Human Services (DHS) / HUD Shelter Plus Care	14.238	24443/PO 24443-4		610,617
City of Chicago / Department of Human Services (DHS) / HUD Shelter Plus Care	14.238	24443/PO 24443-5		126,462
City of Chicago / Department of Human Services (DHS) / HUD Shelter Plus Care	14.238	24444/PO 24444-4		153,663
City of Chicago / Department of Human Services (DHS) / HUD Shelter Plus Care	14.238	24444/PO 24444-5		220,927
City of Chicago / Department of Human Services (DHS) / HUD Shelter Plus Care	14.238	24445/PO 24445-4		123,263
City of Chicago / Department of Human Services (DHS) / HUD Shelter Plus Care	14.238	24445/PO 24445-5		63,800
City of Chicago, Illinois / Department of Housing / CDBG Multi-family Loan State Program / HAP Section 8	14.195			292,498
City of Chicago, Illinois / Department of Housing / CDBG State Program / SNAP Program "Strategic Neighborhood Action Program"	14.228			3,469,591
City of Chicago/ AIDS Foundation of Chicago / Substance Abuse and Mental Health Services Projects of Regional and National Significance	14.235	3LF018		3,117
City of Chicago/ AIDS Foundation of Chicago / Substance Abuse and Mental Health Services Projects of Regional and National Significance	14.235	3LF049		127,321
City of Chicago/Dept of Community Development/HOME	14.239			6,211,488
City of Cincinnati / HOME Investment Partnership Program	14.239	65X0131; 65X015		453,863
City of Cincinnati / HOME Investment Partnership Program	14.239			81,239
City of Council Bluffs / HOME Investment Partnership Program / HAP Section 8	14.195			84,828
City of Daly / HOME Investment Partnership Program	14.239			491,643
City of Daly / HOME Investment Partnership Program / HAP Section 8	14.195			92,615
City of Daly City / CDBG State Loan Program	14.228			536,202
City of Dubuque, Iowa / CDBG State Program	14.228	258-93		528,701
City of Eagle, Idaho County / Idaho Community Development Block Grant	14.228			466,101
City of Encinitas / CDBG State Program	14.228			614,000
City of Folsom / CDBG State Program	14.228			92,940
City of Glendale / HOME Investment Partnership Program	14.239			149,240
City of Greenville (Community Development Department) / Forgivable Loan	14.235			262,406
City of Los Angeles / CDBG State Program	14.228	95-2167; C-93360		956,048
City of Los Angeles / CDBG State Programs and HOME Investment Partnership Program / HAP Section 8	14.195			9,958

Mercy Housing, Inc.

Schedule of Expenditures of Federal Awards Year Ended December 31, 2017

Grantor and Program Title	Federal CFDA Number	Pass-Through Identifying Number	Direct Federal Expenditures	Pass Through Expenditures
<u>United States Department of Housing & Urban Development (HUD)</u>				
City of Los Angeles / HOME Investment Partnership Program	14.239	95.1452; C92700		662,254
City of Los Angeles/HOME Investment Partnership Program	14.239			518,300
City of Santa Cruz / CDBG Revolving Loan Fund	14.228			340,287
City of Santa Cruz / CDBG State Program	14.228	CA027HG701		221,100
City of Santa Cruz / CDBG State Program	14.228			153,197
City of Santa Cruz / HOME Investment Partnership Program	14.239	M-92-SG-19-0100-400-27-04		600,000
City of Santa Cruz / HOME Investment Partnership Program	14.239			2,393,637
City of Seattle/HOME Investment Program	14.239			2,830,921
City of South Lake Tahoe / HOME Investment Partnership Program	14.239	96-HOME-0222; 97-HOME-0280		2,946,393
City of Stockton / HOME Investment Partnership Program	14.239			5,162,691
City of Yolo/CDBG	14.228			792,076
City of Yolo/HOME	14.239			3,320,456
City of Yuba City / HOME Investment Partnership Program	14.239	98-HOME-0341		1,100,446
City of Yuba City / HOME Investment Partnership Program / HAP Section 8	14.195			173,109
Colorado Division of Housing (CDOH) / HOME Investment Partnership Program	14.239			579,356
Colorado Division of Housing (CDOH) / HOME Investment Partnership Program / HAP Section 8	14.195			482,556
Community Development Block Grant / State's Program	14.228			200,000
Community Development Commission of the City of Oxnard / CDBG Section 108 Loan Guarantee	14.248	96-164218		720,846
Community Housing Services Agency / CDBG State Program	14.228			452,458
Community Housing Services Agency / HOME Investment Partnership Program	14.239			243,200
Community Housing Services Agency/CDBG	14.228			1,494,980
County of Alameda / CDBG Section 108 Loan Guarantee	14.248	00-HM-430 / 00-HM-430-731		153,628
County of Alameda / CDBG State Program	14.228			462,097
County of Alameda / HOME Investment Partnership Program	14.239			798,781
County of Contra Costa / CDBG Section 108 Loan Guarantee	14.241			680,000
County of Contra Costa / CDBG Section 108 Loan Guarantee	14.248			1,397,174
County of Contra Costa / HOME Investment Partnership Program	14.239	07-52-HM		1,872,634
County of Contra Costa / HOME Investment Partnership Program	14.239			2,597,278
County of Contra Costa / Housing Opportunities for Persons with AIDS HOPWA Grant / HAP Section 8	14.195			254,764
County of Eldorado / HOME Investment Partnership Program	14.239	02-HOME-0613		3,000,000
County of Kern / HOME Investment Partnership Program	14.239	069-99		400,000
County of Marin / HOME Investment Partnership Program	14.239			889,450
County of Orange / HOME Investment Partnership Program	14.239			822,409
County of Riverside / HOME Investment Partnership Program	14.239	File No: 4HM-02-003		1,038,000
County of Sacramento / Sacramento County Department of Human Assistance / Housing Opportunities for Persons with AIDS / HOPWA Loan	14.241			1,065,000
County of San Diego Department of Housing and Community Development / Housing Opportunities for Persons with AIDS HOPWA Grant	14.241			1,566,621
County of San Mateo / CDBG State Loan Program	14.228			176,797
County of San Mateo / HOME Investment Partnership Program	14.239			362,997
County of San Mateo / Section 108 Loan Guarantee	14.248			1,080,307
County of San Mateo/HOME Investment Partnership Program	14.239			2,245,830
Davis County Housing Authority / CDBG States Program	14.195			573,583
Davis County Housing Authority / CDBG States Program	14.228			334,672
Department of Housing and Community Development of the State of California / HOME Grant CHDO	14.239	96-HOME-0223		1,329,489
Georgia Housing and Finance Authority / HOME Investment Partnership Program	14.239			2,455,098
Georgia Housing and Finance Authority/HOME Investment Program	14.239			6,923,395
El Monte Housing Authority	14.239			1,272,155
HOME Investment Partnership Program	14.239	00-HM-430 / 00-HM-430-731		3,433,286
HOME Investment Partnership Program	14.239	00-HM-430 / 00-HM-430-731		442,869
HOME Investment Partnership Program	14.239	11-HOME6952		2,993,170
HOME Investment Partnership Program	14.239			9,636
HOME Investment Partnership Program	14.239			913,900
HOME Investment Partnership Program	14.239			1,161,690
HOME Investment Partnership Program	14.239			1,835,425
HOME Investment Partnership Program	14.239			1,404,000
HOME Investment Partnership Program	14.239			1,683,190
HOME Investment Partnership Program	14.239			318,116
Housing Authority of the City of Atlanta, Georgia / Hope VI	14.866			5,917,142
Housing Authority of the City of Los Angeles, California / HOME Investment Partnership Program	14.239			6,729,758
Housing Authority of the County of Dekalb Georgia/HOME Investment Partnership Program	14.239			870,158
Housing Authority of the County of Santa Cruz / HAP / Section 8	14.195			179,611
Idaho Housing Agency / HOME Investment Partnership Program	14.239			443,416
Idaho Housing and Finance Association / HOME Investments Partnership Program	14.239			1,112,488
Illinois Housing Development Authority / Section 8 New Construction and Substantial Rehabilitation	14.182			882,259
Illinois Housing Development Authority / Section 8 New Construction and Substantial Rehabilitation	14.195			904,438
Illinois Housing Development Authority / HOME Investment Partnership Program	14.239			6,111,279
Illinois Housing Development Authority / HOME Investment Partnership Program / Multifamily Program / HAP Section 8	14.195			354,627
Iowa Department of Economic Development / HOME Investment Partnership Program	14.239	M-92-SG-19-0100-400-27-04		332,542
King County Dept of Community and Human Services / HOME Investment Program	14.239			1,677,233

Mercy Housing, Inc.

Schedule of Expenditures of Federal Awards Year Ended December 31, 2017

Grantor and Program Title	Federal CFDA Number	Pass-Through Identifying Number	Direct Federal Expenditures	Pass Through Expenditures
<u>United States Department of Housing & Urban Development (HUD)</u>				
None	14.218	34145/PO 31453		240,324
None	14.218			20,933
None	14.228			70,191
None	14.239			7,080
Enterprise Community Partners, Inc. HUD 202 Supportive Housing	14.252			28,284
Omaha Housing Authority of the City of Omaha / Housing Assistance payment (HAP) Section 8	14.195			477,052
Omaha Housing Authority of the City of Omaha / Multi-family Assisted Housing Reform and Affordability Act	14.197	103-11014-PUR/CON-EC-FAM		4,512,584
Pierce County / CDBG State Program	14.228			75,000
Pierce County Community Development / HOME Investment Partnership Program	14.239			54,461
Redevelopment Agency / City and County of San Francisco / CDBG State Program	14.228			357,660
Redevelopment Agency of Sacramento/HOME Investment Program	14.239			8,200,000
Redevelopment Agency of the City and County of San Francisco / Housing Opportunities for Persons with AIDS HOPWA Grant	14.241			5,226,422
Redevelopment Agency of the City and County of San Francisco / Housing Assistance Payment (HAP) Section 8	14.195			1,501,075
Sacramento Housing and Redevelopment Agency / HOME Investment Partnership Program	14.239			10,460,298
Sacramento Housing and Redevelopment Agency / HOME Investment Partnership Program / HAP Section 8	14.195			32,147
Sacramento Housing and Redevelopment Agency / Rural California Housing Corporation / HOME Investment Partnership Program	14.239			852,910
San Francisco Redevelopment Agency / HOPWA Capital Loan Agreement	14.241			618,054
San Francisco Redevelopment Agency / HOPWA Capital Loan Agreement / HAP Section 8	14.195			1,182,672
Section 4 Capacity Building for Community Development and Affordable Housing	14.252			102,571
Snohomish County / HOME Investment Partnership Program	14.218	B-16-UC-53-0003		6,910
Snohomish County / HOME Investment Partnership Program	14.239			2,295,131
State of Arizona / Department of Commerce / HOME Investment Partnership Program	14.239			150,000
State of California / Department of Housing & Community Development / Housing Opportunities for Persons with AIDS HOPWA Grant	14.241	91-HRL-PH-002		837,774
State of Ohio / Division of Community Development / City of Cincinnati / HOME Ownership Program	14.239			252,000
State of Washington / Department of Community, Trade and Economic Development / HOME Investment Partnership Program	14.239			1,358,099
State of Washington/ Department of Commerce/ Housing Division/ HOME Contracts	14.239			1,532,983
State of Washington Department of Community Trade and Economic	14.157	127-EE038		404,636
Tacoma Community Development Authority / CDBG State Program	14.195			241,484
Tacoma Community Development Authority / CDBG State Program	14.228			457,500
Tacoma Community Redevelopment Agency / HOME Investment Partnership Program	14.239			565,000
Tacoma Community Redevelopment Authority / CDBG Loan Agreement	14.228			600,000
Tacoma Community Redevelopment Authority / CDBG State Program	14.228			400,000
Tacoma Community Redevelopment Authority / CDBG State Program / HAP Section 8	14.195			154,795
The Washington State Department of Community, Trade and Economic Development (CTED) / HOME Investment Partnership Program	14.195			161,124
The Washington State Department of Community, Trade and Economic Development (CTED) / HOME Investment Partnership Program	14.239			833,291
Wisconsin Housing and Economic Development Authority / Tax Credit Assistance Program	14.258	468-0323-100-8 & 468-0210-1		1,825,586
Wisconsin Housing and Economic Development Authority / Tax Credit Assistance Program/ HAP Section 8	14.195			547,899
Subtotal HUD			<u>373,324,939</u>	<u>269,949,787</u>
<u>United States Department of Treasury</u>				
Direct				
CDFI Program	21.02		2,750,000	
Subtotal United States Department of Treasury			<u>2,750,000</u>	<u>-</u>
Total Expenditures of Direct and Indirect Federal Awards			<u>\$ 403,582,305</u>	<u>\$ 271,152,766</u>
Total Expenditures of Federal Awards				<u>\$ 674,735,071</u>

Mercy Housing, Inc.

**Schedule of Expenditures of Federal Awards
Year Ended December 31, 2017**

Summary by CFDA Number:		Federal Expenditures
USDA Rural Rental Housing Loans	10.415	\$ 24,168,976
USDA Rural Rental Assistance Payments	10.427	2,546,776
Supplemental Nutrition Assistance Program	10.551	1,278
USDA Intermediary Relending Program	10.767	790,336
HUD Interest Reduction Payments Section 236	14.103	85,374
HUD Mortgage Insurance for the Purchase Section 223(a)(7)	14.155	84,060,974
HUD Supportive Housing for the Elderly Direct Loan Section/Capital Advance Section 202/HUD Project Rental Assistance contract (PRAC) Section 202	14.157	207,660,205
HUD Supportive Housing for Persons with Disabilities Capital Advance Section 811/HUD Project Rental Assistance Contract (PRAC) Section 811	14.181	8,936,674
Preservation of Affordable Housing	14.187	11,414,014
HUD Housing Finance Agencies (HFA) Risk Sharing Loans	14.188	3,672,750
HUD Multi-Family Services Coordinator Grant	14.191	1,513,531
HUD Section 8 New Construction and Substantial Rehabilitation	14.182	\$ 882,259
HUD Housing Assistance Payments (HAP) Section 8	14.195	52,420,821
Subtotal Section 8 Project-Based Cluster		53,303,080
HUD Multi-Family Assisted Housing Reform & Affordability Act	14.197	12,212,584
HUD Community Development Block Grant Entitlement Grant	14.218	9,963,934
HUD Comm. Dev. Block Grant/Technical Assistance Program	14.227	63,932
HUD Community Development Block Grant/State's Program	14.228	21,387,000
HUD Supportive Housing Program - Capital Advance/Office of Community Planning & Development - Supportive Housing Program/Forgivable Loan	14.235	9,184,863
HUD Shelter Plus Care	14.238	1,298,732
HUD HOME Investment Partnership Program/HOME Grant CHDO	14.239	170,230,580
HUD Housing Opportunities for Persons with AIDS HOPWA Grant	14.241	10,793,871
HUD Community Development Block Section 108 Loan Guarantee	14.248	3,351,955
HUD Capacity Building For Affordable Housing And Community Development Grants	14.252	130,855
HUD Tax Credit Assistance Program (Recovery Act Funded)	14.258	27,931,407
Continuum of Care	14.267	161,269
Revitalization of Severely Distressed Public Housing (Hope VI)	14.866	5,917,142
Department of Treasury	21.02	2,750,000
Department of Energy Weatherization Assistance Program (WAP)	81.042	750,000
Substance Abuse & Mental Health Services Projects of Regional & National Significance	93.243	376,915
Department of Health and Human Services for Children and Families	93.558	52,732
ACA - State Innovation Models: Funding for Model Design and Model Testing Assistance	93.624	11,332
State and Local Public Health Actions to Prevent Obesity, Diabetes, Heart Disease and Stroke (PPHF)	93.757	12,000
		\$ 674,735,071

See Notes to Schedule of Expenditures of Federal Awards.

Mercy Housing, Inc.

Notes to Schedule of Expenditures of Federal Awards Year Ended December 31, 2017

Note 1 - Basis of presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal award activity of Mercy Housing, Inc., under programs of the federal government for the year ended December 31, 2017. The information in the 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). Because the Schedule presents only a selected portion of the operations of Mercy Housing, Inc., it is not intended to and does not present the financial position, changes in net assets, or cash flows of Mercy Housing, Inc.

Note 2 - Summary of significant accounting policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following, as applicable, the cost principles contained in OMB Circular A-122, "Cost Principles for Non-Profit Organizations" and the cost principles contained in the Uniform Guidance. Mercy Housing, Inc. has elected not to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

Note 3 - Loan and capital advance program

Mercy Housing, Inc. has received direct loans and capital grant advances under multiple federal programs as listed below. The loan balances outstanding at the beginning of the year is included in the federal expenditures presented in the Schedule. Mercy Housing, Inc. received additional loans during the year. The balance of the loans outstanding at December 31, 2017 consists of:

CFDA Number	Program Name	Outstanding Balance at December 31, 2017
10.415	USDA Rural Rental Housing Loans	\$ 23,489,102
10.767	USDA Intermediary Relending Program	\$ 712,900
14.103	HUD Interest Reduction Payments Section 236	\$ 83,253
14.155	HUD Mortgage Insurance for the Purchase Section 223(a)(7)	\$ 94,600,847
14.157	HUD Supportive Housing for the Elderly Direct Loan Section/Capital Advance Section 202/HUD Project Rental Assistance contract (PRAC) Section 202	\$ 198,545,682
14.181	HUD Supportive Housing for Persons with Disabilities Capital Advance Section 811/HUD Project Rental Assistance Contract (PRAC) Section 811	\$ 8,242,823
14.182	HUD Section 8 New Construction and Substantial Rehabilitation	\$ 916,096
14.187	Preservation of Affordable Housing	\$ 11,414,014
14.188	HUD Housing Finance Agencies (HFA) Risk Sharing Loans	\$ 3,481,598
14.218	HUD Community Development Block Grant Entitlement Grant	\$ 11,601,266
14.227	HUD Comm. Dev. Block Grant/Technical Assistance Program	\$ 63,932
14.228	HUD Community Development Block Grant/State's Program	\$ 17,772,089
14.235	HUD Supportive Housing Program - Capital Advance/Office of Community Planning & Development - Supportive Housing Program/Forgivable Loan	\$ 9,119,940
14.239	HUD HOME Investment Partnership Program/HOME Grant CHDO	\$ 163,260,725
14.241	HUD Housing Opportunities for Persons with AIDS HOPWA Grant	\$ 10,780,408
14.248	HUD Community Development Block Section 108 Loan Guarantee	\$ 3,418,646

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
Mercy Housing, Inc.

We have audited, 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, the financial statements of Mercy Housing, Inc., which comprise the consolidated statement of financial position as of December 31, 2017, and the related consolidated statements of activities, changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements and have issued our report thereon April 19, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Mercy Housing, Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Mercy Housing, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of Mercy Housing, 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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of Mercy Housing, Inc.'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

As part of obtaining reasonable assurance about whether Mercy Housing, Inc.'s 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 or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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 Mercy Housing, Inc.'s internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Mercy Housing, Inc.'s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in cursive script that reads "Cohn Reznick LLP".

Charlotte, North Carolina
April 19, 2018

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
Mercy Housing, Inc.

Report on Compliance for Each Major Federal Program

We have audited Mercy Housing, 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 Mercy Housing, Inc.'s major federal programs for the year ended December 31, 2017. Mercy Housing, 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 federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Mercy Housing, 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 Mercy Housing, 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 Mercy Housing, Inc.'s compliance.

Opinion on Each Major Federal Program

In our opinion, Mercy Housing, 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 December 31, 2017.

Report on Internal Control over Compliance

Management of Mercy Housing, 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 Mercy Housing, 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 Mercy Housing, 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 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 the 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 our testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

A handwritten signature in cursive script that reads "CohnReznick LLP".

Charlotte, North Carolina
April 19, 2018

Mercy Housing, Inc.

**Schedule of Findings and Questioned Costs
December 31, 2017**

Summary of auditor's results

1. The auditor's report expresses an unmodified opinion on whether the financial statements of Mercy Housing, Inc. were prepared in accordance with generally accepted accounting principles.
2. No significant deficiencies related to the audit of financial statements were reported in the 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*. No material weaknesses were reported.
3. No instances of noncompliance material to the financial statements of Mercy Housing, Inc., which would be required to be reported in accordance with *Government Auditing Standards*, were disclosed during the audit.
4. No significant deficiencies in internal control over major federal award programs were disclosed during the audit and reported in the Independent Auditor's Report on Compliance for Each Major Federal Program and on Internal Control over Compliance Required by the Uniform Guidance. No material weaknesses were reported.
5. The auditor's report on compliance for the major federal award programs for Mercy Housing, Inc. expresses an unmodified opinion on all major federal programs.
6. There are no audit findings required to be reported in accordance with 2 CFR Section 200.516(a) in this Schedule.
7. The programs tested as major programs were:

Section 8 Project Based Cluster	14.195 and 14.182
Rural Rental Housing Loans	10.415
Mortgage Insurance for the Purchase or Refinancing of Existing Multifamily Housing Projects	14.155
Preservation of Affordable Housing	14.187
Community Development Block Grants	14.248
Tax Credit Assistance Program	14.258
Demolition and Revitalization of Severely Distressed Public Housing	14.866
Rural Rental Assistance Payments	10.427
Intermediary Relending Program	10.767
Multifamily Services Coordinator Grant	14.191
8. The threshold for distinguishing Type A and B programs was \$3,000,000.
9. Mercy Housing, Inc. was determined to be a low-risk auditee.

Mercy Housing, Inc.

**Schedule of Findings and Questioned Costs
December 31, 2017**

A. Findings - Financial Statements Audit

None.

B. Findings and Questioned Costs - Major Federal Award Programs Audit

None.

C. Status of Prior Year Findings and Questioned Costs

None.