



CONSOLIDATED FINANCIAL STATEMENTS
AND INDEPENDENT AUDITORS' REPORT

**HAWAII COMMUNITY REINVESTMENT
CORPORATION AND SUBSIDIARY**

DECEMBER 31, 2007 AND 2006

Hawaii Community Reinvestment Corporation and Subsidiary

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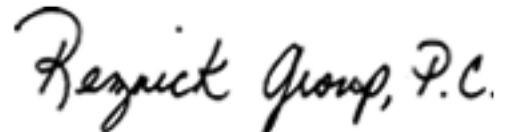
INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Hawaii Community Reinvestment Corporation

We have audited the accompanying consolidated statements of financial position of Hawaii Community Reinvestment Corporation and Subsidiary (the Corporation) as of December 31, 2007 and 2006, and the related consolidated statements of activities and cash flows for the years then ended. The consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Hawaii Community Reinvestment Corporation and Subsidiary as of December 31, 2007 and 2006, and the changes in their consolidated net assets and their consolidated cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.



Bethesda, Maryland
September 12, 2008

Hawaii Community Reinvestment Corporation and Subsidiary
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

December 31, 2007 and 2006

ASSETS

	2007	2006
Cash and cash equivalents	\$ 1,351,527	\$ 199,590
Investments	722,329	1,014,177
Total cash and investments	2,073,856	1,213,767
Interest receivable	58,029	62,351
Other receivables	11,802	32,140
Mortgage loans receivable held for sale	10,561,534	11,231,793
Less deferred loan fees	(73,070)	(81,075)
Net loans	10,488,464	11,150,718
Improvements, furniture and equipment (net)	90,358	108,794
Advances to funds	27	27
Investment in operating partnerships	4,749	5,231
Other assets	22,648	23,829
	\$ 12,749,933	\$ 12,596,857

LIABILITIES AND NET ASSETS

Liabilities		
Other accrued liabilities	\$ 60,849	\$ 41,794
Income taxes payable	172	-
Loans payable - member institutions	10,505,969	11,153,961
Interest payable - member institutions	47,159	49,667
	10,614,149	11,245,422
Net assets - unrestricted	2,135,784	1,351,435
	\$ 12,749,933	\$ 12,596,857

See notes to consolidated financial statements

Hawaii Community Reinvestment Corporation and Subsidiary

CONSOLIDATED STATEMENTS OF ACTIVITIES

Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Change in net assets		
Interest and fee income		
Interest income on loans	\$ 661,611	\$ 710,613
Loan origination fees	12,311	15,965
Other interest income	<u>39,367</u>	<u>51,260</u>
Total interest and fee income	713,289	777,838
Interest expense	<u>576,024</u>	<u>612,709</u>
Net interest and fee income	<u>137,265</u>	<u>165,129</u>
Other income		
Loan application fees	1,000	-
Other	<u>26,915</u>	<u>6,519</u>
	<u>27,915</u>	<u>6,519</u>
Other expenses		
Compensation and employee benefits	343,444	339,273
Office rent and occupancy	103,803	64,798
Depreciation and amortization	29,870	16,916
Professional fees	55,977	92,329
Loss on equity investments	475	473
Loan servicing fee	16,337	17,063
Income taxes (benefit)	172	(3,982)
Other	<u>66,243</u>	<u>71,527</u>
	<u>616,321</u>	<u>598,397</u>
Change in net assets from continuing operations	<u>(451,141)</u>	<u>(426,749)</u>
DISCONTINUED OPERATIONS		
Change in net assets	22,876	(28,929)
Interest income received from sale on discontinued operations	30,164	-
Gain on sale of discontinued operations	<u>1,182,450</u>	<u>-</u>
Change in net assets from discontinued operations	<u>1,235,490</u>	<u>(28,929)</u>
Change in net assets	784,349	(455,678)
Net assets - unrestricted, beginning balance	<u>1,351,435</u>	<u>1,807,113</u>
Net assets - unrestricted, ending balance	<u>\$ 2,135,784</u>	<u>\$ 1,351,435</u>

See notes to consolidated financial statements

Hawaii Community Reinvestment Corporation and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2007 and 2006

	2007	2006
Cash flows from operating activities		
Change in net assets	\$ 784,349	\$ (455,678)
Adjustments to reconcile change in net assets to net cash used in operating activities		
Depreciation	29,870	16,916
Loss on equity investments	475	473
Gain on sale of discontinued operations	(1,212,614)	-
Distributions from equity investments	7	10
Decrease (increase) in assets		
Interest receivable	4,322	8,673
Other receivables	20,338	(19,776)
Other assets	1,181	(10,382)
Increase (decrease) in liabilities		
Deferred loan fees	(8,005)	(11,302)
Other accrued liabilities	19,055	(15,902)
Income taxes payable	172	(38,829)
Interest payable - member institutions	(2,508)	(2,912)
Net cash used in operating activities	<u>(363,358)</u>	<u>(528,709)</u>
Cash flows from investing activities		
Withdrawals from restricted cash - net	-	500,247
(Increase) decrease in investments, net	291,848	(413,098)
Proceeds, including interest income, from sale of assets in subsidiary	1,212,614	-
Purchase of fixed assets	(11,434)	(97,605)
Repayments from funds	-	12,331
Collections on mortgage loans	670,259	1,516,829
Net cash provided by investing activities	<u>2,163,287</u>	<u>1,518,704</u>
Cash flows from financing activities		
Payments on loans payable - member institutions	(647,992)	(1,372,740)
Net cash used in financing activities	<u>(647,992)</u>	<u>(1,372,740)</u>
Net increase (decrease) in cash and cash equivalents	1,151,937	(382,745)
Cash and cash equivalents at beginning of year	199,590	582,335
Cash and cash equivalents at end of year	<u>\$ 1,351,527</u>	<u>\$ 199,590</u>
Supplemental disclosure of cash flow information		
Cash paid during the year for interest	<u>\$ 578,532</u>	<u>\$ 615,621</u>
Cash flows from discontinued operations		
Operating	\$ (1,189,739)	\$ (28,929)
Investing	1,212,614	-
Total	<u>\$ 22,875</u>	<u>\$ (28,929)</u>

See notes to consolidated financial statements

Hawaii Community Reinvestment Corporation and Subsidiary
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING
POLICIES

Hawaii Community Reinvestment Corporation (HCRC), a nonprofit corporation, was formed in July 1990, for the primary purpose of providing financing and technical assistance to facilitate the development of affordable housing in the State of Hawaii. HCRC also provides consulting services on affordable rental projects for owners, developers, investors, and lenders. Nine financial institutions have agreed to participate in an equity percentage interest in the mortgage loans originated by HCRC.

HCRC, through its wholly-owned subsidiary, Hawaii Investors for Affordable Housing, Inc. (HIAHI) organized Hawaii Affordable Housing Fund II LLC (HAHFII), Hawaii Affordable Housing Fund III LLC (HAHFIII), Hawaii Equity Fund IV LLC (HEFIV) and Diamond Head Equity Fund, LLC (DHEF), (the Funds), which assist operating partnerships in the production, rehabilitation and preservation of affordable housing in Hawaii. HCRC works with nonprofit and for-profit developers to create affordable housing using the Low-Income Housing Tax Credit Program as defined by Internal Revenue Code Section 42(c). HIAHI maintained a nonmember manager interest in the Funds until August 31, 2007. On that date, HIAHI sold its assets to an unrelated party, formed and controlled by former employees of HCRC. Outside investors (collectively, the Members) maintain limited member interests in the Funds. HIAHI maintains a general partnership or special limited partnership interest in some of the operating partnerships.

Basis of Presentation

The accompanying consolidated financial statements include the accounts of HCRC and its wholly-owned subsidiary (the Corporation). Interentity transactions and balances have been eliminated in consolidation.

The Corporation conforms with Statement of Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations." Under SFAS No. 117, the Corporation is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets and permanently restricted net assets. All the net assets of the Corporation are unrestricted. Furthermore, information is required to segregate program service expenses from management and general expenses.

Hawaii Community Reinvestment Corporation and Subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

December 31, 2007 and 2006

The Corporation also conforms with SFAS No. 116, "Accounting for Contributions Received and Contributions Made." In conformity with SFAS No. 116, contributions received, if any, are recorded as unrestricted, temporarily restricted or permanently restricted support, depending on the existence and/or nature of any donor restrictions.

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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Acquisition Fees

The Corporation recognized revenue related to syndication activities in accordance with Statement of Position No. 92-1 (SOP 92-1) *Accounting for Real Estate Syndication Income*. In accordance with SOP 92-1, acquisition fees associated with the underwriting and investment in properties were recognized in accordance with Statement of Financial Accounting Standards No. 66 (SFAS 66) *Accounting for Sales of Real Estate*, whereby revenue was recognized under methods consistent with the underlying sale of real estate. Once the minimum initial investment, as defined by SFAS 66 was met, HCRC recognized the entire amount of acquisition revenue earned from the Funds. On August 31, 2007, the acquisition fees relating to existing agreements with the funds were assigned to an unrelated party.

Depreciation

Property and equipment is carried at cost. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives by use of accelerated methods for financial reporting purposes. As of December 31, 2007 and 2006, accumulated depreciation was \$84,419 and \$54,549, respectively.

Hawaii Community Reinvestment Corporation and Subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

December 31, 2007 and 2006

Functional Expenses

The costs of providing the various programs and other activities have been summarized on a functional basis. Accordingly, certain costs from continuing operations have been allocated among the program and management and general services benefited.

	<u>2007</u>	<u>2006</u>
Program services		
Lending	\$ 576,024	\$ 612,709
Investment	555,414	538,438
Management and general	<u>60,907</u>	<u>59,959</u>
	<u>\$ 1,192,345</u>	<u>\$ 1,211,106</u>

Investments

The Corporation classifies certificate of deposits with original maturity dates of 90 days or more to be investments. The Corporation holds certificates of deposit at December 31, 2007 and 2006 with maturity dates ranging from March 17, 2008 to April 29, 2008 which earn interest ranging from 4.15% to 5.00%, and January 16, 2007 to December 5, 2007, which earn interest ranging from 3.70% to 5.00%, respectively.

Investment in Operating Partnerships

HIAHI is a .10% special limited partner in three operating partnerships. The Corporation accounts for its investment in the operating partnerships using the equity method of accounting. Under the equity method, the initial investment is recorded at cost and increased or decreased by the Corporation's share of income or losses, contributions and distributions.

Cash and Cash Equivalents

The Corporation considers all highly-liquid investments with original maturities of 90 days or less to be cash equivalents.

Income Taxes

HCRC is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. HIAHI uses the asset and liability method to account for deferred income taxes. At

Hawaii Community Reinvestment Corporation and Subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

December 31, 2007 and 2006

December 31, 2007 and 2006, HIAHI did not have any net operating loss carryforwards, for federal income tax purposes. During the year ended December 31, 2007, HIAHI had net operating income. As a result, HIAHI incurred income taxes of \$172 all of which is included in income taxes payable at December 31, 2007. During the year ended December 31, 2006, HIAHI had a net operating loss. The net operating loss was carried back to 2005. As a result, as of December 31, 2006, an income tax receivable of \$13,678 was included in other receivables.

Deferred Loan Fees

Loan origination fees, net of certain direct loan origination costs, are deferred and amortized over the contractual lives of the loans using the effective interest method. Deferred revenue reflected on the statements of financial position relates to loan origination fees on loans under contract. Once the loans close, these amounts are reclassified to deferred loan fees.

Mortgage Loans Held for Sale

Mortgage loans held for sale are carried at the lower of cost or fair value, which is estimated based on current market prices for similar loans. The method used to determine this amount is the individual loan method. Interest income on mortgage loans is recognized using the interest method.

Guarantee Obligation

HCRC accounts for exposure to losses under guarantees entered into in accordance with Financial Accounting Standards Board (FASB) Financial Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Pursuant to FIN 45, an obligation equal to the estimated fair value of the guarantee based on the facts and circumstances' existing at the time the guarantee is undertaken will be recorded. Determining the fair value measurement of a contingent liability requires management to make estimates and assumptions including, among others, market interest rates, historical loss experience on similar guarantees, total financial exposure, probability of loss, and severity and timing of possible losses. The guarantee obligation is reduced as identified risks are deemed to have expired based upon the satisfaction of applicable measures or milestones which reduce or eliminate the guarantee exposure.

Hawaii Community Reinvestment Corporation and Subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

December 31, 2007 and 2006

Reclassifications

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

NOTE 2 - MORTGAGE LOANS RECEIVABLE AND LOANS PAYABLE

Funding

Funding for mortgage loans originated by HCRC is provided by borrowings from financial institutions and is limited to an aggregate balance of \$50,000,000. The repayment terms of the borrowings from these institutions generally are the same as the repayment terms of the mortgage loans HCRC originates. An agent, which is one of the participating institutions, collects loan participation from the members and disburses loan proceeds to the borrowers. Loan payments are made by the borrowers to HCRC. HCRC then makes loan payments to the agent, which pays down the borrowings from the financial institutions and passes through a nominal interest rate spread to HCRC to cover operating expenses. Loan receivable and loan payable balances are decreasing differently due to the spread between the interest rates on the loans due from the borrowers and the interest rates on the corresponding amounts payable to the financial institutions. The loans receivable bear interest rates ranging from 4.875% to 7.125%. The loans payable bear interest rates ranging from 4.0% to 6.25% and mature from February 1, 2014 through October 1, 2020.

All mortgage loans receivable are pledged to the agent as security for HCRC's loans payable. Mortgage loans receivable are secured by residential real estate located in the State of Hawaii. Due to the terms of the Credit and Security Agreement between HCRC and the financial institutions, loan losses are borne by the institutions; therefore, no allowance for loan losses is provided.

Annual principal payments on the loans payable for the next five years are as follows:

Year ended December 31, 2008	\$	275,268
2009		291,175
2010		307,929
2011		325,655
2012		344,185

Hawaii Community Reinvestment Corporation and Subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

December 31, 2007 and 2006

Classification of Loans

Due to the ceiling amount placed on its borrowing facility, HCRC must sell loans from time to time. During the years ended December 31, 2007 and 2006, management sold \$0 and \$700,000, respectively, of loans for no gain or loss.

NOTE 3 - LEASE COMMITMENT

HCRC entered into an operating lease for office space which expired on September 30, 2006. On September 12, 2006, HCRC entered into a new lease which will expire on August 31, 2011. In addition to specified rents, the lease requires payment of the tenant's share of operating costs. During 2007 and 2006, the Corporation incurred \$96,844 and \$47,590, respectively, of rent expense. The amount is included in office rent and occupancy expense in the consolidated statements of activities. Minimum future lease payments are as follows:

2008	\$	62,311
2009		64,180
2010		66,105
2011		44,943

NOTE 4 - RELATED PARTY TRANSACTIONS

Acquisition Fees

HIAHI entered into an agreement with an affiliated entity under which it was entitled to earn an acquisition fee of up to 7% of the aggregate capital commitment of the investor members of the Funds in which it was the nonmember manager. The fee was for identification of suitable investments and work related to the negotiation and acquisition of partnership interests in various Operating Partnerships in which the Funds invested. During 2007 and 2006, fees of \$0 and \$51,928 were earned, respectively. On August 31, 2007, the fees relating to existing agreements with the funds were assigned to an unrelated party.

NOTE 5 - CONCENTRATION OF CREDIT RISK

The Corporation maintains its operating account balances in five financial institutions. The balances are insured by the Federal Deposit Insurance Corporation up to a maximum of \$100,000 at each financial institution. As of December 31, 2007, the total cash balances of the Corporation exceed the FDIC insurance limit and the uninsured portion is \$1,634,602.

Hawaii Community Reinvestment Corporation and Subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

December 31, 2007 and 2006

NOTE 6 - GUARANTY OBLIGATION

On January 25, 2006, HCRC entered into a guaranty agreement with an investor to which it sold a loan. The guaranty is for 10% of the loan amount, with a maximum of \$70,000, for the first three years after the loan sale. HCRC is completely relieved of the obligation after the three year period, or after a minimum debt coverage ratio of 1.2 is maintained for two consecutive years, if sooner. Management has assessed the value of the guarantee to be immaterial and therefore has not recorded a liability.

NOTE 7 - GAIN ON SALE OF DISCONTINUED OPERATIONS

On August 31, 2007, HCRC and its wholly-owned subsidiary HIAHI entered into an agreement with an unrelated party to sell the assets of HIAHI. These assets included the non-member managing interests in the funds, and the assignment of acquisition fees, advisory fees, consulting fees, expense reimbursement agreements, and asset management fees. The Corporation recorded a net gain on the sale of \$1,182,450 and related interest income of \$30,614, and received net proceeds in the same amount. In addition, the agreement calls for additional proceeds to be paid to HCRC upon the investment of certain projects named in the agreement. The additional proceeds are limited to 10% of the acquisition fees of three potential operating partnerships named in the sales agreement. The funds were in negotiations with the operating partnerships at the time of entering into the sales agreement.