DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT STATE FUNDED LOAN PROGRAMS

Financial Statements together with Report of Independent Public Accountants

For the Years Ended June 30, 2018 and 2017

SB & COMPANY, LLC
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JUNE 30, 2018 AND 2017

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Office of the Secretary of the Department of Housing and Community Development

Report on the Financial Statements

We have audited the accompanying statements of net position of certain Department of Housing and Community Development (DHCD), State Funded Loan Programs, as of June 30, 2018 and 2017, and the related statements of revenue, expenses, an changes in net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise DHCD's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these 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 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.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the certain Department of Housing and Community Development, State Funded Loan Programs, as of June 30, 2018 and 2017, and the respective changes in their financial position and their cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

As discussed in Note 2, the financial statements of the certain Department of Housing and Community Development, State Funded Loan Programs, are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the State of Maryland that is attributable to the transactions of the certain Department of Housing and Community Development, State Funded Loan Programs. They do not purport to, and do not, present fairly the financial position of the State of Maryland as of June 30, 2018 and 2017, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Hunt Valley, Maryland
September 28, 2018

SB + Company, LLC

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
STATE FUNDED LOAN PROGRAMS

Statements of Net Position
As of June 30, 2018 and 2017

	2018	2017
ASSETS		
Current Assets		
Deposit with State Treasurer	**$ 3,978,037**	$ -
Restricted deposits - MD BRAC loans	**2,438,160**	1,831,468
State appropriations receivable	**47,714,947**	52,850,007
Loans and notes receivable, net	**14,717,339**	11,918,394
Accounts receivable	**215,683**	1,204,536
Accounts receivable - non-operating	**6,035,555**	2,123,903
Accrued interest receivable	**-**	26,864
Total Current Assets	**75,099,721**	**69,955,172**
Non-Current Assets		
Restricted deposits - CAP	**390,831**	390,405
Loans and notes receivable, net	**536,179,131**	514,401,719
Total Non-Current Assets	**536,569,962**	514,792,124
Total Assets	**611,669,683**	584,747,296
LIABILITIES		
Current Liabilities		
Account payable	**2,934,475**	3,226,263
Escrow held for borrowers	**8,389**	546,390
Total Current Liabilities	**2,942,864**	3,772,653
Non-Current Liabilities		
Restricted deposits - CAP	**390,831**	390,405
MD BRAC notes payable	**3,585,000**	4,585,000
Total Non-Current Liabilities	**3,975,831**	4,975,405
Total Liabilities	**6,918,695**	8,748,058
Unrestricted Net Position	**$ 604,750,988**	$ 575,999,238

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

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
STATE FUNDED LOAN PROGRAMS

Statements of Revenues, Expenses and Change in Net Position
For the Years Ended June 30, 2018 and 2017

	2018	2017
Operating Revenues		
Interest	**$ 11,994,465**	$ 9,256,273
Charges for services and fees	**480,568**	735,448
Other	**523,775**	105,812
Total Operating Revenues	**12,998,808**	10,097,533
Operating Expenses		
General and administrative	**9,470,278**	6,282,496
Servicer fees	**662,989**	632,966
Foreclosure expenses	**306,795**	745,250
Provision for loan losses	**9,240,454**	6,039,906
Grants	**37,764,272**	20,576,030
Total Operating Expenses	**57,444,788**	34,276,648
Operating Loss	**(44,445,980)**	(24,179,115)
Non-Operating Revenues		
State contributions	**64,331,353**	53,738,569
Contributions from outside sources	**8,866,377**	4,263,649
Total Non-Operating Revenues	**73,197,730**	58,002,218
Change in net position	**28,751,750**	33,823,103
Net position, beginning of year	**575,999,238**	542,176,135
Net Position, End of Year	**$ 604,750,988**	$ 575,999,238

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

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
STATE FUNDED LOAN PROGRAMS

Statements of Cash Flows
For the Years Ended June 30, 2018 and 2017

	2018	2017
Cash Flows from Operating Activities		
Cash Receipts:		
Interest	**$ 11,998,232**	$ 7,542,715
Payoffs of loan principal	**13,689,511**	8,621,933
Principal repayments	**15,288,200**	11,331,447
Charges for services and fees	**480,568**	735,448
Revenue sharing and other	**523,775**	105,813
Recovery on loan losses	**515**	1,589
Sales of owned real estate	**29,655**	212,396
Total Cash Receipts	**42,010,456**	28,551,341
Cash Disbursements:		
General and administrative	**10,185,440**	6,967,423
Foreclosure expenses	**306,795**	879,723
Financing loans	**62,747,275**	56,360,087
Grants	**37,607,354**	18,881,510
Total Cash Disbursements	**110,846,864**	83,088,743
Net Cash From Operating Activities	**(68,836,408)**	(54,537,402)
Cash Flows from Non-Capital Financing Activities		
Contributions from outside sources	**5,617,929**	3,677,707
Prior year State Contributions in receivables from the State	**5,135,060**	(2,679,706)
State treasurer contributions	**62,668,148**	53,738,569
Net Cash From Non-Capital Financing Activities	**73,421,137**	54,736,570
Net increase in cash and cash equivalents	**4,584,729**	199,168
Deposit with State Treasurer and restricted deposits, beginning of year	**1,831,468**	1,632,300
Deposit with State Treasurer and restricted deposits, End of Year	**$ 6,416,197**	$ 1,831,468

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

DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT
STATE FUNDED LOAN PROGRAMS

Statements of Cash Flows (continued)
For the Years Ended June 30, 2018 and 2017

	2018	2017
Cash Flows from Operating Activities		
Reconciliation of operating loss to net cash from operating activities:		
Operating loss	**$ (44,445,980)**	$ (24,179,115)
Effect of changes in non-cash operating assets and liabilities:		
Accounts receivable and accrued interest	**1,015,717**	(634,681)
Loans and notes receivable	**(24,576,357)**	(28,893,774)
Accounts payable	**(829,788)**	(829,832)
Total adjustments	**(24,390,428)**	(30,358,287)
Net Cash From Operating Activities	**$ (68,836,408)**	$ (54,537,402)

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

1. ORGANIZATION AND PROGRAM DESCRIPTION

The Department of Housing and Community Development (DHCD) was formed in 1987 (Chapter 311, Acts of 1987) and charged with the administration of State Funded Loan Programs (SFLP). DHCD is a cabinet level agency that reports annually to the Governor and the General Assembly on its financial health. DHCD was created to work with partners to finance housing opportunities and revitalize great places for Maryland citizens to live, work and prosper. SFLP are among many groups of loan programs administered by the State of Maryland (the State). SFLP are a part of DHCD and do not operate as a separate legal entity or agency of the State. The summary outlined below highlights the various SFLPs administered by DHCD.

A. Rental Housing Programs (RHP)

Authority: Article - Housing and Community Development,
§§ 4-401 through 4-411;

The programs aim to increase and preserve affordable rental housing for occupancy by families of limited or low-income, including individuals and elderly households (30%-80% of area median income). Financing is provided in the form of loans for affordable rental housing development including apartments, rental town homes, congregate housing, single-room occupancy, emergency shelters, assisted living and shared living facilities. Projects may be restricted to elderly residents or special needs populations. The maximum loan amount is $2,500,000; however, the limit may be waived on a case-by-case basis. Recipients agree to rent the units to income-eligible residents for the greater of 15 years or as long as the loan is outstanding. RHP can be used for the conversion of older commercial and office buildings to market rate rental housing in designated revitalization areas in order to promote economic diversity and revitalization (the “Office Space Program”). Although the Office Space Program is currently inactive, the Department also administers Rental Housing Works for similar purposes. Rental Housing Works (RHW) was created in FY 2013 as an initiative to stimulate the economy by increasing new construction and renovation of rental housing developments statewide. RHW also received an appropriation of $24.7 million in general obligation bond funds in the FY 2015 budget. The Department applies the RHP Regulation and policies for loans under RHW. RHW funds are generally allocated in connection with bond funds.

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

B. MD-BRAC Preservation Loan Fund

Authority: Housing and Community Development Article of the Annotated Code of Maryland, as amended, §§ 2-102(3) and 2-102(6)

The purpose of the MD-BRAC Preservation Loan Fund is to leverage DHCD, federal, local and private funds to preserve affordable rental housing by providing flexible, short-term (typically 12 - 36 months) loans to spur additional affordable rental housing preservation activities in the MD-BRAC geographic footprint. Projects eligible for financing must be existing multifamily rental housing with a demonstrated need for short-term financing. Multifamily rental housing may include apartment buildings, townhouses, single room occupancy (SRO) and shared housing facilities with five (5) or more units. The Fund's definition of rental housing preservation is intentionally broad, and will extend to properties that will ultimately include all or only a portion of their units restricted to households at moderate and low income levels. Projects that do not currently meet affordability standards will be required to institute income and rent restrictions following receipt of the MD-BRAC Preservation Loan. Units must be restricted as affordable for a period of no less than 10 years. "Affordable" means rental housing with existing income or rent restrictions, or housing with rents that are affordable to households that earn up to 100% of County or Area Median Income, whichever is greater.

C. Homeownership Programs

Authority: Article - Housing and Community Development, §§4-801 through 4-810; §§4-814 through 4-816; 4-301 through 4-309; § 4-501 and §4-502

The Homeownership Programs provide low interest rate mortgages for low and moderate income first-time homebuyers who would otherwise lack the resources to purchase a home. The program began in 1970. The program includes the Downpayment and Settlement Expense Loan Program (DSELP), which provides funds for down payment and settlement expenses, and the Maryland Home Financing Program (MHFP), which makes direct loans to households to purchase homes or to disabled borrowers or borrowers with a disabled child or eligible family member under the Homeownership for Individuals with Disabilities Program. Financing is provided in the form of a loan. Regulations covering the Programs, are found at COMAR 05.03.01, and 05.03.04.

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

D. Special Loan Programs

Authority: Article – Housing and Community Development, §§4-901 through 4-923, §4-926, §4-927 and §4-933, for the Maryland Housing Rehabilitation Program, Indoor Plumbing Loan Program and the Accessory, Shared and Sheltered Housing Program

Article – Housing and Community Development, §§4-701 through 4-712 for the Lead Hazard Reduction Grant and Lead Hazard Reduction Grant Program and Lead Hazard Reduction Loan Program

Article – Housing and Community Development §§4-601 and §4-612 for the Group Home Financing Program

Article – Housing and Community Development §4-501 and §4-505

The Special Loan Programs provide preferred interest rate loans and grants to low and moderate-income families, sponsors of rental properties occupied primarily by limited income families, and non-profit sponsors of housing facilities, including group homes.

The programs are designed to bring housing up to code and to remediate lead paint hazards that are present in the housing stock and/or acquire, construct and modify homes suitable for use as group homes for persons with special housing needs. A listing of various activities conducted within the Special Loan Programs follows.

Maryland Housing Rehabilitation Program
The Maryland Housing Rehabilitation Program – Single Family (MHRP-SF) was effective August 3, 1977. The purpose of the program is to extend loans to eligible individuals and sponsors to finance the rehabilitation of housing occupied by families of limited income. The loan funds are used to eliminate health, safety and maintenance deficiencies and eliminate the residential properties' health, safety and maintenance deficiencies and ensure compliance with applicable housing codes and standards. The requirements of the program are outlined in COMAR 05.04.01.

Accessible Homes for Senior Homeowners Grant Program
The Accessible Homes for Senior Homeowners Grant Program was effective October 1, 2013. The purpose of the program is to finance accessibility-related renovation or repair activities for elderly homeowners. Program requirements are being drafted in response to the legislation passed in the 2013 session. The requirements of the program are outlined in COMAR 05.04.15.

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

D. Special Loan Programs (continued)

Indoor Plumbing Loan Program
The Indoor Plumbing Program (IPP) was effective August 28, 1986. The purpose of the program is to make loans to or for the benefit of individuals with limited income to finance indoor plumbing pipes, equipment, wells, septic tanks, or other on-site sewage systems or connection to community water and sewage systems. The requirements of the program are outlined in COMAR 05.04.05.

Accessory, Shared and Sheltered Housing Program
The Accessory, Shared and Sheltered Housing Program (ASSP) was effective August 28, 1986. The purpose of the program is to make loans to or for the benefit of individuals with limited income to finance rehabilitation projects to provide housing opportunities for families of limited income by creating accessory, shared and sheltered housing facilities. The requirements of the program are outlined in COMAR 05.04.08.

Lead Hazard Reduction Grant and Loan Program
The Lead Hazard Reduction Grant and Loan Program (LHP) was effective August 28, 1986. It was previously called the Residential Lead Paint Abatement Program. The purpose of the program is to extend loans and grants to eligible individuals, child care centers and sponsors to finance the lead hazard reduction in residential housing units. The requirements of the program are outlined in COMAR 05.04.06.

Group Home Financing Program
The Group Home Financing Program (GHFP) was effective February 23, 1987. The purpose of the program is to provide loans to sponsors to finance the costs of acquiring, constructing, and modifying or refinancing buildings or to refinance loans which will provide or maintain group homes for low-income, elderly, handicapped, disabled, and other residents of the State with special housing needs. The requirements of the program are outlined in COMAR 05.04.09.

E. Neighborhood Business Works

Authority: Article – Housing and Community Development, §§6-301 through 6-311. Regulations concerning the program are found at COMAR 05.13.01

Neighborhood Business Development Program
The Neighborhood Business Development Program, operating as Neighborhood Business Works (NBW) was established October 1, 1995, to provide flexible gap financing for small businesses starting up or expanding in designated sustainable communities throughout Maryland. Loans are made to Maryland-based local development corporations, microenterprises, non-profit organizations, or small businesses.

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

E. Neighborhood Revitalization Programs (continued)

Loans and grants are made to those organizations whose activities contribute to a broader revitalization of the sustainable community (e.g., reuse of vacant/underutilized buildings or providing needed goods or services to area residents). Financing ranges from $1,000 up to the lesser of (i) $500,000 or (ii) 50% of the total project costs. Loan applicants must provide a cash contribution of at least 5 percent of the total project costs. Regulations concerning the program are found at COMAR 05.13.01.

Capital Access Program
The Capital Access Program (CAP), a component of NBW, was established October 1, 2000 to stimulate the provision of private capital to small businesses in Priority Funding Areas throughout the State. This program stimulates private sector lending to small businesses by offering an incentive to private lenders to make loans to borrowers that otherwise might not qualify for conventional loans. It enables private lenders to establish a loan loss reserve fund from fees paid by borrowers, lenders, and the State. Enrolled amounts may range from $1,000 to $1,000,000, and either the entire loan or a portion of the loan may be enrolled. Up to $1 million from the annual appropriation for the Neighborhood Business Development Program may be used for this program. There is currently only one bank (BB&T) enrolled in the program and there has been no lending activity since 2012.

Legislative changes to the Neighborhood Business Works Program in 2004 gave the Department the ability to:

- Assign or sell up to $4 million in loans from the BBDP each year, generating funds for new loans to small businesses. The loans can be sold to national partners, such as the Community Reinvestment Fund, who support neighborhood revitalization initiatives and purchase loans from state and local governments.
- Expand eligible uses of the Program to include microenterprises, creating jobs and expanding economic opportunities for lower income individuals and neighborhoods.

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

E. Neighborhood Revitalization Programs (continued)

Legislative changes to the Neighborhood Business Works Program in 2010 gave the Department the ability to:

- Expand lending to microenterprises by reducing administrative barriers to making microloans and provide better access to capital for establishing and sustaining micro-businesses. This change also authorizes the Department to provide financial assistance to a certain entity for the purposes of the entity making subloans to eligible microenterprises. Eligible microenterprises will have less than five employees and can receive loans up to $35,000.

Terms are typically less than five years and rates and fees will vary depending on the size of the loan, loan underwriting and market conditions, but would be below the rates charged for comparable loans by the U.S. Small Business Administration, which currently range from 8 to 13 percent. On average, a combined interest rate of 5 – 7% would be the maximum rate goal predicated on credit and capacity to repay the loan.

F. Community Legacy Program

Authority: Article – Housing and Community Development, Title 6, Subtitle 2, §§ 6-201 through 6-213. Regulations concerning the program are found at COMAR 05.17.01

Community Legacy Program (CLP) improves the effectiveness of State support for neighborhood revitalization by complementing and supplementing existing resources. The program provides gap resources to stabilize or revitalize communities located in Sustainable communities, and in accordance with Sustainable Community Plan. Sustainable Community Areas are a result of the 2010 Sustainable Communities Act that created a consolidated area for revitalization investment. Sustainable Community Areas were formerly known separately as Community Legacy Areas and Designated Neighborhoods and also now include Base Realignment and Closure (BRAC) Zones and designated Transit Oriented Development (TODs).

For example, the following activities have been included in Community Legacy applications:

- Establishment of programs to attract home buyers to purchase and rehabilitate vacant homes;
- Programs for existing homeowners and businesses to improve their properties;
- Development of mixed-use projects that may combine housing, retail, office, public, and open spaces.

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

F. Community Legacy Program (continued)

The Neighborhood Intervention Component of the Community Legacy Program is intended to function as a preventative measure either in or outside of a Sustainable Community to address problem properties that are having a negative impact on the community. The two eligible uses of a Neighborhood Intervention Project are:

- To buy properties that need rehabilitation and redeveloping the properties through rehabilitation, demolition, reconstruction or re-use; or
- Strategically demolishing buildings that are dangerous for use or occupancy, or so deteriorated that rehabilitation is not feasible, and preparing the property for revitalization, redevelopment or re-use.

G. Strategic Demolition Fund (SDF)

Authority: Article – Housing and Community Development, Title 4, Subtitle 5, § 4-508.

The Strategic Demolition Fund (SDF) accelerates economic development and job production in existing Maryland communities. The SDF aims to improve the economic potential of otherwise blighted areas. Awards focus on blight removal and redevelopment projects that can have a high economic and revitalization impact in their existing communities. Projects are located in designated Sustainable Communities throughout Maryland. Sustainable Communities are areas found within Priority Funding Areas and are local targets for revitalization. Awards are made available on a competitive basis. Lead applicants are local governments or nonprofit community development organizations

During the 2016 legislative session, the Strategic Demolition Fund was codified as a special non-lapsing fund. Within the legislation, specific funding levels were included for FY 17 through FY 19 ($21.5 million for FY 17, $25,625,000 for FY 2018 and $28,500,000 for FY 2019). Of $28.5 million for FY 19, $25 million will be earmarked for projects in Baltimore City and $3.5 million for projects throughout the State.

This initial commitment of $18 million to Baltimore City builds on the FY 16 investment of approximately $10 million to Baltimore City projects and is the genesis for an important Governor’s initiative - Project C.O.R.E.

Project C.O.R.E. or Creating Opportunities for Renewal and Enterprise, is creating a new canvas for Baltimore, clearing the way for new green space, new affordable and mixed use housing, new and greater opportunities for small business owners to innovate and grow. The initiative will generate jobs, strengthen the partnership between the City of Baltimore and the State of Maryland and lead to safer, healthier and more attractive spaces for families to live and put down roots.

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

H. Baltimore Regional Neighborhood Initiative (BRNI)

Authority: Article – Housing and Community Development, Title 6, Subtitle 5, §§ 6-501 through 6-510.

The Baltimore Regional Neighborhood Initiative (BRNI) aims to demonstrate how strategic investment in local housing and businesses can lead to healthy, sustainable communities with a growing tax base and enhanced quality-of-life. The initiative targets communities located in the Baltimore region where modest investment and a coordinated strategy will have an appreciable neighborhood revitalization impact. Created as a pilot in the 2013 Maryland General Assembly Session, the program is a recommendation of the House Regional Revitalization Workgroup, organized by Speaker Michael Busch. Capital and operating projects will be located in the designated Sustainable Communities in Baltimore City and the inner Baltimore beltway communities of Anne Arundel and Baltimore Counties. Sustainable Communities are areas found within Priority Funding Areas (PFAs) and are targeted for revitalization.

Awards are made available on a competitive basis. Lead applicants will be nonprofit community development organizations (CDCs or Coalitions) in Baltimore City, or the inner beltway communities of Baltimore County or Anne Arundel County, that are implementing a clear revitalization strategy in a specific neighborhood or set of neighborhoods. The revitalization strategy would aim for the goal of growing the targeted community's population and workforce, and improving key quality-of-life features that establish the conditions for increasing market-rate investment, positioning the target communities to be competitive for residential and economic investment in the region. In addition to other partners, eligible applicants are encouraged to apply along with a nonprofit Community Development Financial Institution (CDFI) partner.

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

H. Baltimore Regional Neighborhood Initiative (BRNI) (continued)

The program funds will support a wide range of capital and operating community enhancement projects, including but not limited to:

- Down payment assistance to attract home buyers to purchase and rehabilitate homes;
- Funds for the acquisition and rehabilitation of vacant homes for resale to new homebuyers;
- Programs for existing homeowners and businesses to improve their properties;
- Programs that encourage weatherization and energy retrofits to achieve energy efficiency;
- Development of mixed-use projects that may combine housing, retail and office space;
- Development or enhancement of community open space;
- Development of public infrastructure, such as parking and lighting and improvements to pedestrian and bicycle circulation;
- Strategic demolition, including land and banking, to stimulate redevelopment; and
- Operating costs associated with implementing BRNI-supported capital projects, including staff and consultants.

I. Partnership Rental Housing Program

Authority: Article - Housing and Community Development,
§§4-1201 through 4-1209 and §4-503. Regulations covering the program are found at COMAR 05.05.05

The Partnership Rental Housing Program is to expand the supply of affordable housing for low-income households through a partnership between the State and local governments. The program was created in 1988 as a pilot program and was enacted as a permanent program in fiscal year 1991. In 2006, the Program was amended to expand borrower eligibility to include private sector entities that agree to provide rental units to lower-income eligibility to include private sector entities that agree to provide rental units to lower-income households that include one or more individuals with disabilities or special needs. Financing is provided in the form of deferred loans to projects that can be maintained economically as lower income housing. Except in the case of housing for individuals in disabilities or if there is a conflict with federal law, residents must contribute services to enhance or maintain the facility, grounds or community.

1. ORGANIZATION AND PROGRAM DESCRIPTION (continued)

J. Housing & Building Energy Programs

Empower

The Maryland Public Service Commission Order No. 88514 awarded $83.4 million of Special Funds for a third three-year period covering CY 2018 to CY2020 to DHCD to manage the weatherization and energy efficiency programs intended for low income households under EmPOWER MD. The purpose of the Empower Program is to promote energy efficiency and affordability in the State's multifamily rental housing developments for low and moderate income households. These improvements are intended to reduce a building's energy use and lower utility bills for occupants and owners. Financing is provided in the form of loans and grants with flexible terms.

Energy-Efficiency Homes Construction Loan Program

The Energy-Efficiency Homes Construction Loan Program was created in 2014 to provide construction loans for low-energy and net-zero homes. A "Low-energy home" means a home that is designed to be at least 60% more energy efficient than a home built to applicable building code standards in effect before July 1, 2014. A "Net-zero home" means a home that is designed to produce an amount of energy in one year that is equal to the amount of energy that the home uses in one year.

In FY 2017, DHCD provided $2.1 million ($700,000 Energy Efficiency Block Grant and $1.4 million Strategic Energy Investment Funds (SEIF) for the Net Zero Program) for renovating 42 single family homes into 75 net zero duplex or single family homes for at-risk or homeless veterans.

DHCD entered into a Memorandum of Understanding with the Maryland Energy Administration in FY 2018 that provided DHCD with $1.1 million of Strategic Energy Investment Funds (SEIF) for the Net Zero Program. The program also received $500,000 of General Funds (appropriated in FY 2017) and $1 million of GO Bonds is included in the CIP for FY 2020.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

SFLP utilize the enterprise fund accounting method for financial reporting purposes in accordance with governmental accounting principles generally accepted in the United States of America. The accompanying financial statements present the financial position, change in financial position and cash flows of SFLP.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. 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. These estimates and assumptions affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues, expenses, gains and losses during the reporting periods. Actual results could differ from these estimates.

C. Relationship with the State

SFLP are just a few of the many programs administered by DHCD and the State. Other State agencies, such as the Department of Budget and Management, support DHCD by providing services for DHCD and thus allocate a portion of their expenses to DHCD. SFLP have no direct employees and are entirely supported by staff at DHCD to perform all necessary functions of SFLP. DHCD allocates certain operating, general and administrative costs to SFLP, which is DHCD's estimate of its cost to manage and administer SFLP's operations. This allocation from DHCD is not necessarily representative of SFLP cost as if they were a stand-alone entity and could significantly change in the future. SFLP records these costs as invoiced by DHCD for the fiscal year. However, the allocation is subject to review and adjustment subsequent to year end. Any adjustment is included on the invoice and recorded in the period in which the adjustment is identified.

SFLP's accompanying financial statements are not indicative of SFLP as if it were a stand-alone entity. SFLP are included in the enterprise funds of the State.

D. Revenues and Expenses

SFLP distinguish operating revenue and expenses from non-operating items. Operating revenues and expenses generally result from mortgage lender activities in connection with SFLP's ongoing operations. The primary operating revenues are interest income on loans. Operating expenses include expenses relating to the servicing of the loans, provision for loan losses, asset management, salaries, and administrative expenses. Non-operating revenues and expenses include payments related to participants in MD BRAC and contributions from the State. To the extent considered to be material by management, loan origination fees and costs are capitalized and amortized over the estimated life of the related loans.

3. CASH AND CASH EQUIVALENTS

A. Definition

SFLP define cash and cash equivalents as cash and short-term investments that are held on deposit with the State Treasurer and any unspent appropriations. Cash receipts and disbursements of SFLP are made through a cash pool maintained by the State Treasurer. The cash is invested under the State's guidelines. Additional information can be obtained from the State of Maryland Comprehensive Annual Financial Report.

As of June 30, 2018 and 2017, SFLP had deposit balances with the State Treasurer and restricted deposits of $6,416,197 and $1,831,468 respectively. This balance included treasury securities investments of $1,084,811 as of June 30, 2017 that were sold in April of 2018 due to the maturation of the concerned loans.

B. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. SFLP adhere to Maryland State Treasurer's policy for managing its exposure to fair value loss arising from increasing interest rates. The Maryland State Treasurer's investment policy states that to the extent possible, it will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the Treasurer's Office will not directly invest in securities maturing more than five years from the date of purchase.

C. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. SFLP's policy for reducing its exposure to credit risk is to comply with the Maryland State Treasurer's policy, which requires that the Treasurer's investments in repurchase agreements be collateralized by U.S. Treasury and agency obligations. In addition, investments may be made directly in U.S. Treasuries or agency obligations.

D. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. SFLP's policy for reducing this risk of loss is to comply with the Maryland State Treasurer's policy, which limits the amount of repurchase agreements to be invested with a particular institution to 30 percent of the portfolio. Otherwise, there is no limit on the amount that may be invested in any one issuer.

3. CASH AND CASH EQUIVALENTS (continued)

E. Restricted Deposits

Under Government Accounting Standards Board (GASB) Statement No. 34, net assets should be reported as restricted when constraints placed on net assets use are either: externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other government; or are imposed by law through constitutional provisions or enabling legislation. Accordingly, all funds and accounts whose purpose is to pay future claims are restricted as to their use, as is interest earned on these restricted assets.

One of the SFLP's programs, CAP, is designed to enable private lenders to establish a loan loss reserve fund from fees paid by borrowers, lenders, and the State. CAP is exempt from the requirements of Title 6, Subtitle 2 of the State Finance and Procurement Article, which is the source of the State's investment policy (specifically, Section §6-223 of the Finance and Procurement Article).

CAP is exempt from the requirement cited in that section by virtue of Article – Housing and Community Development, Section §6-309(f)(2), which specifically exempts DHCD's contributions from the requirements of Title 6, Subtitle 2. Therefore, CAP reserve accounts are not required to be under the $250,000 maximum insurance coverage per account from the Federal Deposit Insurance Corporation (FDIC).

The CAP reserves are restricted deposits in what management believes to be high quality financial institutions. However, to the extent that each of these accounts exceeds $250,000, they are exposed to custodial credit risk as the excess is both uninsured and uncollateralized. As of June 30, 2018, the combined restricted cash bank and book balance was $390,831 of which $41,102 was not insured and collateralized. As of June 30, 2017, the combined restricted cash bank and book balance was $390,405 of which $40,686 was not insured and collateralized. The increase in the CAP reserves is the difference between the interest earned and the monthly service fees charged by the custodial financial institutions. No payment from the CAP reserves is due in the current year.

As of June 30, 2018 and 2017, the MD BRAC program had $2,438,160 and $1,831,468 in cash. This program is restricted to making loans for the specific purpose of providing multifamily developers with short term loan financing. These developers will help to alleviate the impact of the Base Realignment and Closure (BRAC) initiative in the Counties surrounding the Fort Meade area.

3. CASH AND CASH EQUIVALENTS (continued)

F. Custodial Credit Risk-Deposits

Custodial credit risk is the risk that, in the event of a bank failure, SFLP's deposits may not be returned to it. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in SFLP's name. SFLP do not have a formal deposit policy for custodial credit risk, but follow the Maryland State Treasurer's policy, which states the Treasurer may deposit in a financial institution in the State, any unexpended or surplus money in which the Treasurer has custody. As of June 30, 2018 and 2017, all of the SFLP's cash was deposited with the State Treasury, and this was not subject to custodial risk.

4. LOANS AND NOTES RECEIVABLE, NET OF ALLOWANCE

Loans are stated at the amount of unpaid principal adjusted for any write-offs, allowance for loan losses, and deferred fees or costs on originated loans.

The allowance for loan losses is established through a provision for loan losses when management believes that repayment of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb estimated losses on existing loans that may become uncollectible, based on current factors and prior loan loss experience.

Current factors include, but are not limited to, changes in the composition and volume of the loan portfolio, overall portfolio quality, and review of specific problem loans in conjunction with the current economic conditions that may affect the borrower's ability to pay.

While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in the factors considered, such as the economic condition of the borrower or certain related industry concentrations. All loans are for property located within the State of Maryland.

Management considers a loan to be impaired when the loan is 60 days delinquent from its stated repayment terms. As of June 30, 2018 and 2017, there were 1,840 and 1,784 loans, respectively, with outstanding principal of $18,081,888 and $18,583,347, respectively, considered impaired and written down to their estimated net realizable value.

Composition of SFLP Loan Portfolio

SFLP established a 100 percent allowance for loan losses on all Partnership Rental Housing Program loans because the program is such that the loans do not have to be repaid as long as the borrower complies with the terms of the program and continues to use the property in accordance with regulatory agreements.

4. LOANS AND NOTES RECEIVABLE, NET OF ALLOWANCE (continued)

Composition of SFLP Loan Portfolio (continued)

For the years ended June 30, 2018 and 2017, the provision for loan losses includes $5,215,104 and $2,485,102 respectively, related to loans issued during the year from the Partnership Rental Housing Program.

The change in the allowance for loan losses was as follows for the years ended June 30, 2018 and 2017:

	2018	2017
Beginning balance	**$ 317,609,688**	$ 313,424,607
Provision for loan losses	**9,240,454**	6,039,906
Loans (charged off) / recovery	**(1,476,737)**	(1,854,824)
Ending Balance	**$ 325,373,405**	$ 317,609,689

As of June 30, 2018	Number of Loans/Notes	Outstanding Principal	Allowance for Loan Losses	Loans/Notes Receivable, Net
Rental Housing Programs*	**411**	**$ 422,861,698**	**$ 62,901,140**	**$ 359,960,558**
Homeownership Programs	**16,229**	**116,526,534**	**16,559,362**	**99,967,172**
Special Loan Programs	**1,734**	**71,829,946**	**19,472,001**	**52,357,945**
Neighborhood Revitalization Programs	**231**	**40,191,499**	**5,889,454**	**34,302,045**
Partnership Rental Housing Programs	**107**	**220,360,198**	**220,360,198**	**-**
BRAC - MF loans	**1**	**4,500,000**	**191,250**	**4,308,750**
Total Loans Receivable	**18,713**	**$ 876,269,875**	**$ 325,373,405**	**$ 550,896,470**

*Includes Construction Loan Program

As of June 30, 2017	Number of Loans/Notes	Outstanding Principal	Allowance for Loan Losses	Loans/Notes Receivable, Net
Rental Housing Programs*	397	$ 394,601,751	$ 61,488,449	$ 333,113,302
Homeownership Programs	15,970	116,786,152	16,257,824	100,528,328
Special Loan Programs	1,752	72,806,135	18,433,021	54,373,114
Neighborhood Revitalization Programs	248	38,052,670	6,030,301	32,022,369
Partnership Rental Housing Programs	105	215,145,094	215,145,094	-
BRAC - MF loans	1	6,000,000	255,000	5,745,000
Loans receivable	18,473	843,391,802	317,609,689	525,782,113
Notes receivable	1	538,000	-	538,000
Total Loans and Notes Receivable	18,474	$ 843,929,802	$ 317,609,689	$ 526,320,113

*Includes Construction Loan Program

5. NOTES PAYABLE

In April 2010, the DHCD obtained a loan from the John D. and Catherine T. MacArthur Foundation to foster and enable preservation of affordable housing for low-income persons and families near military bases in those counties in Maryland which are impacted by the Base Realignment and Closure initiative (BRAC). The entire potential amount of the loan is $4,000,000, of which $3,000,000 has been received as of June 30, 2018. DHCD may decide to draw the additional $1,000,000 before the end of the agreement in 2020. DHCD is required to make quarterly payments of interest on the unpaid principal balance. The current outstanding principal balance $2,000,000.

DHCD Loan principal payback schedule due to MacArthur Foundation

Date		Amount
April 1, 2019	$	1,000,000
April 1, 2020		1,000,000
Total	**$**	**2,000,000**

Interest expense for the years ended June 30, 2018 and 2017 were $55,000 and $60,000 respectively, at the rate of 2% per year.

In FY 2012, Montgomery County, Harford County, and Howard County committed matching funds for participation in the Base Realignment and Closure initiative (BRAC). The beginning balance of the total BRAC notes payable as of June 1, 2018 was $4,585,000. As of June 30, 2018, the total notes payable for BRAC is $3,585,000. The decrease is due to the commencement of the repayment schedule of the BRAC note payable in accordance with the memorandum of understanding between DHCD and the MacArthur foundation. A repayment of $1,000,000 is scheduled for April 1, 2019. The BRAC notes payable balance includes the following loans received from MacArthur Foundation as well as several Maryland counties as shown below:

Loans Payable as of June 30, 2018

MacArthur Foundation	$	2,000,000
Montgomery County		320,000
Harford County		312,500
Howard County		320,000
Baltimore County		312,500
Prince George's County		320,000
Total loans payable	**$**	**3,585,000**

5. NOTES PAYABLE (continued)

The funds have been committed for no less than 10 years unless DHCD fails to fulfill any or all of its obligations related to the program. The Counties may terminate their association with BRAC if the default by DHCD is not cured within 30 days. If the default is not cured within 30 days, DHCD will reimburse the Counties' contributions in excess of any loan fund dollars applied towards County projects, subject to the available balance in the MD BRAC Loan Fund.

6. COMMITMENTS

As of June 30, 2018 and June 30, 2017, SFLP committed to provide $139,114,911 and $141,178,824 in loans and is holding $8,389 and $546,390 in escrow accounts for borrowers. DHCD does not currently have any tax abatement program applicable under GASB 77.

7. PENSION AND OTHER POSTRETIREMENT BENEFITS

Eligible employees who perform services for SFLP and employees of the State are covered under the retirement plans of the State Retirement and Pension System of Maryland (the System) and are also entitled to certain healthcare benefits upon retirement. SFLP's only liability for retirement and post-employment benefits is its required annual contribution to DHCD, which in turn was paid in full to the State of Maryland prior to year end. The System is considered part of the State's financial reporting entity and is not considered a part of SFLP's reporting entity. The State subsidizes a portion of the covered medical, dental, prescription, and hospitalization costs, depending on the type of insurance plan. Costs for postretirement benefits are for State retirees and primarily funded by the State. The State does not distinguish employees by employer/State agency. As such, the State has elected to maintain the entire net other postretirement benefit liability as a liability of the general fund of the State and has not allocated any balances to State entities including SFLP. The System prepares a separate Comprehensive Annual Financial Report, which can be obtained from the State Retirement and Pension System of Maryland at 120 East Baltimore Street, Baltimore, Maryland 21202.