

FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT

OTHELLO STREET LIMITED PARTNERSHIP

DECEMBER 31, 2008

Othello Street Limited Partnership

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INDEPENDENT AUDITORS' REPORT

To the Partners
Othello Street Limited Partnership

We have audited the accompanying balance sheet of Othello Street Limited Partnership as of December 31, 2008, and the related statements of operations, partners' equity (deficit) and cash flows for the year then ended. These financial statements are the responsibility of the partnership's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Othello Street Limited Partnership as of December 31, 2008, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Reznick Group, P.C.

Atlanta, Georgia
March 13, 2009

Othello Street Limited Partnership

BALANCE SHEET

December 31, 2008

ASSETS

| | |
|------------------------------------|-----------------------------|
| Investment in rental property, net | \$ 12,598,806 |
| Cash | 70,948 |
| Restricted cash | |
| Tenants' security deposits | 36,697 |
| Other reserves | <u>828,680</u> |
| Total restricted cash | <u>865,377</u> |
| Tenants' accounts receivable | 41,750 |
| Prepaid expenses | 30,185 |
| Deferred loan costs, net | 421,411 |
| Other assets | <u>5,731</u> |
| Total assets | <u><u>\$ 14,034,208</u></u> |

LIABILITIES AND PARTNERS' EQUITY (DEFICIT)

| | |
|--|-----------------------------|
| Liabilities | |
| Accounts payable - operations | \$ 7,428 |
| Accounts payable and accrued expenses | 9,769 |
| Accrued interest - first mortgage | 78,925 |
| Accrued interest - other loans | 694,362 |
| Tenants' security deposits liability | 34,000 |
| Mortgages and notes payable | <u>10,450,384</u> |
| Total liabilities | <u>11,274,868</u> |
| Contingencies | - |
| Partners' equity (deficit) | <u>2,759,340</u> |
| Total liabilities and partners' equity (deficit) | <u><u>\$ 14,034,208</u></u> |

See notes to financial statements

Othello Street Limited Partnership

STATEMENT OF OPERATIONS

Year ended December 31, 2008

| | |
|-----------------------------------|----------------------------|
| Revenue | |
| Rental income | \$ 818,316 |
| Vacancies and concessions | (76,644) |
| Other operating income | <u>18,780</u> |
| Total revenue | <u>760,452</u> |
| Operating expenses | |
| Salaries and employee benefits | 183,773 |
| Repairs and maintenance | 109,221 |
| Utilities | 73,222 |
| Property management fee | 57,744 |
| Property insurance | 39,834 |
| Miscellaneous operating expenses | <u>64,657</u> |
| Total operating expenses | <u>528,451</u> |
| Net operating income (loss) | <u>232,001</u> |
| Other income (expense) | |
| Interest income | 14,777 |
| Interest expense - first mortgage | (159,078) |
| Interest expense - other loans | (83,399) |
| Other financial income (expense) | 67 |
| Depreciation | (408,771) |
| Amortization | <u>(17,231)</u> |
| Total other income (expense) | <u>(653,635)</u> |
| Net loss | <u><u>\$ (421,634)</u></u> |

See notes to financial statements

Othello Street Limited Partnership

STATEMENT OF PARTNERS' EQUITY (DEFICIT)

Year ended December 31, 2008

| | General Partner | Limited Partner | Total Partners' Equity (Deficit) |
|--|--------------------|---------------------|--|
| | <u> </u> | <u> </u> | <u> </u> |
| Balance, January 1, 2008 | \$ (219) | \$ 3,181,193 | \$ 3,180,974 |
| Net loss | <u>(42)</u> | <u>(421,592)</u> | <u>(421,634)</u> |
| Balance, December 31, 2008 | <u>\$ (261)</u> | <u>\$ 2,759,601</u> | <u>\$ 2,759,340</u> |
| Partners' percentage of partnership losses | <u>0.01%</u> | <u>99.99%</u> | <u>100.00%</u> |

See notes to financial statements

Othello Street Limited Partnership

STATEMENT OF CASH FLOWS

Year ended December 31, 2008

| | |
|--|-------------------|
| Cash flows from operating activities | |
| Net loss | \$ (421,634) |
| Adjustments to reconcile net loss to net cash provided by operating activities | |
| Depreciation | 408,771 |
| Amortization | 17,231 |
| Changes in: | |
| Tenants' accounts receivable | (28,265) |
| Prepaid expenses | 77 |
| Other assets | (5,731) |
| Accounts payable - operations | 7,428 |
| Other accrued liabilities | 5,972 |
| Accrued interest - first mortgage | (1,225) |
| Accrued interest - other loans | 83,400 |
| Tenants' security deposits liability, net | <u>(2,676)</u> |
| Net cash provided by operating activities | <u>63,348</u> |
| Cash flows from investing activities | |
| Change in other reserves | <u>(23,883)</u> |
| Net cash used in investing activities | <u>(23,883)</u> |
| Cash flows from financing activities | |
| Principal payments on mortgage note payable | <u>(35,000)</u> |
| Net cash used in financing activities | <u>(35,000)</u> |
| Net increase in cash | 4,465 |
| Cash, beginning | <u>66,483</u> |
| Cash, end | <u>\$ 70,948</u> |
| Supplemental disclosure of cash flow information | |
| Cash paid for interest | <u>\$ 160,302</u> |

See notes to financial statements

Othello Street Limited Partnership

NOTES TO FINANCIAL STATEMENTS

December 31, 2008

NOTE 1 - ORGANIZATION AND NATURE OF OPERATIONS

Othello Street Limited Partnership (the Partnership) was formed as a limited partnership on September 8, 1999, under the laws of the state of Washington, for the purpose of acquiring, constructing, developing and operating a low-income residential housing project. The property consists of 96 rental units located in Seattle, Washington, and operates under the name Holly Park Phase II (the Project).

Effective June 19, 2000, the partnership agreement was amended to admit a new limited partner and to permit the withdrawal of the existing limited partner. This amendment provides for ownership and allocations of profits, losses and tax credits as follows:

| | |
|-----------------|----------------|
| General partner | .01% |
| Limited partner | <u>99.99%</u> |
| | <u>100.00%</u> |

The general partner is The Housing Authority of the City of Seattle (SHA) and the current limited partner is The Housing Outreach Fund VIII Limited Partnership (HOFVIII).

The Project consists of 21 buildings which qualified for and were allocated low-income housing tax credits pursuant to Internal Revenue Code Section 42 (Section 42), which regulates the use of the Project as to occupant eligibility and unit gross rent, among other requirements. Each building of the Project must meet the provisions of these regulations during each of 15 consecutive years in order to remain qualified to receive the credits. In addition, the Partnership has executed a land use restriction agreement which requires the utilization of the Project pursuant to Section 42 for a minimum of 40 years, even after disposition of the Project by the Partnership.

The partnership agreement remains in effect until December 31, 2100.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

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. Accounting principles generally accepted in the United States of America require that the allowance method be used to recognize bad debts; however, the effect of using the direct write-off method is not materially different from the results that would have been obtained under the allowance method.

Othello Street Limited Partnership

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2008

Investment in Real Estate

The investment in real estate is carried at cost. Depreciation is provided for in amounts sufficient to relate the cost of the buildings, land improvements and equipment to operations over their estimated useful lives using the straight-line method. Improvements are capitalized, while expenditures for maintenance and repairs are charged to expense as incurred.

Impairment of Long-Lived Assets

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Partnership reviews its rental property for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the fair value is less than the carrying amount of the asset, an impairment loss is recognized for the difference. No impairment loss has been recognized during the year ended December 31, 2008.

Deferred Financing Cost

Deferred financing costs are amortized over the term of the loan using the effective-yield method. Amortization expense for the year ended December 31, 2008 was \$17,231. Estimated amortization expense for each of the five ensuing years through December 31, 2013 is \$ 17,836, \$18,432, \$19,012, \$19,570 and \$20,098, respectively.

Rental Income

Rental income is recognized as rentals become due. Rental payments received in advance are deferred until earned. All leases between the Partnership and tenants of the property are operating leases.

Advertising Costs

The Company's policy is to expense advertising costs when incurred.

Income Taxes

No provision or benefit for income taxes has been included in these financial statements since taxable income or loss passes through to, and is reportable by, the partners individually.

Othello Street Limited Partnership

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2008

Uncertainty in Income Taxes

In June 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes" an interpretation of FASB Statement No. 109. The effective date of FIN 48 was for fiscal years beginning after December 15, 2006. The effective date was delayed in 2007 and was delayed again in 2008 for nonpublic companies. The new effective date for FIN 48 for nonpublic companies is for fiscal years beginning after December 15, 2008. The Partnership has elected to defer application of FIN 48, as permitted by FSP FIN 48-3, "Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises," until 2009. The Partnership does not anticipate that the provisions of FIN 48 will have any significant impact on its financial statements. However, additional disclosures may be required of situations, if any, where the Partnership's tax positions are considered uncertain. Currently, the FASB is deliberating the manner and extent to which pass-through entities such as the Partnership will need to apply the provisions of FIN 48.

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.

NOTE 3 – RESTRICTED CASH

PHU Reserves

Under the partnership agreement, the general partner is required to fund operating reserves prior to completion date, as defined, as follows: (1) Public Housing Operating Reserve (PHOR Reserve) in the amount of \$278,640 and (2) Public Housing Expense Reserve (PHER Reserve) in the amount of \$99,000. In addition, the Partnership is obligated to deposit \$59,400 into a Tax Credit Reserve (TC Reserve) for the support of Tax Credit Units (TC Units), as defined, collectively, the PHU Reserve. As of December 31, 2008 the PHOR reserve and PHER reserve balances were \$316,548 and \$112,610, respectively.

Othello Street Limited Partnership

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2008

Replacement Reserve Account

Under the Partnership Agreement, the general partner is required to establish a Replacement Reserve during 2001 equal to \$300 per tax credit-market rate unit (TCMR), prorated in 2001 based on placed in service date. Beginning in 2002, the annual deposits are to increase 3 percent annually throughout the term of the Partnership Agreement. As of December 31, 2008 the Replacement Reserve balance was \$67,505.

Debt Service Reserve

Under the Partnership Agreement, the general partner is required to establish a Debt Service Reserve prior to the bond conversion date in an amount equal to \$195,328. As of December 31, 2008 the Debt Service Reserve balance was \$195,328.

Funds Held In Escrow

As described in Note 5, the proceeds from the issuance of the Variable Rate Bonds were deposited into an escrow account maintained by Bank of New York Western Company. The reimbursement agent is KeyBank National Association. Under the reimbursement agreement, the proceeds of the Variable Rate Bonds of \$9,500,000 are to be disbursed in accordance with the Trust Indenture. The funds held by the Bank of New York Western Company are invested in accordance with the Trust Indenture, primarily in short-term U.S. Treasury obligations. The trust account is stated at cost, which approximates market value due to the short-term highly liquid nature of the investments. The proceeds from the Variable Rate Bonds have been deposited in construction funds to be used to fund approved development costs. The balance of the fund held by Bank of New York Western Company at December 31, 2008, was \$314,253. The funds held by KeyBank National were used to payoff the Variable Rate Bonds during 2003.

NOTE 4 - RELATED PARTY TRANSACTIONS

Management Agreement

On June 3, 2003, the Partnership entered into a management agreement with Impact Property Management, an affiliate of the general partner. The management agreement provides for fees of \$2,400 per month. For the year ended December 31, 2008, \$57,744 of management fees have been earned and paid.

Othello Street Limited Partnership

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2008

Ground Lease Agreement

On June 17, 2000, the Partnership entered into a ground lease agreement with the general partner. The Partnership will pay the general partner rent equal to \$10 per year for a period of 99 years. As of December 31, 2002, the entire amount of the lease was paid in full. The lease is being accounted for as an operating lease.

Development Services Fee

On June 19, 2000, the Partnership entered into a development services agreement with the general partner for services in connection with the development of the Project. The development services agreement provides for a fee equal to \$1,629,000. The fee was capitalized into the cost of the building. As of December 31, 2008, the entire \$1,629,000 has been earned and no development service fee remains payable.

Partnership Administration Fee

The Partnership entered into a partnership administration agreement on June 19, 2000 with the general partner. The partnership administration agreement provides for an annual fee of \$10,000 increasing 3 percent per year beginning January 1, 2003. The fee is payable to the extent net cash flows, as defined, is available. Any unpaid fees will not accrue. As of December 31, 2008, no partnership administration fee has been paid.

Investor Services Fee

The Partnership entered into an investor services agreement on June 19, 2000 with The Enterprise Social Investment Corporation (ESIC). The investor services agreement provides for an annual fee of \$1,500 increasing 4 percent per year beginning January 1, 2003. The investor services fee is payable to the extent surplus cash, as defined, is available. Any unpaid fees will not accrue. As of December 31, 2008, \$0 of investor services fees has been paid.

Othello Street Limited Partnership

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2008

NOTE 5 - MORTGAGE NOTES PAYABLE

First Mortgage - The Housing Authority of The City Of Seattle

The Partnership entered into a loan agreement on December 1, 1999 with the general partner in the original amount of \$9,500,000. Under the terms of the Trust Indenture dated December 1, 1999, the loan was funded by Variable Rate Demand Revenue Bonds 1999, (New Holly Project Phase II) (the Variable Rate Bonds). On June 19, 2000, pursuant to the First Supplemental Trust Indenture, dated June 1, 2000, \$2,440,000 of the Variable Rate Bonds was converted into Fixed Rate Bonds. Payments of interest and principal are due in accordance with the loan agreements. At December 31, 2008, the interest rate on the \$2,440,000 Fixed Rate Bonds was 7 percent. During 2002, the variable rate bonds were satisfied in full from amounts being held in other reserves and from the limited partner's final capital contribution. The fixed rate bonds mature on January 1, 2032 and are secured by a first lien deed of trust on the rental property. As of December 31, 2008, the outstanding principal was \$2,255,000 and the accrued interest outstanding was \$78,925, respectively. Interest expense for the year ending December 31, 2008 was \$159,078.

SHA Loan #1

The Partnership has entered into a loan agreement on June 19, 2000 with the general partner in the original amount of \$4,195,384. The note was funded with proceeds provided to the general partner through HOPE VI grants. The loan accrues interest at 1 percent per annum. Beginning on July 1, 2002, interest only payments are due on the outstanding principal balances from available cash flow, as defined. The unpaid principal and accrued interest are due at maturity on July 1, 2051. The loan is secured by a deed of trust on the Partnership's property. At December 31, 2008, the outstanding principal and accrued interest was \$4,195,384 and \$357,987, respectively. Interest expense for the year ending December 31, 2008 was \$41,953.

SHA Loan #2

The Partnership entered into two additional loan agreements on June 19, 2000 with the general partner in the original amounts of \$300,000 and \$1,700,000, collectively SHA Loan #2. The \$300,000 note was funded with proceeds provided to the general partner through a grant and the \$1,700,000 note was funded with proceeds provided to the general partner through City Funds. The loans accrue interest at 1 percent. Beginning on July 1, 2003 interest only payments are due on the outstanding principal balances from available net cash flow, as defined. The unpaid

Othello Street Limited Partnership

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2008

principal and accrued interest are due on July 1, 2051. The loans are secured by a deed of trust on the Partnership's property. At December 31, 2008, the outstanding principal and accrued interest was \$2,000,000 and \$170,658, respectively. Interest Expense for the year ending December 31, 2008 was \$20,000.

Washington State Housing Loan

The Partnership entered into a loan agreement on June 19, 2000 in the amount of \$2,000,000 with the Washington State Housing Assistance Program. Payments of principal and interest are deferred for thirty years until December 31, 2032, with interest accruing at 1 percent per annum during the deferral period. At December 31, 2032, all unpaid principal and accrued interest will be amortized over 20 years with annual payments of \$149,383 due on December 31 of each year. The final payment is due and payable on or before December 31, 2052. The loans are secured by a deed of trust on the Partnership's property. As of December 31, 2008, the outstanding principal and accrued interest was \$2,000,000 and \$165,717, respectively. Interest expense for the year ending December 31, 2008 was \$21,446.

Aggregate annual maturities of the mortgages payable over each of the next five years as of December 31, are as follows:

| | Fixed Rate Bonds | SHA Loan #1 | SHA Loan #2 | Washington State Housing | Total |
|-------------------------|---------------------|---------------------|---------------------|-----------------------------|----------------------|
| 2009 | \$ 40,000 | \$ - | \$ - | \$ - | \$ 40,000 |
| 2010 | 40,000 | - | - | - | 40,000 |
| 2011 | 45,000 | - | - | - | 45,000 |
| 2012 | 50,000 | - | - | - | 50,000 |
| 2013 | 50,000 | - | - | - | 50,000 |
| Thereafter | <u>2,030,000</u> | <u>4,195,384</u> | <u>2,000,000</u> | <u>2,000,000</u> | <u>10,225,384</u> |
| Total | <u>\$ 2,255,000</u> | <u>\$ 4,195,384</u> | <u>\$ 2,000,000</u> | <u>\$ 2,000,000</u> | <u>10,450,384</u> |
| Less current maturities | | | | | <u>(40,000)</u> |
| Net long-term portion | | | | | <u>\$ 10,410,384</u> |

NOTE 6 - CONCENTRATION OF CREDIT RISK

The Partnership maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Partnership has not experienced any losses in such accounts. The Partnership believes it is not exposed to any significant credit risk on such accounts.

Othello Street Limited Partnership

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2008

NOTE 7 - COMMITMENTS AND CONTINGENCIES

Operating Deficit Advances

Under the Partnership Agreement, the general partner is required to make operating deficit advances to the Partnership in an amount not to exceed an unpaid balance of \$250,000 beginning at break-even date until the end of the compliance period, as defined. The operating deficit advances are non-interest bearing and are payable from net cash flow of the Partnership, as defined. As of December 31, 2008, no such advances have been made.

Tax Credit Compliance

The Project's low-income housing tax credits are contingent on its ability to maintain compliance with applicable sections of Section 42. Failure to maintain compliance with occupant eligibility, and/or unit gross rent, or to correct noncompliance within a specified time period could result in recapture of previously taken tax credits plus interest. In addition, such potential noncompliance may require an adjustment to the contributed capital by the limited partner.