

Sustainable Communities Fund

Financial Statements

December 31, 2018

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Sustainable Communities Fund
Los Angeles, California

We have audited the accompanying financial statements of Sustainable Communities Fund (a California nonprofit corporation) (the "SCF"), which comprise the statement of financial position as of December 31, 2018, and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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 (the "U.S."); 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the U.S. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sustainable Communities Fund as of December 31, 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the U.S.

Change in Accounting Principle

As described in Note 2 to the financial statements, SCF, has adopted Financial Accounting Standards Board Accounting Standards Update ("ASU") 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to that matter.

A handwritten signature in black ink that reads "Armanino LLP".

Armanino^{LLP}
Los Angeles, California

May 8, 2019

Sustainable Communities Fund
Statement of Financial Position
December 31, 2018

ASSETS

| | | |
|---|--------|----------------------|
| Cash and cash equivalents | \$ | 871,080 |
| Contributions receivable, net | | 2,503,793 |
| Program-related investment assets, net, including interest receivable of \$20,899 | | 1,570,548 |
| Mission-related investment assets, including interest receivable of \$6,978 | | <u>356,978</u> |
| Total assets | \$ | <u>5,302,399</u> |

LIABILITIES AND NET ASSETS

| | | |
|---|--------|----------------------|
| Liabilities | | |
| Accounts payable and accrued expenses | \$ | 27,598 |
| Total liabilities | | <u>27,598</u> |
| Net assets | | |
| Without donor restrictions | | |
| Operating reserve | | 109,000 |
| Designated for future funding commitments | | 550,000 |
| General | | <u>2,112,008</u> |
| Total assets without donor restrictions | | 2,771,008 |
| With donor restrictions | | <u>2,503,793</u> |
| Total net assets | | <u>5,274,801</u> |
| Total liabilities and net assets | \$ | <u>5,302,399</u> |

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

Sustainable Communities Fund
Statement of Activities
For the Year Ended December 31, 2018

| | <u>Without Donor Restrictions</u> | <u>With Donor Restrictions</u> | <u>Total</u> |
|--|---------------------------------------|------------------------------------|---------------------|
| Revenues, gains and other support | | | |
| Contributions | | | |
| Contributions, net | \$ - | \$ 389,865 | \$ 389,865 |
| Grants | 73,561 | - | 73,561 |
| Net assets released from restriction | <u>834,642</u> | <u>(834,642)</u> | <u>-</u> |
| Total contributions | 908,203 | (444,777) | 463,426 |
| Interest income | <u>37,551</u> | <u>-</u> | <u>37,551</u> |
| | <u>945,754</u> | <u>(444,777)</u> | <u>500,977</u> |
| Functional expenses | | | |
| Program services | 176,615 | - | 176,615 |
| Support services | | | |
| Management and general | <u>95,447</u> | <u>-</u> | <u>95,447</u> |
| Total functional expenses | <u>272,062</u> | <u>-</u> | <u>272,062</u> |
| Change in net assets from operations | 673,692 | (444,777) | 228,915 |
| Loss on uncollectible promises to give | <u>-</u> | <u>(292,601)</u> | <u>(292,601)</u> |
| Change in net assets | 673,692 | (737,378) | (63,686) |
| Net assets, beginning of year | <u>2,097,316</u> | <u>3,241,171</u> | <u>5,338,487</u> |
| Net assets, end of year | <u>\$ 2,771,008</u> | <u>\$ 2,503,793</u> | <u>\$ 5,274,801</u> |

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

Sustainable Communities Fund
Statement of Functional Expenses
For the Year Ended December 31, 2018

| | <u>Program services</u> | <u>Management and general</u> | <u>Total</u> |
|-------------------------------------|-----------------------------|-----------------------------------|-------------------|
| Accounting services | \$ - | \$ 15,450 | \$ 15,450 |
| Bad debt allowance | 50,000 | - | 50,000 |
| Bank charge | - | 135 | 135 |
| Books, subscriptions and reference | 123 | - | 123 |
| Business taxes and fees | - | 292 | 292 |
| Conference, convention and meetings | 6,150 | - | 6,150 |
| General and administrative | 270 | - | 270 |
| Insurance | 608 | 1,292 | 1,900 |
| Legal fees | 5,310 | 2,325 | 7,635 |
| Membership dues | 1,000 | - | 1,000 |
| Overhead fee | 1,315 | 659 | 1,974 |
| Payroll administration | 14,780 | 9,850 | 24,630 |
| Salaries | 79,529 | 53,019 | 132,548 |
| Staff consulting | 17,530 | 9,766 | 27,296 |
| Telephone and telecommunications | - | 259 | 259 |
| Website | - | 2,400 | 2,400 |
| | <u>\$ 176,615</u> | <u>\$ 95,447</u> | <u>\$ 272,062</u> |

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

Sustainable Communities Fund
Statement of Cash Flows
For the Year Ended December 31, 2018

| | |
|---|-------------------|
| Cash flows from operating activities | |
| Change in net assets | \$ (63,686) |
| Adjustments to reconcile changes in net assets to net cash provided by operating activities | |
| Allowance for doubtful contributions receivable | 149,744 |
| Allowance for doubtful program-related investment assets | 50,000 |
| Direct write-off of uncollectible contributions receivable | 142,857 |
| Discounts on contributions receivable | (49,865) |
| Changes in operating assets and liabilities | |
| Contributions receivable | 494,642 |
| Program-related investment assets | (504,547) |
| Interest receivable | (17,292) |
| Accounts payable and accrued expenses | (13,590) |
| Deferred revenue | <u>(63,560)</u> |
| Net cash provided by operating activities | <u>124,703</u> |
| Net increase in cash and cash equivalents | 124,703 |
| Cash and cash equivalents, beginning of year | <u>746,377</u> |
| Cash and cash equivalents, end of year | <u>\$ 871,080</u> |

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

Sustainable Communities Fund
Notes to Financial Statements
December 31, 2018

1. NATURE OF OPERATIONS

Sustainable Communities Fund ("SCF") has been established to alleviate poverty by supporting financial, economic and social inclusion strategies that empower low-income people and strengthen communities.

SCF is a private operating foundation which operates as a revolving investment fund capitalized by funds originating from investment activities generated primarily by National New Markets Fund ("NNMF"), a joint venture partnership between Strategic Development Solutions, LLC ("SDS") and Economic Innovations International ("EII"). SCF was created to revolve donations coming from NNMF's investment projects as well as other sources, into a new generation of investments benefiting very high-poverty communities or individuals. SCF achieves its mission by investing in organizations with innovative prototype lending or investing models that create significant social and environmental impacts. SCF particularly seeks organizations with new financing models that may need early stage seed funding where its investment can help them "prove" their model – and thus spur follow-on investors to bring additional resources to the effort.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Income tax status

SCF is exempt from federal income taxes under Section 501(c)(3) and is classified as a private operating foundation under Section 509(a) of the Internal Revenue Code. SCF is subject to federal excise taxes on its net investment income.

Change in accounting principle

SCF has adopted the Financial Accounting Standards Board Accounting Standards Update ("ASU") 2016-14, *Presentation of Financial Statements of Not-for-Profit-Entities*. The standard requires (1) that net assets be classified and presented in two categories: net assets without donor restrictions and net assets with donor restrictions and (2) additional disclosures concerning the liquidity of SCF, among other requirements.

Basis of accounting and financial statement presentation

The financial statements of SCF have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles ("GAAP") in the United States of America.

SCF reports information regarding its financial position and activities based on the existence or absence of donor imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

- *Without donor restrictions, operating reserve* - Includes net assets designated as an operating reserve.

Sustainable Communities Fund
Notes to Financial Statements
December 31, 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Basis of accounting and financial statement presentation (continued)

- *Without donor restrictions, designated for future funding commitments* - Includes net assets designated for approved program-related investment assets ("PRIs") and mission-related investment assets ("MRIs") that have not yet been funded (see Note 5).
- *Without donor restrictions, general* - Includes contributions, interest income, and other forms of revenue that are not restricted by the donor or grantor as well as expenditures related to the general operations of SCF.
- *With donor restrictions* - Includes net assets subject to donor (or certain grantor) imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. At December 31, 2018, net assets with donor restrictions consisted of uncollected contributions net of an allowance for uncollectible contributions and present value discount and are being reclassified to net assets without donor restrictions when paid.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and those differences could be material.

Cash and cash equivalents

We consider all cash and highly liquid financial instruments with original maturities of three months or less, which are neither held for nor restricted by donors for long-term purposes, to be cash and cash equivalents. Cash and highly liquid financial instruments restricted to building projects, endowments that are perpetual in nature, or other long-term purposes are excluded from this definition. There were no cash equivalents at December 31, 2018.

Program-related investment assets (PRIs)

SCF makes PRIs to other organizations to achieve its charitable purposes in alignment with SCF's strategies. At December 31, 2018, SCF had eight outstanding PRIs in the form of certificates of deposit (one), equity (one) and loans (six).

Sustainable Communities Fund
Notes to Financial Statements
December 31, 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Program-related investment assets (PRIs) (continued)

PRIs are evaluated annually for impairment and no impairment losses were recorded during the year ended December 31, 2018.

Mission-related investment assets (MRIs)

SCF makes MRIs to other organizations to achieve its charitable purposes in alignment with SCF's strategies. MRIs are market-rate investments and, unlike PRIs, are not considered to be qualified distributions for tax purposes. At December 31, 2018, SCF had two outstanding MRIs in the form of certificates of deposit.

MRIs are evaluated annually for impairment and no impairment losses were recorded during the year ended December 31, 2018.

PRI and MRI allowance for loan losses

SCF has the following process in determining its allowance for Loan Losses: SCF assesses each individual investment on its own to determine its individual contribution to the overall PRI or MRI allowance for loan losses.

Initial Investment - At the time of reviewing a prospective investment, SCF underwriters assess organizational and project-level risks and assign a risk rating score of 1-5 (1= lowest risk). Each of these risk-rating scores has been assigned a percentage range of the dollar amount of the loan to be allocated to the allowance for loan losses. Underwriters assign this dollar amount for the allowance for loan losses as is deemed appropriate based on the specific perceived investment risk rating, and SCF will set aside this dollar amount into its respective PRI or MRI allowance for loan losses account as the investment funds deploy.

Annual Re-assessment - Each investment is assessed annually for its level of risk during its annual asset management review or during an interim assessment if SCF learns of additional investment risks during the course of on-going borrower communications. Based on the new risk assessment, the allowance for loan losses may be increased or decreased as appropriate.

At the end of 2018, there was \$50,000 in the PRI allowance for loan losses account for our nine PRI investments (in eight agreements). At the end of 2018, there was \$0 in our MRI allowance for loan losses account for our two MRI investments as they are rated Risk Level 1 because both investments have 100% payment guarantees.

Sustainable Communities Fund
Notes to Financial Statements
December 31, 2018

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Contributions receivable and promises to give

SCF records unconditional promises to give that are expected to be collected within one year at net realizable value. Unconditional promises to give expected to be collected in future years are recorded as contributions receivable and are initially recorded at fair value using present value techniques incorporating risk-adjusted discount rates designed to reflect the assumptions market participants would use in pricing the asset. In subsequent years, amortization of the discounts is included in contribution revenue in the statement of activities. SCF determines the allowance for uncollectible promises to give based on historical experience, an assessment of economic conditions, and a review of subsequent collections. Promises to give are written off when deemed uncollectible. During the year, one promise with a remaining balance of \$142,857 was deemed uncollectible and written off. In addition, at December 31, 2018, management estimated that a portion of the total contributions receivable balance may be uncollectible and, therefore, management has recorded an allowance for doubtful contributions receivable of \$149,744.

Revenue recognition

Contributions are recognized when cash, securities or other assets, an unconditional promise to give, or notification of a beneficial interest is received. Grant revenue is recognized consistent with the terms of the grant agreement. Deferred revenue represents cash received in excess of costs incurred on cost reimbursement grants.

Functional expenses

The costs of program and supporting services activities have been summarized on a functional basis in the statement of activities. The statement of functional expenses present the natural classification detail of expenses by function. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Subsequent events

SCF has evaluated events subsequent to December 31, 2018, to assess the need for potential recognition or disclosure in the financial statements. Such events were evaluated through May 8, 2019, the date the financial statements were available to be issued. Based upon this evaluation it was determined no subsequent events occurred that require recognition or additional disclosure in the financial statements, except as disclosed in Note 5.

Sustainable Communities Fund
Notes to Financial Statements
December 31, 2018

3. CONTRIBUTIONS RECEIVABLE

Contributions receivable consist of the following:

| | |
|---|----------------------------|
| Khan Family Office | \$ 340,000 |
| CSOTD Holdings, Inc. | 130,000 |
| Aker Biomarine Manufacturing, LLC | 85,714 |
| Sarla Manufacturing Associates, LLC | 92,857 |
| MIA Land & Property, LLC | 170,000 |
| Detroit Manufacturing Systems, LLC | 128,571 |
| Pizitz, LLC | 394,286 |
| American Tubing Arkansas, LLC | 175,000 |
| PDPP Abilene, LLC | 360,000 |
| SAFB Real Estate, Inc. | 175,000 |
| SALB Real Estate Ventures, Inc. | 127,000 |
| 2301 LA Holdings | 130,400 |
| The Nucleus Real Properties, Inc. | 150,000 |
| CMC Steel Oklahoma, LLC | <u>315,000</u> |
| | 2,773,828 |
| Less: allowance for doubtful contributions receivable | (149,744) |
| Less: discount to present value | <u>(120,291)</u> |
| | <u><u>\$ 2,503,793</u></u> |

Contributions receivable by year are as follows:

| | |
|---|----------------------------|
| Due in less than 1 year | \$ 1,381,507 |
| Due in 1 to 5 years | 1,307,321 |
| Due in more than 5 years | <u>85,000</u> |
| | 2,773,828 |
| Less: allowance for doubtful contributions receivable | (149,744) |
| Less: discount to present value | <u>(120,291)</u> |
| | <u><u>\$ 2,503,793</u></u> |

SCF uses 2.5% as its present value discount factor which is based on an average of 5-year U.S. Treasury rates.

4. FEDERAL EXCISE TAXES

SCF is subject to federal excise taxes imposed on private foundations at 2%, or at 1% if certain conditions are met. The excise tax is imposed on net investment income, as defined under federal law, which includes interest, dividends, and net related gains on the sale of investments. Management records excise tax expense on the cash basis as the amount due is estimated to be de minimis.

Sustainable Communities Fund
Notes to Financial Statements
December 31, 2018

5. INVESTMENT ASSETS

PRIs are strategic investments, beyond grants, made by SCF for the specific objective of furthering SCF's charitable purpose. The production of income is not the primary objective of a PRI.

Deployed

SCF's portfolio includes loans and certificates of deposit invested in not-for-profit entities and one equity investment in a for-profit entity. The majority of these investments are in support of economic development activities in low-income communities in the United States. They enable partner organizations to invest in small business development and entrepreneurship in select communities. Interest payments are due on the outstanding loan and certificate of deposit amounts at interest rates generally ranging between 1% and 3%.

During the year ended December 31, 2018, SCF made three PRI investments. Two of the new investments were loans totaling \$200,000 and \$300,000, respectively. The third was in the form of a certificate of deposit totaling \$254,649.

The PRIs are summarized in the table below as follows:

| | |
|--|----------------------------|
| PRIs, beginning of year | \$ 1,095,000 |
| Additional loans | 754,649 |
| Principal repayments | <u>(250,000)</u> |
| | 1,599,649 |
| Less: allowance for doubtful program-related investment assets | <u>(50,000)</u> |
| | 1,549,649 |
| Interest receivable | <u>20,899</u> |
| PRIs, end of year | <u><u>\$ 1,570,548</u></u> |

In addition to the PRIs detailed above, SCF had \$350,000 in mission-related investments (MRIs) at December 31, 2018 with interest receivable of \$6,978.

Committed/Undeployed

SCF has two unfunded commitments at December 31, 2018 totaling \$550,000. These unfunded commitments consist of one PRI and one MRI in the amounts of \$150,000 and \$400,000, respectively. The unfunded PRI is subject to certain conditions and SCF will fund the remaining commitment amount when the conditions have been met. Funding for the MRI requires formal capital calls from the investee. During 2019, the investee has submitted capital calls totaling \$9,400 which SCF has funded.

Sustainable Communities Fund
Notes to Financial Statements
December 31, 2018

5. INVESTMENT ASSETS (continued)

The future maturities of the program-related and mission-related investments are as follows:

| <u>Year ending December 31,</u> | |
|---------------------------------|---------------------|
| 2019 | \$ 625,000 |
| 2020 | 374,649 |
| 2021 | 200,000 |
| 2022 | <u>750,000</u> |
| | <u>\$ 1,949,649</u> |

6. RELATED PARTY TRANSACTIONS

SCF has entered into a shared services agreement with Strategic Development Solutions, LLC ("SDS"). SDS is owned by individuals that serve on the board of directors of SCF and are therefore considered disqualified persons under the Internal Revenue Code. SCF has determined that this arrangement qualifies as reimbursement for reasonable and necessary costs. Under the agreement, SCF will reimburse SDS for direct costs of services provided by SDS personnel (which includes a 7.5% overhead charge applied to this total), up to \$35,000 in 2018. Any services provided directly by disqualified persons are not charged to SCF. During 2018, total costs reimbursable to SDS totaled \$28,295, of which \$10,265 was included in accounts payable and accrued expense at December 31, 2018.

7. EFFECTS OF IMPLEMENTATION OF ASU 2016-14

As described in Note 2, during the year SCF adopted ASU 2016-14, resulting in a re-characterization of the classifications of its net assets. As a result, net assets previously referred to as temporarily restricted net assets are now referred to as net assets with donor restrictions.

Endowment net asset composition by type of fund as of December 31, 2017 is as follows:

| | Unrestricted - Without Donor <u>Restrictions</u> | Temporarily restricted | With Donor Restrictions | <u>Total</u> |
|---|---|---------------------------|----------------------------|---------------------|
| Net assets as previously reported, December 31, 2017 | \$ 2,097,316 | \$ 3,241,171 | \$ - | \$ 5,338,487 |
| Reclassification resulting from ASU 2016-14 | <u>-</u> | <u>(3,241,171)</u> | <u>3,241,171</u> | <u>-</u> |
| | <u>\$ 2,097,316</u> | <u>\$ -</u> | <u>\$ 3,241,171</u> | <u>\$ 5,338,487</u> |

Sustainable Communities Fund
Notes to Financial Statements
December 31, 2018

8. LIQUIDITY AND AVAILABILITY

SCF is significantly supported by contributions. SCF's liquidity management policy is designed to provide that its remaining financial assets are available for operations as its general expenditures, liabilities, and other obligations come due.

The following reflects SCF's financial assets reported on the statement of financial position, reduced by amounts not available for general use within one year because of contractual or time restrictions, or commitments to provide funding to identified investments.

Liquidity of financial assets as of December 31, 2018 is as follows:

| | |
|--|---------------------|
| Cash and cash equivalents | \$ 871,080 |
| Contributions receivable | 2,773,828 |
| Interest receivable | <u>27,877</u> |
| | <u>3,672,785</u> |
| | |
| Contributions receivable due past one year | (1,392,321) |
| Interest receivable due past one year | (27,877) |
| Operating reserve | (109,000) |
| Designated for future funding commitments | <u>(550,000)</u> |
| | <u>(2,079,198)</u> |
| | |
| Net liquid assets available for operations | <u>\$ 1,593,587</u> |

