

WATERSIDE COURT, LTD.
FINANCIAL STATEMENTS
For the year ended December 31, 2008
with
Report of Independent Auditors

Report of Independent Auditors

To the Partners of
Waterside Court, Ltd.:

We have audited the accompanying balance sheet of Waterside Court, Ltd. as of December 31, 2008, and the related statements of operations, changes in partners' capital 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 Waterside Court, Ltd. 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.

Novogradac & Company LLP

March 30, 2009

WATERSIDE COURT, LTD.
BALANCE SHEET
December 31, 2008

ASSETS

Cash and cash equivalents	\$ 168,353
Restricted cash	531,205
Accounts receivable	2,000
Prepaid expenses	14,060
Fixed assets, net of accumulated depreciation	14,923,190
Intangible assets, net of accumulated amortization	<u>382,457</u>
Total assets	<u>\$ 16,021,265</u>

LIABILITIES AND PARTNERS' CAPITAL

Liabilities	
Accounts payable	\$ 10,538
Security deposits payable	61,203
Accrued interest	35,245
Accrued expenses	30,182
Due to related party	4,570
Development fee payable	370,550
HOME loan payable	500,000
Mortgage loan payable	<u>4,775,461</u>
Total liabilities	5,787,749
Partners' capital	<u>10,233,516</u>
Total liabilities and partners' capital	<u>\$ 16,021,265</u>

see accompanying notes

WATERSIDE COURT, LTD.
STATEMENT OF OPERATIONS
For the year ended December 31, 2008

REVENUE	
Rental revenue	\$ 1,034,184
Other income	<u>50,437</u>
Total revenue	1,084,621
OPERATING EXPENSES	
General and administrative	36,989
Payroll	180,506
Utilities	74,862
Taxes and Insurance	30,393
Property management fees	56,231
Repairs and maintenance	131,655
Legal and other professional fees	26,379
Marketing and advertising	<u>8,714</u>
Total operating expenses	<u>545,729</u>
Operating income	538,892
OTHER INCOME AND (EXPENSES)	
Interest income	7,563
Interest expense	(415,840)
Depreciation and amortization	(625,174)
Other partnership expenses	<u>(6,231)</u>
Net other income and (expenses)	<u>(1,039,682)</u>
Net loss	<u><u>\$ (500,790)</u></u>

see accompanying notes

WATERSIDE COURT, LTD.
STATEMENT OF CHANGES IN PARTNERS' CAPITAL
For the year ended December 31, 2008

	<u>General Partner</u>	<u>Limited Partners</u>	<u>Total Partners' Capital</u>
BALANCE, JANUARY 1, 2008	\$ (38)	\$ 7,744,563	\$ 7,744,525
Capital contributions	-	2,989,781	2,989,781
Net loss	<u>(50)</u>	<u>(500,740)</u>	<u>(500,790)</u>
BALANCE, DECEMBER 31, 2008	<u><u>\$ (88)</u></u>	<u><u>\$ 10,233,604</u></u>	<u><u>\$ 10,233,516</u></u>

see accompanying notes

WATERSIDE COURT, LTD.
STATEMENT OF CASH FLOWS
For the year ended December 31, 2008

CASH FLOWS FROM OPERATING ACTIVITIES

Net loss	\$ (500,790)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation and amortization	625,174
Increase in restricted cash	(3,418)
Increase in prepaid expenses	(14,060)
Increase in accounts payable	935
Increase in security deposits payable	3,418
Decrease in accrued interest	(7,325)
Decrease in accrued expenses	(32,870)
Net cash provided by operating activities	<u>71,064</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Increase in restricted cash	(470,002)
Purchases of fixed assets	(8,243)
Increase in intangible assets	(10,773)
Payment of contractor payable	(72,685)
Net cash used in investing activities	<u>(561,703)</u>

CASH FLOWS FROM FINANCING ACTIVITIES

Payment of due to related party	(88,430)
Payment of development fee payable	(1,505,000)
Proceeds from HOME loan payable	50,000
Payment of construction loans payable	(870,994)
Payment of mortgage loan payable	(24,539)
Capital contributions	2,989,781
Net cash provided by financing activities	<u>550,818</u>

NET INCREASE IN CASH AND CASH EQUIVALENTS 60,179

CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR 108,174

CASH AND CASH EQUIVALENTS AT END OF YEAR \$ 168,353

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid for interest	<u><u>\$ 423,165</u></u>
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see accompanying notes

WATERSIDE COURT, LTD.
STATEMENT OF CASH FLOWS (CONTINUED)
For the year ended December 31, 2008

SUPPLEMENTAL DISCLOSURE OF NON-CASH
INVESTING AND FINANCING ACTIVITIES

Increase in accounts receivable due to reclass of restricted cash	<u>\$ 2,000</u>
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Decrease in construction loan payable from conversion to mortgage loan payable	<u>\$ 4,800,000</u>
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see accompanying notes

WATERSIDE COURT, LTD.
NOTES TO FINANCIAL STATEMENTS
For the year ended December 31, 2008

1. General

Waterside Court, Ltd. (the “Partnership”), a Texas limited partnership, was formed on February 20, 2004 to acquire, construct, develop and operate a 118-unit apartment project known as Waterside Court (the “Project”) in Houston, Texas. The Project is rented to low-income tenants and is operated in a manner necessary to qualify for federal low-income housing tax credits as provided for in Section 42 of the Internal Revenue Code.

The general partner is HCHA Waterside, LLC (the “General Partner”). The limited partners (the “Limited Partners”) are Investors Affordable Housing Group X, LLC (the “Class A Limited Partner”), Hudson SLP, LLC (the “Special Limited Partner”), and Hudson Waterside, LLC (the “Investment Limited Partner”). The Partnership will operate until December 31, 2080, or until its earlier dissolution or termination.

Profits, losses, and tax credits are allocated in accordance with the Amended and Restated Agreement of Limited Partnership of Waterside Court, Ltd., dated June 22, 2006, and as amended (the “Partnership Agreement”). Profits and losses from operations and low-income housing tax credits are allocated 99.99% to the Limited Partners and 0.01% to the General Partner.

Pursuant to the Partnership Agreement, the Investment Limited Partner is required to provide capital contributions to the Partnership totaling \$11,140,928, as adjusted for any tax credit adjustments. As of December 31, 2008, the Investment Limited Partner had provided cumulative contributions in the amount of \$11,118,524.

2. Summary of significant accounting policies and nature of operations

Basis of accounting

The Partnership prepares its financial statements on the accrual basis of accounting consistent with accounting principles generally accepted in the United States of America.

Cash and cash equivalents

Cash and cash equivalents include all cash balances and highly liquid investments with maturities of three months or less at date of acquisition. Restricted cash is not considered cash equivalents.

Concentration of credit risk

The Partnership places its temporary cash investments with high credit quality financial institutions. At times, the account balances may exceed the institutions’ federally insured limits. The Partnership has not experienced any losses in such accounts.

WATERSIDE COURT, LTD.
NOTES TO FINANCIAL STATEMENTS
For the year ended December 31, 2008

2. Summary of significant accounting policies and nature of operations (continued)

Income taxes

Income taxes on Partnership income are levied on the partners in their individual capacity. Accordingly, no provision for income taxes is reflected in the accompanying financial statements.

In July 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109* (“FIN 48”). FIN 48 prescribes detailed guidance for financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise’s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. Pursuant to FSP-FIN 48-3, the effective date has been deferred for nonpublic organizations and will become effective for fiscal years beginning after December 15, 2008. The Partnership has elected to defer the application of FIN 48. Management believes that the implementation of FIN 48 will not have a material effect on the financial statements.

Estimates

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

Economic concentrations

The Partnership operates one property located in Houston, Texas. Future operations could be affected by changes in economic or other conditions in that geographical area or by changes in federal low-income housing subsidies or the demand for such housing.

Fixed assets

Fixed assets are recorded at cost. Residential rental buildings are depreciated over their estimated useful lives of 40 years using the straight-line method. Site improvements are depreciated over 15 years using the straight-line method. Personal property is depreciated over 5 years using the straight-line method. Depreciation expense for 2008 was \$608,917.

Fixed assets consisted of the following at December 31, 2008:

Buildings	\$ 12,539,072
Site improvements	2,578,104
Personal property	617,835
Less: accumulated depreciation	<u>(811,821)</u>
Fixed assets, net	<u>\$ 14,923,190</u>

WATERSIDE COURT, LTD.
NOTES TO FINANCIAL STATEMENTS
For the year ended December 31, 2008

2. Summary of significant accounting policies and nature of operations (continued)

Intangible assets

Intangible assets include financing fees of \$357,353 and tax credit fees of \$67,425, which are amortized using the straight-line method over the life of the loan and tax credit period, respectively. As of December 31, 2008, accumulated amortization was \$42,321. Amortization expense for 2008 was \$16,257.

Impairment of long-lived assets

The Partnership reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Recoverability is measured by a comparison of the carrying amount to the future net undiscounted cash flow expected to be generated and any estimated proceeds from the eventual disposition. If the long-lived asset is considered to be impaired, the impairment to be recognized is measured at the amount by which the carrying amount exceeds the fair value as determined from an appraisal, discounted cash flows analysis, or other valuation technique. There was no impairment loss recognized during 2008.

Revenue recognition

Rental revenue attributable to residential leases is recorded when due from residents, generally upon the first day of each month. Leases are for periods of up to one year, with rental payments due monthly. Other income result from fees earned for late payments, cleaning, damages and laundry facilities and is recorded when earned.

Tenant receivables

An allowance for bad debts is not maintained. Accounts receivable are written off when they are determined to be uncollectible. Accounting principles generally accepted in the United States of America require that an allowance for uncollectible accounts be maintained in lieu of using the direct charge-off method; however, it has been determined that such an allowance would be immaterial with respect to the financial statements taken as a whole.

3. Restricted cash

Security deposits

Tenant security deposits are placed into an interest-bearing account and are generally held until termination of the leases, at which time some or all of the deposits may be returned to the lessees. As of December 31, 2008, the security deposits balance was \$61,203.

WATERSIDE COURT, LTD.
NOTES TO FINANCIAL STATEMENTS
For the year ended December 31, 2008

3. Restricted cash (continued)

Tax and insurance escrows

Monthly deposits are made for the payment of Project insurance and taxes. All deposits are pledged as additional security for the Project mortgage. As of December 31, 2008, tax and insurance escrows balance was \$50,050.

Operating reserve

Pursuant to the Partnership Agreement, the General Partner is required to establish an operating reserve with a minimum deposit of \$100,000 to be increased to \$275,000 upon funding of the HOME loan payable. The funds may be released to pay operating expenses with the approval of the Special Limited Partner. As of December 31, 2008, the operating reserve had been funded from proceeds of the HOME loan payable and the third and fourth capital contribution installments, which occurred during 2008, and is included in the interest bearing accounts.

Replacement reserve

Pursuant to the Partnership Agreement, monthly deposits are placed into an interest-bearing account held by Amegy Mortgage Company, L.L.C. for major repairs and improvements of the Project. Deposits to the replacement reserve account began in 2008. All deposits in the account are pledged as additional security for the Project mortgage. As of December 31, 2008, the replacement reserve balance was \$17,206.

Interest bearing accounts

The Partnership maintains interest bearing accounts, including money market accounts and certificates of deposit, with various interest rates and maturities. As of December 31, 2008, the accounts totaled \$402,746.

4. Related party transactions

Property management fees

Pursuant to the property management agreement, Hettig Management Corp., a related party of the Class A Limited Partner, receives property management fees in the amount of 5% of the gross effective income collected from operations, provided that payment of 20% of the property management fee shall be subordinated to the payment of Project debt service and other operating expenses. During 2008, property management fees of \$56,231 were incurred. As of December 31, 2008, property management fees of \$4,570 were outstanding and are included in "Due to related party" on the accompanying balance sheet.

WATERSIDE COURT, LTD.
NOTES TO FINANCIAL STATEMENTS
For the year ended December 31, 2008

4. Related party transactions (continued)

Development fee payable

Hettig Development Group X, Ltd., a related party of the Class A Limited Partner, has earned a fee of \$2,125,550 for development services rendered in connection with the construction and development of the Project. Payments of the development fee are to be made from Project cash flow and from additional capital contributions, which may be received from the Investment Limited Partner. Pursuant to the development agreement, the development fee does not earn interest and shall be paid in full no later than fourteen years after receipt of the completion certificate. As of December 31, 2008, development fee payable of \$370,550 was outstanding.

Incentive partnership management fee

Pursuant to the Partnership Agreement, the General Partner and Class A Limited Partner are entitled to receive an annual, non-cumulative incentive partnership management fee equal to 11% of gross effective income and payable from net cash flow available for distribution. The Partnership achieved positive net cash flow during 2008; however, based on the priority distribution in the Partnership Agreement, net cash flow generated was not available to pay the incentive partnership management fee. No incentive partnership management fee was accrued during 2008.

Ground lease

In October 2005, the Partnership entered into a 65-year ground lease agreement (the "Ground Lease") with Harris County Housing Authority, a related party of the General Partner. Under the terms of the Ground Lease, the Partnership is required to make annual lease payments of \$1,000 during the first 17 years. Beginning in year 18, the annual lease payment increases to \$65,000 for the remaining term of the Ground Lease, with all but \$1,000 of that waived, provided that the Project is leased to tenants in accordance with all applicable Low Income Housing Requirements. During 2008, Ground Lease expense of \$1,000 was charged to operations and is included in "General and administrative" on the accompanying statement of operations. As of December 31, 2008, outstanding Ground Lease payable was \$1,000 and is included in "Accrued expenses" on the accompanying balance sheet.

HOME loan payable

In June 2006, the Partnership obtained a HOME loan from Harris County Housing Authority in the total amount of \$500,000. The HOME loan accrues interest on the outstanding balance at the applicable federal interest rate (AFR) of 5.32%, and matures on June 30, 2028. The HOME loan is collateralized by the Project and is subordinate to the mortgage loan payable. Interest only payments are required until maturity, at which time all outstanding principal and interest is due. As of December 31, 2008, principal of \$500,000 and accrued interest of \$35,245 was outstanding.

WATERSIDE COURT, LTD.
NOTES TO FINANCIAL STATEMENTS
For the year ended December 31, 2008

5. Construction loans payable

In June 2006, the Partnership obtained financing comprised of two loans for the Project from Amegy Mortgage Company, L.L.C. (the "Lender") which consisted of original principal amounts of \$4,800,000 and \$5,570,386. The loans bore interest at the rates of 7.38% and at the greater of 5.5% or LIBOR plus 2.25%, respectively, per annum. During 2008, the construction loan of \$4,800,000 converted to permanent financing, and the remaining balance on the construction loan of \$5,570,386 was paid in full. During 2008, interest incurred on the construction loans was \$170,513, which was paid in full at conversion.

6. Mortgage loan payable

On June 1, 2008, the construction loan in the principal amount of \$4,800,000 held with the Lender converted to permanent financing. The mortgage loan payable bears interest at 7.38% with principal and interest payments due monthly based on a thirty year amortization period. The mortgage loan payable is collateralized by the Project and matures in June 2026. As of December 31, 2008, the principal balance of \$4,775,461 was outstanding. Interest expense of \$210,082 was incurred on the outstanding balance from conversion to December 31, 2008, and no interest was accrued as of December 31, 2008.

Future minimum principal payment requirements over each of the next five years and thereafter are as follows:

Year ending December 31,	
2009	\$ 46,282
2010	49,896
2011	53,727
2012	56,884
2013	62,285
Thereafter	<u>4,506,387</u>
Total	<u>\$ 4,775,461</u>

7. Property exemption

The Partnership applied for and was granted exemption from property tax by Harris County Appraisal District, pursuant to Section 392.005 of the Texas Local Government Code. Pursuant to the code, a multifamily residential development which is owned by a housing authority is property tax exempt.

WATERSIDE COURT, LTD.
NOTES TO FINANCIAL STATEMENTS
For the year ended December 31, 2008

8. Low-income housing tax credits

The Partnership expects to generate an aggregate of \$11,541,000 of low-income housing tax credits (“Tax Credits”). The Tax Credits include an annual allocation of \$1,054,000 from 2005 and an additional annual allocation of \$100,100 allocated in 2008. Generally, such Tax Credits are available for use by the partners pro-rata over a ten-year period that began in 2007. In order to qualify for these Tax Credits, the Project must comply with various federal and state requirements. These requirements include, but are not limited to, renting to low-income tenants at rental rates, which do not exceed specified percentages of area median gross income for the first 15 years of operation. The Partnership has also agreed to maintain and operate the Project as low-income housing for another 15 years after that period ends. Because the Tax Credits are subject to certain compliance requirements, there can be no assurance that the aggregate amount of Tax Credits will be realized and failure to meet all such requirements may result in less Tax Credits than expected.