

**Houston Food Bank
and Subsidiaries**

Consolidated Financial Statements
and Independent Auditors' Report
for the years ended June 30, 2010 and 2009

Independent Auditors' Report

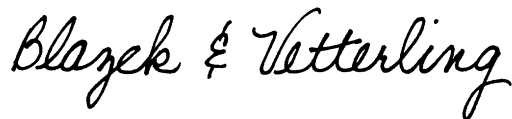
To the Board of Directors of
Houston Food Bank:

We have audited the accompanying consolidated statements of financial position of Houston Food Bank and its subsidiaries as of June 30, 2010 and 2009 and the related consolidated statements of activities, of functional expenses, and of cash flows for the years then ended. These financial statements are the responsibility of the management of Houston Food Bank. 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Houston Food Bank and its subsidiaries as of June 30, 2010 and 2009 and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 2010, on our consideration of Houston Food Bank's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



December 10, 2010

Houston Food Bank and Subsidiaries

Consolidated Statements of Financial Position as of June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
ASSETS		
Cash and cash equivalents (<i>Notes 3 and 7</i>)	\$ 100,000	\$ 5,484,450
Receivables:		
Government grants and contract receivables	1,036,185	528,765
Agency accounts receivable	621,197	372,968
Food inventory	4,769,266	3,571,733
Prepaid expenses and other assets	340,927	398,364
Operating pledges receivable, net (<i>Note 5</i>)	324,064	138,537
Investments (<i>Notes 6 and 7</i>)	5,248,969	9,644,844
Debt issuance cost	391,784	
Cash restricted by notes payable (<i>Note 9</i>)	25,168,487	
Pledges receivable restricted for property, net (<i>Note 5</i>)	12,450,055	8,065,971
Note receivable (<i>Note 4</i>)	36,856,479	
Property and equipment, net (<i>Note 8</i>)	<u>30,364,059</u>	<u>7,018,367</u>
TOTAL ASSETS	<u>\$117,671,472</u>	<u>\$ 35,223,999</u>
LIABILITIES AND NET ASSETS		
Liabilities:		
Accounts payable	\$ 929,069	\$ 679,030
Accrued expenses	436,907	256,795
Deferred revenue	89,925	316,626
New market tax credits notes payable (<i>Note 8</i>)	48,964,971	
Notes payable (<i>Note 10</i>)	<u>12,120,631</u>	<u>890,302</u>
Total liabilities	<u>62,541,503</u>	<u>2,142,753</u>
Net assets:		
Unrestricted (<i>Notes 11 and 14</i>)	17,352,605	16,353,985
Temporarily restricted (<i>Notes 12 and 14</i>)	36,098,536	15,048,433
Permanently restricted (<i>Notes 13 and 14</i>)	<u>1,678,828</u>	<u>1,678,828</u>
Total net assets	<u>55,129,969</u>	<u>33,081,246</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$117,671,472</u>	<u>\$ 35,223,999</u>

See accompanying notes to consolidated financial statements.

Houston Food Bank and Subsidiaries

Consolidated Statement of Activities for the year ended June 30, 2010

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Donated food and household items <i>(Note 15)</i>	\$ 101,473,986			\$ 101,473,986
Contributions	5,582,341	\$ 17,159,940		22,742,281
In-kind contributions <i>(Note 15)</i>	254,520	5,339,730		5,594,250
Special events	681,729			681,729
Direct donor benefit costs	(29,942)			(29,942)
Government grants and contracts <i>(Note 16)</i>	3,324,848			3,324,848
Agency fees	2,435,853			2,435,853
Investment return <i>(Note 6)</i>	873,919	88,793		962,712
Food preparation fees	588,071			588,071
Sales of purchased food	454,759			454,759
Other income	<u>455,499</u>			<u>455,499</u>
Total revenue	116,095,583	22,588,463		138,684,046
Net assets released from restrictions:				
Expenditures for program purposes	<u>1,538,360</u>	<u>(1,538,360)</u>		
Total	<u>117,633,943</u>	<u>21,050,103</u>		<u>138,684,046</u>
EXPENSES:				
Food distribution program <i>(Note 15)</i>	111,849,545			111,849,545
Management and general	2,537,813			2,537,813
Fundraising	<u>2,247,965</u>			<u>2,247,965</u>
Total expenses	<u>116,635,323</u>			<u>116,635,323</u>
CHANGES IN NET ASSETS	998,620	21,050,103		22,048,723
Net assets, beginning of year	<u>16,353,985</u>	<u>15,048,433</u>	<u>\$ 1,678,828</u>	<u>33,081,246</u>
Net assets, end of year	<u>\$ 17,352,605</u>	<u>\$ 36,098,536</u>	<u>\$ 1,678,828</u>	<u>\$ 55,129,969</u>

See accompanying notes to consolidated financial statements.

Houston Food Bank and Subsidiaries

Consolidated Statement of Activities for the year ended June 30, 2009

	<u>UNRESTRICTED</u>	<u>TEMPORARILY RESTRICTED</u>	<u>PERMANENTLY RESTRICTED</u>	<u>TOTAL</u>
REVENUE:				
Donated food and household items <i>(Note 15)</i>	\$ 95,510,017			\$ 95,510,017
Contributions	5,126,765	\$ 8,526,085		13,652,850
In-kind contributions <i>(Note 15)</i>	841,586			841,586
Special events	226,412			226,412
Direct donor benefit costs	(50,023)			(50,023)
Government grants and contracts <i>(Note 16)</i>	1,862,147			1,862,147
Agency fees	1,824,591			1,824,591
Investment return <i>(Note 6)</i>	(905,641)	(111,409)		(1,017,050)
Food preparation fees	392,234			392,234
Sales of purchased food	627,946			627,946
Other income	<u>388,678</u>			<u>388,678</u>
Total revenue	105,844,712	8,414,676		114,259,388
Net assets released from restrictions:				
Expenditures for program purposes	<u>4,310,597</u>	<u>(4,310,597)</u>		
Total	<u>110,155,309</u>	<u>4,104,079</u>		<u>114,259,388</u>
EXPENSES:				
Food distribution program <i>(Note 15)</i>	104,443,266			104,443,266
Management and general	2,598,516			2,598,516
Fundraising	<u>1,885,941</u>			<u>1,885,941</u>
Total expenses	<u>108,927,723</u>			<u>108,927,723</u>
CHANGES IN NET ASSETS	1,227,586	4,104,079		5,331,665
Net assets, beginning of year	<u>15,126,399</u>	<u>10,944,354</u>	<u>\$ 1,678,828</u>	<u>27,749,581</u>
Net assets, end of year	<u>\$ 16,353,985</u>	<u>\$ 15,048,433</u>	<u>\$ 1,678,828</u>	<u>\$ 33,081,246</u>

See accompanying notes to consolidated financial statements.

Houston Food Bank and Subsidiaries

Consolidated Statement of Functional Expenses for the year ended June 30, 2010

	FOOD DISTRIBUTION PROGRAM	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries	\$ 3,129,576	\$ 1,151,260	\$ 841,202	\$ 5,122,038
Contract labor	578,607	197,541	18,171	794,319
Payroll taxes and benefits	<u>681,701</u>	<u>250,774</u>	<u>183,235</u>	<u>1,115,710</u>
Total salaries and related expenses	4,389,884	1,599,575	1,042,608	7,032,067
Donated food and supplies	100,247,145	28,647	30,100	100,305,892
Purchased food	1,689,863			1,689,863
Professional fees	224,268	328,798	419,507	972,573
Trucking expense	1,042,180			1,042,180
Depreciation	750,181	101,365	21,482	873,028
Value-added processing expense	865,098			865,098
Repairs and maintenance	638,972	20,823	10,870	670,665
Supplies and office expense	322,126	134,274	198,704	655,104
Printing and boxes	242,551	982	408,734	652,267
Utilities and telephone	348,651	60,528	7,093	416,272
Warehouse expense	335,989			335,989
Advertising	4,925	181,729	64,316	250,970
Equipment rental	234,761	5,762	1,733	242,256
Insurance	153,400	17,288	5,683	176,371
Travel	116,534	28,548	16,664	161,746
Volunteer meals	108,759			108,759
Interest	88,369			88,369
Training and seminars	15,119	19,163	20,471	54,753
Agency grants	15,500			15,500
Bad debt expense		8,823		8,823
Other	<u>15,270</u>	<u>1,508</u>	<u> </u>	<u>16,778</u>
Total expenses	<u>\$ 111,849,545</u>	<u>\$ 2,537,813</u>	<u>\$ 2,247,965</u>	116,635,323
Direct donor benefit costs				<u>29,942</u>
Total				<u>\$ 116,665,265</u>

See accompanying notes to consolidated financial statements.

Houston Food Bank and Subsidiaries

Consolidated Statement of Functional Expenses for the year ended June 30, 2009

	FOOD DISTRIBUTION PROGRAM	MANAGEMENT AND GENERAL	FUNDRAISING	TOTAL
Salaries	\$ 2,514,677	\$ 1,005,871	\$ 670,581	\$ 4,191,129
Contract labor	733,632	193,896	31,250	958,778
Payroll taxes and benefits	<u>525,640</u>	<u>210,256</u>	<u>140,171</u>	<u>876,067</u>
Total salaries and related expenses	3,773,949	1,410,023	842,002	6,025,974
Donated food and supplies	94,613,188	1,287	53,969	94,668,444
Purchased food	1,226,164			1,226,164
Professional fees	53,757	262,146	339,862	655,765
Trucking expense	897,836			897,836
Depreciation	735,248	99,572	20,653	855,473
Value-added processing expense	615,668			615,668
Repairs and maintenance	498,542	83,459	755	582,756
Supplies and office expense	302,419	175,124	153,190	630,733
Printing and boxes	127,831	87,970	367,090	582,891
Utilities and telephone	316,411	64,339	9,407	390,157
Warehouse expense	338,684			338,684
Advertising	9,676	247,456	46,805	303,937
Equipment rental	226,038	5,390		231,428
Insurance	132,299	6,787	11,022	150,108
Travel	87,255	58,716	35,323	181,294
Volunteer meals	125,200			125,200
Interest	66,294			66,294
Training and seminars	10,646	24,209	5,758	40,613
Agency grants	235,186			235,186
Bad debt expense		71,822		71,822
Other	<u>50,975</u>	<u>216</u>	<u>105</u>	<u>51,296</u>
Total expenses	<u>\$ 104,443,266</u>	<u>\$ 2,598,516</u>	<u>\$ 1,885,941</u>	108,927,723
Direct donor benefit costs				<u>50,023</u>
Total				<u>\$ 108,977,746</u>

See accompanying notes to consolidated financial statements.

Houston Food Bank and Subsidiaries

Consolidated Statements of Cash Flows for the years ended June 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Changes in net assets	\$ 22,048,723	\$ 5,331,665
Adjustments to reconcile changes in net assets to net cash provided (used) by operating activities:		
Depreciation	873,028	855,473
Contributions restricted for capital campaign	(16,144,965)	(4,585,095)
Donated property	(5,340,000)	
Realized and unrealized (gain) loss on investments	(774,033)	1,212,848
Changes in operating assets and liabilities:		
Receivables	(755,649)	(395,602)
Food inventory	(1,197,533)	(1,205,880)
Prepaid expenses and other assets	57,437	132,569
Pledges receivable (excluding capital campaign pledges)	(185,527)	151,952
Accounts payable and accrued expenses	430,151	415,934
Deferred revenue	<u>(226,701)</u>	<u>201,574</u>
Net cash provided (used) by operating activities	<u>(1,215,069)</u>	<u>2,115,438</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investments	4,876,806	3,704,773
Purchases of investments	(2,809,175)	(3,516,120)
Net change in money market mutual funds and cash held for investment	3,102,277	(1,299,718)
Issuance of note receivable	(36,856,479)	
Net change in cash restricted by notes payable	(25,168,487)	
Purchases of property and equipment	<u>(16,878,720)</u>	<u>(1,510,129)</u>
Net cash used by investing activities	<u>(73,733,778)</u>	<u>(2,621,194)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from contributions restricted for capital campaign	11,760,881	4,284,659
Proceeds from notes payable	81,894,348	75,000
Payments of notes payable	(23,699,048)	(150,386)
Debt issuance cost	<u>(391,784)</u>	
Net cash provided by financing activities	<u>69,564,397</u>	<u>4,209,273</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(5,384,450)	3,703,517
Cash and cash equivalents, beginning of year	<u>5,484,450</u>	<u>1,780,933</u>
Cash and cash equivalents, end of year	<u>\$ 100,000</u>	<u>\$ 5,484,450</u>
<i>Supplemental disclosure of cash flow information:</i>		
Interest paid	\$60,503	\$66,294
Purchase of building financed by note payable	\$2,000,000	

See accompanying notes to consolidated financial statements.

Houston Food Bank and Subsidiaries

Notes to Consolidated Financial Statements for the years ended June 30, 2010 and 2009

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization – Houston Food Bank is a Texas nonprofit organization founded in 1982 to help feed the hungry by seeking food donations and distributing them to local charitable agencies that care for the needy. Houston Food Bank is a certified affiliate of Feeding America.

Houston Food Bank Endowment (the Endowment) was organized in 1990 as a Texas nonprofit organization to receive and maintain contributed funds and to support the Houston Food Bank. Houston Food Bank is the sole member of the Endowment.

The Mary Barden Keegan Food Fund, Inc. (MBKFF) was organized in 2000 as a Texas nonprofit corporation to receive and maintain contributed funds to support End Hunger Network, Houston (End Hunger) or its successor organization. Houston Food Bank is the sole member of MBKFF.

HFB QALICB LLC (QALICB) was organized in 2010 as a Texas limited liability company. Houston Food Bank has a 99.9% membership interest and MBKFF has a 0.10% membership interest in the QALICB. QALICB was organized to acquire and remodel a warehouse facility for future use by the Houston Food Bank.

Basis of consolidation – These financial statements include the consolidated statements of financial position, activities, functional expenses, and cash flows for Houston Food Bank, the Endowment, MBKFF, and QALICB (collectively the Food Bank). All balances and transactions between the consolidated entities have been eliminated.

Business combination – On October 24, 2008, Houston Food Bank and End Hunger completed a merger of their operations. The merger was accounted for similar to a pooling of interests. Accordingly, Houston Food Bank's 2009 consolidated financial statements include the results of End Hunger. End Hunger was a community-based organization that worked collaboratively with food pantries, soup kitchens, and residential shelters to strengthen hunger-relief programs through collection and distribution of perishable and non-perishable food.

All transactions between Houston Food Bank and End Hunger have been eliminated and there were no material adjustments to conform the accounting policies of the organizations.

Summarized results of operations of Houston Food Bank and End Hunger for the period from July 1, 2008 to October 24, 2008, the date of acquisition, are as follows:

	HOUSTON FOOD BANK	END HUNGER
Revenue	\$ 16,706,120	\$ 535,751
Expenses	<u>(15,398,394)</u>	<u>(584,249)</u>
Change in net assets	<u>\$ 1,307,726</u>	<u>\$ (48,498)</u>

Federal income tax status – Houston Food Bank, the Endowment, and MBKFF are exempt from federal income tax under §501(c)(3) of the Internal Revenue Code and Houston Food Bank is classified as a public charity under §170(b)(1)(A)(vi). The Endowment is classified as a Type III supporting organization under §509(a)(3). MBKFF is classified as a Type I supporting organization under §509(a)(3).

Cash equivalents include highly liquid financial instruments with original maturities of three months or less. Cash and cash equivalents held for long-term purposes are classified as investments.

Allowance for uncollectible receivables – An allowance for accounts receivable is provided when management believes the accounts may not be collected in full. The amount of bad debt expense recorded each period and the resulting adequacy of the allowance at the end of each period are determined using a combination of historical loss experience and customer-by-customer analysis of accounts receivable balances each period.

Food inventory consists primarily of canned goods, produce, and durable household goods. Donated food inventory is valued at approximate average wholesale value of one pound of donated product based on the national per pound price as provided by the most recent Feeding America Product Valuation Survey. Purchased food is valued at the cost of products purchased as determined by the first-in, first-out method. The Food Bank recognizes donated food and commodities as inventory and as contributions in these consolidated financial statements.

Pledges receivable that are expected to be collected within one year are recorded at net realizable value. Amounts expected to be collected in more than one year are discounted to estimate the present value of future cash flows.

Investments are recorded at fair value.

Debt issuance costs represents costs incurred related to the issuance of the new market tax credits notes payable and are amortized over the term of the debt.

Note receivable is reported at its outstanding principal balance. The note receivable is considered to be fully collectible, and accordingly, no allowance for doubtful accounts has been provided. In making that determination, management evaluated the financial condition of the borrower, the estimated value of the underlying collateral, and current economic conditions. Interest on the note receivable is recognized over the term of the note receivable and is calculated using the simple-interest method on principal amounts outstanding.

Property and equipment are recorded at cost, if purchased, or at the fair value at the date of gift, if donated. Depreciation is provided on a straight-line basis over estimated useful lives of 25 years for buildings and 5 years for furniture, equipment, and motor vehicles.

Net asset classification – Contributions, investment return, and the related net assets are classified based on the existence or absence of donor-imposed restrictions, as follows:

- *Unrestricted net assets* include those net assets whose use is not restricted by donor-imposed stipulations, even though their use may be limited in other respects, such as by contract or board designation.
- *Temporarily restricted net assets* include contributions and investment return restricted by the donor for specific purposes or time periods. When a purpose restriction is accomplished or a time restriction ends, temporarily restricted net assets are released to unrestricted net assets.
- *Permanently restricted net assets* include contributions that donors have restricted in perpetuity.

Contributions are recorded as revenue at fair value when an unconditional commitment is received from the donor. Contributions received with donor stipulations that limit their use are recorded as restricted support. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Food Bank reports expirations of donor restrictions when the donated or acquired long-lived assets are placed in service.

Non-cash contributions – Donated materials and use of facilities are recorded at fair value as contributions when an unconditional commitment is received from the donor. The related expense is recorded as the item is used. Contributions of services are recognized when services received (a) create or enhance non-financial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would need to be purchased if not provided by donation. A substantial number of volunteers have contributed significant amounts of time in connection with the food distribution program for which no amount has been recorded in the financial statements because the donated services did not meet the criteria for recognition under generally accepted accounting principles.

Government grants and contracts are recognized when the related services are provided. Advances received for services not yet performed are included in the statement of financial position as deferred revenue.

Agency fees represent fees paid by agencies for food handling charges and are recognized when shipments of food are made to the agencies.

Sales of purchased food are recognized as revenue when shipments of food are made to agencies.

Food preparation fees represent fees paid by agencies for reimbursement of costs of processing, cooking, and freezing meats for distribution. Fees are recognized when the meals are delivered.

Advertising costs are expensed as incurred.

Estimates – Management must make estimates and assumptions to prepare financial statements in accordance with generally accepted accounting principles. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, the amounts reported as revenue and expenses, and the allocation of expenses among various functions. Actual results could vary from the estimates that were used.

NOTE 2 – CHANGE IN ESTIMATE

In 2010, the Food Bank reported the value of food received from general donations and from the USDA based on estimated values published in the annual Feeding America Product Valuation Survey. Prior to 2010, the Food Bank valued the USDA food donations based on the USDA’s average commodity price. This change in estimate resulted in an increase of \$10.5 million in donated food revenue, an increase of \$10.9 million in food distribution program expenses for the year ended June 30, 2010 and an increase of \$400,000 in food inventory at year end.

NOTE 3 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>2010</u>	<u>2009</u>
Certificates of deposit	\$ 100,000	\$ 100,000
Offshore bank deposits		5,061,685
Money market mutual funds		228,143
Demand deposits		<u>94,622</u>
Total cash and cash equivalents	<u>\$ 100,000</u>	<u>\$ 5,484,450</u>

Bank deposits exceed the federally insured limit per depositor per institution.

NOTE 4 – NOTE RECEIVABLE

Houston Food Bank entered into an agreement on June 23, 2010 to lend \$36,856,479 to Chase NMTC Houston Food Bank Investment Fund, LLC (Chase NMTC Fund). The note is secured by Chase NMTC Fund's membership interest in NDC New Markets Investments LIX, LLC (NDC CDE), Business Loan Conduit No. 10, LLC (CRF CDE), and New Markets Investment 46, LLC (LISC CDE), (collectively the CDE's) and other cash accounts held by a secured party. The interest rate on the note is fixed at 1%. Interest is payable quarterly beginning September 2010 until December 2017. All principal and unpaid interest are due and payable in June 2040. Interest earned in 2010 was \$10,238, and was accrued at June 30, 2010. The Food Bank may accelerate the maturity date of the note to December 2017 with 30 days notice to Chase NMTC Fund.

At anytime after the seventh anniversary and before the eighth anniversary of the note receivable, J.P. Morgan Chase Bank, N.A. can exercise its put option to sell its interest in the NMTC Fund to the Houston Food Bank for \$1,000. After exercising its option to purchase the interest in the NMTC, the Houston Food Bank may cancel the new market tax credits notes payable.

NOTE 5 – PLEDGES RECEIVABLE

The Food Bank launched the *Hunger Can't Wait Capital Campaign* in 2007 to grow the Food Bank. The goal of this campaign is to raise \$55 million to purchase the Portwall facility and build agency infrastructure in order to increase distribution. Through June 30, 2010, total contributions to the campaign were approximately \$38.3 million before discounts.

Pledges receivable consist of the following:

	<u>2010</u>	<u>2009</u>
Total pledges receivable	\$ 12,863,525	\$ 8,328,914
Discount to estimated present value at 1.79% to 2.54%	<u>(89,406)</u>	<u>(124,406)</u>
Total pledges receivable, net	12,774,119	8,204,508
Pledges receivable restricted for property	<u>(12,450,055)</u>	<u>(8,065,971)</u>
Pledges receivable, net	<u>\$ 324,064</u>	<u>\$ 138,537</u>

Pledges receivable at June 30, 2010 are expected to be collected as follows:

Receivable in one year	\$ 9,075,373
Receivable in one to five years	3,648,152
Receivable in more than five years	<u>140,000</u>
Total pledges receivable	<u>\$ 12,863,525</u>

At June 30, 2010, approximately 83% of pledges receivable were due from four donors.

NOTE 6 – INVESTMENTS

Investments consist of the following:

	<u>2010</u>	<u>2009</u>
Equity securities	\$ 1,466,929	\$ 1,312,539
Equity mutual funds	1,243,379	2,718,227
Corporate bonds	937,084	632,185
Municipal bonds	738,556	974,761
Certificates of deposit	449,681	371,592
Money market mutual funds	139,111	3,177,591
Bond index mutual fund	115,804	102,011
Cash	106,058	169,855
U.S. government and agency securities	<u>52,367</u>	<u>186,083</u>
Total investments	<u>\$ 5,248,969</u>	<u>\$ 9,644,844</u>

Investments are exposed to various risks such as interest rate, market and credit risks. Because of these risks, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of financial position and statement of activities.

Investment return, including earnings on cash and cash equivalents, consists of the following:

	<u>2010</u>	<u>2009</u>
Interest and dividends	\$ 188,679	\$ 195,798
Realized and unrealized gain (loss) on investments	<u>774,033</u>	<u>(1,212,848)</u>
Total investment return	<u>\$ 962,712</u>	<u>\$ (1,017,050)</u>

NOTE 7 – FAIR VALUE MEASUREMENTS

Generally accepted accounting principles require that certain assets and liabilities be reported at fair value and establish a hierarchy that prioritizes inputs used to measure fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The three levels of the fair value hierarchy are as follows:

- *Level 1* – Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date.
- *Level 2* – Inputs are other than quoted prices included in Level 1, which are either directly observable or can be derived from or corroborated by observable market data at the reporting date.
- *Level 3* – Inputs are not observable and are based on the reporting entity's assumptions about the inputs market participants would use in pricing the asset or liability.

Assets measured at fair value at June 30, 2010 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Equity securities	\$ 1,466,929			\$ 1,466,929
Equity mutual funds	1,243,379			1,243,379
Corporate bonds		\$ 937,084		937,084
Municipal bonds		738,556		738,556
Certificates of deposit		449,681		449,681
Money market mutual funds	139,111			139,111
Bond index mutual fund	115,804			115,804
U.S. government and agency securities		52,367		52,367
Total assets measured at fair value	<u>\$ 2,965,223</u>	<u>\$ 2,177,688</u>	<u>\$ 0</u>	<u>\$ 5,142,911</u>

Assets measured at fair value at June 30, 2009 are as follows:

	<u>LEVEL 1</u>	<u>LEVEL 2</u>	<u>LEVEL 3</u>	<u>TOTAL</u>
Equity securities	\$ 1,312,539			\$ 1,312,539
Equity mutual funds	2,718,227			2,718,227
Corporate bonds		\$ 632,185		632,185
Municipal bonds		974,761		974,761
Certificates of deposit		371,592		371,592
Money market mutual funds	3,405,734			3,405,734
Bond index mutual fund	102,011			102,011
U.S. government and agency securities		186,083		186,083
Total assets measured at fair value	<u>\$ 7,538,511</u>	<u>\$ 2,164,621</u>	<u>\$ 0</u>	<u>\$ 9,703,132</u>

Valuation methods used for assets measured at fair value are as follows:

- *Equity securities* are valued at the closing price reported on the active market on which the individual securities are traded.
- *Mutual funds* are valued at the net asset value of shares held at year end.
- *Corporate bonds, municipal bonds, certificates of deposit, and U.S. government and agency securities* are valued using prices obtained from independent quotation bureaus that use computerized valuation formulas which may include market-corroborated inputs for credit risk factors, interest rate and yield curves and broker quotes, to calculate fair values.

These valuation methods may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Food Bank believes its valuation methods are appropriate, the use of different methods or assumptions could result in a different fair value measurement at the reporting date.

NOTE 8 – PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

	<u>2010</u>	<u>2009</u>
Land	\$ 5,223,692	\$ 875,291
Buildings	23,714,275	5,502,498
Furniture and equipment	4,087,557	3,625,380
Motor vehicles	3,627,345	3,028,326
Construction in progress	<u>597,346</u>	<u> </u>
Total property and equipment, at cost	37,250,215	13,031,495
Accumulated depreciation	<u>(6,886,156)</u>	<u>(6,013,128)</u>
Property and equipment, net	<u>\$ 30,364,059</u>	<u>\$ 7,018,367</u>

In 2010, the Food Bank entered into construction commitments of approximately \$21 million for the renovation of the Portwall facility.

NOTE 9 – NEW MARKET TAX CREDITS NOTES PAYABLE

QALICB, a Houston Food bank subsidiary, executed a loan agreement on June 23, 2010, that provides for borrowings of \$12,125,000, \$26,500,000 and \$10,339,971 from NDC CDE, CRF CDE, and LISC CDE, respectively. The loans are to finance the purchase and renovations of the Portwall facility and are intended to be treated as a “qualified low-income community investment” for purposes of generating New Market Tax Credits under Section 45D of the Internal Revenue Code of 1986, as amended. The loans are secured by a property deed of trust, security agreement and fixture filing on this property and a guaranty by Houston Food Bank’s obligations under the loan agreement.

Pursuant to the issuance of the New Market Tax Credits Financing Commitment, QALICB is required to maintain certain funds for the renovation of the Portwall facility. At June 30, 2010, \$25,168,487 are held at JPMorgan Chase Bank for this purpose.

Under the terms of the loan agreement, each loan has an interest rate of 0.814%, payable quarterly, beginning in September 2010, and the principal balance is due in its entirety on the stated maturity dates. QALICB is not permitted to prepay any portion of the loans in whole or in part until the seventh anniversary of the loan. The balances outstanding on the notes payable, maturity dates and repayment terms are disclosed below:

	<u>AMOUNT</u>
Note payable to NDC New Markets Investments LIX, LLC, matures on June 21, 2040, with principal payments commencing in September 2020.	\$ 7,832,827
Note payable to NDC New Markets Investments LIX, LLC, matures on June 21, 2040, with principal payments commencing in September 2030.	2,507,144
Note payable to NDC New Markets Investment 46, LLC, Matures on June 23, 2040, with principal payments commencing in September 2020.	8,878,237

Note payable to NDC New Markets Investment 46, LLC, matures on June 23, 2040, with principal payments commencing in September 2030.	3,059,263
Note payable to NDC New Markets Investment 46, LLC, matures on June 23, 2017, with principal payments commencing in September 2030.	187,500
Note payable to Business Loan Conduit No.10, LLC matures on June 23, 2040, with principal payments commencing in September 2020.	20,146,863
Note payable to Business Loan Conduit No.10, LLC matures on June 23, 2040, with principal payments commencing in September 2030.	<u>6,353,137</u>
Total new market tax credits notes payable	<u>\$ 48,964,971</u>

NOTE 10 – NOTES PAYABLE

Notes payable to financial institutions consists of the following:

	<u>2010</u>	<u>2009</u>
Note payable to a bank, interest payable in April of each year beginning in 2010 at the higher of prime rate or adjusted one month LIBOR Rate plus 1.25% (4.50% at June 30, 2010), matures June 15, 2014, and collateralized by pledges receivable.	\$ 9,500,000	
Note payable to a bank, interest payable in April of each year beginning in 2010 at the higher of prime rate or adjusted one month LIBOR Rate (3.52% at June 30, 2010), matures June 30, 2011, and is collateralized by pledges receivable and deposit account held at a bank.	2,000,000	
Note payable to a bank, interest payable monthly at a fixed rate of 6.75%, matures in December 2013 and collateralized by certain land and property.	620,631	\$ 775,719
Line of credit with a bank, interest payable monthly at prime (5.00% at June 30, 2009), matured in May 2010 and was collateralized by inventory, accounts receivable and equipment.	<u> </u>	<u>114,583</u>
Total notes payable	<u>\$ 12,120,631</u>	<u>\$ 890,302</u>

Notes payable, including the new market credit notes payable, at June 30, 2010 are due as follows:

2011	\$ 9,000,000
2012	0
2013	0
2014	3,120,631
2015	0
Thereafter through 2030	<u>48,964,971</u>
Total notes payable	<u>\$ 61,085,602</u>

NOTE 11 – UNRESTRICTED NET ASSETS

Unrestricted net assets are available for the following purposes:

	<u>2010</u>	<u>2009</u>
Undesignated	\$ 13,612,156	\$ 12,944,731
Board designated:		
Quasi-endowment for general operations	3,594,328	3,253,996
Grant programs	202,816	296,194
Aggregate deficiency of endowment funds	<u>(56,695)</u>	<u>(140,936)</u>
Total unrestricted net assets	<u>\$ 17,352,605</u>	<u>\$ 16,353,985</u>

NOTE 12 – TEMPORARILY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	<u>2010</u>	<u>2009</u>
Capital campaign	\$ 35,405,285	\$ 14,274,332
Time restricted	241,535	
Equipment	200,774	171,059
Mobile Meals for Kids	78,358	111,904
Accumulated earnings on general endowment	75,947	47,256
Backpack Buddy Club	20,839	131,953
Mobile food pantry		78,000
Operation Frontline		50,752
Other	<u>75,798</u>	<u>183,177</u>
Total temporarily restricted net assets	<u>\$ 36,098,536</u>	<u>\$ 15,048,433</u>

NOTE 13 – PERMANENTLY RESTRICTED NET ASSETS

Permanently restricted net assets are invested to support the following:

	<u>2010</u>	<u>2009</u>
Houston Food Bank Endowment – general operations	\$ 946,390	\$ 946,390
End Hunger central building	495,000	495,000
Mary Barden Keegan Food Fund – general operations	<u>237,438</u>	<u>237,438</u>
Total permanently restricted net assets	<u>\$ 1,678,828</u>	<u>\$ 1,678,828</u>

NOTE 14 – ENDOWMENT FUNDS

The Boards of Directors of MBKFF and the Endowment have interpreted the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Food Bank classifies the original value of gifts donated to the permanent endowment as permanently restricted net assets. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by MBKFF and the Endowment in a manner consistent with the standard of prudence prescribed by TUPMIFA. In accordance with TUPMIFA, MBKFF and the Endowment considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the funds
- The purposes of the Food Bank and the donor-restricted endowment funds
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Food Bank
- The investment policies of MBKFF and the Endowment

Return Objectives and Risk Parameters

MBKFF and the Endowment have adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to the Food Bank while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that MBKFF and the Endowment must hold in perpetuity or for a donor-specified period as well as board-designated funds. Under this policy, as approved by the Board of Directors, the endowment assets of the Endowment are invested in a manner that will seek to maintain a level of portfolio risk that is no more than 125% of the risk of the portfolio's tactical index. The Endowment expects its endowment funds, over time, to provide an average rate of return net of investment management expenses, of 5% plus the annual rate of inflation over any 10 year period. MBKFF does not have a stated annual return objective.

Strategies Employed for Achieving Objectives

To satisfy their long-term rate-of-return objectives, MBKFF and the Endowment rely on a total return strategy in which investment return is achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). MBKFF and the Endowment targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve their long-term return objectives within prudent risk constraints.

Spending Policy

The Endowment has a policy of not appropriating more than 5% of the endowment fund's average market value as of the end of the last three fiscal years prior to the year in which the distribution is planned. In establishing this policy, the Endowment considered the long-term expected return and the effects of inflation on its endowment. This is consistent with the Endowment's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return. The Board of Directors of MBKFF determines annually the amount of appropriations to be made to the Food Bank.

Endowment net asset composition as of June 30, 2010 is as follows:

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
Donor-restricted endowment funds	\$ 76,060	\$ 127,097	\$ 1,183,828	\$ 1,386,985
Board-designated endowment funds	<u>3,594,328</u>	<u> </u>	<u> </u>	<u>3,594,328</u>
Endowment net assets	<u>\$ 3,670,388</u>	<u>\$ 127,097</u>	<u>\$ 1,183,828</u>	<u>\$ 4,981,313</u>

Endowment net asset composition as of June 30, 2009 is as follows:

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
Donor-restricted endowment funds	\$ (23,119)	\$ 72,256	\$ 1,183,828	\$ 1,232,965
Board-designated endowment funds	<u>3,253,996</u>	<u> </u>	<u> </u>	<u>3,253,996</u>
Endowment net assets	<u>\$ 3,230,877</u>	<u>\$ 72,256</u>	<u>\$ 1,183,828</u>	<u>\$ 4,486,961</u>

Changes in net assets of the endowment funds are as follows:

	<u>UNRESTRICTED</u>	TEMPORARILY <u>RESTRICTED</u>	PERMANENTLY <u>RESTRICTED</u>	<u>TOTAL</u>
Endowment net assets, July 1, 2008	<u>\$ 4,543,547</u>	<u>\$ 241,240</u>	<u>\$ 1,183,828</u>	<u>\$ 5,968,615</u>
Investment return:				
Interest and dividends	58,247	20,738		78,985
Net realized and unrealized loss	(1,106,573)	(127,018)		(1,233,591)
Investment management fees	<u>(21,535)</u>	<u>(5,129)</u>		<u>(26,664)</u>
Net investment return	<u>(1,069,861)</u>	<u>(111,409)</u>		<u>(1,181,270)</u>
Distribution	<u>(242,809)</u>	<u>(57,575)</u>		<u>(300,384)</u>
Endowment net assets, June 30, 2009	<u>3,230,877</u>	<u>72,256</u>	<u>1,183,828</u>	<u>4,486,961</u>
Investment return:				
Interest and dividends	58,068	12,367		70,435
Net realized and unrealized gain	647,063	81,285		728,348
Investment management fees	<u>(19,824)</u>	<u>(4,859)</u>		<u>(24,683)</u>
Net investment return	<u>685,307</u>	<u>88,793</u>		<u>774,100</u>
Distribution	<u>(245,796)</u>	<u>(60,102)</u>		<u>(305,898)</u>
Contributions		<u>26,150</u>		<u>26,150</u>
Endowment net assets, June 30, 2010	<u>\$ 3,670,388</u>	<u>\$ 127,097</u>	<u>\$ 1,183,828</u>	<u>\$ 4,981,313</u>

Funds with Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or TUPMIFA require the Endowment and MBKFF to retain as a fund of perpetual duration. Deficiencies of this nature are reported as unrestricted net assets. These deficiencies resulted from unfavorable market fluctuations and continued appropriations deemed prudent by the Boards of Directors.

The Endowment loaned funds to Houston Food Bank for the construction of the Portwall facility. It is anticipated that the funds will be repaid to the Endowment by contributions raised for the Hunger Can't Wait Capital Campaign. The outstanding balance of the loan is \$1,950,000 at June 30, 2010.

NOTE 15 – NON-CASH CONTRIBUTIONS

Food donations – The majority of food distributed by the Food Bank is received by contribution from general donations and from the U.S. Department of Agriculture (USDA). The estimated value of these contributions is recorded in the consolidated financial statements as contribution revenue and program expenses. The pounds collected are recorded by the Food Bank staff at the time of receipt based on actual weight. The total value of contributed food for the years ended June 30, 2010 and 2009 is as follows:

	2010			2009		
	<u>POUNDS</u>	<u>VALUE PER POUND</u>	<u>AMOUNT</u>	<u>POUNDS</u>	<u>VALUE PER POUND</u>	<u>AMOUNT</u>
General donations	49,378,941	\$1.60	\$ 79,006,306	54,267,537	\$1.58	\$ 85,742,708
USDA	<u>14,042,300</u>	\$1.60	<u>22,467,680</u>	<u>11,490,952</u>	\$0.85	<u>9,767,309</u>
Total	<u>63,421,241</u>		<u>\$101,473,986</u>	<u>65,758,489</u>		<u>\$ 95,510,017</u>

Other donations – During 2010, the Food Bank received \$5,594,520 of donated property, goods and services, including a \$5,000,000 discount on the purchase of the new facility, \$340,000 in donated professional services related to the purchase of the facility, \$186,819 of vehicles and equipment and \$67,701 of gift certificates and supplies. During 2009, the Food Bank received \$841,586 of other donated goods and services, including \$169,350 of donated warehouse space and related costs, \$30,800 of airline tickets, \$405,693 of operation trucks and forklifts, and \$235,743 of gift certificates and supplies.

NOTE 16 – GOVERNMENT GRANTS AND CONTRACTS

The Food Bank is party to contracts with federal, state and local governmental agencies. Should these contracts not be renewed, a replacement for this source of support may not be forthcoming and related expenses would not be incurred. Sources of government grants and contracts are as follows:

	<u>2010</u>	<u>2009</u>
U. S. Department of Agriculture	\$ 2,926,159	\$ 1,662,463
Federal Department of Homeland Security	<u>398,689</u>	<u>199,684</u>
Total government grants and contracts	3,324,848	1,862,147
U.S. Department of Agriculture commodities	<u>22,467,680</u>	<u>9,767,309</u>
Total federal awards	<u>\$ 25,792,528</u>	<u>\$ 11,629,456</u>

The grants from federal and state funding sources require fulfillment of certain conditions as set forth in the grant contracts and are subject to review and audit by the awarding agencies. Such reviews and audits could result in the discovery of unallowable activities and unallowable costs. Consequently, any of the funding sources may, at their discretion, request reimbursement for expenses or return of funds as a result of non-compliance by the Food Bank with the terms of the contracts. Management believes such disallowances, if any, would not be material to the Food Bank's financial position or changes in net assets.

NOTE 17 – FREEZER LEASE

The Food Bank has entered into a 20-year lease agreement on February 15, 2010 to rent the freezer facility at the Portwall facility effective January 2011. The following is a schedule of future rent income as of June 30, 2010:

2011	\$ 441,699
2012	883,398
2013	883,398
2014	883,398
2015	883,398
Thereafter through 2031	<u>14,454,219</u>
Total	<u>\$ 18,429,510</u>

No rent income has been recorded in the 2010 consolidated financial statements related to this lease agreement.

NOTE 18 – EMPLOYEE BENEFIT PLANS

The Food Bank offers a defined contribution §401(k) benefit plan to qualified employees. The Food Bank matches 50% of an employee's contribution up to 6% of the employee's compensation. Contributions made by the Food Bank vest at the end of one year. The Food Bank's contributions to the plan totaled \$57,508 in 2010 and \$44,058 in 2009.

NOTE 19 – SUBSEQUENT EVENTS

Management has evaluated subsequent events through December 10, 2010, which is the date that the financial statements were available for issuance. As a result of this evaluation, no events were identified that are required to be disclosed or would have a material impact on reported net assets or changes in net assets.
