

THE F.B. HERON FOUNDATION

FINANCIAL STATEMENTS

DECEMBER 31, 2004

INDEPENDENT AUDITORS' REPORT

The Board of Directors
The F.B. Heron Foundation

We have audited the accompanying statement of financial position of The F.B. Heron Foundation (the Foundation) as of December 31, 2004 and the related statements of activities and cash flows for the year then ended. These financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of The F.B. Heron Foundation for the year ended December 31, 2003 were audited by other auditors, whose report dated March 12, 2004, expressed an unqualified opinion on those statements.

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 The F.B. Heron Foundation as of December 31, 2004, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information shown on page 12 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2004 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2004 basic financial statements taken as a whole.

J. Connor Javier Munn + Tobbin, LLP

March 21, 2005
New York, NY

THE F.B. HERON FOUNDATION

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2004 AND 2003

A S S E T S

	<u>2004</u>	<u>2003</u>
Cash and cash equivalents	\$ 2,492,722	\$ 5,562,019
Traditional investments	224,432,032	209,585,700
Mission-related investments	45,604,909	42,497,737
Other assets	403,748	357,686
Property and equipment, net	<u>294,500</u>	<u>368,340</u>
	<u>\$273,227,911</u>	<u>\$258,371,482</u>

LIABILITIES AND NET ASSETS

Liabilities		
Accounts payable and accrued expenses	\$ 74,465	\$ 79,734
Grants payable	2,715,000	3,970,000
Deferred Federal excise tax payable	<u>308,746</u>	<u>218,425</u>
Total liabilities	3,098,211	4,268,159
Unrestricted net assets	<u>270,129,700</u>	<u>254,103,323</u>
	<u>\$273,227,911</u>	<u>\$258,371,482</u>

See notes to financial statements.

THE F.B. HERON FOUNDATION

STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Net investment income		
Interest and dividends	\$ 7,199,425	\$ 7,180,528
Less:		
Investment expenses	1,146,779	980,999
Current Federal excise tax	<u>175,000</u>	<u>56,164</u>
Net investment income	<u>5,877,646</u>	<u>6,143,365</u>
Expenses		
Program services		
Grants	8,003,660	10,037,426
Program expenses	<u>1,753,961</u>	<u>1,706,603</u>
Total program services	9,757,621	11,744,029
Supporting services - administrative expenses	<u>375,819</u>	<u>338,444</u>
Total expenses	<u>10,133,440</u>	<u>12,082,473</u>
Net appreciation in fair value of investments, net of deferred Federal excise tax	<u>20,282,171</u>	<u>35,846,018</u>
Change in net assets	16,026,377	29,906,910
Unrestricted net assets, beginning of year	<u>254,103,323</u>	<u>224,196,413</u>
Unrestricted net assets, end of year	<u>\$270,129,700</u>	<u>\$254,103,323</u>

See notes to financial statements.

THE F.B. HERON FOUNDATION

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities		
Change in net assets	\$16,026,377	\$29,906,910
Adjustments to reconcile change in net assets to net cash (used in) operating activities		
Depreciation and amortization	73,840	73,842
Net (appreciation) in fair value of investments	(20,372,492)	(36,064,443)
Deferred Federal excise tax	90,321	218,425
Net change in operating assets and liabilities		
Other assets	(46,062)	(55,996)
Accounts payable and accrued expenses	(5,269)	6,221
Grants payable	<u>(1,255,000)</u>	<u>1,390,000</u>
Net cash (used in) operating activities	<u>(5,488,285)</u>	<u>(4,525,041)</u>
Cash flows from investing activities		
Purchases of traditional investments	(27,915,224)	(58,936,862)
Proceeds of traditional investments sold	33,611,586	76,661,378
Purchases of mission-related investments	(20,033,048)	(25,273,039)
Proceeds from mission-related investments sold or repaid	<u>16,755,674</u>	<u>14,689,663</u>
Net cash provided by investing activities	<u>2,418,988</u>	<u>7,141,140</u>
Net (decrease) increase in cash and cash equivalents	(3,069,297)	2,616,099
Cash and cash equivalents, beginning of year	<u>5,562,019</u>	<u>2,945,920</u>
Cash and cash equivalents, end of year	<u>\$ 2,492,722</u>	<u>\$ 5,562,019</u>
Supplemental disclosure		
Federal excise tax paid	<u>\$ 176,000</u>	<u>\$ 74,000</u>

See notes to financial statements.

THE F.B. HERON FOUNDATION

NOTES TO FINANCIAL STATEMENTS

Note 1. Organization and Summary of Significant Accounting Policies

Organization

The F.B. Heron Foundation (the Foundation) is a not-for-profit, charitable corporation formed in December 1991 under the General Corporation Law of the State of Delaware. The Foundation is exempt from income tax under Section 501(c)(3) of the Internal Revenue Code (IRC or the Code) and is classified as a private foundation under Section 509(a) of the Code. The Foundation's principal purpose is to support qualified organizations in various ways.

To advance its mission of helping people and communities to help themselves, the Foundation supports organizations that help low-income people to create wealth and take control of their lives. The Foundation makes grants to and investments in organizations engaged in the following wealth-creation strategies for urban and rural communities: advancing home ownership; supporting enterprise development; reducing the barriers to full participation in the economy by providing quality child care; increasing access to capital; and employing comprehensive community development approaches with a strong focus on the wealth-creation strategies noted above.

Basis of Accounting

The accompanying financial statements are prepared on the accrual basis. All of the activity and net assets of the Foundation are unrestricted.

Basis of Presentation

Net assets and revenues, expenses, gains and losses are classified based on the existence or absences of donor-imposed restrictions. Accordingly, the Foundation's net assets are classified as permanently-restricted, temporarily-restricted or unrestricted.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted un the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies 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.

THE F.B. HERON FOUNDATION

NOTES TO FINANCIAL STATEMENTS

(Continued)

Note 1. Organization and Summary of Significant Accounting Policies (Cont'd.)

Cash and Cash Equivalents

Cash and cash equivalents include short-term investments with maturities of three months or less at the time of purchase, which are intended to be used for payment of expenses and grants and exclude those amounts used by investment managers for long-term investment strategies.

Investments

Investments (both traditional and mission-related), with the exception of program-related investments, are stated at fair value. For marketable securities, fair value is determined by the last sales price reported by a national securities exchange. For fixed-income and equity funds, the fair value is the value determined and reported by the fund manager. For limited partnerships, fair value is the latest value reported by the partnerships adjusted for any cash transactions occurring between the reported date and the statement of financial position date. For insured and uninsured deposits, fair value is the amount of the deposit. Program-related investments are stated at cost.

Grants

Grants are recorded when approved by the Board of Directors, unless conditions imposed on the grantee have not been fulfilled. Such conditional grants are recorded when the conditions have been satisfied. All multiyear grants are subject to review and approval of the program and financial reports, a work plan, and a budget for the ensuing period of the grant.

Property and Equipment

Leasehold improvements have been capitalized at cost less amounts reimbursed by the landlord, and are being amortized over the life of the lease, which is ten years. Furniture and equipment are capitalized at cost and are being depreciated over seven years and five years, respectively.

Fair Value of Financial Instruments

The fair value of investments has been determined as indicated above. The carrying amount of all of the Foundation's other financial instruments approximates fair value.

THE F.B. HERON FOUNDATION

NOTES TO FINANCIAL STATEMENTS

(Continued)

Note 2. Traditional Investments

At December 31, 2004 and 2003, traditional investments consisted of the following:

	<u>2004</u>		<u>2003</u>	
	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>
Invested cash and cash equivalents	\$ 5,932,292	\$ 5,932,292	\$ 288,033	\$ 288,033
Fixed-income securities	49,904,443	51,464,396	51,677,303	53,348,237
Common and preferred stock and equity funds	168,595,297	136,333,526	152,415,286	129,407,537
Absolute return fund	<u>-</u>	<u>-</u>	<u>5,205,078</u>	<u>5,000,000</u>
	<u>\$224,432,032</u>	<u>\$193,730,214</u>	<u>\$209,585,700</u>	<u>\$188,043,807</u>

Note 3. Mission-Related Investments

Mission-related investments advance the mission of the Foundation using the core program strategies articulated in note 1. These include both risk-adjusted, market-rate investments that advance the mission and program-related investments (PRIs).

PRIs, defined in IRC 4944(c), have a primary purpose of advancing the mission of the Foundation without a significant purpose of the production of income or the appreciation of property. PRIs are treated as charitable distributions on Internal Revenue Service form 990-PF, the tax and information return filed by private foundations for minimum-distribution requirement purposes. The Foundation's PRI loans bear interest at below-market rates, from 1% to 6%, generally payable on March 31 and September 30 of each year. Four PRIs are limited partnerships interests in community development venture funds and one is preferred stock in a community development bank. The Foundation expects to hold all PRIs to maturity.

THE F.B. HERON FOUNDATION
NOTES TO FINANCIAL STATEMENTS
(Continued)

Note 3. Mission-Related Investments (Continued)

At December 31, 2004 and 2003, mission-related investments consisted of the following:

	<u>2004</u>		<u>2003</u>	
	<u>Fair or Carrying Value</u>	<u>Cost</u>	<u>Fair or Carrying Value</u>	<u>Cost</u>
Invested cash and cash equivalents	\$ 576,040	\$ 576,040	\$ 544,996	\$ 544,996
Insured and uninsured deposits in Community Development Credit Unions and Community Development Banks	4,250,000	4,250,000	4,300,000	4,300,000
Fixed-income securities	19,344,102	19,145,828	18,594,425	18,284,437
Limited partnership interests	4,457,375	4,482,900	3,573,795	3,583,222
Program-related investments	<u>16,977,392</u>	<u>16,977,392</u>	<u>15,484,521</u>	<u>15,484,521</u>
	<u>\$45,604,909</u>	<u>\$45,432,160</u>	<u>\$42,497,737</u>	<u>\$42,197,176</u>

At December 31, 2004 and 2003, the Foundation had capital commitments of approximately \$4,150,000 and \$4,820,000, respectively, to mission-related limited partnerships.

The following summarizes changes in PRIs as of December 31, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Balance at beginning of year	\$15,484,521	\$12,373,125
Additions:		
Disbursements	4,844,167	4,787,708
Deductions:		
Collections	<u>(3,351,296)</u>	<u>(1,676,312)</u>
Balance at end of year	<u>\$16,977,392</u>	<u>\$15,484,521</u>

THE F.B. HERON FOUNDATION

NOTES TO FINANCIAL STATEMENTS

(Continued)

Note 3. Mission-Related Investments (Continued)

PRI principal repayments are scheduled as follows:

	<u>Amount</u>
Year ending December 31:	
2005	\$ 2,461,348
2006	2,454,500
2007	1,977,418
2008	1,585,000
2009	2,449,126
Thereafter	<u>6,050,000</u>
	<u>\$16,977,392</u>

Note 4. Property and Equipment

Property and equipment consisted of the following at December 31, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Leasehold improvements	\$446,255	\$446,255
Furniture	120,581	120,581
Equipment	<u>59,948</u>	<u>59,948</u>
	\$626,784	\$626,784
Accumulated depreciation and amortization	<u>(332,284)</u>	<u>(258,444)</u>
	<u>\$294,500</u>	<u>\$368,340</u>

Note 5. Grants Payable

The following summarizes changes in grants payable as of December 31, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Balance at beginning of year	\$3,970,000	\$ 2,580,000
Additions:		
Grants authorized	8,003,660	10,037,426
Deductions:		
Grants paid	<u>(9,258,660)</u>	<u>(8,647,426)</u>
Balance at end of year	<u>\$2,715,000</u>	<u>\$ 3,970,000</u>

THE F.B. HERON FOUNDATION

NOTES TO FINANCIAL STATEMENTS

(Continued)

Note 6. Qualifying Distributions and Federal Excise Tax

As a private foundation, the Foundation is normally subject to a Federal excise tax equal to 2% of its net investment income for tax purposes. However, under Section 4940(e) of the Code, this tax is reduced to 1% if certain conditions are met. Since the Foundation met the requirements for the reduced tax rate in 2004 and 2003, current taxes are estimated at 1% of net investment income, as defined in the Code.

Deferred taxes are recorded on the unrealized appreciation of investments using the Foundation's current excise tax rate. For 2004 and 2003, deferred Federal excise tax was recorded in the amount of \$308,746 and \$218,425, respectively.

For Federal excise tax purposes, realized gains and losses from the sale of securities are determined on the specific-identification basis. Net realized gain or loss on funds is based on the Foundation's allocated share, and, on sale, average cost is used. In 2004, realized gains for tax purposes were \$11,340,379. In 2003, the Foundation had realized losses of \$3,981,435. Unrealized gains are recorded net of deferred excise taxes.

In addition, the IRC requires that certain minimum distributions be made in accordance with a specified formula. In 2004, the Foundation's qualifying distributions were approximately \$16.2 million representing grants paid of \$9.3 million, PRIs made of \$4.8 million and qualifying expenses of \$2.1 million.

Note 7. Lease Commitment

In November 1999, the Foundation entered into a lease agreement expiring August 31, 2010 for office space. The future minimum rental payments under this agreement area are as follows:

	<u>Amount</u>
Year ending December 31:	
2005	\$ 307,100
2006	325,900
2007	325,900
2008	325,900
2009	325,900
Thereafter	<u>220,000</u>
	<u>\$1,830,700</u>

THE F.B. HERON FOUNDATION

NOTES TO FINANCIAL STATEMENTS

(Continued)

Note 7. Lease Commitment (Continued)

Rent expense for the years ended December 31, 2004 and 2003 was \$293,806 and \$284,753, respectively.

Note 8. Retirement Plans

The Foundation sponsors a defined contribution retirement plan under Section 401(a) of the IRC in which all employees, as defined, are eligible to participate. The Foundation is obligated to contribute 12% of the employee's basic compensation for all eligible employees. The Foundation also sponsors a 401(k) savings plan. Eligible participants, as defined, may make voluntary contributions into the savings plan. The Foundation is obligated to match 50% of participant contributions, not to exceed 3% of base compensation. For the years ended December 31, 2004 and 2003, the Foundation contributed \$180,847 and \$169,960, respectively, to the plans on behalf of its employees.

THE F.B. HERON FOUNDATION

SCHEDULE OF PROGRAM, ADMINISTRATIVE AND INVESTMENT EXPENSES

YEAR ENDED DECEMBER 31, 2004

	<u>Program</u> <u>Expenses</u>	<u>Administrative</u> <u>Expenses</u>	<u>Investment</u> <u>Expenses</u>	<u>Total</u>
Salary and related costs	\$1,235,042	\$242,801	\$ 376,967	\$1,854,810
Consulting fees	111,352	13,118	20,181	144,651
Equipment rental and repair	21,960	4,261	6,555	32,776
Office expenses	36,308	7,045	10,838	54,191
Occupancy	205,633	39,899	61,383	306,915
Travel, meetings and conferences	68,701	13,315	22,233	104,249
Telephone	13,283	2,577	3,965	19,825
Legal fees		28,285	28,031	56,316
Audit expenses		12,550	12,550	25,100
Insurance	12,209	2,369	3,644	18,222
Depreciation and amortization	49,473	9,599	14,768	73,840
Custody fees			30,770	30,770
Investment advisory	_____	_____	554,894	554,894
	<u>\$1,753,961</u>	<u>\$375,819</u>	<u>\$1,146,779</u>	<u>\$3,276,559</u>