<u>THE F.B. HERON FOUNDATION</u>

FINANCIAL STATEMENTS

<u>DECEMBER 31, 2005 AND 2004</u>

O'Connor Davies Munns & Dobbins, llp
ACCOUNTANTS AND CONSULTANTS

INDEPENDENT AUDITORS' REPORT

The Board of Directors
The F.B. Heron Foundation:

We have audited the accompanying balance sheets of The F.B. Heron Foundation (the Foundation) as of December 31, 2005 and 2004, and the related statements of activities and cash flows for the years 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 audits.

We conducted our audits 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 audits provide 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, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our 2005 audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in schedule 1 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 2005 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2005 basic financial statements taken as a whole.

O'Connor Davies Munns & Dobbins, LLP

New York, New York
March 14, 2006

The Lincoln Building, 60 East 42nd Street, New York, New York 10165 212.286.2600 tel 212.286.4080 fax www.odmd.com

THE F.B. HERON FOUNDATION

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2005 and 2004

ASSETS

	2005	2004
Cash and cash equivalents	$ 498,845	$ 2,492,722
Traditional investments	220,201,187	224,432,032
Mission-related investments	58,502,393	45,604,909
Other assets	467,068	403,748
Property and equipment, net	226,654	294,500
	$ 279,896,147	$ 273,227,911

LIABILITIES AND NET ASSETS

	2005	2004
Liabilities		
Accounts payable and accrued expenses	$ 101,526	$ 74,465
Grants payable	3,017,500	2,715,000
Deferred Federal excise tax payable	197,778	308,746
Total liabilities	3,316,804	3,098,211
Unrestricted net assets	276,579,343	270,129,700
	$ 279,896,147	$ 273,227,911

See notes to financial statements.

THE F.B. HERON FOUNDATION

STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2005 AND 2004

	2005	2004
Net investment income:		
Interest and dividends	$ 7,228,411	$ 7,199,425
Less:		
Investment expenses	(1,030,893)	(1,146,779)
Current Federal excise tax	(318,000)	(175,000)
Net investment income	5,879,518	5,877,646
Expenses		
Program services		
Grants	11,960,523	8,003,660
Program expenses	1,720,057	1,753,961
Total program services	13,680,580	9,757,621
Supporting services – administrative expenses	472,710	375,819
Total expenses	14,153,290	10,133,440
Net appreciation in fair value of investments, net of deferred Federal excise tax	14,723,415	20,282,171
Change in net assets	6,449,643	16,026,377
Net assets at beginning of year	270,129,700	254,103,323
Net assets at end of year	$ 276,579,343	$ 270,129,700

See notes to financial statements.

THE F.B. HERON FOUNDATION

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2005 AND 2004

	2005	2004
Cash flows from operating activities		
Change in net assets	$ 6,449,643	$ 16,026,377
Adjustments to reconcile change in net assets to net cash (used in) operating activities:		
Depreciation and amortization	67,845	73,840
Net (appreciation) in fair value of investments	(14,612,447)	(20,372,492)
Deferred Federal excise tax	(110,968)	90,321
Net change in operating assets and liabilities		
Other assets	(63,320)	(46,062)
Accounts payable and accrued expenses	27,061	(5,269)
Grants payable	302,500	(1,255,000)
Net cash used in operating activities	(7,939,686)	(5,488,285)
Cash flows from investing activities		
Purchases of traditional investments	(244,484,387)	(27,915,224)
Proceeds from traditional investments sold	262,888,524	33,611,586
Purchases of mission-related investments	(24,139,362)	(20,033,048)
Proceeds from mission-related investments sold or repaid	11,681,034	16,755,674
Net cash provided by investing activities	5,945,809	2,418,988
Net (decrease) in cash and cash equivalents	(1,993,877)	(3,069,297)
Cash and cash equivalents, beginning of year	2,492,722	5,562,019
Cash and cash equivalents, end of year	$ 498,845	$ 2,492,722
Supplemental disclosure		
Federal excise tax paid	$ 306,000	$ 176,000

See notes to financial statements.

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 (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.

2. Summary of Significant Accounting Policies

Basis of Accounting

The accompanying financial statements are prepared on the accrual basis.

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. All of the activity and net assets of the Foundation are unrestricted.

Use of Estimates

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

2. **Summary of Significant Accounting Policies (Continued)**

Cash Equivalents

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 other fixed-income and equity funds, the fair value is determined and reported by the fund manager or custodian. 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 balance sheet date. For insured 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 program and financial reports, a work plan, and a budget for the ensuing period of the grant.

Property and Equipment

Property and equipment are capitalized at cost and are being depreciated over seven years and five years, respectively. 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.

Fair Value of Financial Instruments

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

2. Traditional Investments

At December 31, 2005 and 2004, traditional investments consisted of the following:

	2005		2004	
	Fair value	Cost	Fair value	Cost
Invested cash and cash equivalents	$ 29,231	29,231	5,932,292	5,932,292
Fixed-income securities	51,119,259	53,130,546	49,904,443	51,464,396
Common and preferred stock and equity funds	169,052,697	147,516,985	168,595,297	136,333,526
	$ 220,201,187	200,676,762	224,432,032	193,730,214

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.

3. Mission-Related Investments (Continued)

At December 31, 2005 and 2004, mission-related investments consisted of the following:

	2005		2004	
	Fair or carrying value	Cost	Fair or carrying value	Cost
Invested cash and cash equivalents	$ 487,116	487,116	576,040	576,040
Insured deposits in low income designated Credit Unions and Community Development Banks	5,000,000	5,000,000	4,250,000	4,250,000
Fixed-income securities	19,743,300	19,718,494	19,344,102	19,145,828
Common and preferred stock and equity funds	10,221,087	10,013,091		
Limited partnership interests	5,474,846	5,454,314	4,457,375	4,482,900
Program-related investments	17,576,044	17,576,044	16,977,392	16,977,392

At December 31, 2005 and 2004, the Foundation had capital commitments of approximately $8,546,000 and $6,018,000, respectively, to mission-related limited partnerships.

The following summarizes changes in PRIs as of December 31, 2005 and 2004:

	2005	2004
Balance at beginning of year	$ 16,977,391	15,484,521
Additions:		
Disbursements	3,353,234	4,844,167
Deductions:		
Collections	(2,754,581)	(3,351,296)
Balance at end of year	$ 17,576,044	16,977,392

3. Mission-Related Investments (Continued)

PRI principal repayments are scheduled as follows:

		Amount
Year ending December 31:		
2006	$	3,244,500
2007		2,017,418
2008		1,625,000
2009		2,889,126
2010		3,000,000
Thereafter		4,800,000
	$	17,576,044

4. Property and Equipment

Property and equipment consisted of the following at December 31, 2005 and 2004:

		2005	2004
Leasehold improvements	$	446,255	446,255
Furniture		120,581	120,581
Equipment		59,948	59,948
		626,784	626,784
Accumulated depreciation and amortization		(400,130)	(332,284)
	$	226,654	294,500

5. Grants Payable

The following summarizes changes in grants payable as of December 31, 2005 and 2004:

		2005	2004
Balance at beginning of year	$	2,715,000	3,970,000
Additions:			
Grants authorized		11,960,523	8,003,660
Deductions:			
Grants paid		(11,658,023)	(9,258,660)
Balance at end of year	$	3,017,500	2,715,000

THE F.B. HERON FOUNDATION

NOTES TO FINANCIAL STATEMENTS
(Continued)

6. 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 2005 and 2004, 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 2005 and 2004, deferred taxes were $197,778 and $308,746, 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 2005 and 2004, realized gains for tax purposes were $25,709,255 and $11,340,379, respectively. Unrealized gains are recorded net of deferred excise taxes.

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 are as follows:

	Amount
Year ending December 31:	
2006	$ 325,900
2007	325,900
2008	325,900
2009	325,900
2010	220,000
	$ 1,523,600

Rent expense for the years ended December 31, 2005 and 2004 was $313,762 and $293,806, respectively.

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, 2005 and 2004 the Foundation expense was $182,322 and 180,847, respectively, for the retirement and savings plans.

Schedule 1

THE F.B. HERON FOUNDATION

SCHEDULE OF PROGRAM, ADMINISTRATIVE, AND INVESTMENT EXPENSES

YEAR ENDED DECEMBER 31, 2005

	Program Expenses	Administrative Expenses	Investment Expenses	Total
Salary and related costs	$ 1,185,598	$ 321,299	$ 314,810	$ 1,821,707
Consulting fees	116,064	17,396	16,430	149,890
Equipment rental and repair	12,976	3,593	3,394	19,963
Office expenses	33,226	9,201	8,689	51,116
Occupancy	216,293	59,897	56,569	332,759
Travel, meetings, and conferences	80,097	13,344	13,232	106,673
Telephone	11,562	3,202	3,024	17,788
Legal fees		14,320	14,055	28,375
Audit expenses		12,668	12,667	25,335
Insurance	20,142	5,578	5,268	30,988
Depreciation and amortization	44,099	12,212	11,534	67,845
Custody fees			35,872	35,872
Investment advisory			535,349	535,349
	$ 1,720,057	$ 472,710	$ 1,030,893	$ 3,223,660

See independent auditors' report.