REPORT OF INDEPENDENT AUDITORS
AND CONSOLIDATED FINANCIAL STATEMENTS
WITH SUPPLEMENTAL INFORMATION

CRAFT3 AND SUBSIDIARIES

December 31, 2018 and 2017

MOSSADAMS

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Report of Independent Auditors

To the Board of Directors
Craft3 and Subsidiaries

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Craft3 and Subsidiaries ("Craft3"), which comprise the consolidated statement of financial position as of December 31, 2018, and the consolidated statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these consolidated financial statements based on our audit. We conducted our audit 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 the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Craft3 as of December 31, 2018, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The consolidated financial statements of Craft3 as of and for the year ended December 31, 2017, were audited by other auditors whose report dated April 18, 2018, expressed an unmodified opinion on those statements.

Other Information

Our audit was conducted for the purpose of forming opinions on the consolidated financial statements that collectively comprise Craft3's basic financial statements. The consolidated statement of financial position as of December 31, 2018 and the consolidating statement of activities for the year then ended, are presented for the purposes of additional analysis and are not a required part of the consolidated financial statements. The accompanying schedule of expenditures of federal rewards as required by Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* is also presented for purposes of additional analysis and is not a required part of the consolidated financial statements.

Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, during the year ended December 31, 2018, Craft3 adopted ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities.* Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 17, 2019 on our consideration of Craft3's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely 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 effectiveness of Craft3's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Craft3’s internal control over financial reporting and compliance.

Moss Adams LLP

Portland, Oregon
May 17, 2019, except for the Schedule of Expenditures of Federal Awards and the Notes to Schedule of Expenditures of Federal Awards, as to which the date is June 10, 2019.

ASSETS

	December 31, 2018	December 31, 2017
CURRENT ASSETS		
Cash and cash equivalents	$ 6,582,876	$ 9,042,120
Restricted cash and cash equivalents	3,943,932	3,115,595
Investments, at fair value	5,339,830	6,716,335
Restricted investments, at fair value	2,241,644	2,244,883
Grants receivable	1,034,810	2,831,207
Accrued interest, other receivables, and prepaid expenses	1,488,548	1,386,123
Current portion of commercial loans receivable, net deferred loan fees	19,878,859	14,290,123
Current portion of consumer loans receivable, net deferred loan fees	1,738,884	1,371,024
Total current assets	42,249,383	40,997,410
LOANS RECEIVABLE		
Commercial loans, net deferred loan fees	107,157,745	114,471,397
Consumer loans, net deferred loan fees	23,459,481	18,472,435
Total loans receivable, net	130,617,226	132,943,832
Less: current portion, net	(21,617,743)	(15,661,147)
Less: reserve for loan losses	(7,400,338)	(6,537,415)
	101,599,145	110,745,270
OTHER ASSETS		
Cash and cash equivalents, restricted for loan loss reserves	1,441,079	1,559,120
Furniture and equipment, net	626,257	672,860
Deferred tax asset	-	359,165
Other	2,207,451	745,630
Total other assets	4,274,787	3,336,775
Total assets	$ 148,123,315	$ 155,079,455

LIABILITIES AND NET ASSETS

	2018	2017
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 1,315,041	$ 1,102,661
Current portion of long-term debt	24,038,727	15,830,928
Total current liabilities	25,353,768	16,933,589
LONG-TERM DEBT		
Notes payable	89,007,777	96,230,521
Equity equivalent investments	9,814,568	9,814,568
Total long-term debt	98,822,345	106,045,089
Less: current portion	(24,038,727)	(15,830,928)
Total long-term debt, net of current portion	74,783,618	90,214,161
Total liabilities	100,137,386	107,147,750
NET ASSETS		
Without donor restrictions	47,215,936	46,522,530
With donor restrictions	769,993	1,409,175
Total net assets	47,985,929	47,931,705
Total liabilities and net assets	$ 148,123,315	$ 155,079,455

Craft3 and Subsidiaries
Consolidated Statements of Activities

	2018			2017		
	Without Donor Restrictions	With Donor Restrictions	Total	Without Donor Restrictions	With Donor Restrictions	Total
REVENUE AND OTHER SUPPORT						
Interest income on outstanding loans	$ 10,304,959	$ -	$ 10,304,959	$ 9,553,256	$ -	$ 9,553,256
Grants and contributions	4,733,242	690,000	5,423,242	6,504,446	460,000	6,964,446
Loan origination and servicing fees	1,477,597	-	1,477,597	1,247,132	-	1,247,132
NMTC management and servicing fees	441,449	-	441,449	590,989	-	590,989
Interest income on investments	221,778	-	221,778	193,789	-	193,789
Net realized losses on investments	(8,496)	-	(8,496)	(1,156)	-	(1,156)
Miscellaneous income	28,317	-	28,317	1,621	-	1,621
Net assets released from restrictions	1,329,182	(1,329,182)	-	2,314,800	(2,314,800)	-
Total revenue and other support	18,528,028	(639,182)	17,888,846	20,404,877	(1,854,800)	18,550,077
EXPENSES						
Program services:						
Commercial lending activities	12,253,075	-	12,253,075	11,674,483	-	11,674,483
Consumer lending activities	2,518,859	-	2,518,859	2,232,124	-	2,232,124
Consulting and management services	506,234	-	506,234	437,009	-	437,009
Total program services	15,278,168	-	15,278,168	14,343,616	-	14,343,616
Supporting services:						
Management and administration	1,933,516	-	1,933,516	1,913,242	-	1,913,242
Development	284,212	-	284,212	252,235	-	252,235
Total supporting services	2,217,728	-	2,217,728	2,165,477	-	2,165,477
Total expenses	17,495,896	-	17,495,896	16,509,093	-	16,509,093
Change in net assets before bargain purchase gain, unrealized gains (losses), and federal income tax	1,032,132	(639,182)	392,950	3,895,784	(1,854,800)	2,040,984
BARGAIN PURCHASE GAIN	-	-	-	378,890	-	378,890
NET UNREALIZED GAINS (LOSSES) ON INVESTMENTS	12,657	-	12,657	(3,032)	-	(3,032)
INCOME TAX (EXPENSE) BENEFIT	(351,383)	-	(351,383)	85,622	-	85,622
Change in net assets	693,406	(639,182)	54,224	4,357,264	(1,854,800)	2,502,464
NET ASSETS, beginning of year	46,522,530	1,409,175	47,931,705	42,165,266	3,263,975	45,429,241
NET ASSETS, end of year	$ 47,215,936	$ 769,993	$ 47,985,929	$ 46,522,530	$ 1,409,175	$ 47,931,705

See accompanying notes.

	For the Year Ended December 31, 2018							
	Program Services				Supporting Services			
	Commercial Lending Activities	Consumer Lending Activities	Consulting and Management Services	Total Program Services	Management and Administration	Development	Total Supporting Services	Total
Expenses:								
Salaries and wages	$ 3,650,946	$ 928,244	$ 284,794	$ 4,863,984	$ 764,711	$ 177,103	$ 941,814	$ 5,805,798
Payroll taxes and fringe benefits	893,349	299,223	68,653	1,261,225	195,914	34,138	230,052	1,491,277
Provision for loan losses	3,492,248	578,725	-	4,070,973	-	-	-	4,070,973
Interest expense	2,974,626	169,782	-	3,144,408	-	-	-	3,144,408
Loan costs	380,410	212,900	-	593,310	-	-	-	593,310
Occupancy expenses	218,537	99,335	14,900	332,772	149,002	14,900	163,902	496,674
Technology expense	182,095	82,770	12,416	277,281	124,155	12,416	136,571	413,852
Travel	143,157	20,242	3,353	166,752	130,397	19,542	149,939	316,691
Consultants	13,827	25,156	105,808	144,791	143,213	-	143,213	288,004
Taxes and licenses	90,496	41,135	6,170	137,801	61,702	6,170	67,872	205,673
Professional fees	49,868	-	1,600	51,468	81,850	8,770	90,620	142,088
Depreciation	56,346	25,612	3,842	85,800	38,418	3,842	42,260	128,060
Insurance	52,338	23,789	3,568	79,695	35,684	3,568	39,252	118,947
Office supplies	16,063	7,301	1,095	24,459	10,952	1,095	12,047	36,506
Other operating costs	38,769	4,645	35	43,449	197,518	2,668	200,186	243,635
Total expenses	$ 12,253,075	$ 2,518,859	$ 506,234	$ 15,278,168	$ 1,933,516	$ 284,212	$ 2,217,728	$ 17,495,896
Percent of total expenses	70%	14%	3%	87%	11%	2%	13%	100%

See accompanying notes.

Craft3 and Subsidiaries
Consolidated Statements of Functional Expenses

	For the Year Ended December 31, 2017							
	Program Services				Supporting Services			
	Commercial Lending Activities	Consumer Lending Activities	Consulting and Management Services	Total Program Services	Management and Administration	Development	Total Supporting Services	Total
Expenses:								
Salaries and wages	$ 3,098,820	$ 966,887	$ 189,445	$ 4,255,152	$ 697,076	$ 134,400	$ 831,476	$ 5,086,628
Payroll taxes and fringe benefits	744,715	294,081	42,157	1,080,953	181,003	42,087	223,090	1,304,043
Provision for loan losses	2,977,805	343,162	-	3,320,967	-	-	-	3,320,967
Interest expense	3,434,960	148,396	-	3,583,356	-	-	-	3,583,356
Loan costs	382,333	150,674	-	533,007	-	-	-	533,007
Occupancy expenses	254,517	109,079	10,908	374,504	154,528	16,362	170,890	545,394
Technology expense	166,853	71,508	7,151	245,512	101,303	10,726	112,029	357,541
Travel	128,432	17,965	4,125	150,522	126,493	13,246	139,739	290,261
Consultants	91,166	17,979	158,203	267,348	205,396	-	205,396	472,744
Taxes and licenses	98,621	42,266	4,227	145,114	59,877	6,340	66,217	211,331
Professional fees	30,756	375	9,870	41,001	72,804	17,015	89,819	130,820
Depreciation	65,897	28,242	2,824	96,963	40,009	4,236	44,245	141,208
Insurance	40,608	17,403	1,740	59,751	24,654	2,610	27,264	87,015
Office supplies	36,223	15,524	1,552	53,299	21,992	2,329	24,321	77,620
Other operating costs	122,777	8,583	4,807	136,167	228,107	2,884	230,991	367,158
Total expenses	$ 11,674,483	$ 2,232,124	$ 437,009	$ 14,343,616	$ 1,913,242	$ 252,235	$ 2,165,477	$ 16,509,093
Percent of total expenses	70%	14%	3%	87%	11%	2%	13%	100%

 See accompanying notes.

	Years Ended December 31, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ 54,224	$ 2,502,464
Adjustments to reconcile change in net assets to net cash flows from operating activities:		
Depreciation	128,060	141,208
Provision for loan losses	4,070,973	3,320,967
Net realized and unrealized (gains) losses on investments	(4,161)	4,188
Deferred income tax expense (benefit)	359,165	(85,622)
Other	-	83,781
Changes in operating assets and liabilities:		
Grants receivable	1,796,397	(2,081,207)
Accrued interest, other receivables, and prepaid expenses	(102,425)	984,696
Other assets	538,179	51,605
Accounts payable and accrued expenses	212,380	(102,045)
Net cash flows from operating activities	7,052,792	4,820,035
CASH FLOWS FROM INVESTING ACTIVITIES		
Loans receivable	(2,881,444)	(10,491,889)
Purchases of investments	(7,844,016)	(12,133,904)
Proceeds from sales of investments	477,921	2,086,387
Maturities of investments	8,750,000	12,500,000
Purchases of furniture and equipment	(81,457)	(589,764)
Change in restricted cash	(710,296)	4,439,759
Net cash flows from investing activities	(2,289,292)	(4,189,411)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of long-term debt	17,216,624	16,166,953
Principal payments on long-term debt	(24,439,368)	(22,027,097)
Net cash flows from financing activities	(7,222,744)	(5,860,144)
CHANGE IN CASH AND CASH EQUIVALENTS	(2,459,244)	(5,229,520)
CASH AND CASH EQUIVALENTS, beginning of year	9,042,120	14,271,640
CASH AND CASH EQUIVALENTS, end of year	$ 6,582,876	$ 9,042,120
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest on long-term debt	$ 3,120,394	$ 3,515,546
SUPPLEMENTAL NONCASH DISCLOSURES		
Net acquisition of assets in settlement of loans	$ 2,000,000	$ -
Acquisition of loan fund:		
Assets acquired and recognized	$ -	$ 1,606,200
Liabilities assumed	$ -	$ 1,189,981

See accompanying notes.

Note 1 – Organization and Summary of Significant Accounting Policies

Craft3 is a Washington nonprofit corporation with a mission to strengthen economic, ecological, and family resilience in Pacific Northwest communities. Craft3 provides loans and assistance to entrepreneurs, nonprofits, individuals, and others who may not have access to traditional financing.

Funding for Craft3's lending and other activities comes from grants and loans made to Craft3 by financial institutions, governmental entities, nonprofit organizations, and individuals.

Craft3 is certified as a Community Development Financial Institution by the Community Development Financial Institutions Fund, a division within the U.S. Department of the Treasury.

Craft3 Capital Corporation ("C3CC") is a wholly-owned, for-profit subsidiary of Craft3. C3CC was established to provide loans to small and mid-market businesses in the State of Washington that can create or retain large numbers of jobs. During the year ended December 31, 2018, C3CC's long-term debt was repaid in full and remaining assets and liabilities were transferred to Craft3.

Windfarm Investments, Inc. ("Windfarm") is a wholly-owned, for-profit subsidiary of Craft3. Windfarm was created to facilitate the funding of a New Markets Tax Credit ("NMTC") investment.

Craft3 Investment II, LLC ("Investment II") is 99.99% owned by Craft3 and 0.01% owned by Windfarm. Investment II was utilized to facilitate the funding of a NMTC-related investment.

Craft3 Investment VII, LLC; Craft3 Investment VIII, LLC; and Craft3 Investment IX, LLC were established to facilitate NMTC investments. In 2018, the seven-year term of the NMTCs expired for these entities and Craft3 obtained 100% ownership. These entities had little to no activity after the NMTC expiration date and will be dissolved before their next license renewal dates.

Principles of consolidation – These consolidated financial statements include the accounts of Craft3 and its wholly-owned subsidiaries, C3CC, Windfarm, and Investment II (collectively, "Craft3"). All material intercompany balances and transactions have been eliminated in consolidation.

Related entities – Craft3 is related to a series of limited liability companies ("LLCs") that were established to take advantage of the NMTC program, which is described in Note 14 to these consolidated financial statements. Craft3 manages the LLCs, but does not have a controlling interest. Accordingly, Craft3's investment in the LLCs is accounted for at cost, subject to possible impairment. Craft3 earns management and other fees for activities related to the LLCs.

Use of estimates – The preparation of consolidated 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 disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and fair value measurements.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Basis of accounting – The accompanying consolidated financial statements of Craft3 have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States (U.S. GAAP). Under the accrual basis of accounting, contributions are recognized when promised, revenues are recognized when earned and expenses are recognized when incurred. Craft3 is required to report information regarding its financial position and activities according to the following classes of net assets:

> ***Net assets without donor restrictions*** – Net assets available for use in general operations and not subject to donor restrictions. A portion of these net assets may be designated by the Board of Directors for specific purposes.
>
> ***Net assets with donor restrictions*** - Net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both.

Cash and cash equivalents – All short-term deposits and investments with an original maturity of three months or less are considered to be unrestricted cash and cash equivalents unless the amounts are restricted. Craft3 has cash balances in excess of federally insured limits Craft3 places its cash and restricted cash with high quality financial institutions.

Restricted cash – Restricted cash consists of cash with limitations on Craft3's ability to use it for general operating expenses due to restrictions imposed by donors, grantors and financial institutions.

Restricted cash is held for the following purposes at December 31:

	2018	2017
Self-Help Credit Union Reserve Accounts	$ 1,441,079	$ 1,559,120
Banner Bank	2,000,000	2,000,000
U.S. Department of Agriculture Intermediary Relending Program ("IRP")	1,821,555	675,375
U.S. Small Business Administration Intermediary Lending Program ("ILP")	122,377	440,220
Total	$ 5,385,011	$ 4,674,715

The Self-Help Credit Union Reserve accounts represent loan loss reserves set up as a result of the Self-Help Energy Loan Sale discussed in Note 7.

The funds held at Banner Bank are restricted as part of the $10 million syndication described in Note 9.

The U.S. Department of Agriculture Intermediary Relending Program requires cash used in this program to be segregated and deposited in a dedicated bank account.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

The U.S. Small Business Administration Intermediary Lending Program requires cash used in this program to be segregated and deposited in a dedicated bank account.

Investments – Investments are carried at fair value. Net investment gain (loss) is reported in the statements of activities and consists of interest and dividend income, realized and unrealized capital gains and losses, less external and direct internal investment expenses. Amortization of premiums and accretions of discounts are recognized in interest income over the period to estimated maturity.

Grants receivable, accrued interest, and other receivables – Receivables consist of amounts owed to Craft3 from customers, related party LLCs, grantor agencies, and accrued interest on loans receivable.

Accounts and grants receivable are stated at their principal balances and are generally uncollateralized. Management has determined that no allowance for possible uncollectible accounts or grants receivable is required, but if an allowance were required, it would be established. If an amount was determined to be uncollectible, it would be written off against the allowance. As of December 31, 2018 and 2017, Craft3 determined that no allowance for doubtful accounts was required.

Loans receivable and reserves for loan losses – Loans receivable are stated at the amount of unpaid principal, reduced by general and specific reserves for loan losses. Interest income on loans is recognized when earned. Loans are made to individuals, businesses, and nonprofit agencies located in the Pacific Northwest. Loans to businesses and nonprofits generally require collateral and personal guarantees from the principal owners or members of management.

A loan is placed on non-accrual status when it is specifically determined to be impaired and when, in the opinion of management, there is an indication that the borrower may be unable to make payments as they become due. Craft3's policy requires that a loan be placed on non-accrual status when payments are 120 days or more past due and the value of the related collateral does not exceed the outstanding balance due. Interest income generally is not recognized on impaired loans. Payments received on such loans are applied as a reduction of the loan principal balance. Generally, a loan would not be converted back to accrual status unless the borrower has made 12 consecutive payments on time.

The reserves (general and specific) for loan losses are maintained at a level that, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio in consideration of the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. Reserves for impaired loans are generally determined after considering collateral values. An increase to reserves increases the provision for loan losses, which is charged to expense. The reserve is reduced by loan charge-offs, net of recoveries.

Impairment is considered to exist when it is probable that not all amounts due will be collected under the terms of the loan receivable. Factors considered by Management in determining whether a loan is impaired include payment status and ability of collecting scheduled principal and interest payments when due. If Management determines that the value of the impaired loan is less than the recorded investment in the loan, Craft3 considers the impairment in the calculation of the overall allowance for loan losses.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

In situations where, for economic or legal reasons related to a borrower's financial difficulties, Craft3 grants a concession for other than an insignificant period of time to the borrower that Craft3 would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before it is charged off. Concessions could include a reduction in the interest rate to a rate that is below market on the loan, payment extensions, forgiveness of principal, forbearance, and other actions designed to maximize collections. In cases where Craft3 grants the borrower new terms that provide for a reduction of either interest or principal, Craft3 measures any impairment as noted above for impaired loans. TDR loans are classified as impaired until they are fully repaid or charged off. TDR loans are subject the same nonaccrual and charge off policies as noted above with respect to their restructured principal balance.

Credit quality indicators – Craft3's credit risk management is monitored with a loan risk rating system. The originating loan officer assigns borrowers an initial risk rating, which is based primarily on a thorough analysis of each borrower's financial capacity to repay in conjunction with economic trends. Approvals are made based upon the amount of inherent credit risk specific to the transaction and are reviewed for appropriateness by loan officer and credit management personnel. Loans are monitored by loan officers and credit management personnel for deterioration in a borrower's financial condition, which would impact the ability of the borrower to perform under the contract. Risk ratings are adjusted periodically during term loan reviews or upon identification of specific events affecting borrower ability to repay.

Loans are risk rated into the following categories (Credit Quality Indicators):

Pass (risk rating of 4 – 5) – These loans range from minimal credit risk to lower than average, but still acceptable, credit risk.

Pass Watch List (risk rating of 6) – Pass Watch List loans usually require more than normal management attention. Loans that qualify for the Pass Watch List may involve borrowers with adverse financial trends, higher debt/equity ratios, or weaker liquidity positions, but not to the degree of being considered a problem loan where risk of loss may be apparent. Additionally, loans are placed on the watch list if they are regularly on the 30+ day past due list or become more than 60 days past due (unless there is a realistic plan for the loan to become current before it becomes 120 days past due).

Problem (risk rating of 7 - 8) – Loans are classified as Problem loans when the borrower's primary source of repayment capacity is impaired to the point that the borrower's payments do not cover principal payments on a reasonable amortization rate; a voluntary liquidation plan has been negotiated; or the loan is more than 120 days past due (unless there is a realistic plan for the loan to become current before it becomes 180 days past due).

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Loss – Whenever any portion of a loan is deemed uncollectible, in part or in whole, a partial or full charge-off will be made against the reserve for loan losses based on a conservative estimate of the realizable liquidation value. A loan that becomes 180 days past due must be charged off unless there are realistic expectations that the borrower can bring the account current or a realistic restructure can be negotiated.

Furniture and equipment – Furniture and equipment are recorded at cost. Depreciation is recorded using the straight-line method over the estimated useful lives of the assets ranging from 3 to 30 years, or in the case of leasehold improvements, the lesser of the useful life of the asset or the lease term. Purchases of assets with a cost in excess of $2,500 are capitalized. Maintenance and repairs are charged to expense as incurred and major replacements and improvements are capitalized. Furniture and equipment balances are shown net of accumulated depreciation of $711,786 and $647,569 at December 31, 2018 and 2017, respectively.

Foreclosed and repossessed assets – Foreclosed and repossessed assets are recorded in other assets in the statements of financial position and are property acquired through foreclosure or other proceedings. When these assets are acquired, any excess of the loan balance over the estimated fair value is charged to the allowance for loan losses. Holding costs, subsequent write-downs to fair value, if any, or any disposition gains or losses are included in lending program services.

Business combination – In August 2017, Craft3 acquired substantially all of the assets and liabilities of North Central Washington Business Loan Fund. Assets consisted of approximately $1,100,000 of discounted loans receivable from various businesses and cash of $500,000. Liabilities consisted of approximately $1,200,000 in notes payable. Craft3 recognized a bargain purchase gain of $378,890 on the acquisition. Expenses related to the business combination were less than material.

Revenue and revenue recognition – Revenue is recognized when earned. Program service fees and payments under cost-reimbursable contracts received in advance are deferred to the applicable period in which the related services are performed or expenditures are incurred, respectively. Contributions are recognized when cash, securities or other assets, an unconditional promise to give, or notification of a beneficial interest is received. Conditional promises to give are not recognized until the conditions on which they depend have been substantially met.

Interest income – Interest income consists of interest earned on loans and interest earned on certificates of deposits and money market accounts. Interest income is recognized in the period earned.

Deferred fee income – Craft3 charges fees based on loan types and related funding requirements. Loan fees (less direct expenses) are deferred and recognized ratably over the term of the loan.

Functional allocation of expenses – The costs of providing the various programs and other activities have been summarized on a functional basis in the consolidated statements of activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Income taxes – Craft3 is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. C3CC files as a for-profit corporation. See Note 13 for further discussion. Craft3 and C3CC are subject to certain business and occupation taxes, which apply equally to for-profit and nonprofit businesses, imposed by state and local taxing authorities. The taxes are assessed on a percentage of a portion of Craft3's revenues. Unrelated business income tax, if any, is insignificant and no tax provision has been made in the accompanying consolidated financial statements. Craft3 had no uncertain tax positions as of December 31, 2018 and 2017. Interest and penalties related to unrecognized tax benefits are recognized by Craft3 as an administrative expense. During the years ended December 31, 2018 and 2017, Craft3 recognized no interest and penalties.

Fair value of assets and liabilities – Fair value is defined as 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. Generally accepted accounting principles establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Accounting principles describe three levels of inputs that may be used to measure fair value:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than Level 1 prices, such as quoted prices for similar assets and liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The degree of judgment utilized in measuring fair value generally correlates to the level of pricing observability. Assets and liabilities with readily available active quoted prices, or for which fair value can be measured from actively quoted prices, generally will have a higher degree of pricing observability and a lesser degree of judgment utilized in measuring fair value. Conversely, assets and liabilities rarely traded or not quoted will generally have little or no pricing observability and a higher degree of judgment utilized in measuring fair value. Pricing observability is impacted by a number of factors, including the type of asset or liability, whether it is new to the market and not yet established, and the characteristics specific to the transaction.

Craft3 used the following methods and significant assumptions to estimate fair value for its assets and liabilities measured and carried at fair value in the financial statements on a recurring or nonrecurring basis:

Investments – Fair values of investments are obtained from an independent pricing service. The fair value measurements consider both observation and unobservable data that may include active quotes, dealer quotes, market spreads, cash flows, and the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and bond terms and conditions, among other things. When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Foreclosed and repossessed assets – Fair values of foreclosed and repossessed assets, primarily shares in a real estate company holding wetlands mitigation credits, are measured based on the underlying assets' observable market price. For real estate, prices are derived from independent appraisals, recent sales and offers.

New accounting pronouncement – During the fiscal year ended December 31, 2018, Craft3 adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities*. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. Main provisions of this guidance include: presentation of two classes of net assets versus the previously required three; recognition of capital gifts for construction as a net asset without donor restrictions when the associated long-lived asset is place in service; recognition of underwater endowment funds as a reduction in net assets with donor restrictions; and reporting investment income net of external and direct internal investment expenses. The guidance also enhances disclosures for board designated amounts, compositions of net assets with donor restrictions and how the restrictions affect the use of resources, qualitative and quantitative information about the liquidity and availability of financial assets to meet general expenditures within one year of the statement of financial position date, and expenses by both their natural and functional classification, including methods used to allocate costs among program and support functions and underwater endowments.

Certain reclassifications have been made to the 2017 financial statements to conform with ASU 2016-14. Such reclassifications did not change net assets or changes in net assets, as reflected in the 2017 financial statements.

Reclassification – Certain amounts in the prior year consolidated financial statements have been reclassified to conform to the current year presentation. The reclassifications had no impact on previously reported net assets.

Subsequent events – Subsequent events are events or transactions that occur after the date of the consolidated statement of financial position but before the consolidated financial statements are issued. Craft3 recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated statements of financial position, including the estimates inherent in the process of preparing the consolidated financial statements.

Craft3 has evaluated subsequent events through May 17, 2019, which is the date the consolidated financial statements became available for issuance.

Note 2 – Investments

Investments consist of the following as of December 31:

	2018	2017
Unrestricted Investments:		
Municipal bonds	$ 2,909,216	$ 3,362,207
U.S Government obligations	996,186	1,997,839
Federal agency securities	947,193	849,559
Corporate bonds	487,235	506,730
Restricted Investments:		
U.S Government obligations	2,241,644	2,244,883
Total	$ 7,581,474	$ 8,961,218

Debt instruments issued by agencies of the U.S. Government include debt issued by Fannie Mae and the Federal Home Loan Bank System.

A portion of the investments are restricted for the Intermediary Relending Program.

The net unrealized loss on investments as of December 31, 2018 and 2017 was $37,017 and $83,459, respectively.

Note 3 – Fair Value Measurements

The following table presents information about assets measured at fair value on a recurring basis as of December 31, 2018 and 2017, and indicates the fair value hierarchy of the valuation technique utilized by Craft3 to determine such fair value:

	Fair Value Measurements at Report Date Using:			
	Fair Value	Level 1	Level 2	Level 3
December 31, 2018				
Recurring items:				
Investments:				
Municipal bonds	$ 2,909,216	$ -	$ 2,909,216	$ -
U.S Government obligations	3,237,830	3,237,830	-	-
Federal agency securities	947,193	-	947,193	-
Corporate bonds	487,235	487,235	-	-
Total recurring items	$ 7,581,474	$ 3,725,065	$ 3,856,409	$ -
Nonrecurring items:				
Foreclosed and repossessed assets	$ 2,000,000	$ -	$ -	$ 2,000,000
December 31, 2017				
Recurring items:				
Investments:				
Municipal bonds	$ 3,362,207	$ -	$ 3,362,207	$ -
U.S Government obligations	4,242,722	4,242,722	-	-
Federal agency securities	849,559	-	849,559	-
Corporate bonds	506,730	506,730	-	-
Total recurring items	$ 8,961,218	$ 4,749,452	$ 4,211,766	$ -

Recurring assets are initially measured at fair value and are required to be re-measured at fair value in the financial statements at each reporting date. Assets measured on a non-recurring basis are assets that due to an event or circumstance, were required to be re-measured at fair value after initial recognition in the financial statements at some time during the reporting period.

The following table provides a description of valuation technique, significant unobservable inputs, and qualitative information about the unobservable inputs for Craft3's assets classified as Level 3 and measured at fair value on a nonrecurring basis at December 31, 2018:

Financial Instrument	Valuation Technique	Unobservable Inputs	Discount
Foreclosed and repossessed assets	Discounted cash flows	Discount rate	8%

There were no assets measured at fair value on a nonrecurring basis at December 31, 2017.

Note 4 – Grants Receivable

Grants receivable consist of the following at December 31:

	2018	2017
U.S. Department of Treasury	$ 700,000	$ 686,500
Oregon Department of Environmental Quality	283,352	174,949
Washington Department of Ecology	21,418	546,201
Washington State Department of Commerce	-	1,400,000
Others	30,040	23,557
Total grants receivable	$ 1,034,810	$ 2,831,207

Note 5 – Related Parties

Accounts receivable from related party LLCs are included in accrued interest, other receivables, and prepaid expenses in the consolidated statements of financial position. There were no receivables from related parties as of December 31, 2018 and $127,971 receivable at December 31, 2017.

The equity associated with C3CC, Investment II, and Windfarm are included within net assets without donor restrictions in these consolidated financial statements. The equity and net assets (liabilities) included in the consolidated financial statements at December 31, 2018 and 2017, for these subsidiaries was:

	2018	2017
Windfarm	$ 2,050	$ 2,171
C3CC	-	18,738,241
Investment II	(28,816)	(21,798)
Total	$ (26,766)	$ 18,718,614

As described in Note 1, during the year ended December 31, 2018, C3CC's long-term debt was repaid in full and remaining assets and liabilities were transferred to Craft3.

Note 6 – Loans Receivable

Customers may access one or more types of loan products available from Craft3. However, no single customer (individual, business, or principal) shall access from Craft3 more than $3,000,000 ($10,000,000 if there is a government guarantee of at least 70%) of total principal outstanding to a borrower, co-borrower, guarantor, or in situations where common collateral is used. The Board of Directors, as an exception to the policy, must specifically approve any loan or investment that will cause a violation of this policy. The borrower exposure limit excludes amounts loaned to borrowers from other entities that may be managed by Craft3, namely the related party LLCs discussed in Note 14.

Note 6 – Loans Receivable (continued)

At December 31, 2018, outstanding loans to individual borrowers were as large as $9,414,303 and loans yielded interest rates from 0% to 18.90% per annum. At December 31, 2017, outstanding loans to individual borrowers were as large as $9,564,440 and loans yielded interest rates from 0% to 18.75% per annum. Commercial loans are generally made to small and mid-size businesses and nonprofit organizations in a variety of industries located in the Pacific Northwest. Consumer loans generally consist of the clean water (that is, septic system repair and replacement) and energy retrofit loans.

The following table represents the approximate number of loans made and outstanding by specific industries at December 31:

	2018			2017		
	Number of Loans	Balance	Percentage of Total	Number of Loans	Balance	Percentage of Total
Manufacturing	51	$ 22,434,358	17%	43	$ 22,823,653	17%
Clean energy	26	18,548,575	14%	32	19,879,919	15%
Forestry and fishing	17	17,664,414	13%	26	17,967,822	13%
Clean water	857	14,413,476	11%	656	10,553,591	8%
Tourism	31	12,587,359	10%	39	8,147,402	6%
Community development	127	9,509,607	7%	112	11,862,210	9%
Services	63	8,580,761	7%	58	8,992,228	7%
Energy retrofit	949	8,144,368	6%	770	6,992,517	5%
Real estate	18	7,395,520	6%	15	12,023,069	9%
Retail	57	6,260,379	5%	46	9,140,262	7%
Professional services	29	4,300,831	3%	22	2,298,185	2%
Agriculture	10	1,086,956	1%	11	2,815,664	2%
Totals	2,235	130,926,604	100%	1,830	133,496,522	100%
Deferred loan origination costs		(309,378)			(552,690)	
Reserve for loan losses		(7,400,338)			(6,537,415)	
		$ 123,216,888			$ 126,406,417	

Loans receivable consist of the following at December 31:

	2018	2017
Commercial loans receivable	$ 107,467,123	$ 115,024,087
Consumer loans receivable	23,459,481	18,472,435
Total loans receivable	$ 130,926,604	$ 133,496,522

The current portion of loans receivable is summarized as:

	2018	2017
Current portion of commercial loans receivable	$ 19,996,512	$ 14,480,621
Current portion of consumer loans receivable	1,738,884	1,371,024
Less: deferred loan costs	(117,653)	(190,498)
Total current portion loans receivable, net	$ 21,617,743	$ 15,661,147

Note 6 – Loans Receivable (continued)

The long-term portion of loans receivable is summarized as:

	2018	2017
Total loans receivable	$ 130,926,604	$ 133,496,522
Less: current portion, net	(21,617,743)	(15,661,147)
Less: loan loss reserve	(7,400,338)	(6,537,415)
Less: deferred loan costs	(309,378)	(552,690)
Total long-term portion loans receivable, net	$ 101,599,145	$ 110,745,270

Activity in the loan loss reserve for 2018 and 2017 is as follows:

	2018	2017
Loan loss reserve, beginning of year	$ 6,537,415	$ 6,219,467
Charge-offs	(4,228,559)	(3,465,954)
Recoveries	1,020,509	462,935
Provision for loan losses	4,070,973	3,320,967
Loan loss reserve, end of year	$ 7,400,338	$ 6,537,415

The loan loss reserve is composed of a general reserve and a specific reserve as follows:

	2018	2017
General reserve	$ 5,026,684	$ 4,269,707
Specific reserve	2,373,654	2,267,708
Total reserve	$ 7,400,338	$ 6,537,415

The general loan loss reserve is measured on loans collectively evaluated for impairment. The specific loan loss reserve is measured on loans individually evaluated for impairment.

In addition, through one of the energy loan programs, an off-balance sheet reserve is being held in fully insured bank accounts by the funder of the program. The balance of this reserve is not on Craft3's books at year-end, but is available to Craft3 for unrecovered losses on certain energy loans once payments are 180 days delinquent and best efforts to collect the outstanding payments have been exercised. The balance as of December 31, 2018 and 2017, was $181,097 and $180,890, respectively.

Management believes the reserve for loan losses is adequate to offset future loan losses in Craft3's current loan portfolio. When determining the reserve for loan losses, management considers factors that mitigate losses, including collateral associated with loans receivable. When a loan is determined to be uncollectible, it is charged against the loan loss reserve. Most loans offered by Craft3 are collateralized. Because of inherent uncertainties in estimating the reserve for loan losses, it is at least reasonably possible that the estimates used will change in the near term.

Note 6 – Loans Receivable (continued)

Management has assessed compliance with loan loss reserve requirements according to the Small Business Administration's Community Advantage Program. As of December 31, 2018, management believes it is in compliance with these requirements.

Future principal payments scheduled to be received on loans receivable are as follows for the year ending December 31:

2019	$ 21,735,396
2020	15,680,324
2021	24,840,433
2022	13,880,933
2023	5,095,467
Thereafter	49,694,051
	$ 130,926,604

Note 7 – Energy Loan Sale

On December 1, 2013, and October 1, 2015, Craft3 sold 1,252 and 438 energy loans ("the Loans") respectively, to Self-Help Credit Union ("SHCU"). The Loans were sold at par and the total principal balance of the Loans was $15,700,426 for the sale that occurred on December 1, 2013, and $6,443,833 for the sale that occurred on October 1, 2015. At December 31, 2018, the outstanding balance of the sold loans serviced by Craft3 was $5,632,985. As part of the sale agreement, Craft3 provided certain cash credit enhancements in support of the Loans (collectively known as "the Reserve Sources"). The Reserve Sources guarantee 30% of the Loans. Under the terms of the sale agreement, Craft3 funded and pledged two accounts ("the Reserve Accounts") to SHCU. At December 31, 2018, the Reserve Accounts are included in restricted cash on the consolidated statements of financial position, and balances were as follows:

- Craft3 SHCU Reserve Account balance of $178,143
- Craft3 Self-Help Federal Credit Union ("SHFCU") Reserve Account balance of $1,262,936

Enhabit (formerly known as Clean Energy Works, Inc.) is an unrelated organization that partnered with Craft3 in the loan program. Enhabit has established a loan loss reserve ("Enhabit Reserve") for eligible loans funded in 2011 and 2012. The reserve funds available in the Enhabit Reserve totaled $993,938 at the time of the sale in 2013. The Reserve Accounts and the Enhabit Reserve combine to be the Reserve Sources and provide the guarantee for 30% of the Loans mentioned above.

SHCU may withdraw the loss amount from the Reserve Sources in the event that payments on any of the Loans become 150 days or more delinquent. If the Loan is eligible, Enhabit Reserve funds will be used first. If the Loan is not eligible for Enhabit Reserve funds or if the Enhabit Reserve funds are depleted, funds from the SHCU Reserve will be withdrawn. If there are no remaining funds in the SHCU Reserve, funds may be withdrawn from the SHFCU Reserve. SHCU is responsible for the potential loss on the next 20% of Loans and Craft3 guarantees the remaining 50% of losses related to the Loans. Potential losses to Craft3 have been incorporated into the loan loss reserve discussed in Note 6.

Note 8 – Credit Quality and Reserve for Loan Losses

The following tables show the loan portfolio allocation by Craft3's internal risk ratings:

	December 31, 2018			
	Pass	Pass – Watch List	Problem	Total Loans
Manufacturing	$ 20,126,411	$ 2,274,082	$ 33,865	$ 22,434,358
Clean energy	17,149,797	-	1,398,778	18,548,575
Forestry and fishing	6,412,444	3,883,699	7,368,271	17,664,414
Clean water	14,110,103	111,267	192,106	14,413,476
Tourism	11,183,355	245,762	1,158,242	12,587,359
Community development	9,323,302	186,305	-	9,509,607
Services	4,603,870	2,205,941	1,770,950	8,580,761
Energy retrofit	7,677,590	222,106	244,672	8,144,368
Real estate	6,943,444	452,076	-	7,395,520
Retail	5,475,894	775,862	8,623	6,260,379
Professional services	3,482,066	59,963	758,802	4,300,831
Agriculture	995,321	46,219	45,416	1,086,956
Totals	$ 107,483,597	$ 10,463,282	$ 12,979,725	$ 130,926,604

	December 31, 2017			
	Pass	Pass – Watch List	Problem	Total Loans
Manufacturing	$ 22,803,888	$ -	$ 19,765	$ 22,823,653
Clean energy	16,908,357	2,392,743	578,819	19,879,919
Forestry and fishing	17,442,501	128,955	396,366	17,967,822
Clean water	10,334,776	47,044	171,771	10,553,591
Tourism	7,014,087	-	1,133,315	8,147,402
Community development	8,927,596	21,949	2,912,665	11,862,210
Services	7,325,707	67,868	1,598,653	8,992,228
Energy retrofit	6,678,865	185,439	128,213	6,992,517
Real estate	11,933,654	89,415	-	12,023,069
Retail	8,596,422	279,654	264,186	9,140,262
Professional services	2,295,429	2,756	-	2,298,185
Agriculture	858,121	1,801,846	155,697	2,815,664
Totals	$ 121,119,403	$ 5,017,669	$ 7,359,450	$ 133,496,522

Note 8 – Credit Quality and Reserve for Loan Losses (continued)

The following table shows an aging analysis of the loan portfolio by the time past due:

December 31, 2018	Current	1–30 Days Past Due	31–60 Days Past Due	61–90 Days Past Due	91–120 Days Past Due	121+ Days Past Due	Total Loans
Manufacturing	$ 18,581,186	$ 3,853,172	$ -	$ -	$ -	$ -	$ 22,434,358
Clean energy	18,094,840	453,735	-	-	-	-	18,548,575
Forestry and fishing	5,011,491	6,515,213	21,165	6,116,545	-	-	17,664,414
Clean water	13,973,848	264,743	99,486	16,814	32,533	26,052	14,413,476
Tourism	10,525,793	928,251	-	-	-	1,133,315	12,587,359
Community development	9,495,578	-	14,029	-	-	-	9,509,607
Services	6,987,924	-	-	1,592,837	-	-	8,580,761
Energy retrofit	7,935,602	-	-	89,354	36,286	83,126	8,144,368
Real estate	7,395,520	-	-	-	-	-	7,395,520
Retail	6,260,379	-	-	-	-	-	6,260,379
Professional services	4,265,249	35,582	-	-	-	-	4,300,831
Agriculture	1,086,956	-	-	-	-	-	1,086,956
Totals	$ 109,614,366	$ 12,050,696	$ 134,680	$ 7,815,550	$ 68,819	$ 1,242,493	$ 130,926,604

December 31, 2017	Current	1–30 Days Past Due	31–60 Days Past Due	61–90 Days Past Due	91–120 Days Past Due	121+ Days Past Due	Total Loans
Manufacturing	$ 22,823,653	$ -	$ -	$ -	$ -	$ -	$ 22,823,653
Clean energy	19,776,217	-	103,702	-	-	-	19,879,919
Forestry and fishing	17,612,042	237,588	34,654	-	-	83,538	17,967,822
Clean water	10,486,947	30,837	2,196	-	33,611	-	10,553,591
Tourism	6,835,328	165,093	-	13,666	1,133,315	-	8,147,402
Community development	8,949,545	-	2,912,665	-	-	-	11,862,210
Services	8,912,474	79,754	-	-	-	-	8,992,228
Energy retrofit	6,922,455	-	-	25,504	28,830	15,728	6,992,517
Real estate	11,933,654	-	-	89,415	-	-	12,023,069
Retail	8,905,129	235,133	-	-	-	-	9,140,262
Professional services	2,298,185	-	-	-	-	-	2,298,185
Agriculture	2,700,193	75,970	39,501	-	-	-	2,815,664
Totals	$ 128,155,822	$ 824,375	$ 3,092,718	$ 128,585	$ 1,195,756	$ 99,266	$ 133,496,522

Included in Forestry and fishing loans are two loans funded by Craft3 and Investment II to unrelated entities arising from the same NMTC transaction. The loan funded by Craft3 had a principal balance of $6,315,200 as of December 31, 2018 and 2017 and is included in the 1 – 30 days past due category. The loan funded by Investment II had a principal balance of $6,116,545 and $6,191,094 as of December 31, 2018 and 2017, respectively, and is included in the 61 – 90 days past due category.

The following tables present the recorded investment in loans by portfolio segment and based on impairment method:

December 31, 2018	Commercial	Consumer	Total Loans
Loans individually evaluated for impairment	$ 16,539,708	$ 786,755	$ 17,326,463
Loans collectively evaluated for impairment	90,927,415	22,672,726	113,600,141
Totals	$ 107,467,123	$ 23,459,481	$ 130,926,604

Note 8 – Credit Quality and Reserve for Loan Losses (continued)

	December 31, 2017		
	Commercial	Consumer	Total Loans
Loans individually evaluated for impairment	$ 12,377,118	$ 554,416	$ 12,931,534
Loans collectively evaluated for impairment	102,646,969	17,918,019	120,564,988
Totals	$ 115,024,087	$ 18,472,435	$ 133,496,522

The following tables present loans individually evaluated for impairment by class of loans:

	December 31, 2018				
	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with an Allowance	Total Recorded Investment	Specific Allowance
Commercial	$ 20,685,464	$ 10,361,441	$ 6,178,267	$ 16,539,708	$ 2,373,654
Consumer	-	786,755	-	786,755	-
	$ 20,685,464	$ 11,148,196	$ 6,178,267	$ 17,326,463	$ 2,373,654

	December 31, 2017				
	Unpaid Contractual Principal Balance	Recorded Investment with No Allowance	Recorded Investment with an Allowance	Total Recorded Investment	Specific Allowance
Commercial	$ 14,022,777	$ 5,279,473	$ 7,097,645	$ 12,377,118	$ 2,267,708
Consumer	-	554,516	-	554,516	-
	$ 14,022,777	$ 5,833,989	$ 7,097,645	$ 12,931,634	$ 2,267,708

Interest recognized on impaired loans subsequent to the determination of impairment was immaterial to the consolidated financial statements for the years ended December 31, 2018 and 2017.

As of December 31, 2018 and 2017, loans on nonaccrual were as follows:

	2018	2017
Commercial	$ 1,982,131	$ 5,280,167
Consumer	163,964	184,511
	$ 2,146,095	$ 5,464,678

Note 8 – Credit Quality and Reserve for Credit Losses (continued)

The following table presents troubled debt restructurings as of December 31, 2018 and 2017:

	2018	2017
Commercial	$ 12,721,053	$ 7,264,090

During the years ended December 31, 2018 and 2017, Craft3 restructured commercial loans totaling approximately $7,018,105 and $4,697,404, respectively. There were no TDRs that defaulted during the years ended December 31, 2018 and 2017 and for which the default occurred within 12 months of the modification date.

Note 9 – Long-Term Debt

Long-term debt consists of the following as of December 31:

Long-term notes payable

	2018	2017
Notes payable to financial institutions in varying amounts with interest rates ranging from 1% to 5.38%. Notes are unsecured and the final due date is May 15, 2027.	$ 39,950,000	$ 37,850,000
Notes payable to individuals, businesses, nonprofit organizations, and trusts in varying amounts with interest rates ranging from 0% to 4.25%. Notes are unsecured and have a variety of dues dates; the final due date is February 22, 2029.	31,463,589	26,173,255
Notes payable to U.S. Department of Agriculture with 1% interest rates. Notes are secured by the program receivables and a portion of restricted cash, and the final due date is October 20, 2044.	6,501,387	6,939,090
Note payable from Craft3 Investment II, LLC to Pacesetter CDE XXIV, LLC with a variable interest rate based on the Wall Street Journal Prime Rate plus 4.25%. The note is unsecured and the final due date is October 25, 2035.	6,213,362	6,224,581
Notes payable to government agencies in varying amounts with interest rates ranging from 0% to 2.4%. Notes are unsecured and the final due date is August 26, 2031.	4,879,439	3,176,928

Note 9 – Long-Term Debt (continued)

Long-term notes payable (continued)

	2018	2017
Note payable to leading bank of the C3CC syndication, Wells Fargo Bank, with a variable interest rate of LIBOR plus 3.5%. Note is secured by the assets at C3CC and the final due date is August 21, 2020.	$ -	$ 15,866,667
Total long-term notes payable	89,007,777	96,230,521
Less: current portion	(21,593,808)	(15,653,009)
	$ 67,413,969	$ 80,577,512

Equity equivalent investments

	2018	2017
Notes payable to financial institutions in varying amounts with interest rates ranging from 1% to 4%. Notes are unsecured with a variety of due dates; the final due date is November 30, 2025.	$ 6,447,568	$ 6,447,568
Notes payable to government agencies in varying amounts with interest rates ranging from 2.0% to 2.4%. Notes are unsecured with a variety of due dates; the final due date is March 1, 2022.	3,367,000	3,367,000
Total equity equivalent investments	9,814,568	9,814,568
Less: current portion	(2,444,919)	(177,919)
	$ 7,369,649	$ 9,636,649

Equity equivalent investments (or "EQ2") is debt that is subordinated to all other Craft3 debt and may only be repaid when, and if, its repayment does not materially impair Craft3's operating or loan capital liquidity.

The current portion of long-term debt is summarized at December 31:

	2018	2017
Long-term notes payable	$ 21,593,808	$ 15,653,009
Equity equivalent investments debt	2,444,919	177,919
	$ 24,038,727	$ 15,830,928

Note 9 – Long-Term Debt (continued)

The following is a summary of scheduled principal maturities of all long-term debt for the years ending December 31:

2019	$ 24,038,727
2020	19,978,470
2021	14,597,046
2022	8,495,521
2023	5,753,136
Thereafter	25,959,445
	$ 98,822,345

A number of Craft3's notes payable credit agreements contain restrictive covenants related to minimum capital requirements, the ratio of net assets to total assets, and liquidity, as defined. Craft3 was out of compliance with certain covenants and received waivers from lenders as of December 31, 2018.

In December 2014, Craft3 entered into a $10 million revolving line of credit with a group of banks partially secured by $2 million on deposit at Banner Bank. At the borrower's option, the line of credit shall bear interest at a rate of either prime or 30-day LIBOR plus a margin and will have a termination date of November 2019. As of December 31, 2018 and 2017, there was no outstanding balance on the line of credit.

In August 2014, C3CC entered into a $31.5 million line of credit with a group of banks and other lenders secured by all assets of C3CC. The line of credit bore interest at LIBOR plus 3.5%. The loan was repaid in full during the year ended December 31, 2018 and the line closed. As of December 31, 2017, the outstanding balance of this loan was $15,866,667.

Note 10 – Leasing Agreements

Craft3 leases office space and other properties under non-cancelable operating leases that expire at various dates through 2031. Craft3 also leases property under month-to-month agreements. Expenditures under these leases are included on the consolidated statements of functional expenses as occupancy expenses. The following is a summary of future minimum lease payments for the years ending December 31:

2019	$ 400,151
2020	391,936
2021	365,528
2022	353,415
2023	379,932
Thereafter	2,021,311
	$ 3,912,273

Rent expense was $388,406 and $436,250 for the years ended December 31, 2018 and 2017, respectively.

Note 11 – Grants and Contributions

Grants and contributions were provided by the following organizations:

	2018	2017
Washington Department of Ecology	$ 2,766,329	$ 1,486,793
Oregon Department of Environmental Quality	1,063,015	548,446
U.S. Department of the Treasury	700,000	686,500
Northwest Area Foundation	400,000	-
The Heron Foundation	100,000	-
JPMorgan Chase Foundation	75,000	110,000
Washington State Department of Commerce	-	2,800,000
Ford Family Foundation	-	500,000
Meyer Memorial Trust	-	250,000
Others	318,898	582,707
Total grants and contributions	$ 5,423,242	$ 6,964,446

Note 12 – Contingent Liabilities and Funds Subject to Recapture

Federal grants and loans are subject to audit and adjustment by grantor agencies. Any disallowed claims or findings of noncompliance with grant terms as a result of such an audit may constitute a liability to Craft3.

In prior years, Craft3 received grants totaling approximately $3,440,000 to fund energy efficiency loans in two underserved Portland neighborhoods. Craft3 is required to return 70% of the principal of these loans to Enhabit as the loans are repaid or sold. Craft3 did not return any funds to Enhabit during 2018 and returned $2,550 in 2017. As of December 31, 2018, the remaining amount eligible for repayment was $65,975.

Note 13 – Federal Income Taxes

As described in Note 1, C3CC is a Craft3 subsidiary that files a tax return as a for-profit corporation. The tax provision associated with C3CC is composed of:

	2018	2017
Current benefit	$ -	$ -
Deferred (expense) benefit	(359,165)	85,622
	$ (359,165)	$ 85,622

Note 13 – Federal Income Taxes (continued)

The net deferred tax asset is composed of:

	2018	2017
Net operating loss carryforward	$ -	$ 359,165
Loan loss reserve	-	634,067
	-	993,232
Valuation allowance	-	(634,067)
Net deferred tax asset	$ -	$ 359,165

There was a decrease in the valuation allowance of $634,067 for 2018 and a decrease in the valuation allowance of $91,833 for 2017. The net operating loss carryforward expires beginning in 2035. Due to the dissolution of C3CC in 2018, there was no net deferred tax asset or liability at December 31, 2018.

Investment II and the other subsidiaries are organized as limited liability corporations ("LLCs"). Net income from the LLCs is passed through to Craft3, which is a nonprofit corporation organized under Internal Revenue Code Section 501(c)(3). No liability has been recorded for uncertain tax positions as of December 31, 2018 or 2017, and management believes no material uncertain tax positions have been taken.

Note 14 – New Markets Tax Credits

As discussed in Note 1, Craft3 is certified by the Community Development Financial Institutions Fund, a division within the U.S. Department of the Treasury. Craft3 has applied for and received allocations of the NMTC within the meaning of the Internal Revenue Code. These credits can be offered to certain investors for the purpose of stimulating increased investment and economic growth in low-income communities.

Craft3 is related to a series of LLCs that are used to take advantage of the NMTC. In some cases, NMTC program periods expired, and Craft3 obtained 100% control of the LLCs (included in the consolidated financial results or the entities were dissolved at the end of the NMTC period). In other cases, Craft3 owns 0.01% of each of these entities, and they are accounted for at cost.

As discussed in Note 1, the seven-year NMTC term expired during 2018 for Craft3 Investment VII, LLC, Craft3 Investment VIII, LLC, and Craft3 Investment IX, LLC and Craft3 obtained 100% ownership of these entities. These entities had little to no activity after the NMTC expiration date and will be dissolved before their next license renewal dates.

As of December 31, 2017, Craft3 owned 0.01% of these entities and they were not consolidated with Craft3 due to lack of control.

Note 14 – New Markets Tax Credits (continued)

The activities with these entities are summarized as follows:

- Craft3 Investment VII, LLC ("Investment VII") – Craft3 invested $1,800 into Investment VII, and had no advances to Investment VII at December 31, 2018 and $68,893 at December 31, 2017. During 2018 and 2017, Craft3 earned fees of $187,720 and $225,771, respectively, from Investment VII.

- Craft3 Investment VIII, LLC ("Investment VIII") – Craft3 invested $460 into Investment VIII, and had no advances to Investment VIII at December 31, 2018 and $9,131 at December 31, 2017. During 2018 and 2017, Craft3 earned fees of $54,928 and $59,785, respectively, from Investment VIII.

- Craft3 Investment IX, LLC ("Investment IX") – Craft3 invested $1,628 into Investment IX, and had no advances to Investment IX at December 31, 2018 and $49,947 at December 31, 2017. During both 2018 and 2017, Craft3 earned fees of $167,451 and $194,865, respectively, from Investment IX.

Note 15 – Net Assets with Donor Restrictions

Net assets with donor restrictions by purpose and net assets released from restrictions (by grantor/donor) as of December 31, 2018 and 2017 and for the year ended December 31, 2018 are as follows:

	2017	Grants and Contributions	Net Assets Released	2018
Subject to expenditure for specified purpose:				
Lending activities:				
JPMorgan Chase Foundation	$ 362,832	$ -	$ (362,832)	$ -
Meyer Memorial Trust Clean Water	200,000	-	(163,523)	36,477
	562,832	-	(526,355)	36,477
General operations:				
Kaiser Permanente	48,027	-	(48,027)	-
Meyer Memorial Trust Land Conservation	168,346	-	(168,346)	-
Meyer Memorial Trust Expansion	193,819	-	(193,819)	-
JPMorgan Chase Foundation – Opportunity Fund Collaboration	38,566	-	(38,566)	-
Wells Fargo Foundation	182,564	-	(49,915)	132,649
Northwest Area Foundation – Uplift America	40,313	400,000	(75,738)	364,575
Meyer Memorial Trust Clean Water	50,000	-	(50,000)	-
JPMorgan Chase Foundation – Small Business Forward	74,708	-	(74,708)	-
Meyer Memorial Trust Food & Farm	50,000	-	-	50,000
Bullitt ADU	-	30,000	-	30,000
Philanthropy Northwest	-	260,000	(103,708)	156,292
	846,343	690,000	(802,827)	733,516
Total net assets with donor restrictions	$ 1,409,175	$ 690,000	$ (1,329,182)	$ 769,993

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of the passage of time or other events specified by the donors as follows for the year ended December 31, 2018:

Satisfaction of purpose restrictions:	
Lending activities	$ 526,355
General operations	802,827
Total net assets with donor restrictions released	$ 1,329,182

There were no net assets restricted for Board designated purposes as of December 31, 2018 or 2017.

Note 16 – Liquidity and Funds Available

The following table reflects Craft3's financial assets as of December 31, 2018 available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of the balance sheet date. Financial assets are considered unavailable when illiquid or not convertible to cash within one year. Other considerations of non-liquid assets are donor restricted assets for specific expenditures, contractual reserve requirements, or governing board designations.

Cash and cash equivalents	$ 6,582,876
Investments, at fair value	5,339,830
Contributions receivable	1,034,810
Accrued interest, other receivables, and prepaid expenses	1,488,548
Current portion of loans receivable, net	21,617,743
	$ 36,063,807

As part of Craft3's liquidity management plan, management invests cash in excess of daily requirements in short-term investments and money market funds. See Note 9 for available borrowings.

Supplemental Information

Craft3 and Subsidiaries
Consolidating Statement of Financial Position
December 31, 2018

	Craft3	Craft3 Capital Corporation	Craft3 Investment II, LLC	Windfarm Investments, Inc.	Eliminating Entries	Consolidated Total
ASSETS						
CURRENT ASSETS						
Cash and cash equivalents	$ 6,574,547	$ -	$ 6,911	$ 1,418	$ -	$ 6,582,876
Restricted cash and cash equivalents	3,943,932	-	-	-	-	3,943,932
Investments, at fair value	5,339,830	-	-	-	-	5,339,830
Restricted investments, at fair value	2,241,644	-	-	-	-	2,241,644
Grants receivable	1,034,810	-	-	-	-	1,034,810
Accrued interest, other receivables,			-	-	-	
and prepaid expenses	1,342,291	-	146,257	-	-	1,488,548
Current portion of commercial loans						
receivable, net	19,795,885	-	82,974	-	-	19,878,859
Current portion of consumer loans						
receivable, net	1,738,884	-	-	-	-	1,738,884
Total current assets	42,011,823	-	236,142	1,418	-	42,249,383
LOANS RECEIVABLE						
Commercial loans, net	101,041,200	-	6,116,545	-	-	107,157,745
Consumer loans, net	23,459,481	-	-	-	-	23,459,481
Total loans receivable	124,500,681	-	6,116,545	-	-	130,617,226
Less: current portion, net	(21,534,769)	-	(82,974)	-	-	(21,617,743)
Less: reserve for loan losses	(7,368,762)	-	(31,576)	-	-	(7,400,338)
Total loans receivable, net of current portion and reserve for loan losses	95,597,150	-	6,001,995	-	-	101,599,145
OTHER ASSETS						
Cash and cash equivalents restricted						
for loan loss reserves	1,441,079	-	-	-	-	1,441,079
Furniture and equipment, net	626,257	-	-	-	-	626,257
Investment in subsidiaries	(27,398)	-	-	632	26,766	-
Other	2,207,451	-	-	-	-	2,207,451
Total other assets	4,247,389	-	-	632	26,766	4,274,787
Total assets	$ 141,856,362	$ -	$ 6,238,137	$ 2,050	$ 26,766	$ 148,123,315

	Craft3	Craft3 Capital Corporation	Craft3 Investment II, LLC	Windfarm Investments, Inc.	Eliminating Entries	Consolidated Total
LIABILITIES AND NET ASSETS						
CURRENT LIABILITIES						
Accounts payable and accrued expenses	$ 1,261,450	$ -	$ 53,591	$ -	$ -	$ 1,315,041
Current portion of long-term liabilities	24,013,400	-	25,327	-	-	24,038,727
Total current liabilities	25,274,850	-	78,918	-	-	25,353,768
LONG-TERM DEBT						
Notes payable	82,794,415	-	6,213,362	-	-	89,007,777
Equity equivalent investments	9,814,568	-	-	-	-	9,814,568
Total long-term debt	92,608,983	-	6,213,362	-	-	98,822,345
Less: current portion	(24,013,400)	-	(25,327)			(24,038,727)
Total long-term debt, net of current portion	68,595,583	-	6,188,035	-	-	74,783,618
Total liabilities	93,870,433	-	6,266,953	-	-	100,137,386
NET ASSETS						
Without donor restrictions	47,215,936	-	(28,816)	2,050	26,766	47,215,936
With donor restrictions	769,993	-	-	-	-	769,993
Total net assets	47,985,929	-	(28,816)	2,050	26,766	47,985,929
Total liabilities and net assets	$ 141,856,362	$ -	$ 6,238,137	$ 2,050	$ 26,766	$ 148,123,315

Craft3 and Subsidiaries
Consolidating Statement of Activities
December 31, 2018

	Craft3	Craft3 Capital Corporation	Craft3 Investment II, LLC	Windfarm Investments, Inc.	Eliminating Entries	Consolidated Total
REVENUE AND OTHER SUPPORT						
Interest income on outstanding loans	$ 8,481,148	$ 1,261,918	$ 561,893	$ -	$ -	$ 10,304,959
Grants and contributions	5,423,242	-	-	-	-	5,423,242
Loan closing and origination fees	1,280,834	196,763	-	-	-	1,477,597
NMTC management and service fees	525,629	-	-	-	(84,180)	441,449
Interest income on investments	221,778	-	-	-	-	221,778
Net realized losses on investments	(8,496)	-	-	-	-	(8,496)
Miscellaneous income	629,093	-	-	-	(600,776)	28,317
Total revenue and other support	16,553,228	1,458,681	561,893	-	(684,956)	17,888,846
EXPENSES						
Program services						
Commercial lending activities	11,268,838	460,794	568,911	120	(45,588)	12,253,075
Consumer lending activities	2,518,859	-	-	-	-	2,518,859
Consulting and management services	506,234	38,363	-	-	(38,363)	506,234
Total program services	14,293,931	499,157	568,911	120	(83,951)	15,278,168
Supporting services						
Management and administration	1,933,516	-	-	-	-	1,933,516
Development	284,212	-	-	-	-	284,212
Total supporting services	2,217,728	-	-	-	-	2,217,728
Total expenses	16,511,659	499,157	568,911	120	(83,951)	17,495,896
Change in net assets before bargain purchase gain, unrealized losses, and federal income tax	41,569	959,524	(7,018)	(120)	(601,005)	392,950
NET UNREALIZED GAINS ON INVESTMENTS	12,657	-	-	-	-	12,657
INCOME TAX EXPENSE	-	(351,383)	-	-	-	(351,383)
Change in net assets/net income (loss)	$ 54,226	$ 608,141	$ (7,018)	$ (120)	$ (601,005)	$ 54,224

Supplementary Reports and Schedules in Accordance with *Government Auditing Standards* and the Uniform Guidance

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Directors
Craft3 and Subsidiaries

We have audited, in accordance with the 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, the financial statements of Craft3 and Subsidiaries (Craft3), which comprise the consolidated statements of financial position as of December 31, 2018 and 2017, and the related consolidated statements of activities, functional expenses, and cash flows for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated May 17, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Craft3's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Craft3's internal control. Accordingly, we do not express an opinion on the effectiveness of Craft3's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and question costs as item 2018-001, that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Craft3's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Craft3's Response to Findings

Craft3's response to the findings identified in our audit are described in the accompanying schedule of management's view and correcting action plan. Craft3's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Moss Adams LLP

Portland, Oregon
May 17, 2019

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Report of Independent Auditors on Compliance for Each Major Federal Program and on Internal Control Over Compliance

The Board of Directors
Craft3 and Subsidiaries

Report on Compliance for Each Major Federal Program

We have audited Craft3 and Subsidiaries' ("Craft3") compliance with the types of compliance requirements described in the OMB Compliance Supplement that could have a direct and material effect on each of Craft3's major federal programs for the year ended December 31, 2018. Craft3's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Craft3's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200*, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Craft3's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Craft3's compliance.

Opinion on Each Major Federal Program

In our opinion, Craft3 complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2018.

Report on Internal Control Over Compliance

Management of Craft3 is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Craft3's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Craft3's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Moss Adams LLP

Portland, Oregon
June 10, 2019

Craft3 and Subsidiaries
Schedule of Expenditures of Federal Awards
For the Year Ended December 31, 2018

Federal Grantor	Award Number	Federal CFDA Number	Federal Expenditures
U.S. Department of Housing & Urban Development			
Pass-through City of Spokane, WA			
North Monroe Working Capital Pilot			
Community Development Block Grant	B-17-MC-53-0006	14.218	$ 30,040
U.S. Department of Treasury			
CDFI Cluster			
Community Development Financial Institution Fund	181FA023085	21.020	54,000
Loans Payable with continuing requirements:			
Community Development Financial Institution Fund	991CD001371	21.020	1,500,000
Total CDFI Cluster			1,554,000
Total U.S. Department of Treasury			1,554,000
U.S. Environmental Protection Agency			
Pass-through Tacoma-Pierce County Health Department			
Puget Sound Action Agenda: Technical Investigations and Implementation Assistance Program	2014-00000098	66.123	17,990
Clean Water State Revolving Fund Cluster			
Pass-through State of Washington Department of Ecology			
Capitalization Grants for Clean Water State Revolving Funds*	C1700016	66.458	1,500,000
Loans payable with continuing requirements:			
Pass-through State of Washington Department of Ecology			
Capitalization Grants for Clean Water State Revolving Funds*	C1700016	66.458	2,679,141
Pass-through Kitsap Public Health District, WA			
Capitalization Grants for Clean Water State Revolving Funds*	1529	66.458	795,269
Total Clean Water State Revolving Fund Cluster			4,974,410
Total U.S. Environmental Protection Agency			4,992,400
U.S. Department of Agriculture			
Intermediary Relending Program*	D01	10.767	363,194
Intermediary Relending Program*	D02	10.767	370,728
Intermediary Relending Program*	D03	10.767	441,330
Intermediary Relending Program*	D04	10.767	544,620
Intermediary Relending Program*	D05	10.767	649,789
Intermediary Relending Program*	D06	10.767	915,677
Intermediary Relending Program*	D08	10.767	324,469
Intermediary Relending Program*	D09	10.767	326,697
Intermediary Relending Program*	D10	10.767	437,612
Intermediary Relending Program*	D11	10.767	576,576
Intermediary Relending Program*	D12	10.767	534,115
Intermediary Relending Program*	D13	10.767	119,962
Intermediary Relending Program*	D14	10.767	132,460
Intermediary Relending Program*	D15	10.767	456,632
Intermediary Relending Program*	D16	10.767	307,524
Total U.S. Department of Agriculture			6,501,385
U.S. Small Business Administration			
Intermediary Lending Pilot Program	48159850-02	59.062	766,578
Total expenditures of federal awards			$ 13,844,403

*Denotes a major program

Note 1 – Basis of Presentation

The accompanying schedule of expenditures of federal awards ("the Schedule") includes the federal grant activity of Craft3 under programs of the federal government for the year ended December 31, 2018. The information in the Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards ("Uniform Guidance"). Because the Schedule presents only a selected portion of the operations of Craft3, it is not intended to and does not present the financial position, changes in net assets, or cash flows of Craft3.

Note 2 – Summary of Significant Accounting Principles

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Pass-through entity identifying numbers are presented where available.

Note 3 – Indirect Cost Rate

Craft3 has elected not to use the 10 percent de minimis indirect cost rate as allowed under the Uniform Guidance.

Note 4 – Loans Outstanding

Federal loans outstanding with continuing compliance requirements are considered as expenditures on the Schedule. These outstanding loan balances total $12,296,375 at December 31, 2018.

Section I – Summary of Auditor's Results

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☒ Yes ☐ None reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over major federal programs:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☐ Yes ☒ None reported

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? ☐ Yes ☒ No

Identification of major federal programs and type of auditor's report issued on compliance for major federal programs:

CFDA Number	*Name of Federal Program or Cluster*	*Type of Auditor's Report Issued on Compliance for Major Federal Programs*
66.458	Capitalization of Grants for Clean Water State Revolving Funds	Unmodified
59.062	Intermediary Lending Pilot Program	Unmodified

Dollar threshold used to distinguish between type A and type B programs: $ 750,000

Auditee qualified as low-risk auditee? ☒ Yes ☐ No

Section II – Financial Statement Findings

FINDING 2018-001 – Significant Deficiency in Internal Controls Related to the Preparation of the Allowance for Loan Losses

Criteria or specific requirement:

Accounting Standards Codification (ASC) sections *450 – Contingencies* and *310 – Receivables* state the allowance for loan losses should be based on reasonable and supportable estimates and prescribes methods for estimating loan loss reserves for loans identified as impaired.

Condition:

Three conditions existed as of December 31, 2018:

- The calculation of general reserves in accordance with ASC 450 did not include a complete population of loans.
- The calculation of impairments for troubled debt restructurings included reserves for those loans for which no impairment was measured. Further, when calculating reserves, the greatest reserve under various measurement methods was used rather than using the method most appropriate based on underlying loan facts.
- The unallocated portion of the allowance for loan losses representing qualitative and environmental factors was not supported by accompanying analysis supporting these reserves.

Context:

As it relates to all three conditions, the matters were identified during our testing of the model used by Craft3 to estimate the allowance for loan losses as of December 31, 2018. The model is prepared on a monthly basis using the prior month model as a basis. As the model represents a point in time, the effects are not cumulative.

Effect:

The results of the first condition resulted in approximately $170,000 in unallocated reserves reclassified to general reserves and there was no effect on overall reserve levels. The second and third conditions did not result in adjustments within the model.

Cause:

Craft3's allowance review controls and allowance preparation procedures were not sufficiently designed as of December 31, 2018.

Recommendation:

We recommend Craft3 review existing allowance review controls and procedures to ensure inputs, specifically loan balances, are complete and accurate, ensure reserves on impaired loans are in accordance with ASC 310 and, ensure unallocated reserves are appropriately supported.

Views of responsible officials and planned corrective actions:

Craft3 understands and concurs with this finding. See management response and corrective action plan.

Section III – Federal Award Findings and Questioned Costs

None reported

CRAFT3

Lending to people, Investing for resilience

Management Response and Corrective Action Plan
For the year ended December 31, 2018

Finding 2018-001 – Significant Deficiency in Internal Controls Related to the Preparation of the Allowance for Loan Losses

Condition 1 Response and Correction Action Plan:

Management agrees with this finding. Craft3 proposes putting a structure in place to both review and approve ALL. The ALL reviewing team will consist of the Chief Financial Officer (CFO), Chief Credit Officer (CCO), Credit Officer (CO) and Credit Risk Assessment Manager (CRAM) who will meet on a quarterly basis and review the Craft3 ALL that will then be presented to the Craft3 Special Assets Committee. A quorum will be three members. The team will have access to background information on how the ALL was calculated for the period. Additionally, the controller will review the calculation of the ALL on a quarterly basis. A log will also be created that shows any formula changes that have been made to the ALL. This will insure that loan data input to the ALL is complete and calculations within the ALL model are accurate. Quarterly, a memo will be presented by the CRAM that outlines the recommendation for ALL and the methodology behind it. Upon provisional approval by this group, the results will be forwarded to the Special Asset Committee for final approval. The results of the vote will be memorialized in the meeting minutes of the Special Asset Committee each quarter.

Condition 2 Response and Corrective Action Plan:

Management agrees with this finding. It is noted correctly above that the greater amount of impairment calculated is generally included in the allowance for loan losses. Craft3 also includes an extra reserve on TDRs that are fully collateralized. The extra reserve is based on a three-year average charge off rate and allocates a small reserve to these loans as if they were not problem credits. Craft3 acknowledges Moss Adams' finding that if no impairment is calculated, it would not be appropriate to include an additional general reserve on the loan.

Craf3 proposes discontinuing the practice of taking additional reserves based on the three-year average charge off rate on TDR and problem loans that are fully collateralized when no impairment has been identified. The designed controls recommended above will be implemented as part of the Craft3 ALL committee referenced above.

Condition 3 Response and Corrective Action Plan:

Management agrees with this finding. While the Craf3 loan policy does allow the latitude to increase loan loss reserves as needed, the Craft3 ALL committee will provide a written explanation on a quarterly basis explaining increases in the ALL above the calculated *reserve. The Special Asset Committee will review and approve this memo on a quarterly basis.*

Position of Responsible Official:
Adam Zimmerman
Craft3, CEO & President
azimmerman@craft3.org

Anticipated Completion Date: December 31, 2019

Adam Zimmerman
Craft3, CEO & President
June 10, 2019

MOSSADAMS