CITY YEAR, INC.

Financial Statements

June 30, 2007 and 2006

(With Independent Auditors' Report Thereon)

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Independent Auditors' Report

The Board of Trustees
City Year, Inc.:

We have audited the accompanying statements of financial position of City Year, Inc. (City Year) as of June 30, 2007 and 2006, and the related statements of activities, cash flows and functional expenses for the years then ended. These financial statements are the responsibility of City Year's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on City Year's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of City Year as of June 30, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

December 20, 2007

CITY YEAR, INC.

Statements of Financial Position

June 30, 2007 and 2006

Assets		**2007**	**2006**
Cash and equivalents	$	4,026,387	1,882,678
Government grants receivable, net		5,614,876	4,267,361
Contributions receivable, net (note 8)		10,279,798	18,347,297
Other assets		593,852	646,470
Investments, at fair value (note 7)		8,747,804	7,537,453
Property and equipment, net (notes 9 and 10)		17,313,983	13,188,010
Total assets	$	46,576,700	45,869,269
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued expenses	$	2,791,068	2,853,938
Accrued payroll and related expenses		1,411,533	1,421,110
Deferred revenue (note 9)		99,995	835,269
Line of credit (note 13)		3,500,000	5,250,000
Revolving bridge loan (note 13)		2,998,966	1,412,235
Bonds payable (note 14)		9,000,000	9,000,000
Total liabilities		19,801,562	20,772,552
Commitments and contingencies (notes 11, 12 and 14)			
Net assets:			
Unrestricted		10,232,564	5,473,055
Temporarily restricted (note 3)		12,010,921	15,092,009
Permanently restricted (note 4)		4,531,653	4,531,653
Total net assets		26,775,138	25,096,717
Total liabilities and net assets	$	46,576,700	45,869,269

See accompanying notes to financial statements.

CITY YEAR, INC.

Statements of Activities

Years ended June 30, 2007 and 2006

	2007	2006
Changes in unrestricted net assets:		
Operations:		
Revenues and other support:		
Contributions and private grants (note 6)	$ 23,487,983	20,224,892
Contributions and private grants – capital campaign (note 10)	3,259,600	2,900,000
Federal grants – Corporation for National and Community Service (note 11)	12,808,586	11,735,541
Other government grants	4,144,470	3,685,879
Investment return utilized for operations (note 7)	307,852	274,466
Other income (note 9)	866,858	368,012
Net assets released from restrictions (note 5)	7,797,781	7,202,055
Total operating revenues and other support	52,673,130	46,390,845
Expenses:		
Program services	38,456,461	36,680,037
Support services:		
Organizational support	4,927,656	4,566,594
Fundraising	4,577,811	4,402,768
Total support services	9,505,467	8,969,362
Total expenses	47,961,928	45,649,399
Increase in unrestricted net assets from operations	4,711,202	741,446
Nonoperating transactions:		
Investment return in excess of amounts utilized for operations (note 7)	230,982	98,326
Unrealized net losses on changes in fair value of interest-rate swaps (note 14)	(27,951)	(179,381)
Other changes (note 15)	(154,724)	—
Increase (decrease) in unrestricted net assets from nonoperating transactions	48,307	(81,055)
Increase in unrestricted net assets	4,759,509	660,391
Changes in temporarily restricted net assets:		
Contributions	4,763,305	9,011,855
Unspent realized and unrealized net gains on endowments (note 7)	809,652	349,021
Other changes (note 15)	(856,264)	—
Net assets released from restrictions (note 5)	(7,797,781)	(7,202,055)
(Decrease) increase in temporarily restricted net assets	(3,081,088)	2,158,821
Increase in net assets	1,678,421	2,819,212
Net assets, beginning of year	25,096,717	22,277,505
Net assets, end of year	$ 26,775,138	25,096,717

See accompanying notes to financial statements.

CITY YEAR, INC.

Statements of Cash Flows

Years ended June 30, 2007 and 2006

		2007	2006
Cash flows from operating activities:			
Increase in net assets	$	1,678,421	2,819,212
Adjustments to reconcile increase in net assets to net cash used in operating activities:			
Depreciation and amortization		864,403	1,634,727
Loss on disposal of assets		3,625	—
Realized and unrealized net gains on investments		(1,202,076)	(606,145)
Unrealized net losses on changes in fair value of interest-rate swaps		27,951	179,381
Contributions of securities		(762,860)	(573,510)
Contributions of land, equipment, and improvements		(413,973)	(491,000)
Contributions restricted for long-term investment – capital campaign		(4,225,350)	(850,000)
Contributed legal services		—	(140,000)
Amortization of lease obligation		(735,269)	—
Changes in operating assets and liabilities:			
Contributions receivable		8,067,499	(2,893,878)
Government grants receivable		(1,347,515)	(755,200)
Other assets		52,618	180,042
Accounts payable, accrued expenses, and other deferrals		(34,409)	757,151
Net cash provided by (used in) operating activities		1,973,065	(739,220)
Cash flows from investing activities:			
Proceeds from sale and maturities of investments		1,458,006	2,223,640
Purchases of investments		(703,421)	(1,065,937)
Purchase of land		—	(4,884,000)
Renovations of building		(3,607,028)	(6,132,105)
Purchases of equipment		(1,028,994)	(245,437)
Net cash used in investing activities		(3,881,437)	(10,103,839)
Cash flows from financing activities:			
Proceeds from line of credit		2,000,000	3,850,000
Repayments under line of credit and note payable		(3,750,000)	(2,138,462)
Proceeds from bond payable		—	9,000,000
Proceeds from revolving bridge loan		1,986,731	1,412,235
Repayments under revolving bridge loan		(400,000)	—
Bond issuance costs paid		(10,000)	(248,036)
Contributions restricted for long-term investment – capital campaign		4,225,350	850,000
Net cash provided by financing activities		4,052,081	12,725,737
Net increase in cash and equivalents		2,143,709	1,882,678
Cash and equivalents, beginning of year		1,882,678	—
Cash and equivalents, end of year	$	4,026,387	1,882,678
Supplemental data:			
Cash paid for interest	$	837,811	382,908
Noncash-investing activity – assumption of lease obligation		—	735,269
Noncash-investing activity – accrued plant, property, and equipment		284,072	314,344
Noncash-investing activity – contributions of land, equipment, and securities		1,176,833	1,028,510
Noncash-financing activity – accrued issuance costs		—	10,000

See accompanying notes to financial statements.

CITY YEAR, INC.

Statement of Functional Expenses

Year ended June 30, 2007

	Program services	Organizational support	Fundraising	Total
Personnel expenses:				
Staff salaries	$ 12,836,978	1,813,567	2,301,787	16,952,332
Corp member salaries	9,251,715	—	—	9,251,715
Payroll taxes and employee benefits	4,579,443	317,727	380,292	5,277,462
	26,668,136	2,131,294	2,682,079	31,481,509
Other expenses:				
Contract services	1,110,910	231,460	303,177	1,645,547
Professional services	4,553	449,521	—	454,074
Transportation, travel, and lodging	2,052,916	33,529	40,052	2,126,497
Retreats and conferences	304,948	3,914	11,080	319,942
Materials and supplies	2,738,705	77,110	813,327	3,629,142
Postage and shipping	137,252	8,598	32,765	178,615
Telecommunications	1,021,911	19,553	67,976	1,109,440
Printing, publications, dues, and fees	287,713	238,247	156,824	682,784
Occupancy and insurance	2,238,873	583,709	—	2,822,582
Equipment/space rental and repair	1,229,685	86,619	470,531	1,786,835
Interest	256,735	603,823	—	860,558
Depreciation	404,124	460,279	—	864,403
	11,788,325	2,796,362	1,895,732	16,480,419
Total expenses	$ 38,456,461	4,927,656	4,577,811	47,961,928

See accompanying notes to financial statements.

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CITY YEAR, INC.

Statement of Functional Expenses

Year ended June 30, 2006

	Program services	Organizational support	Fundraising	Total
Personnel expenses:				
Staff salaries	$ 12,128,652	1,625,455	2,297,075	16,051,182
Corp member salaries	8,478,170	—	—	8,478,170
Payroll taxes and employee benefits	4,571,709	319,048	514,018	5,404,775
	25,178,531	1,944,503	2,811,093	29,934,127
Other expenses:				
Contract services	975,427	199,642	286,333	1,461,402
Professional services	4,754	503,364	200	508,318
Transportation, travel, and lodging	2,053,039	54,575	132,018	2,239,632
Retreats and conferences	1,221,762	5,605	13,957	1,241,324
Materials and supplies	2,277,676	54,559	571,111	2,903,346
Postage and shipping	187,643	16,056	32,206	235,905
Telecommunications	503,298	31,507	9,848	544,653
Printing, publications, dues, and fees	351,187	203,188	129,967	684,342
Occupancy and insurance	2,131,944	572,204	—	2,704,148
Equipment/space rental and repair	822,850	48,091	370,496	1,241,437
Interest	—	316,000	—	316,000
Depreciation	971,926	617,300	45,539	1,634,765
	11,501,506	2,622,091	1,591,675	15,715,272
Total expenses	$ 36,680,037	4,566,594	4,402,768	45,649,399

See accompanying notes to financial statements.

(1) Organization Background and History

City Year, Inc. (the Organization or City Year) is a not-for-profit organization as described in Section 501(c)(3) of the Internal Revenue Code (IRC), and is generally exempt from income taxes under IRC Section 501(a). An “action tank” for national service, City Year seeks to demonstrate, improve, and promote the concept of national service as a means of building a stronger democracy. City Year unites a diverse group of young people, ages 17-24, for a year of full-time, rigorous community service, leadership development, and civic engagement. City Year works to fulfill this mission through five primary activities: (1) operating a national youth service corps; (2) building the infrastructure of national service by setting up new operating sites across the country; (3) providing technical assistance to individuals and organizations in national and community service; (4) planning and running large civic events to engage citizens and organizations in activities that promote service, inclusivity, leadership, and citizenship; and (5) constantly developing new ways to engage people and resources to promote the concept of voluntary national service. City Year’s vision is that one day, the most commonly asked question of an 18-year-old will be: “Where are you going to do your service year?”

City Year was founded in Boston, Massachusetts in 1988 and now operates in seventeen locations across the United States, including Columbia, South Carolina, Rhode Island, Chicago, Illinois, Columbus, Ohio, San Jose, California, San Antonio, Texas, Cleveland, Ohio, Philadelphia, Pennsylvania, Seattle, Washington, Detroit, Michigan, Washington, DC, New Hampshire, New York City, Little Rock, Arkansas, Louisiana, and Los Angeles, California. In 2005, City Year established its first international program in Johannesburg, South Africa, creating a separate legal entity, City Year South Africa Citizen Service Organization, that is incorporated under South African Charitable Organization laws.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

Net assets and revenues are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted net assets – Net assets not subject to donor-imposed stipulations.

Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Organization and/or the passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be maintained in perpetuity. Generally, the donors of these assets permit the Organization to use all or part of the income earned and capital gains, if any, on related investments for general or specific purposes.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions, including time restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulations or law. Expirations of temporary restrictions on net assets are reported as reclassifications between the applicable classes of net assets.

Expirations of temporary restrictions occur when donor-imposed stipulated purposes have been accomplished and/or the stipulated time period has elapsed. If an expense is incurred for a purpose for which both unrestricted and temporarily restricted net assets are available, a donor-imposed restriction is fulfilled to the extent of the expense incurred unless the expense is incurred for a purpose that is directly attributable to another specific external source of revenue.

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Contributions and earnings subject to donor-imposed stipulations that are met in the same reporting period are reported as unrestricted revenue. Promises to give that are scheduled to be received after the consolidated statement of financial position date are shown as increases in unrestricted net assets or temporarily restricted net assets. Temporarily restricted net assets are reclassified to unrestricted net assets when the purpose or time restrictions are met. Promises to give subject to donor-imposed stipulations that the corpus be maintained permanently are shown as increases in permanently restricted net assets. Conditional promises to give are not recognized until they become unconditional, that is when the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value. Contributions to be received after one year are discounted at the appropriate rate commensurate with the risks and duration involved. Amortization of the discount is recorded as additional contribution revenue in accordance with the donor-imposed restrictions, if any.

Dividends, interest, and net unrealized gains (losses) on long-term investments are reported as follows:

- increases in permanently restricted net assets if the terms of the contributions or relevant State law required these to be added to principal;
- increases (decreases) in temporarily restricted net assets if the terms of the contributions impose restrictions on the use of the income and gains; or
- increases (decreases) in unrestricted net assets in all other cases.

(b) Operating and Nonoperating Activities

The statements of activities report all changes in net assets, including changes in unrestricted net assets from operating and nonoperating transactions. Operating revenues consist of those items attributable to City Year's ongoing service efforts. Unrestricted contributions are reported as operating revenues. City Year's spending rule allows for the expenditure of 4.5% of the average investment balance of certain qualifying investments for the trailing eight quarters, starting with

March 31 of the prior fiscal year to fund operations. Certain amounts included in operations as defined for purposes of the statements of activities differ from amounts reported as cash flows from operating activities.

Investment return in excess of amounts authorized for operations and unrealized net gains or losses from changes in fair value of interest rate swaps are reported as nonoperating items in the statements of activities.

(c) Cash and Equivalents

For purposes of the statements of cash flows, cash and cash equivalents consist of cash, money market mutual funds and short-term investments with original maturity dates of three months or less at date of acquisition. All are stated at cost, which approximates market.

(d) Investments

Investments are reported at fair value. The fair value of investments containing publicly traded securities is based on market quotes from the principal exchanges in which the securities are traded.

(e) Property and Equipment

Property and equipment are stated at cost, except for donated assets, which are recorded at fair market value at the date of gift. Ordinary repairs and maintenance are expensed as incurred. Depreciation and amortization are calculated on a straight-line basis over the following estimated useful lives:

Building	40 years
Furniture and fixtures	3-7 years
Equipment and software	3-10 years
Leasehold improvements	Shorter of life of lease or improvements

(f) Contributed Goods and Professional Services

Contributed goods and professional services are reflected as contributions in the accompanying statements of activities at their estimated fair value at the date received or provided.

(g) Program Services

Program services consist of expenses related to operations, education, training, corps development, new site development, special events, external affairs, and organizational development.

(h) Derivative Instruments

City Year utilizes interest-rate swap agreements to effectively convert certain of its long-term variable-rate debt to fixed rates and not for speculative purposes. SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, is applied to such instruments. SFAS No. 133 requires the swaps' fair value and changes therein to be recognized in the financial

(Continued)

statements. Differences between the fixed and variable rates in effect at each interest due date are settled net under each swap, increasing or decreasing interest expense. The net termination value (cost) of each swap is measured at each reporting date and presented as an asset (liability) using techniques such as discounted cash flow analysis and option pricing models that incorporate assumptions about future market interest or exchange rates, as appropriate.

(i) Fair Value of Financial Instruments

SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, requires City Year to disclose fair value information about all financial instruments, whether or not recognized in the statements of financial position, for which it is practicable to estimate fair value. The Organization's financial instruments not carried at fair value are carried at net realizable value, which approximates fair value, in the statements of financial position. Such financial instruments consist of cash and equivalents, receivables from grantors and donors, and accounts payable and accrued expenses. Because the Organization's bonds payable are at variable rates, their carrying values approximate their fair values.

(j) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the dates of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

(k) Bond Issuance Costs

Bond issuance costs are deferred as other assets and are amortized over the life of the related bonds.

(l) Allocations

The Organization reports expenses by their functional classification. Accordingly, depreciation, interest, and operations and maintenance costs have been allocated to functional classifications based upon relative expenditure levels.

(m) Reclassifications

Certain 2006 information has been reclassified to conform to the 2007 presentation.

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(3) Temporarily Restricted Net Assets

Temporarily restricted net assets consisted of the following at June 30:

		2007	2006
Time restrictions	$	3,423,390	4,737,804
Purpose restrictions		6,942,482	9,518,808
Accumulated realized and unrealized net gains on permanently restricted assets		1,645,049	835,397
	$	12,010,921	15,092,009

(4) Permanently Restricted Net Assets

Permanently restricted net assets at June 30 consisted of the following endowment gifts whose income is restricted for the following purpose:

		2007	2006
Program sponsorships	$	4,531,653	4,531,653

Permanently restricted net assets include individual endowment fund balances stated at original principal balance.

(5) Net Assets Released from Restrictions

Net assets released from restrictions consisted of the following for the years ended June 30:

		2007	2006
Expiration of time restrictions	$	2,337,655	2,025,317
Satisfaction of purpose restrictions		5,460,126	5,176,738
	$	7,797,781	7,202,055

(Continued)

(6) In-Kind Contributions

Contributed goods and services included in program and support services during the years ended June 30 were for the following purposes:

Nature		2007	2006
Program services:			
Uniforms	$	1,175,432	908,541
Professional services		—	26,287
Advertising (recruitment)		3,500	20,000
Transportation and travel		392,598	545,900
Rent		407,778	306,109
Equipment rental and maintenance		757,431	223,874
Workshops and conferences		378	158,848
Materials and supplies		119,524	86,519
Food		158,945	162,127
Printing and copying		15,734	12,505
Total program services		3,031,320	2,450,710
Support services:			
Professional services		401,177	412,661
Rent		101,944	76,528
Total support services		503,121	489,189
Depreciation and amortization		52,355	417,061
Total	$	3,586,796	3,356,960

Contributions of equipment, improvements, and land held for resale in 2007 and 2006 were $413,973 and $491,000, respectively.

(7) Investments

Investments consisted of the following at June 30:

		2007	2006
Equity mutual funds	$	6,900,937	5,915,351
Equities		77,628	102,793
Fixed-income mutual funds		1,070,164	1,018,881
Money markets and other cash equivalents		214,075	15,428
Land held for resale		485,000	485,000
Total investments	$	8,747,804	7,537,453

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Under the Organization's spending policy, up to 4.5% of the total investments' average fair value as of March 31 of the previous fiscal year for the trailing eight quarters may be authorized by the City Year Endowment Investment Committee for spending as operating revenue. The Committee recommended, and the board of trustees approved, spending $307,852 in Fiscal 2007 and $274,466 in Fiscal 2006. These amounts are classified as unrestricted operating revenue in the statements of activities.

The following are the components of the return on investments for the years ended June 30:

		2007	2006
Dividends and interest	$	146,410	115,668
Realized and unrealized net gains on investments		1,202,076	606,145
Total return on investments	$	1,348,486	721,813

Following is a reconciliation of total investment return to amounts reported in the statements of activities for the years ended June 30:

		2007	2006
Investment return utilized for operations	$	307,852	274,466
Investment return in excess of amounts authorized for operations		230,982	98,326
Unspent realized and unrealized net gains on endowments		809,652	349,021
Total return on investments	$	1,348,486	721,813

City Year has interpreted relevant state law as generally permitting the spending of gains on endowment funds over a stipulated period of time. State law allows the Board to appropriate a portion of earnings on endowment as is prudent considering City Year's long- and short-term needs, present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions. Currently, City Year records unrealized net gains on permanently restricted net assets as temporarily restricted until appropriated by City Year.

(8) Contributions Receivable

Contributions receivable consisted of the following at June 30:

		2007	2006
Capital campaign	$	1,085,000	2,100,000
Unrestricted		2,303,208	4,254,605
Restricted to future periods		7,514,305	12,859,672
	$	10,902,513	19,214,277

Contributions receivable were scheduled to be received as followed as of June 30:

		2007	2006
Due within one year	$	7,888,813	13,688,149
Due within two to five years		3,013,700	5,526,128
		10,902,513	19,214,277
Less: present value discount (ranging from 3% to 5.38%) and other allowances		(622,715)	(866,980)
	$	10,279,798	18,347,297

(9) Property and Equipment

Property and equipment consisted of the following at June 30:

		2007	2006
Land	$	4,884,000	4,884,000
Building		10,675,284	7,181,718
Furniture and fixtures		915,244	36,360
Equipment and software		2,840,201	3,119,679
Leasehold improvements		1,342,046	2,329,975
		20,656,775	17,551,732
Less accumulated depreciation and amortization		(3,342,792)	(4,363,722)
	$	17,313,983	13,188,010

In 2006, City Year disposed of various hardware and software systems prior to the end of their estimated useful lives. Accordingly, City Year accelerated the depreciation of these assets resulting in an additional charge to depreciation expense of $718,208 being recorded in the operating section of the 2006 statement of activities. Depreciation and amortization charged to operations was $864,403 and $1,634,727 in 2007 and 2006, respectively.

On June 21, 2006, City Year purchased property in Boston (note 10) at a total capitalized cost of $12,065,718. This capitalized value included the purchase price of $11,000,000, $330,449 of direct acquisition costs, and the assumption of a liability, which has been estimated at $735,269 and included in deferred revenue, to allow the current occupants to remain in the building rent-free through December 31, 2006. During the first six months of fiscal 2007, that amount was amortized and reflected in other income in the statement of activities. Renovation of the interior space was substantially completed by June 30, 2007 at a cost of approximately $5,100,000.

(10) Headquarters for Idealism

On June 21, 2006, City Year purchased property located at 287 Columbus Avenue in Boston to develop a "Headquarters for Idealism" that will serve as the permanent home of its Boston service corps, national headquarters, and emerging global initiatives. In addition to serving as the home to City Year's growing network of sites, the facility will serve as a community resource and incubator for social entrepreneurs, as it will be made available to community organizations across the city.

In 2006 City Year launched a capital campaign, the Campaign for the City Year Headquarters for Idealism, to partially fund the acquisition and renovation costs and to provide for capital reserves. The original campaign goal was $10,000,000 and was increased to $15,000,000 in 2007. The total acquisition and renovation costs are approximately $17,400,000. The acquisition was partially financed with proceeds from a $9,000,000 bond issuance (note 14). City Year supplemented the bond proceeds by utilizing $5,075,350 paid to date on a total of $6,160,350 in contributions raised as of June 30, 2007, specifically for the purchase and renovation of this property. As the purpose of the restricted funds has been met, this amount is recorded as unrestricted and included in unrestricted contributions and grants revenue. As of June 30, 2007 an additional amount of approximately $4,700,000 has been pledged, but this amount has not been recorded yet as it does not satisfy revenue recognition policies.

(11) Federal Grants

City Year received grant awards from the Corporation for National and Community Service (CNCS) totaling $14,242,533 and $13,301,755 for fiscal year 2007 and 2006, respectively. The funds were awarded through the AmeriCorps program administered by CNCS. Funds expended in fiscal year 2007 and 2006 totaled $12,808,586 and $11,735,541, respectively.

In 2006, City Year also received a subgrant award from Education Development Center, Inc. totaling $425,750. The funds were awarded to provide support for the program entitled City Year South African National Youth Service Program. The prime award is funded by the United States Agency for International Development (USAID). Funds expended in fiscal year 2006 totaled $425,750.

The Organization's federal grant programs are subject to financial and compliance audits in accordance with Office of Management and Budget Circular A-133. In addition, various federal, state, and private funding agencies reserve the right to perform separate program audits.

(12) Leases

Rental expense for office space was $1,931,165 and $1,549,268 for the years ended June 30, 2007 and 2006, respectively, exclusive of certain in-kind arrangements. Lease arrangements with an original term of more than one year expire on various dates through 2011.

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Future minimum lease payments under operating leases as of June 30, 2007 are as follows:

		Amount due
Fiscal years ending June 30:		
2008	$	1,172,021
2009		1,017,997
2010		652,082
2011		609,505
	$	3,451,605

The Organization is also liable for reimbursing certain real estate taxes and operating costs under certain of the office lease terms.

(13) Credit Facility

The Organization has a credit facility with Bank of America, N.A. (BoA) consisting of a line of credit and a revolving bridge loan. The credit facility is secured by all assets of the Organization, except for the portion of assets equal to the amount of permanently restricted net assets.

Line of Credit

The Organization has a committed line of credit (the Line) under the facility of $6,000,000. City Year has the option of borrowing at BoA's prime lending rate plus a lender's margin or at the LIBOR rate plus a lender's margin. The lender's margin is adjusted based upon specified compliance levels as determined under City Year's debt service coverage ratio as defined in the agreement. The lender's margin may be adjusted to a change in the compliance level as of the rate adjustment date, which is defined as the 70th day after the close of each fiscal quarter of the borrower with respect to the first three quarters of each fiscal year and the 160th day after the close of each fiscal year of the borrower. The interest rate at June 30, 2007 was 8.25%.

The Line contains certain financial covenants, including a ratio requirement, an annual clean-up period, and limitations on the amount of the Organization's annual capital expenditures. The Organization was in compliance with such covenants at June 30, 2007 and 2006, with the exception of the clean-up period requirement. The clean-up period requirement states that the balance outstanding on the Line must be equal to zero for at least 30 consecutive days within each fiscal year. BoA waived the clean-up period requirement for fiscal year 2007 and 2006.

On September 25, 2006, City Year entered into a Tenth Loan Modification Agreement with Bank of America with respect to the Line. This agreement provided the aforementioned waiver for Fiscal 2006 of the 30-day clean-up provision and made rate adjustment dates consistent with financial reporting dates. On the same date City Year entered into a Modification Agreement with BoA with respect to its Revolver (as described below), making the same adjustments to rate and financial reporting dates.

(Continued)

On April 2, 2007 City Year entered into an Eleventh Loan Modification that provided the waiver for Fiscal 2007 of the 30-day clean-up provision, adjusted other various provision so as to be consistent with the Reimbursement Agreement (note 14), and extended the expiration date of the line to March 31, 2008.

Borrowings outstanding under the Line amounted to $3,500,000 at June 30, 2007 and $5,250,000 at June 30, 2006.

Revolving Bridge Loan

On June 21, 2006, City Year entered into a revolving bridge loan (the Revolver) with BoA, the purpose of which is to bridge the timing of the Headquarters for Idealism campaign pledges and costs incurred to complete the acquisition and renovation of City Year's headquarters building. The amount of the Revolver is a maximum of $5,000,000, with step-down provisions over five years. The principal is due in full on June 21, 2011. For each loan taken under this agreement, City Year has the option of borrowing at BoA's prime lending rate plus a lender's margin or at the LIBOR rate plus a lender's margin. The lender's margin is adjusted as described above for the line of credit.

The Revolver has financial covenants consistent with the Line financial covenants. The Organization was in compliance with such covenants at June 30, 2007 and 2006. Borrowings outstanding under the Revolver amounted to $2,998,966 at June 30, 2007 and $1,412,235 at June 30, 2006.

Interest expense under the credit facility was $533,164 and $376,808, respectively, for the years ended June 30, 2007 and 2006.

(14) Long-Term Debt

Bonds Payable

City Year entered into an indenture agreement with Massachusetts Development Finance Agency, dated June 1, 2006, to issue Variable Rate Demand Revenue Bonds, City Year Issue, Series 2006, in the aggregate principal amount of $9,000,000. The proceeds of the bonds were loaned to City Year pursuant to a Loan and Trust Agreement to finance the acquisition and development cost of City Year's Headquarter for Idealism (note 10) and to pay certain costs of issuance totaling $258,036, which are included in other assets and are being amortized over the life of the bonds.

The bonds mature through July 1, 2036 and bear interest at a Weekly Interest Rate (maximum of 12%) as determined by the remarketing agent. The interest rate at June 30, 2007 was 3.71%. The debt repayment schedule provides for principal payments beginning July 1, 2008 and continuing over the remainder of the thirty-year term. The costs associated with this bond issue will be amortized over thirty years.

Payment of the principal and interest on the bonds is secured by an irrevocable, direct-pay letter-of-credit reimbursement agreement between City Year and BoA, as described below. A remarketing agreement among the Issuer, the Borrower, and Bank of America Securities, LLC, the remarketing agent, provides for the remarketing of the bonds.

Interest expense was $384,295 for the year ended June 30, 2007.

(Continued)

Aggregate scheduled annual principal repayments for the credit facility and bonds payable as of June 30, 2007 were as follows:

		Amount due
Fiscal years ending June 30:		
2008	$	3,500,000
2009		678,966
2010		1,695,000
2011		1,200,000
2012		210,000
Thereafter		8,215,000
Total	$	15,498,966

Letter of Credit

On June 21, 2006 City Year obtained a $9,133,151 irrevocable, direct-pay letter of credit (the Letter) with BoA primarily to guarantee the repayment of the bond principal. The beneficiary is J.P. Morgan Trust Company.

The Letter is collateralized by land and improvements in Boston and matures on June 21, 2011. The Letter carries an annual fee equal to ninety (90) basis points on the outstanding balance of the letter of credit (principal plus 45 days interest at 12%), payable quarterly in advance. The outstanding balance available under the Letter is equal to the outstanding bonds payable balance at June 30, 2007.

In addition to and in conjunction with the letter of credit, City Year entered into a Reimbursement Agreement with BoA, and other related agreements, dated June 1, 2006. This agreement contains certain financial covenants, including a ratio requirement, minimum liquidity requirement, and limitations on the amount of annual capital expenditures. The Organization was in compliance with such covenants at June 30, 2007.

Interest Rate Swaps

On June 21, 2006, City Year entered into two interest rate swap agreements with BoA to mitigate its exposure to variability in interest payments on the bonds payable. The agreements have an effective date of July 1, 2006. The terms of the swap agreements were as follows at June 30, 2007:

Counterparty	Issue date	Effective date	Expiration date	Remaining notional amount	Swap fixed rate	Fair value at June 30 asset (liability) 2007	Fair value at June 30 asset (liability) 2006	Incremental interest savings (expense) 2007	Incremental interest savings (expense) 2006
Bank of America, N.A.	06/21/06	07/01/06	07/01/26	$ 2,250,000	4.210%	$ (62,139)	(57,856)	(10,003)	—
Bank of America, N.A.	06/21/06	07/01/06	07/01/16	6,750,000	4.160%	(145,193)	(121,525)	(26,916)	—
				$ 9,000,000		$ (207,332)	(179,381)	(36,919)	—

While the swaps' fair values were zero at inception of the agreements on the issue date of June 21, 2006, interest rate volatility, remaining outstanding principal, and time to maturity will affect each swap's fair value at subsequent reporting dates. The fair value of the liability as of June 30, 2007 represents the amounts City Year would have had to pay BoA to terminate the swaps as of that date. To the extent City Year holds a swap through its expiration date, the swap's fair value will reach zero. Interest payable or receivable under the swaps began to accrue as of the effective date of July 1, 2006.

(15) Related Party

In 2005, City Year established its first international program in Johannesburg, South Africa, creating a separate legal entity, City Year South Africa Citizen Service Organization (City Year South Africa), which is incorporated under South African Charitable Organization laws. City Year is one of seven members of City Year South Africa. One other individual member of City Year South Africa is also a Trustee of City Year. None of the assets of City Year South Africa may be distributed to its members, and the liability of members for payment of debts and liabilities is limited to ten Rand, or approximately $6.50.

City Year previously supported the program by providing startup and operating subsidies and transferring staff from the United States to Johannesburg. Through June 30, 2006, the financial results of City Year South Africa were consolidated as part of the financial statements of City Year, Inc. After two years of operations, City Year discontinued operating subsidies, reassigned the staff to other positions in the United States, and determined that it will have no obligation to support or be a beneficiary of the net assets of City Year South Africa. As such, in accordance with Statement of Position 94-3, Reporting of Related Entities by Not-for-Profit Organizations, the financial records are no longer consolidated here within, as the criteria for such consolidation is no longer met. The effect of this deconsolidation is a loss of $1,010,988. This loss is shown as a decrease in unrestricted net assets from nonoperating transactions of $154,724 and a decrease is temporarily restricted net assets of $856,264. This is a non-recurring transaction.