INTERSTATE GENERAL CO L P
Form 10-K
March 22, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended **December 31, 2000** Commission File Number 1-9393

INTERSTATE GENERAL COMPANY L.P.

(Exact name of registrant as specified in its charter)

Delaware	52-1488756
(Exact name of registrant as specified in its charter)	(I.R.S. Employer Identification Number)
5160 Parkstone Drive, Suite 260-B Chantilly, Virginia 20151 (Address of principal executive offices)	(703) 263-1191 (Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Class A Units representing assignment of beneficial ownership of Class A limited partnership interest and evidenced by beneficial assignment certificates ("Units")	American Stock Exchange Pacific Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such report(s), and (2) has been subject to such filing requirements for the past 90 days.

Yes /X/ No / /

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained

herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

As of March 12, 2001, the aggregate market value of the Units held by non-affiliates of the registrant based on the closing price reported on the American Stock Exchange was $11.35.

Class A Units Outstanding at (date): 2,055,780 Class A Units

DOCUMENTS INCORPORATED BY REFERENCE

Form 10-K
Item
N/A

INTERSTATE GENERAL COMPANY L.P.

2000 FORM 10-K ANNUAL REPORT

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PART I

ITEM 1. BUSINESS

COMPANY PROFILE

Interstate General Company L.P. (the "Company" or "IGC") was formed as a Delaware limited partnership in 1986. Directly and through predecessors, the Company has been engaged in business since 1957. IGC's headquarters are located in Chantilly, Virginia. IGC has traded publicly as a master limited partnership since February 1987 on the American Stock Exchange ("AMEX") and Pacific Stock Exchange ("PSE"). During 1998, the Company's management and the Board of Directors of the Company's Managing General Partner restructured IGC and transferred the primary real estate operations to American Community Properties Trust ("ACPT") and distributed, as a dividend, the common shares of ACPT to its unit holders (the "Distribution").

IGC owns the following assets: Land zoned commercial in St. Charles, Maryland; developable land in Charles County and St. Mary's County, Maryland and in Prince William County, Virginia; a 50% interest in a partnership that owns land under development in Brandywine, Maryland; all of AFH; a note receivable of $7.305 million (principal and interest) payable by a subsidiary of American Community Properties Trust ("ACPT"); as well as fractional interests in Chastleton Apartment Associates (District of Columbia) and Coachman's Limited Partnership (Maryland). In addition, IGC owns all of the common stock of Interstate Waste Technologies (IWT) and Caribe Waste Technologies (CWT) (excluding shares issued as incentive compensation for employees). These shares are held in a trust (the "IWT/CWT Trust") for the benefit of IGC's Unit holders.

The following summarizes the business operations and segments of IGC follows:

LAND DEVELOPMENT

IGC has extensive experience in developing planned communities, shopping centers, and other commercial and residential properties. The Company and its predecessors have developed land for more than 13,000 housing units, several shopping centers, and other commercial and retail uses.

The Company currently holds 152 acres in Towne Center South, St. Charles, Maryland. The property is zoned for commercial, retail, and office development. The Company is proceeding with plans for development of 82 acres, with the bulk of the remainder subject to a court-entered consent decree calling for the creation of wetlands.

The Company is planning to develop 610 of the 812 acre property in Pomfret, Maryland, known as Waverly. The plan calls for 50-60 estate lots in a gated equestrian community.

In addition, the Company is developing the 170-acre planned community of Westbury, located in Lexington Park, Maryland. The community is located in St. Mary's County, approximately one mile from the Patuxent River Naval Air Warfare Center. Development at Westbury includes town home and single-family lots. In March 1997, the Company entered into a contract to sell 52 of the town home lots to a third-party homebuilder. As of December 31, 2000, 13 of those town home lots remain to be purchased. In Westbury's final phase, consisting of approximately 250 single-family home lots, 63 have been developed, of which 40 have been sold and 23 are under contract. The other 187 lots remain to be developed.

In Prince George's County, Maryland, the Company is proceeding with the development of Phase One of the 277-acre mixed-use project known as Brandywine. IGC obtained building permits for the first phase of 48 single-family homes in December 1998. Lot development began in the spring of 2000.

Environmental Impact. Management believes that all current land development plans can be completed without a material adverse environmental impact and in compliance with government regulations.

Competition. IGC is subject to intense market competition in all its land sales and development activities. The Company believes it can compete successfully by offering well-located land for sale or land developed in a way that is attractive to the market.

INVESTMENT IN WASTE TECHNOLOGIES

In 1990, IGC formed a wholly owned subsidiary, Interstate Waste Technologies, Inc. ("IWT"), to develop innovative solutions for the disposal of municipal waste and to pursue waste disposal contracts with municipalities and government entities as well as industrial and commercial waste generators.

In 1996, a second subsidiary, Caribe Waste Technologies, Inc. ("CWT"), was formed in Puerto Rico. CWT was established to perform waste disposal projects in the Caribbean.

IWT/CWT's business plan is to develop and operate waste disposal projects using an environmentally superior technology licensed from Thermoselect S.A., a Swiss Company. Project development efforts are worldwide. IWT/CWT has the right to develop projects using the Thermoselect technology in North, Central, and South America and for selected other projects worldwide. Typically, IWT/CWT and its alliance partners offer to own, finance, build, and operate a plant for 25 or 30 years. Current alliance partners include the technology provider, Thermoselect, the designer and constructor, HDR/Zachary, and our plant operator, two subsidiaries of the Vivendi Group, the world's most experienced waste plant operator. IWT has also signed an agreement with Thermoselect to be sales and marketing representative for Thermoselect domestic waste facilities in North America and the Caribbean.

In December 1998, CWT entered into a Host Community And Sponsor Agreement with the Municipality of Caguas, Puerto Rico. The agreement describes the basis on which CWT will enter into a contract to develop and construct a Thermoselect waste facility with a capacity of up to 3,000 tons per day to process waste from the metropolitan San Juan area. CWT announced on November 30, 2000 that it received a "Certificate of Conformity" from the Puerto Rico Solid Waste Management Authority. This will allow IGC's subsidiary, Caribe Waste Technologies (CWT), to begin permitting and other activities necessary to implement the project. CWT has now successfully obtained (1) a Host Community Agreement to locate the facility in the municipality of Caguas; (2) enabling legislation passed unanimously by the legislature and signed by the Governor; and (3) the required Certificate of Conformity. The next steps will be to prepare an Environmental Impact Statement and to obtain all necessary regulatory permits and licenses. Concurrently, CWT will begin discussions with the Solid Waste Management Authority, other involved government agencies, and the municipalities to be served by the facility. CWT will then negotiate long-term contracts for the delivery of solid waste and payment for its processing with the municipalities as well as industrial waste generators.

The government of the U.S. Virgin Islands conducted a competitive procurement and selected CWT as the preferred bidder to negotiate contracts for a two-line Thermoselect plant. The government of the U.S. Virgin Islands informed CWT on November 9, 2000 that it has been selected to negotiate contracts to build one or more facilities to process the Islands' waste. Contracting and financing activities are currently underway. Industry experience suggests that contracting and permitting activities could take approximately one year. CWT will work closely with the Virgin Islands' government and the U.S. Environmental Protection Agency to get to financial close and to begin construction expeditiously.

IWT is also pursuing projects in China, Chile, Costa Rica, Hong Kong, and elsewhere, all of which are in the exploratory stage.

Certain IWT/CWT costs have been capitalized and their recovery is dependent upon future revenues from the construction and operation of waste disposal plants. During 1999, IWT and CWT elected to write off $1,180,000 against costs incurred related to several waste development projects that the Company is still pursuing. While the Company believes there is sufficient interest to warrant continuing efforts, the probability of recovering the

investment from future revenues from these projects is presently estimated to be less than 50%.

At December 31, 2000 and 1999, deferred costs regarding waste technology, net of direct write-offs, were $5,606,000 and $4,161,000, respectively. As of December 31, 2000, these deferred costs relate to Puerto Rico and Virgin Islands projects.

Environmental Impact.

Management believes that the proposed IWT and CWT facilities can be completed without a material adverse environmental impact and in compliance with government regulations. The many approvals and permits required under the U.S. Clean Air Act, U.S. Clean Water Act, and corresponding foreign regulations will require substantial time and effort to obtain.

Competition.

There is intense competition for municipal waste disposal contracts throughout the United States and internationally. The competition uses a variety of methods with a wide range of costs available. Management believes IWT and CWT can provide superior facilities at a competitive price.

HOMEBUILDING (Discontinued)

AFH built semi-custom homes for homebuyers who own land or have land under contract. In 2000, AFH operated out of seven offices in Virginia, North Carolina, and South Carolina.

AFH has continued to lose money requiring substantial cash infusions to meet operating needs. Further, sales and construction starts decreased significantly during the third quarter of 2000. Management employed a number of different strategies to make AFH profitable, however, none were successful. Effective November 13, 2000, IGC's Board of Directors adopted a plan to wind down and cease AFH's operations following completion of the 30 homes then under construction. Accordingly, the results of operations for AFH are reported as from discontinued operations. The Company estimates that it will incur a loss of approximately $700,000 as a result of closing down AFH. Of this estimated amount, $202,000 has been incurred through December 31, 2000. The estimate includes projected costs to complete the remaining homes, as well as operating costs during that period, along with remaining lease costs the Company is obligated to pay. A provision for this loss has been included under results from discontinued operations. Management believes closing AFH at this time is in the best interest of the Company.

Environmental Impact. Management believes that the Company's homebuilding operations are in compliance with governmental regulations.

GENERAL

Employees.

IGC had 21 full-time employees as of December 31, 2000. All employees are based in the United States.

Significant Customers. No single customer accounted for more than 10% of IGC's revenues during the year ended December 31, 2000.

ITEM 2. PROPERTIES

IGC owns real property in Charles County, Maryland; Prince George's County, Maryland; St. Mary's County, Maryland; Prince William County, Virginia; North Carolina; South Carolina, and Virginia.

As of December 31, 2000, the Company's community development land holdings consisted of the following:

Charles County, Maryland	
Finished inventory -	
Residential lots - Single-family homes	1
Commercial, office or light industrial acres	108
Pre-development Residential acres	812
St. Mary's County, Maryland	
Finished inventory -	
Residential lots - Town homes (13); Single-family homes (23)	36
Pre-development -	214
Residential lots	
Prince George's County, Maryland	
Pre-development acres	277
Prince William County, Virginia	
Finished inventory -	
Residential lots - Town homes	6

As of December 31, 2000, the Company's homebuilding inventory consisted of the following:

Virginia	
Homes under construction - Single-family homes	3
North Carolina	
Homes under construction - Single-family homes	8
South Carolina	
Homes under construction - Single-family homes	3

LEGAL PROCEEDINGS

ITEM 3.

Wetlands Litigation

As previously reported, wetlands litigation was commenced by the United States Government in 1996 against the Company, its affiliates, St. Charles Associates, L.P. ("SCA"), and James J. Wilson, the Company's chairman and chief executive officer, charging them with criminal and civil violations of Section 404 of the U.S. Clean Water Act ("CWA") relating to placing fill materials without a permit into wetlands within the jurisdiction of the U.S. Corps of Engineers. In November 1999 the Company pled guilty to a single violation of the CWA, and the Company and its affiliate, SCA, entered into a consent decree whereby the civil complaint by the government against them for alleged violations of the CWA was dismissed. Pursuant to the consent decree, the Company and SCA paid a civil penalty of $360,000 and agreed to complete within 24 months, a remediation plan covering certain land in Town Center South and in another location in St. Charles. As part of the settlement, all of the criminal charges against James J. Wilson, the Company's chairman and chief executive officer, were dismissed.

On March 9, 2001, the Company and SCA filed a petition and motion with the United States District Court for the District of Maryland seeking to set aside the Company's criminal conviction and to vacate the consent decree entered into by the Company and SCA in reliance on the decision by the U.S. Supreme Court in Solid Waste Agency of Northern Cook County, v. U.S. Army Corps of Engineers (decided January 9, 2001) limiting the scope of the Government's jurisdiction under the CWA. Under this new jurisdictional line, the Company and SCA maintain that their previous actions were wholly legal. A separate motion was filed seeking a stay of the time limits within which they are required by the consent decree to carry out the remediation plan pending a final judicial determination of their motions to vacate the consent decree. The court has not set a date for a hearing on the motions.

Sewer and Water Litigation

In St. Charles Associates Limited Partnership, et al. v. County Commissioners of Charles County, et al., No. 89-720 (Circuit Court for Charles County, Maryland), the plaintiffs sought a court ruling that the County was not entitled to impose sewer and water fees at the then-existing level upon residential units in St. Charles Communities. That aspect of the litigation was settled by a Settlement Agreement dated November 1989, which was confirmed in a Consent Decree entered in March 1990. Subsequent aspects of the litigation have resulted from disputes over the interpretation of the Settlement Agreement and Consent Decree. The principal issues contested between the County, St. Charles Community, LLC, IGC, and SCA, are (1) whether a study procured by the County in 1996 justifies the level of sewer and water connection fees which it imposes upon St. Charles Communities and (2) whether SCA and IGC are entitled to recover what they regard as excessive sewer and water connection fees already paid.

On October 6, 1999, the Maryland Court of Special Appeals concluded that the 1996 study procured by the County justified the County's imposition of increased water connection fees in St. Charles Communities, but did not justify a similar increase in sewer connection fees. The Court further held that SCA and IGC may not pursue refund claims for connection fees paid before May 15, 1992 because of an "accord and satisfaction" as to refund claims before that date. The County, St. Charles Community, LLC, IGC, and SCA all sought review of this decision in the Maryland Court of Appeals, but that Court declined to review the case, and the decision of the Court of Special Appeals is therefore final. However, this decision does not affect SCA's and IGC's right under the Settlement Agreement to challenge subsequent sewer and water connection fee studies commissioned by the County. On October 19, 2000, the County submitted such a new sewer connection fee study (dated October 12, 2000) to SCA and IGC. SCA and IGC have filed objections to that study and intend to challenge its validity under the Settlement Agreement.

The County has further appealed an injunction issued by the Circuit Court extending the limitation on sewer connection fees to all residential properties located in the St. Charles Communities. On December 5, 2000, the Court of Special Appeals affirmed the Circuit Court and held that the sewer connection fee limitation is a Covenant that runs with the land in the St. Charles Communities and, therefore, the right to reduced sewer connection fees extends to all those to whom land in the St. Charles Communities is conveyed. On January 18, 2001, the County filed a petition for writ of certiorari with the Court of Appeals seeking review of this decision.

Also pending are SCA's and IGC's claims for refunds of sewer connection fee overpayments from May 15, 1992 to the present.

Other

On February 24, 2000, IGC and one of its officers were named as defendants in a complaint filed in state court alleging trespass and restrictions of access to property resulting from the construction of a county road in Charles County. The construction in question was completed by St. Charles Community, LLC, a subsidiary of ACPT. The first and second counts of the complaint seek $10,000,000 in compensatory damages and $10,000,000 in punitive damages. The third and final count seeks an easement and right-of-way to the county road. The defendants in that case, including IGC, have filed a motion to dismiss the second and third counts, and that motion is scheduled for argument on March 19, 2001. In the meantime, in an effort to reach a non-monetary resolution to this dispute, the parties and certain Charles County officials have been engaged in settlement negotiations.

The Company is also involved from time to time in other miscellaneous legal matters that arise in the normal course of business. In Management's opinion, none of the actions is of a material degree whereby there would be a material adverse impact of the financial condition or results of operations of the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET PRICES AND DISTRIBUTIONS OF UNITS

IGC Units are traded on the American and the Pacific Stock Exchanges. The following table sets forth for the periods indicated, the high and low sales prices per IGC Unit as reported in the consolidated transaction reporting system and cash distributions paid to unit holders during these periods. IGC Units commenced public trading on February 19, 1987.

	Cash Distributions				Price Range of IGC Units		
	Total (in thousands)		Per Unit		High		Low
2000 Quarter:							
Fourth	$ -		$ -		$11 1/8		$9 5/8
Third	-		-		10 7/8		6
Second	-		-		7 3/8		6 3/8
First	-		-		7 1/2		5 7/8
1999 Quarter:							
Fourth	$ -		$ -		$8		$7 1/8
Third	-		-		5 3/4		5
Second	-		-		5 15/16		4 7/8
First	-		-		6 1/8		5 3/8

On October 5, 1998, in conjunction with the Distribution of assets, the Company issued ACPT shares to its unit holders. On that date, each unit holder received one share of ACPT for every two units of IGC owned.

At close of business on March 9, 2001, there were 90 IGC unit holders of record. As of March 12, 2001, the closing price reported by the American Stock Exchange was $11.35 per unit.

IGC is required by its Third Amended and Restated Limited Partnership Agreement, as amended, to make cash distributions to limited partners of not less than 55% of taxable income calculated for public IGC unit holders. During the years ended December 31, 2000 and 1999, IGC had taxable (loss) of ($2,806) and ($1,695) respectively, or ($1.37) and ($.82) respectively, per unit.

ITEM 6. SELECTED FINANCIAL AND OPERATING DATA

The following tables set forth combined financial and operating data for IGC. The following selected statement of income and balance sheet data have been extracted from the audited consolidated financial statements of IGC for each of the years in the five-year period ended December 31, 2000 (see "Management's Discussion and Analysis of Financial Condition and Results of Operations.") This information should be read in conjunction with, and is qualified in its entirety by, the consolidated financial statements and related footnotes.

SELECTED FINANCIAL AND OPERATING DATA						
	Years Ended December 31,					
	2000	1999	1998	1997	1996	
	(In thousands, except per unit amounts)					
Income Statement Data						
Revenues						
Land sales (a)	$ 2,262	$ 1,132	$ 13,446	$ 10,357	$ 11,576	
Equity in earnings-gaming properties	-	-	549	-	-	
Equity in earnings-partnerships and						
development fees	39	193	1,149	1,671	16,609	
Rental/Investment property revenues		-	6,693	8,737	7,577	
Management and other fees	-	-	2,518	3,775	4,816	
Interest and other income	652	967	1,112	956	989	
Total Revenue (b)	$ 2,953	$ 2,292	$ 25,467	$ 25,496	$ 41,567	
Wetlands/Lead-based paint litigation expense	(2)	934	26	1,772	973	
Other expenses	5,191	4,833	22,828	26,381	27,563	
Income taxes	-	-	740	606	3,634	
Minority interest	3	-	446	439	306	
Net (loss) income from continuing operations	(2,241)	(3,322)	1,427	(3,702)	9,091	(c)
Net (loss) income from discontinued operations	(1,732)	(1,221)	(909)	117	754	
Total net (loss) income	(3,973)	(4,543)	518	(3,585)	9,845	
Basic and fully diluted net (loss) income						
per unit	(1.91)	(2.19)	0.25	(1.72)	4.75	(c)
Cash distributions per unit	-	-	0.10	-	0.55	
(a) Includes sales to affiliates	-	-	1,179	3,367	9,086	
(b) Distribution of assets to ACPT occurred in October 1998						

(c) Includes a $932,000 or $.45 per unit reduction for the extraordinary item-early extinguishment of debt.

SELECTED FINANCIAL AND OPERATING DATA					
	As of December 31,				
	2000	1999	1998	1997	1996
	(In thousands)				
Balance Sheet Data					
Assets related to waste technology projects	$ 5,821	$ 4,383	$ 3,557	$ 3,023	$ 2,493
Assets related to land development	20,335	21,076	23,670	82,509	83,085
Assets related to discontinued operations	1,374	4,646	3,099	2,573	2,491
Assets related to rental/investment properties	-	-	46	47,291	52,698
Total	$ 27,530	$ 30,105	$ 30,372	$ 135,396	$ 140,767
Debt related to waste technology projects					
Recourse	$ 188	$ 193	$ 199	$ 204	$ 209
Debt related to land development					
Recourse	$ 1,171	$ 1,928	$ 2,633	$ 35,176	$ 34,077
Non-recourse	-	-	-	2,295	2,153
Debt related to discontinued operations					
Recourse	303	726	740	159	502
Debt related to rental/investment properties	-	-			
Recourse	-	-	-	969	1,139
Non-recourse	-	-	-	39,101	39,508
Total	$ 1,662	$ 2,847	$ 3,572	$ 77,904	$ 77,588
Partners' Capital	$ 18,257	$ 21,991	$ 27,391	$ 43,288	$ 46,594

	As of December 31,				
	2000	1999	1998	1997	1996
Operating Data					
Community Development					
Residential lots sold	80	43	417	250	523

Residential lots used by Company's home building operations	-	-	-	5	27
Residential lots used in joint venture operations	-	-	102	21	-
Residential lots transferred to Company's rental property operations	-	-	-	-	-
Commercial and business park acres sold	-	-	39	17	5
Undeveloped acres sold	-	-	-	381	-
Home building					
New contracts for sale, net of cancellations	26	76	46	73	67
Number of homes sold	80	82	67	112	156
Backlog at end of period	14	76	92	58	68
Property Management					
Rental apartment units managed at end of period	-	-	-	8,139	8,139

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain matters discussed and statements made within this Annual Report on Form 10-K are forward-looking statements within the meaning of the Private Litigation Reform Act of 1995 and as such may involve known and unknown risks, uncertainties, and other factors that may cause the actual results, performance or achievements of the Company to be different from future results, performance or achievements expressed or implied by such forward-looking statements. Although the Company believes the expectations reflected in such forward-looking statements are based on reasonable assumptions, it can give no assurance that its expectations will be attained. These risks are detailed from time to time in the Company's filings with the Securities and Exchange Commission or other public statements.

Effective October 5, 1998, the Company distributed the majority of its real estate development business to ACPT. As a result, the Company's historical results of operations for 2000 and 1999 are not comparable with the results of operations for 1998. Accordingly, the unaudited pro forma results for 1998 have also been presented as if the Distribution had been completed on January 1, 1998. This information is provided for purposes of completing the Management's Discussion and Analysis and should be read in conjunction with the Company's consolidated financial statements and notes thereto included in Part II, Item 8 which show the historical operations of the Company.

INTERSTATE GENERAL COMPANY L.P.
PRO FORMA CONSOLIDATED STATEMENTS OF (LOSS) INCOME

(In thousands, except per Unit amounts)

	Years Ended December 31,		
	2000	1999	1998
	(Historic)	(Historic)	(Proforma)
Revenues			
Land sales	$2,262	$1,132	$ 492
Equity in earnings from partnerships and developer fees	39	193	146
Equity in earnings from gaming properties	-	-	549
Interest and other income	652	967	1,285
Total revenues	$2,953	$2,292	$ 2,472
Expenses			
Cost of land sales	$1,993	$1,171	$ 810
Selling and marketing	-	15	-
General and administrative	2,236	1,894	458
Interest expense	907	357	219
Depreciation and amortization	57	63	90
Wetlands/lead-based paint litigation expense	(2)	934	26
Write-off of deferred project costs	-	1,180	1,191
Total expenses	$5,191	$5,614	$ 2,794
Loss before provision for income taxes	(2,238)	(3,322)	(322)
Provision for income taxes	-	-	158
Loss before minority interest	(2,238)	(3,322)	(480)
Minority interest	3	-	(44)
Net Loss from continuing operations	$ (2,241)	$ (3,322)	$ (436)
Discontinued operations			
Loss from discontinued operations	$ (1,032)	$ (1,221)	$ (869)
Loss on disposal of division	(700)	-	-
Net loss from discontinued operations	$ (1,732)	$ (1,221)	$ (869)
Total net loss	$ (3,973)	$ (4,543)	$ (1,305)

The accompanying notes are an integral part of these consolidated statements.					

Historic for the year ended December 31, 2000 versus 1999

Land Development Operations

Land development sales revenue increased 99.8% to $2,262,000 during the twelve months ended December 31, 2000, compared to sales of $1,132,000 during the twelve months ended December 31, 1999. The 2000 period reflects sales of 26 single family home lots as well as 54 town home lots, while the 1999 period reflects 24 single family sales and 19 town home lots. Fourteen of the 2000 single-family home lot sales occurred in the Dorchester neighborhood of St. Charles, the remaining sales occurred in St. Mary's County, Maryland at the Westbury project. Gross profit margins for these sales were 59% for the Dorchester sales and 26% for the Westbury sales. During 1999 there were no comparable sales at Dorchester and the Westbury gross profit margin was 26% in 1999.

In addition to the single family lot sales, there were sale of 54 town home lots in 2000 compared to 19 in 1999. Forty eight of the town home lot sales for 2000 were in the Montclair project in Prince William County, Virginia. The remainder occurred at the Westbury project. These town home lots were sold at essentially break even pricing. The cost basis of this property is high due to carrying costs capitalized over an extended holding period. While these lots are producing a book loss associated with their extended holding period, they continue to provide positive cash flow for the Company

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Homebuilding Operations (Discontinued)

Effective November 13, 2000, IGC's Board of Directors adopted a plan to wind down and cease AFH's operations following completion of the 30 homes then under construction. Accordingly, the results of operations for AFH are reported as from discontinued operations. The Company estimates that it will incur a loss on disposal of approximately $700,000 as a result of closing down AFH. Of this estimated amount, $202,000 has been incurred through December 31, 2000, at which time 14 homes remained under construction. As such, results are not readily comparable between 2000 and prior years. Please refer to note 3 in the accompanying notes to the consolidated financial statements for further information regarding discontinued operations.

Revenue from discontinued operations increased 4% to $9,916,000 during 2000 compared to $9,536,000 during 1999. However, gross margins per house declined significantly to 7% in 2000 compared to 15% in 1999. This decrease was the result of a variety of factors; all of which led to the decision to discontinue operations.

Equity in Earnings from Partnerships and Developer Fees

Equity in earnings decreased $149,000 to $39,000 during the twelve months ended December 31, 2000, compared to $193,000 during 1999. This decrease was the result of IGC transferring four apartment complex partnerships to ACPT in accordance with the October 1998 restructuring agreement. Please refer to note 2 for further information.

Interest and Other Income

Interest and other income declined 36% to $652,000 during the 12 months ended December 31, 2000, compared to $967,000 during 1999. The decrease is the result of declining interest income on notes receivable due to principal curtailments received in 2000.

Interest Expense

Interest expense increased 154% to $907,000 during 2000, compared to $357,000 in 1999. The increase is a result of continued borrowings as well as higher interest rates.

General and Administrative

General and administrative costs increased 18% to $2,236,000 in 2000, compared to $1,894,000 in 1999. The increase is the result of increased waste project development efforts, including $285,000 in China.

Historic for the year ended December 31, 1999 versus Pro forma 1998

Land Development Operations

Community development land sales revenue increased 130% to $1,132,000 during the twelve months ended December 31, 1999, compared to sales of $492,000 during the twelve months ended December 31, 1998. Single-family lot sales totaled 24 in 1999 compared to 4 in 1998. The gross profit margin on sales of these lots was 26%. Nineteen town home lots were sold in 1999 compared to 11 during 1998. The increased sales were the result of several contracts the Company entered into with homebuilders in order to expedite development. Eleven of these sales occurred in the Westbury project and the remainder in Prince William County, Virginia. The town home lot sales had negative margins for 1999, primarily due to a lack of volume and the carrying costs associated with the extended period these lots remained in inventory. The carrying value of the remaining Westbury town home lots was written down to reflect current market value. At December 31, 1999, 19 town home lots remain in the Westbury project. They are under contract to be sold during 2000.

Homebuilding Operations (Discontinued)

Revenues from home sales increased 34% to $9,864,000 during the twelve months ended December 31, 1999 compared to $7,379,000 during the twelve months ended December 31, 1998. The 1999 revenues were a result of increased home sales. In 1999 the Company sold 82 scatter-site homes as compared to 1998 scatter-site sales of 67. There was a slight 1% decrease in construction gross profit margin for 1999.

Equity in Earnings from Partnerships and Developer Fees

Equity in earnings increased $42,000 to $193,000 during the twelve months ended December 31, 1999, compared to $146,000 during 1998. This increase was primarily due to an increase in occupancy at one of the investment properties, from 83% in 1998 to 92% in 1999.

Interest Expense

Interest expense increased $138,000 to $357,000 during 1999, compared to $219,000 in 1998. The increase is a result of continued borrowings as well as higher interest rates.

General and Administrative Expense

General and administrative expenses increased 314% to $1,894,000 during the twelve months ended December 31, 1999, compared to $458,000 during the same period of 1998. This increase is a result of multiple factors. As part of the restructuring with ACPT, most of the Company's internal support personnel transferred to ACPT. As a result, significant outsourcing costs were incurred while a new management team was assembled. In addition, accounting and consulting costs were higher than normal due to issues relating to the restructuring. Included in the increase is approximately $285,000 of additional expense associated with stock appreciation rights (see Option, Appreciation Right and Warrants discussion beginning on page 44) held by various members of management brought on by a 40% increase in IGC's unit price and the issuance of 100,000 units in connection with the Employee's Unit Incentive Plan. In addition, American Family Homes accounted for $340,000 of the increase due to reorganizing and the hiring of a new president.

Provision for Wetlands and Lead Based Paint Litigation Expense

Expenses related to the environmental legal proceedings increased to $934,000 in 1999 from $26,000 in 1998. The Company revised its reserve to $1,400,000 during 1999, which reflects the fines associated with the wetland's litigation settlement. The Company has accrued $125,000 in legal fees to resolve the lead based paint litigation. In 1999 the Company incurred $295,000 of legal fees associated with lead-based paint matters.

Write-off of Deferred Project Cost

In 1999, the Company wrote off $1,180,000 of deferred project costs related to various waste technology projects. In determining the amount of the reserve, management elected to write off projects where it believes there is a less than 50% probability of obtaining a waste disposal contract. In 1998, the Company wrote off $1,191,000 of deferred project costs related to the waste technology project in Bridgeport, Connecticut.

Liquidity and Capital Resources

Cash and Cash equivalents were $517,000 and $367,000 respectively at December 31, 2000 and December 31, 1999.

IGC historically has met its liquidity requirements principally from cash flow generated from home and land sales, distributions from residential rental partnerships, loans from affiliates, and from bank financing providing funds for development and working capital. In the coming months, the Company's principal need for liquidity will be normal

business operating expenses, development costs for IWT and CWT, land development activities, cash requirements for AFH's wind-down, cessation of operations and continuing warranty costs, and ongoing debt service of existing loans.

IGC's long-term success depends on IWT/CWT's development of solid waste projects. These efforts require substantial capital. The Company intends to use proceeds from the sale of its real estate holdings to finance all or a portion of the development of solid waste projects. It is not likely that the Company will generate near-term revenues from real estate sales sufficient to cover general and administrative expenses plus the costs of developing its solid waste projects. It will be at least December 2001 before a financial close could occur on any of IWT/CWT's waste projects. Moreover, there is no assurance financial closing will occur on any given project. As a result, the Company must continue to borrow using its real estate assets as collateral to meet liquidity needs. For example, during the third quarter, the Company closed a $1.6 million line of credit secured by various real estate parcels. In addition, the Company anticipates relying on the collection of principal and interest relating to a note receivable from an affiliate of ACPT over the remainder of the year. These collections will either be directly from that affiliate or as additional advances from IBC as more fully discussed below.

The Company is aggressively marketing its real estate portfolio. Management is in negotiations with potential purchasers on several of its largest parcels. There is no assurance a sale will be consummated or when any particular property will be sold.

During 2000, AFH continued to lose money requiring substantial cash infusions to meet operating needs. The Board of Directors of IGC approved a plan to wind down and cease the operations of AFH following completion of all existing homes under construction. Fourteen homes remained under construction at year-end. Accordingly, the results of operations for AFH are reported as discontinued operations. The Company estimates that it will incur a loss of $700,000 in closing down AFH. Through December 31, 2000, the Company incurred $202,000 of this amount. A provision for the remaining estimated loss has been included under results from discontinued operations. Refer to note 3 on page 33 for further information.

Termination of AFH's homebuilding business will reduce operating losses and the cash burden on the Company. It will also enable management to focus on real estate development and waste development activities.

The waste disposal plant development operations of IWT/CWT are subject to municipal and other government bidding procedures, contract award, permitting, and other approvals. A number of proposals by IWT/CWT to build waste disposal plants in the Caribbean and elsewhere are in various stages of the approval process. CWT is currently pursuing a project in the Municipality of Caguas, Puerto Rico, where it previously signed a host community agreement. In November, the Company announced that its proposed facility received a "Certificate of Conformity" from the Puerto Rico Solid Waste Management Authority. This will allow CWT to begin contracting and other activities necessary to implement the project. The next steps will be to obtain all necessary regulatory permits and licenses and begin discussions with the Solid Waste Management Authority, other involved governmental agencies, and municipalities to be served by the facility. CWT then expects to negotiate long-term contracts for the delivery of solid waste and payment for its processing services. The target date for completion of all of these activities is the first quarter of 2002. There can be no assurance that CWT will be able to reach agreement on contracts necessary to build and operate this facility or, if it does, that the contracts will be on terms which will allow CWT to go to financial closing.

The government of the U.S. Virgin Islands informed CWT on November 9, 2000 that it had been selected to negotiate contracts to build one or more facilities to process the Island's solid waste. CWT has begun negotiations with government officials and their advisors. Industry experience suggests that contracting and permitting could take approximately nine months to one year. CWT will work closely with the Virgin Islands' government to obtain

required permits, structure the project to get to financial close, and begin construction expeditiously. While CWT believes these negotiations will be successful, there can be no assurance this will be so or that terms can be agreed upon which will allow the project to go to financial closing.

Management cannot predict when, if at all, IWT/CWT will generate positive cash flow.

A balance due from an affiliate of ACPT totaled $8.321 million at March 31, 2000. During the second quarter of 2000, the Company collected $1.5 million of principal and interest on this note leaving a balance at December 31, 2000 of $7.305 million. In the meantime, IBC, IGC's general partner, has signed a working capital support agreement with IGC secured by IGC's interest in this note receivable. As of December 31, 2000, IBC and its affiliates had advanced $5.074 million including interest. Subsequent to the end of the year, IBC advanced an additional $580,000 under this agreement. IBC has expressed a willingness to advance funds under this support agreement in excess of the note securing the advances. However, there is no assurance that IBC and its affiliates will be able to continue to fund IGC. Neither IBC nor its affiliates generate sufficient cash flow from operations to advance the capital necessary to fund the needs of IGC. The ability of IBC and its affiliates to advance cash to IGC is dependent upon the ability to successfully close the sale or refinancing of certain assets.

Management believes that the Company's real estate assets have sufficient value to enable the Company to finance development with conventional financing. The Company currently has development loans in place for its projects at Brandywine and the first section of Phase 2 at Westbury. During 2000, 48 of 54 lots at Montclair were sold and the development financing repaid in full. In addition, 26 single-family lots were sold in the Westbury and Dorchester projects. Infrastructure development activity is continuing in Brandywine. The Company is presently negotiating with several homebuilders and expects the first lot sales to occur in the second quarter of 2001.

Town Center South in St. Charles, Maryland remains the most valuable real estate asset the Company holds and management is aggressively marketing it.

IGC intends to continue to refinance loans as they become due in the normal course of business. Debts totaling $2,507,000 mature during 2001. The Company has already obtained a commitment for a six-month extension of its $1 million operating line of credit, which is included in the preceding amount. The remainder of these loans relate to various real estate development ventures. The Company expects to fulfill these obligations through related property sales.

Management believes that it will have the funds necessary to meet the Company's obligations for the balance of the year. While the Company believes it will obtain financing for continued land development and operational activities beyond the current year, there is no guarantee such financing will be available.

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Debt Summary

As of December 31, 2000, assets with a book value of $12,814,000 were encumbered by $8,052,000 of recourse debt. The significant terms of IGC's recourse debt financing are shown below (dollars in thousands):

								Balance
		Maximum		Interest		Maturity		Outstanding

		Borrowings	Rate	Date	12/31/00
Town Home Development Line	(a)	$ 460	P+1.5%	12/29/01	$ 63
Development Loan	(a)	1,300	P+1.5%	09/30/01	125
Operating Line of Credit	(b)	1,000	P+.5%	08/18/01	1,000
Land Note	(c)	732	10%	10/28/01	732
Operating Line of Credit	(d)	4,400	P+1%	12/23/02	4,004
Development Loan	(e)	800	P+1.5%	09/30/01	250
Operating Line of Credit	(b)	1,600	P+1%	07/01/02	1,357
Other miscellaneous		2,814	Various	Various	520
		$ 13,106			$ 8,051

(a) The two notes require monthly interest payments. Principal curtailments are made from sales of individual lots in the amount of $8,000 and $27,000 respectively.

(b) This line of credit is for operating use.

(c) The note requires monthly interest payments of $6,103. Principal curtailments are made from sales of individual lots in the amount of $4,000 per lot.

(d) The loan provides an operating line of credit. Of the total loan, $1.4 million was used for fines relating to the wetlands settlement and $400,000 is reserved for interest payments on the line.

(e) The note requires monthly interest payments.

The Company has guaranteed loans totaling $10,840,000 related to the Brandywine project of which $3,116,000 was outstanding at December 31, 2000. Assets with a book value of $11,455,000 collateralize this debt. The Brandywine project is being developed in a partnership, the results of which are included using the equity method of accounting. Accordingly, the debt is not included in these statements.

ITEM 7a. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risks relating to its operations result primarily from changes in the prime interest rate. It is management's goal to minimize the impact of variable rate debt by pursuing equity and long-term fixed rate financings and refinancings of current fixed rate debt at lower rates when favorable market conditions exist. The following table

provides information about the Company's financial instruments that are sensitive to changes in interest rates including obligations, principal repayments, related weighted average interest rates by expected maturity dates, and fair values. The Company has no derivative financial instruments.

Interest Rate Sensitivity
Principal Amount by Expected Maturity
Average Interest Rate
(In thousands)

	2001	2002	2003	2004	2005	Thereafter	Total	Fair Value December 31, 2000
Long-term debt, including current portions:								
Fixed rate debt - principal	$ 765	$ 9	$ 8	$ 9	$ 157	$ 5,074	$ 6,022	$ 3,412
Fixed rate debt - interest	518	457	457	457	457	1,636	$ 3,982	
Average interest rate	10.00%	9.19%	9.50%	9.50%	9.50%	9.50%	9.53%	9.53%
Variable rate debt - principal	1,742	5,362	-	-	-	-	$ 7,103	$ 7,103
Variable rate debt - interest	555	457	-	-	-	-	$ 1,013	
Average interest rate	9.57%	9.56%	0.00%	0.00%	0.00%	0.00%	9.57%	9.57%

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To The Partners of

Interstate General Company L.P.:

We have audited the accompanying consolidated balance sheets of Interstate General Company L.P. (a Delaware limited partnership) and subsidiaries (the "Company") as of December 31, 2000 and 1999, and the related consolidated statements of (loss) income, changes in partners' capital and cash flows for each of the years in the three-year period ended December 31, 2000. These consolidated financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the

amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Interstate General Company L.P. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The financial statement schedule included on page 51 of the Form 10-K is presented for the purpose of complying with the Securities and Exchange Commission's rules and is not a required part of the basic consolidated financial statements. This schedule has been subjected to the auditing procedures applied in our audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

ARTHUR ANDERSEN LLP

Vienna, Virginia

March 16, 2001

INTERSTATE GENERAL COMPANY L.P.
CONSOLIDATED STATEMENTS OF (LOSS) INCOME

(In thousands, except per unit amounts)

	YEARS ENDED DECEMBER 31,				
	2000		1999		1998
Revenues					
Land sales	$ 2,262		$ 1,132		$ 13,446
Rental/Investment property revenues	-		-		6,693
Equity in earnings from partnerships and developer fees	39		193		1,149
Equity in earnings from gaming properties	-		-		549
Management and other fees, substantially all from related entities	-		-		2,518
Interest and other income	652		967		1,112
Total revenues	$2,953		$2,292		$ 25,467
Expenses					
Cost of land sales	$1,993		$1,171		$ 8,189
Selling and marketing	-		15		17
General and administrative	2,236		1,894		4,746

Interest expense	907		357		2,596
Rental properties operating expense	-		-		2,748
Depreciation and amortization	57		63		1,510
Wetlands/lead-based paint litigation expense	(2)		934		26
Write-off of deferred project costs	-		1,180		1,191
Spin-off costs	-		-		1,831
Total expenses	$5,191		$5,614		$ 22,854
(Loss) income before provision for income taxes	(2,238)		(3,322)		2,613
Provision for income taxes	-		-		740
(Loss) income before minority interest	(2,238)		(3,322)		1,873
Minority interest	3		-		446
Net (Loss) income from continuing operations	$ (2,241)		$ (3,322)		$ 1,427
Basic and Fully Diluted Net (Loss) Income per unit					
from continuing operations	$ (1.08)		$ (1.60)		$ 0.69
Discontinued operations					
Loss from discontinued operations	$ (1,032)		$ (1,221)		$ (909)
Loss on disposal of division	(700)		-		-
Net loss from discontinued operations	$ (1,732)		$ (1,221)		$ (909)

The accompanying notes are an integral part of these consolidated statements.

INTERSTATE GENERAL COMPANY L.P.

CONSOLIDATED STATEMENTS OF (LOSS) INCOME

(CONTINUED)

(In thousands, except per Unit amounts)

	YEARS ENDED DECEMBER 31,				
	2000		1999		1998
Basic and Fully Diluted Net Loss per unit					
from discontinued operations	$ (0.83)		$ (0.59)		$ (0.44)

Total Net (Loss) Income	$ (3,973)	$ (4,543)		$ 518
Basic and Fully Diluted Net (Loss) Income per unit	$ (1.91)	$ (2.19)		$ 0.25
Net (Loss) Income				
General Partners	$ (40)	$ (45)		$ 5
Limited Partners	(3,933)	(4,498)		513
	$ (3,973)	$ (4,543)		$ 518
Weighted Average Units Outstanding	2,055	2,055		2,044

The accompanying notes are an integral part of these consolidated statements.

INTERSTATE GENERAL COMPANY L.P.
CONSOLIDATED BALANCE SHEETS
(In thousands)

ASSETS

	DECEMBER 31,		
	2000		1999
Cash and Cash Equivalents			
Unrestricted	$ 517		$ 367
Restricted	211		136

	$ 728		$ 503
Assets Related to Waste Technology Projects			
Deferred Costs	$ 5,606		$ 4,161
Property, plant and equipment less accumulated depreciation			
of $170 and $159 as of December 31, 2000 and 1999, respectively	210		203
Other assets	5		19
	$ 5,821		$ 4,383
Assets Related to Land Development			
Land and development costs			
St. Charles, Maryland	$ 6,010		$ 5,700
Brandywine, Maryland	7,935		7,967
Other Maryland and Virginia locations	6,295		7,385
Notes receivable on lot sales and other	46		24
	$ 20,286		$ 21,076
Assets Related to Discontinued Operations			
Homebuilding construction and land	$ 1,243		$ 4,404
Property, plant, and equipment less accumulated depreciation			
of $106 and $578 as of December 31, 2000 and 1999, respectively	27		101
Receivables and other	104		141
	$ 1,374		$ 4,646
Receivables & Other Assets			
Receivables	$ 108		$ 159
LDA note receivable	7,305		8,154
American Land receivable - accrued income tax	-		2,188
Other assets - deposits and prepaids	208		138
Property, plant and equipment, less accumulated depreciation of			
$21 and $16 as of December 31, 2000 and 1999, respectively	41		16
	$ 7,662		$ 10,655
Total Assets	$ 35,871		$ 41,263

The accompanying notes are an integral part of these consolidated statements.

INTERSTATE GENERAL COMPANY L.P.
CONSOLIDATED BALANCE SHEETS

(In thousands)

LIABILITIES AND PARTNERS' CAPITAL

	DECEMBER 31,		
	2000		1999
Liabilities Related to Waste Technology Projects			
Accounts payable and accrued liabilities	$ 310		$ 391
Mortgages and notes payable	188		193
	$ 498		$ 584
Liabilities Related to Land Development			
Recourse debt	$ 1,171		$ 1,928
Accounts payable and accrued liabilities	272		259
	$ 1,443		$ 2,187
Liabilities Related to Discontinued Operations			
Recourse debt	$ 303		$ 726
Accounts payable, accrued liabilities, and deferred revenue	1,508		4,956
Mortgage and notes payable	28		55
Reserve for completing discontinued operations	498		-
	$ 2,337		$ 5,737
Other Liabilities			
Accounts payable and accrued liabilities	$ 1,901		$ 3,551
Loan payable-IBC and related entities	5,074		3,026
Notes payable	6,361		2,000
Accrued income tax liability-current	-		2,187
	$ 13,336		$ 10,764
Total Liabilities	$ 17,614		$ 19,272
Partners' Capital			
General partners' capital	$ 4,075		$ 4,112
Limited partners' capital; 2,055 units			
issued and outstanding as of December 31, 2000			
and December 31, 1999	14,182		17,879

Total partners' capital	$ 18,257		$ 21,991
Total Liabilities and Partners' Capital	$ 35,871		$ 41,263

The accompanying notes are an integral part of these consolidated statements.

INTERSTATE GENERAL COMPANY L.P.
CONSOLIDATED STATEMENTS OF CHANGES IN PARTNERS' CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2000, 1999, AND 1998

(In thousands)

	General Partners' Capital	Limited Partners' Capital	Total
BALANCES, December 31, 1997	$ 4,345	$ 38,943	$ 43,288
Net Income	5	513	518
Cash Distributions	(22)	(207)	(229)
Issuance of warrants	3	265	268
Distribution of ACPT shares to unitholders	(165)	(16,289)	(16,454)
BALANCES, December 31, 1998	$ 4,166	$ 23,225	$ 27,391
Net Loss	(45)	(4,498)	(4,543)
Distributions to unitholders	-	(25)	(25)
Distribution of St. Charles land	(8)	(824)	(832)
BALANCES, December 31, 1999	$ 4,113	$ 17,878	$ 21,991
Net Loss	(40)	(3,933)	(3,973)
Distributions to unitholders	2	237	239
BALANCES, December 31, 2000	$ 4,075	$ 14,182	$ 18,257

The accompanying notes are an integral part of these consolidated statements.

INTERSTATE GENERAL COMPANY L.P.
CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE TWELVE MONTHS ENDED DECEMBER 31,

(In thousands)

	2000	1999	1998
Cash Flows from Operating Activities			
Net (loss) income from continuing operations	$ (2,241)	$ (3,322)	$ 1,427
Net loss from discontinued operations	$ (1,032)	$ (1,221)	$ (909)
Adjustments to reconcile net (loss) income to net cash (used in)			
provided by operating activities:			
Depreciation and amortization	57	138	1,519
Equity in earnings from gaming properties	-	-	(549)
Equity in losses from unconsolidated partnerships	(17)	(188)	(788)
Distributions from unconsolidated partnerships	-	-	1,912
Cost of land development and homebuilding	11,756	10,157	14,885
Homebuilding construction expenditures	(6,602)	(10,788)	(7,379)
Equity in loss from home building joint venture	-	-	(385)
Write-off of deferred project cost	-	1,180	1,191
Collection of fines	-	-	3,212
Changes in other accounts receivable and accounts payable	(4,639)	3,775	2,549
Loss on disposal of segment	(700)	-	-
Net cash (used in) provided by operating activities	$ (3,418)	$ (269)	$ 16,685
Cash Flows from Investing Activities			
Investment in land improvements for future sales	(1,181)	(1,460)	(12,197)
Reimbursement of advances to development joint venture	-	1,360	-
Change in assets related to unconsolidated rental property	256	188	157
Change in restricted cash	(75)	(11)	(2,083)

Additions to operating properties, net	-	-	(780)
Additions to deferred costs - waste technology projects	(1,445)	(2,016)	(1,638)
Changes in other assets	(53)	(729)	1,308
Collection on LDA note receivable	868	-	-
Net cash used in investing activities	$ (1,630)	$ (2,668)	$ (15,233)
Cash Flows from Financing Activities			
Cash proceeds from debt financing	5,402	4,431	13,878
Loans from IBC and other related entities	2,047	2,489	537
Payment of debt	(2,252)	(3,624)	(15,340)
Distributions	-	(25)	(229)
Issuance of warrants	-	-	268
Purchase of minority interest in subsidiary	-	-	(3,100)
Net cash provided by (used in) financing activities	$ 5,197	$ 3,271	$ (3,986)

The accompanying notes are an integral part of these consolidated statements.

INTERSTATE GENERAL COMPANY L.P.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE TWELVE MONTHS ENDED DECEMBER 31,

(In thousands)

(CONTINUED)

	2000	1999	1998
Net Increase (Decrease) in Cash and Cash Equivalents	150	334	(2,240)
Cash and Cash Equivalents, Beginning of Year	367	33	2,273
Cash and Cash Equivalents, End of Year	$ 517	$ 367	$ 33
Supplemental Disclosures:			
Interest paid	738	400	292
Assets transferred to ACPT (a)	239	832	16,454
(a) See Note 2			

The accompanying notes are an integral part of these consolidated statements.

INTERSTATE GENERAL COMPANY L.P.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2000 AND 1999

(1) BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Interstate General Company L.P. (the "Company" or "IGC") was formed as a Delaware limited partnership in 1986. Directly and through predecessors, the Company has been engaged in business since 1957. IGC's headquarters are located in Chantilly, Virginia. IGC has traded publicly as a master limited partnership since February 1987 on the American Stock Exchange ("AMEX") and Pacific Stock Exchange ("PSE").

The Company is engaged in three primary lines of business. First, the Company develops residential and commercial land. Second, through its subsidiaries, IGC is engaged in the development of waste disposal projects that use environmentally superior technology. Third, through its wholly owned subsidiary American Family Homes, LLC ("AFH"), the Company builds semi-custom homes on a scattered site basis. AFH operations have been discontinued. Please refer to Note 3.

IGC owns the following assets: Land zoned commercial in St. Charles, Maryland; developable land in Charles County and St. Mary's County, Maryland and in Prince William County, Virginia; a 50% interest in a partnership that owns land under development in Brandywine, Maryland; all of AFH; a note receivable of $7.305 million (principal and interest) payable by a subsidiary of American Community Properties Trust ("ACPT"); as well as fractional interests in Chastleton Apartment Associates (District of Columbia) and Coachman's Limited Partnership (Maryland). In addition, IGC owns all of the common stock of Interstate Waste Technologies (IWT) and Caribe Waste Technologies (CWT) (excluding shares issued as incentive compensation for employees), that is held in a trust (the "IWT/CWT Trust") for the benefit of IGC's Unit holders.

On October 5, 1998 IGC transferred its principal real estate operations to ACPT, and subsequently all the common shares of ACPT to the partners and unitholders of IGC (the "Distribution").

Consolidation and Presentation

The accompanying consolidated financial statements include the accounts of Interstate General Company L.P. and its majority-owned and controlled partnerships and subsidiaries, after eliminating all intercompany transactions. All of the entities included in the consolidated financial statements are hereinafter referred to collectively as the "Company" or "IGC". As of December 31, 2000, the consolidated group includes Interstate General Company L.P., St. Charles Associates Limited Partnership, American Family Homes, LLC, St. Charles Operating Company LLC, Interstate Waste Technologies, Inc., Caribe Waste Technologies, Inc., Pomfret LLC, and various inactive entities. The Company's investments in its non-majority owned partnerships that it does not control are recorded using the equity method of accounting. However, the recognition of losses is limited to the amount of direct or implied financial support.

The accompanying consolidated financial statements reflect the consolidated operations of IGC. No adjustments have been made to these statements to remove, for periods prior to the distribution, any of the activities transferred to ACPT. Certain amounts and balances from prior years have been reclassified to conform to the year 2000 financial presentation.

Sales and Profit Recognition and Cost Capitalization

Sales revenues and profits from land sales and homebuilding activities are recognized at closing only when sufficient down payments have been obtained, possession and other attributes of ownership have been transferred to the buyer, and IGC has no significant continuing involvement.

The cost of acquiring and developing land and the cost of homebuilding construction are allocated to these assets and charged to cost of sales as the related inventories are sold. IGC's interest costs related to homebuilding and land assets are allocated to these assets based on their development stage and relative book value. The portion of interest allocated to land, building, lots under development, and homebuilding construction during the development and construction period is capitalized to the extent of qualifying assets. Remaining interest costs are expensed. IGC carries land, development and homebuilding costs at the lower of cost or net realizable value.

Quarterly, IGC evaluates the carrying value of its long-lived assets in accordance with Statement of Financial Accounting Standard ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." In cases where management is holding for sale particular properties, the Company assesses impairment based on whether the net realizable value (estimated sales price less costs of disposal) of each individual property to be sold is less than the net book value. A property is considered to be held for sale when the Company has made the decision to dispose of the property. Otherwise, the Company assesses impairment of its real estate properties based on whether it is probable that undiscounted future cash flows from each individual property will be less than its net book value. If a property is impaired, its basis is adjusted to its fair market value.

Selling and Marketing Expenses

Selling and marketing expenses consist primarily of advertising costs, which include costs of printed materials, signs, displays, general marketing costs and costs associated with model homes. Advertising costs are expensed as incurred except for capitalized model home costs that are depreciated over their estimated useful lives.

Management Fees

IGC records management fees in the period in which services are rendered.

Deferred Waste Technology Costs

The Company capitalizes the direct costs of procuring waste projects that it thinks are probable of being realized after achieving certain project-related milestones. All other project development costs are expensed as incurred. These costs are evaluated for impairment at each reporting period and if the Company no longer believes the prospects of developing the projects are probable, all or a portion of those costs that it believes are not probable of being realized are written off.

Deferred Project Costs

Pre-construction costs are capitalized as long as the asset is under development. Upon completion of construction, the deferred charges are amortized as a component of the assets' depreciation charge. Deferred project costs determined to be unrecoverable are written off.

Depreciation and Amortization

Buildings are depreciated over 35 to 40 years using the straight-line method. Furniture, fixtures and equipment are depreciated over five to seven years using the straight-line method. Deferred expenses are amortized over the period of estimated benefit using the straight-line method.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, unrestricted deposits with financial institutions and short-term investments with original maturities of three months or less.

Income Taxes

IGC is not subject to U.S. taxes as a partnership. These financial statements do not contain any provision for Federal or state income taxes. All Federal and state income tax liability and/or tax benefits are passed through to the individual partners in accordance with the Internal Revenue Code.

Comprehensive Income

IGC has no items that would be considered comprehensive income that would require separate reporting in the accompanying consolidated statements of income.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Stock-Based Compensation

The Company adopted Statement of Financial Accounting Standard ("SFAS") No. 123, "Accounting for Stock-Based Compensation" during 1996. The Company has elected to continue to measure compensation costs using Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and therefore the adoption of this statement did not have any effect on the financial results of the Company (see Note 10).

Compensation expense related to Unit options issued to directors and employees is recognized at the time the options are granted in an amount equal to the excess of the currently calculated trading value of the Units over the option exercise price. Compensation expense related to Unit Appreciation Rights is recognized quarterly on a cumulative basis since the issuance of the Rights is based on changes in unit prices compared to the "strike" price of the Rights.

Earnings Per Unit

In the fourth quarter of 1997, IGC adopted SFAS No. 128, "Earnings per Share." This statement requires the computation and reporting of both "basic" and "diluted" earnings per unit.

"Basic earnings per unit" is computed as net income multiplied by the limited partner ownership interest, 99%, divided by the weighted average units outstanding.

Reclassification

Certain amounts and balances from 1999 and 1998 have been reclassified to conform to the year 2000 presentation.

Earnings Per Unit

The following table provides a reconciliation between weighted average units outstanding-basic and weighted average units outstanding-diluted.

	Year Ended December 31, (In Thousands)				
	2000		1999		1998
Weighted average units outstanding-basic	2,055		2,055		2,044
Effect of dilutive equivalent units	N/A		N/A		1
Weighted average units outstanding-diluted	2,055		2,055		2,045

The effect of dilutive equivalent units was not applicable in 2000 and 1999 because the Company recorded a net loss for that year. Potentially dilutive options and warrants are described in Note 10.

(2) TRANSFER OF ASSETS TO ACPT

As part of the distribution to ACPT that occurred in October 1998, IGC had a contingent obligation to transfer four of its partnership interests and fourteen acres of land in St. Charles, Maryland. The distribution requirement for the land was completed in December 1999, and the four partnership interests were subsequently transferred in February 2000 at book value.

(3) DISCONTINUED OPERATIONS

AFH has continued to lose money requiring substantial cash infusions to meet operating needs. Further, sales and construction starts decreased significantly during the third quarter. Management employed a number of different strategies to make AFH profitable. However, none was successful. Effective November 13, 2000, IGC's Board of Directors adopted a plan to wind down and cease AFH's operations following completion of the 30 homes currently under construction. Accordingly, the results of operations for AFH are reported as from discontinued operations. The Company estimates that it will incur a loss of approximately $700,000 as a result of closing down AFH. Of this estimated amount, $202,000 has been incurred through December 31, 2000. This estimate is based on projected costs to complete the remaining homes, as well as operating costs during that period, along with remaining lease costs the Company is obligated to pay. A provision for this loss has been included under results from discontinued operations. Management believes closing AFH at this time is in the best interest of the Company.

AFH is currently focusing on completion of its remaining homes. It is accepting no new sales contracts. It is anticipated that the disposal date for AFH will occur approximately March 31, 2001 and that the last home settlement will occur by this date. Management expects that AFH will have no assets remaining subsequent to that date. Management believes that the cost of remaining liabilities of AFH have been included in the charge for discontinued operations.

Termination of AFH's homebuilding business will reduce operating losses and the cash burden on the Company. It will enable management to focus on real estate and waste development activities. Management's long-term business plan is to use funds generated from real estate sales to fund and expand its waste project development activities.

(4) INVESTMENT IN UNCONSOLIDATED PARTNERSHIPS

Development Partnership

The following information summarizes financial data and principal activities of the Brandywine Investment Associates, L.P., which the Company accounts for under the equity method (in thousands):

SUMMARY OF FINANCIAL POSITION:	AS OF DECEMBER 31,		
	2000		1999
Total assets	$ 11,656		$ 9,639
Total non-recourse debt	417		83
Total other liabilities	9,043		7,342
Total equity	2,196		2,214
Company's investment	7,935		7,884

At December 31, 2000, the Company held a 50% limited partnership interest and was the managing general partner of Brandywine Investment Associates, L.P. The partnership owns 277 acres of developable land in Brandywine, Maryland. This property is in the early stages of infrastructure development; therefore, the summary of operations and operating cash flows for Brandywine has been omitted from this presentation. In accordance with FASB Statement No. 94, the equity method is used to account for this investment as it is a non-consolidated majority-owned subsidiary and has been included on the balance sheet under assets related to land development, Brandywine, Maryland. A portion of the investment balance is a note receivable in the amount of $4.635 million.

Housing Partnerships

The following information summarizes financial data and principal activities of unconsolidated housing partnerships that the Company accounts for under the equity method (in thousands):

SUMMARY OF FINANCIAL POSITION:	AS OF DECEMBER 31,		
	2000		1999
Total assets	$ 25,245		$ 33,181
Total non-recourse debt	27,477		42,117
Total other liabilities	17,983		18,487
Total Deficit	(20,215)		(27,423)
Company's investment	(578)		(834)

SUMMARY OF OPERATIONS:	AS OF DECEMBER 31,		
	2000		1999
Total revenue	$ 4,928		$ 8,434
Net loss	(2,361)		(859)
Company's recognition of equity in earnings and developer fees	17		187
SUMMARY OF OPERATING CASH FLOWS:	AS OF DECEMBER 31,		
	2000		1999
Cash flows from operating activities	$ (4,946)		$ 1,935
Company's share of cash flows from operating activities	-		-
Operating cash distributions	-		463
Company's share of operating cash distributions	-		130

Prior to the distribution of ACPT, the company had interests in 19 partnerships owning 4,563 rental units in 22 apartment complexes. During the first quarter of 2000, and as part of its prior reorganization agreement, IGC transferred its interest in Wakefield Terrace Associates, L.P., Headen House Associates, L.P., Palmer Apartments Associates, L.P., and Wakefield Third Age Associates, L.P. to ACPT. At December 31, 2000, IGC had fractional interests in 2 partnerships owning 404 rental units in 2 apartment complexes; both were placed in service prior to 1995. The Company holds a general partner interest in these partnerships and generally shares in zero to 5% of profits, losses and cash flow from operations until such time as the limited partners receive cash distributions equal to their capital contributions. Pursuant to the partnership agreements, the general partners are prohibited from selling or refinancing the apartment complexes without majority limited partner approval. Due to the absence of control and non-majority ownership, these partnerships are accounted for under the equity method of accounting.

(5) LIQUIDITY AND CAPITAL RESOURCES

IGC historically has met its liquidity requirements principally from cash flow generated from home and land sales, distributions from residential rental partnerships, loans from affiliates, and from bank financing providing funds for development and working capital. In the coming months, the Company's principal need for liquidity will be normal business operating expenses, development costs for IWT and CWT, land development activities, cash requirements for AFH's wind-down, cessation of operations and continuing warranty costs, and ongoing debt service of existing loans.

IGC's long-term success depends on IWT/CWT's development of solid waste projects. These efforts require substantial capital. The Company intends to use proceeds from the sale of its real estate holdings to finance all or a portion of the development of solid waste projects. It is not likely that the Company will generate near-term revenues from real estate sales sufficient to cover general and administrative expenses plus the costs of developing its solid waste projects. It will be at least December 2001 before a financial close could occur on any of IWT/CWT's waste projects. Moreover, there is no assurance financial closing will occur on any given project. As a result, the Company must continue to borrow using its real estate assets as collateral to meet liquidity needs. For example, during the third quarter, the Company closed a $1.6 million line of credit secured by various real estate parcels. In addition, the Company anticipates relying on the collection of principal and interest relating to a note receivable from an affiliate of ACPT over the remainder of the year. These collections will either be directly from that affiliate or as additional advances from IBC as more fully discussed below.

The Company is aggressively marketing its real estate portfolio. Management is in negotiations with potential purchasers on several of its largest parcels. There is no assurance a sale will be consummated or when any particular property will be sold.

The waste disposal plant development operations of IWT/CWT are subject to municipal and other government bidding procedures, contract award, permitting, and other approvals. A number of proposals by IWT/CWT to build waste disposal plants in the Caribbean and elsewhere are in various stages of the approval process. CWT is currently pursuing a project in the Municipality of Caguas, Puerto Rico, where it previously signed a host community agreement. In November, the Company announced that its proposed facility received a "Certificate of Conformity" from the Puerto Rico Solid Waste Management Authority. This will allow CWT to begin contracting and other activities necessary to implement the project. The next steps will be to obtain all necessary regulatory permits and licenses and begin discussions with the Solid Waste Management Authority, other involved governmental agencies, and municipalities to be served by the facility. CWT then expects to negotiate long-term contracts for the delivery of solid waste and payment for its processing services. The target date for completion of all of these activities is the first quarter of 2002. There can be no assurance that CWT will be able to reach agreement on contracts necessary to build and operate this facility or, if it does, that the contracts will be on terms which will allow CWT to go to financial closing.

The government of the U.S. Virgin Islands informed CWT on November 9, 2000 that it had been selected to negotiate contracts to build one or more facilities to process the Island's solid waste. CWT has begun negotiations with government officials and their advisors. Industry experience suggests that contracting and permitting could take approximately nine months to one year. CWT will work closely with the Virgin Islands' government to obtain required permits, structure the project to get to financial close, and begin construction expeditiously. While CWT believes these negotiations will be successful, there can be no assurance this will be so or that terms can be agreed upon which will allow the project to go to financial closing. As of December 31, 2000 the only costs deferred on the balance sheet relate to the Caguas, Puerto Rico, and Virgin Islands projects.

Management cannot predict when, if at all, IWT/CWT will generate positive cash flow.

A balance due from an affiliate of ACPT totaled $8.321 million at March 31, 2000. During the second quarter of 2000, the Company collected $1.5 million of principal and interest on this note leaving a balance at December 31, 2000 of $7.305 million. In the meantime, IBC, IGC's general partner, has signed a working capital support agreement with IGC secured by IGC's interest in this note receivable. As of December 31, 2000, IBC and its affiliates had advanced $5.074 million including interest. Subsequent to the end of the year, IBC advanced an additional $580,000 under this agreement. IBC has expressed a willingness to advance funds under this support agreement in excess of the note securing the advances. However, there is no assurance that IBC and its affiliates will be able to continue to fund IGC. Neither IBC nor its affiliates generate sufficient cash flow from operations to advance the capital necessary to fund the needs of IGC. The ability of IBC and its affiliates to advance cash to IGC is dependent upon the ability to successfully close the sale or refinancing of certain assets.

IGC intends to continue to refinance loans as they become due in the normal course of business. Debts totaling $2,507,000 mature during 2001. The Company has already obtained a commitment for a six-month extension of its $1 million operating line of credit, which is included in the preceding amount. The remainder of these loans relate to various real estate development ventures. The Company expects to fulfill these obligations through related property sales.

Management believes that it will have the funds necessary to meet the Company's obligations for the balance of the year. While the Company believes it will obtain financing for continued land development and operational activities beyond the current year, there is no guarantee such financing will be available.

(6) DEBT

The Company's outstanding debt is collateralized primarily by land, land improvements, housing, receivables, and investments in partnerships. The following table summarizes the indebtedness of IGC at December 31, 2000 and 1999 (in thousands) :

					Outstanding December 31, (in thousands)		
	Maturity Dates From/To		Interest Rates* From/To		2000		1999
Related to waste technology ventures:							
Recourse debt	06/30/05		9.5%		$ 188		$ 193
Related to land development:							
Recourse debt	09/30/01/ 12/29/01		P+1%/ 10.0%		$ 1,171		$ 1,928
Related to discontinued operations:							
Recourse debt	Demand/ 03/05/02		P+1%/ P+1.5%		$ 331		$ 781

General:							
Recourse debt	09/30/01/ 06/30/05		P+1%/ 10.99%		$ 6,361		$ 2,000
Related Entity (1)	08/02/09		P+1%		$ 5,074		$ 3,026
Total debt					$ 13,125		$ 7,928
*P = Prime lending interest rate							
(1) =IBC and related entities note payable							

As of December 31, 2000, the $1,171,000 of recourse debt related to community development assets is collateralized by $2,833,000 of community development assets.

The homebuilding debt is secured by substantially all of the homebuilding assets.

The Company is not subject to any material financial covenants under these loan agreements. The Company is in compliance with all debt covenants as of December 31, 2000.

The Company has guaranteed loans totaling $10,840,000 related to the Brandywine project. At December 31, 2000, $3,116,000 is outstanding relating to this debt. The amount outstanding represents the first draw toward the development of this project. Assets with a book value of $11,455,000 serve to collateralize this debt. The Brandywine project is being developed in a partnership, accounted for in the financial statements, using the equity method of accounting. Accordingly, the debt is not included in these financial statements.

The stated maturities (assuming no accelerations) of the Company's indebtedness at December 31, 2000 are as follows (in thousands):

2001	$2,507
2002	5,370
2003	8
2004	9
2005	157
Thereafter	5,074
	$13,125

The interest costs incurred during 2000, 1999, and 1998 were accounted for as follows (in thousands):

	2000	1999	1998
Expensed	$907	$402	$2,804
Capitalized	76	148	25
	$983	$550	$2,829

(7) COMMITMENTS AND CONTINGENT LIABILITIES

Wetlands Litigation

As previously reported, wetlands litigation was commenced by the United States Government in 1996 against the Company, its affiliates, St. Charles Associates, L.P. ("SCA"), and James J. Wilson, the Company's chairman and chief executive officer, charging them with criminal and civil violations of Section 404 of the U.S. Clean Water Act ("CWA") relating to placing fill materials without a permit into wetlands within the jurisdiction of the U.S. Corps of Engineers. In November 1999 the Company pled guilty to a single violation of the CWA, and the Company and its affiliate, SCA, entered into a consent decree whereby the civil complaint by the government against them for alleged violations of the CWA was dismissed. Pursuant to the consent decree, the Company and SCA paid a civil penalty of $360,000 and agreed to complete within 24 months, a remediation plan covering certain land in Town Center South and in another location in St. Charles. As part of the settlement, all of the criminal charges against James J. Wilson, the Company's chairman and chief executive officer, were dismissed.

On March 9, 2001, the Company and SCA filed a petition and motion with the United States District Court for the District of Maryland seeking to set aside the Company's criminal conviction and to vacate the consent decree entered into by the Company and SCA in reliance on the decision by the U.S. Supreme Court in Solid Waste Agency of Northern Cook County, v. U.S. Army Corps of Engineers (decided January 9, 2001) limiting the scope of the Government's jurisdiction under the CWA. Under this new jurisdictional line, the Company and SCA maintain that their previous actions were wholly legal. A separate motion was filed seeking a stay of the time limits within which they are required by the consent decree to carry out the remediation plan pending a final judicial determination of their motions to vacate the consent decree. The court has not set a date for a hearing on the motions.

Sewer and Water Litigation

In St. Charles Associates Limited Partnership, et al. v. County Commissioners of Charles County, et al., No. 89-720 (Circuit Court for Charles County, Maryland), the Company sought a court ruling that the County was not entitled to impose sewer and water fees at the then-existing level upon residential units in St. Charles Communities. That aspect of the litigation was settled by a Settlement Agreement dated November 1989, which was confirmed in a Consent Decree entered in March 1990. Subsequent aspects of the litigation have resulted from disputes over the interpretation of the Settlement Agreement and Consent Decree. The principal issues contested between the County, St. Charles Community, LLC, IGC, and St. Charles Associates, LP ("SCA") are (1) whether a study procured by the County in 1996 justifies the level of sewer and water connection fees which it imposes upon St. Charles Communities and (2) whether SCA and IGC are entitled to recover what they regard as excessive sewer and water connection fees already paid.

On October 6, 1999, the Maryland Court of Special Appeals concluded that the 1996 study procured by the County justified the County's imposition of increased water connection fees in St. Charles Communities, but did not justify a

similar increase in sewer connection fees. The Court further held that SCA and IGC may not pursue refund claims for connection fees paid before May 15, 1992 because of an "accord and satisfaction" as to refund claims before that date. The County, St. Charles Community, LLC, IGC, and SCA all sought review of this decision in the Maryland Court of Appeals, but that Court declined to review the case, and the decision of the Court of Special Appeals is therefore final. However, this decision does not affect SCA's and IGC's right under the Settlement Agreement to challenge subsequent sewer and water connection fee studies commissioned by the County. On October 19, 2000, the County submitted such a new sewer connection fee study (dated October 12, 2000) to SCA and IGC. SCA and IGC have filed objections to that study and intend to challenge its validity under the Settlement Agreement.

The County has further appealed an injunction issued by the Circuit Court extending the limitation on sewer connection fees to all residential properties located in the St. Charles Communities. On December 5, 2000, the Court of Special Appeals affirmed the Circuit Court and held that the sewer connection fee limitation is a Covenant that runs with the land in the St. Charles Communities and, therefore, the right to reduced sewer connection fees extends to all those to whom land in the St. Charles Communities is conveyed. On January 18, 2001, the County filed a petition for writ of certiorari with the Court of Appeals seeking review of this decision.

Also pending are SCA's and IGC's claims for refunds of connection fee overpayments from May 15, 1992 to the present.

Other

On February 24, 2000, IGC and one of its officers were named as defendants in a complaint filed in state court alleging trespass and restrictions of access to property resulting from the construction of a county road in Charles County. The construction in question was completed by St. Charles Community, LLC, a subsidiary of ACPT. The first and second counts of the complaint seek $10,000,000 in compensatory damages and $10,000,000 in punitive damages. The third and final count seeks an easement and right-of-way to the county road. The defendants in that case, including IGC, have filed a motion to dismiss the second and third counts, and that motion is scheduled for argument on March 19, 2001. In the meantime, in an effort to reach a non-monetary resolution to this dispute, the parties and certain Charles County officials have been engaged in settlement negotiations.

The Company is also involved from time to time in other miscellaneous legal matters that arise in the normal course of business. In Management's opinion, none of the actions is of a material degree whereby there would be a material adverse impact of the financial condition or results of operations of the Company.

Guarantees

The Company is guarantor of 23 letters of credit and surety bonds for land development completion and homebuilding warranties.

In addition to the letters of credit, IGC shares the general partner interests in two rental partnerships with Interstate Business Corporation ("IBC"), both of which have previously experienced cash flow problems. Under the terms of the partnership agreement, IBC is the primary obligor for funding operating advances. However, should IBC fail to fulfill its funding obligations, IGC is obligated as a general partner to provide financial support. This obligation involves potential financial exposure in excess of amounts recognized in the consolidated financial statements.

RELATED PARTY TRANSACTIONS

(8)

Certain officers, directors and a general partner ("IBC") of the Company have ownership interests in various entities that conducted business with IGC during the last three years. The financial impact of the related party transactions on the accompanying consolidated financial statements are reflected below:

		Year Ended December 31,				
		2000		1999		1998
INCOME STATEMENT IMPACT						
Land Sales						
Land Sales Revenue	(A)	$ 416		$ -		$ 1,179
		$ -		$ -		$ 1,179
Cost of Land Sales						
Cost of Sales		$ 170		$ -		$ 936
		$ -		$ -		$ 936
Investment in Gaming Properties		$ -		$ -		$ 549
Management and Other Fees	(B)					
Unconsolidated subsidiaries		$ -		$ -		$ 1,795
Affiliate of IBC, general partner of IGC		-		-		183
Affiliate of J. Michael Wilson, and Thomas B. Wilson, former directors,						
and James J. Wilson, director		-		-		118
Affiliate of J. Michael Wilson, and Thomas B. Wilson, former directors,						
James J. Wilson, director, and an Affiliate of IBC, general partner of IGC		-		-		62
		$ -		$ -		$ 2,158
Interest and Other Income						
Unconsolidated subsidiaries		$ 49		$ -		$ 42
Affiliate of a former director		-		-		97
LDA, affiliate of ACPT		651		668		227
		$ 700		$ 668		$ 366
General and Administrative Expense						
Affiliate of IBC, general partner of IGC, accounting support services	(C1)	$ 4		$ 143		$ 246
ARMC, subsidiary of ACPT for support and other services	(C2)	228		159		-
Reserve additions and other write-offs:						
Affiliate of IBC, general partner of IGC		-		-		(59)
Unconsolidated subsidiaries		-		-		8

Interstate General Properties (IGP), tax support services	(C3)	19		36		-
Reimbursement to IBC for IGC's share of J. Michael Wilson's salary		-		-		68
Equus, affiliate of IBC, consulting fee	(C4)	(204)		(153)		(39)
ARMC, subsidiary of ACPT, consulting fee	(C5)	(500)		(500)		(104)
		$ (453)		$ (315)		$ 120
Interest Expense						
IBC, general partner of IGC	(C6)	287		154		8
Affiliates of IBC		41		-		-
		$ 328		$ 154		$ 8

		Balance December 31, 2000	Balance December 31, 1999
BALANCE SHEET IMPACT:			
Other Assets			
Receivables:			
LDA, affiliate of ACPT, note receivable	(C7)	$ 7,305	$ 7,145
ACPT	(C8)	$ -	$ 2,188
		$ 7,305	$ 9,333
Other Liabilities			
Advances, IBC, general partner of IGC	(C6)	$ 4,513	$ 3,026
Advances, affiliates of IBC	(C9)	$ 561	$ -
Accounts payable to IGP for tax support services	(C3)	$ 61	$ 36
Accounts payable to IGP for miscellaneous		$ 14	$ 8
Accounts payable to ARMC for support services	(C2)	$ 132	$ 46
		$ 5,281	$ 3,116

(A) Land Sales

IGC sells land to affiliates and non-affiliates on similar terms. Sales prices to affiliates are based on third party appraisals, payable in cash or a combination of a 20% cash down payment and a note for the balance. Notes receivable are secured by deeds of trust on land sold, and bear an interest rate equal to those charged at that time for land sales. The notes mature in one year, or in five or less years with annual amortizations. From time to time, maturity dates and repayment terms on the notes from affiliates and non-affiliates have been modified.

(B) Management and Other Services

Prior to 1999, IGC provided management and other support services to its unconsolidated subsidiaries and other related entities in the normal course of business. These fees were typically collected on a monthly basis, one month in arrears. These receivables were unsecured and due upon demand. Certain partnerships experiencing cash shortfalls did not pay timely. These receivable balances were reserved until satisfied or the prospects of collectibility improved.

(C) Other

Other transactions with related parties are as follows:

(1) IGC rented executive office space and other property from affiliates both in the United States and Puerto Rico through October 5, 1998. IBC provided IGC with administrative and accounting services during 1999. There have been no similar transactions in 2000. Beginning October 1, 2000, IGC rented office space from IBC.

(2) During 1999 and 2000, American Rental Management Company ("ARMC"), an affiliate of ACPT, provided IGC with land development, accounting, tax, human resources, payroll processing, and other miscellaneous administrative support services. In addition, ARMC provided the usage of photocopy, telephone, postage, and delivery services on a cost reimbursement basis.

(3) During 1999 and ending August 31, 2000, IGP provided IGC with tax support services on a cost reimbursement basis.

(4) In March 1999, James J. Wilson began a consulting agreement with Equus Entertainment Corporation (an affiliate of IBC) providing for a consulting fee of $11,250 per month until October 15, 2000. October 16, 2000, the fee increased to $33,333 per month plus related benefits.

(5) In October 1998, James J. Wilson entered into a consulting agreement with American Rental Management Company (a subsidiary of ACPT) providing for an annual consulting fee of $500,000 per year for a two-year period, then $200,000 per year for an eight-year period. Mr. Wilson's consulting fee is paid directly to IGC, which in turn, pays Mr. Wilson.

(6) During 2000 the Company received working capital advances from IBC. Beginning April 1, 1999 interest accrued at 1% over the prime rate subject to a 9% ceiling. At December 31, 2000, the outstanding balance of working capital loans payable to IBC, including principal and interest was $4.513 million.

(7) Pursuant to the terms of IGC's restructuring, IGC retained a note receivable from Land Development Associates, SE ("LDA"), an affiliate of ACPT. At December 31, 2000, the outstanding balance was $7.305 million.

(8) In conjunction with the Distribution, IGC's liability to pay income taxes for liabilities incurred prior to the Distribution date was assumed by ACPT. Accordingly, the Company recorded a provision for income taxes through the Distribution date for all taxable income prior to October 5, 1998. All obligations were paid by ACPT during 2000.

(9) Through December 31, 2000, IGC received working capital advances from Insular Properties, LP ("Insular") and Santa Maria Associates, SE ("Santa Maria"), affiliates of IBC. The interest on these funds accrues at 1.5% over the prime rate subject to a 9% ceiling. At December 31, 2000, the outstanding balance of working capital loans payable to Insular and Santa Maria, including principal and interest, was $561,000.

(9) INVESTMENT IN WASTE TECHNOLOGIES

In 1990, IGC formed a wholly owned subsidiary, Interstate Waste Technologies, Inc. ("IWT"), to develop innovative solutions for the disposal of municipal waste and to pursue waste disposal contracts with municipalities and government entities as well as industrial and commercial waste generators.

In 1996, a second subsidiary, Caribe Waste Technologies, Inc. ("CWT"), was formed in Puerto Rico. CWT was established to perform waste disposal projects in the Caribbean.

IWT/CWT's business plan is to develop and operate waste disposal projects using an environmentally superior technology licensed from Thermoselect S.A., a Swiss Company. Project development efforts are worldwide. IWT/CWT has the right to develop projects using the Thermoselect technology in North, Central, and South America and for selected other projects worldwide. Typically, IWT/CWT and its alliance partners offer to own, finance, build, and operate a plant for 25 or 30 years. Current alliance partners include the technology provider, Thermoselect, the designer and constructor, HDR/Zachary, and our plant operator, two subsidiaries of the Vivendi Group, the world's most experienced waste plant operator. IWT has also signed an agreement with Thermoselect to be sales and marketing representative for Thermoselect domestic waste facilities in North America and the Caribbean.

In December 1998, CWT entered into a Host Community And Sponsor Agreement with the Municipality of Caguas, Puerto Rico. The agreement describes the basis on which CWT will enter into a contract to develop and construct a Thermoselect waste facility with a capacity of up to 3,000 tons per day to process waste from the metropolitan San Juan area. CWT announced on November 30th that it received a "Certificate of Conformity" from the Puerto Rico Solid Waste Management Authority. This will allow IGC's subsidiary, Caribe Waste Technologies (CWT), to begin permitting and other activities necessary to implement the project. CWT has now successfully obtained (1) a Host Community Agreement to locate the facility in the municipality of Caguas; (2) enabling legislation passed unanimously by the legislature and signed by the Governor; and (3) the required Certificate of Conformity. The next steps will be to prepare an Environmental Impact Statement and to obtain all necessary regulatory permits and licenses. Concurrently, CWT will begin discussions with the Solid Waste Management Authority, other involved government agencies, and the municipalities to be served by the facility. CWT will then negotiate long-term contracts for the delivery of solid waste and payment for its processing with the municipalities as well as industrial waste generators.

The government of the U.S. Virgin Islands conducted a competitive procurement and selected CWT as the preferred bidder to negotiate contracts for a two-line Thermoselect plant. The government of the U.S. Virgin Islands informed CWT on November 9, 2000 that it has been selected to negotiate contracts to build one or more facilities to process the Islands' waste. Contracting and financing activities are currently underway. Industry experience suggests that

contracting and permitting activities could take approximately one year. CWT will work closely with the Virgin Islands' government and the U.S. Environmental Protection Agency to get to financial close and to begin construction expeditiously.

IWT is also pursuing projects in China, Chile, Costa Rica, Hong Kong, and elsewhere, all of which are in the exploratory stage.

Certain IWT/CWT costs have been capitalized and their recovery is dependent upon future revenues from the construction and operation of waste disposal plants. During 1999, IWT and CWT elected to write off $1,180,000 against costs incurred related to several waste development projects that the Company is still pursuing. While the Company believes there is sufficient interest to warrant continuing efforts, the probability of recovering the investment from future revenues from these projects is presently estimated to be less than 50%.

At December 31, 2000 and 1999, deferred costs regarding waste technology, net of direct write-offs, were $5,606,000 and $4,161,000, respectively.

Environmental Impact.

Management believes that the proposed IWT and CWT facilities can be completed without a material adverse environmental impact and in compliance with government regulations. The many approvals and permits required under the U.S. Clean Air Act, U.S. Clean Water Act, and corresponding foreign regulations will require substantial time and effort to obtain.

Competition.

There is intense competition for municipal waste disposal contracts throughout the United States and internationally. The competition uses a variety of methods with a wide range of costs available. Management believes IWT and CWT can provide superior facilities at a competitive price.

(10)	OPTIONS, APPRECIATION RIGHTS AND WARRANTS

IGC maintains Unit incentive plans for directors (the "Directors Plan") and employees (the "Employees Plan"). These plans were amended in 1994 and 1995 to allow for the issuance of Unit Appreciation Rights and other incentive awards. The Directors' Plan is for directors of the managing general partner who are not officers or employees of the Company or of any General Partner or affiliate of the Company. The Employees' Plan is for employees of IGC (due to the Distribution, the employees may be current employees of ACPT), including employees who are Directors of any General Partner of IGC or of any affiliate of IGC. Under the terms of the plans, directors and employees may be granted options, incentive rights or other Unit based awards as determined by a committee of the Directors of the managing general partner, which excludes directors who are eligible to participate in that particular plan ("Committee"). As of December 31, 2000, 249,505 IGC Units are reserved for issuance under both the Directors' and Employees' Plan.

Options

As of December 31, 2000, there are 2,000 options that are fully vested and exercisable. These bear an exercise price of $3.71 per unit, and expire on August 1, 2001.

Appreciation Rights

Under the terms of the Plans, directors and employees may be granted "Unit Appreciation Rights" which entitle the holder to receive upon vesting an amount payable in cash, Class A Units of the Company, other property, or some

combination thereof as determined by the Committee. The amount received upon exercise on or after January 20, 1995, is based on the excess of the fair market value of the Company's Units on the exercise date, plus, for rights granted prior to 1995, 50% of the fair market value of Equus Gaming Company, L.P. ("Equus") Units on the exercise date, over the base price of the Unit Appreciation Right specified in the individual rights agreements. Fair market value is defined in each individual rights agreement but is generally the average of the closing prices of Units on the principal exchange on which they are traded for the 20 trading days beginning ten trading days before the exercise date and ending on the ninth day after the exercise date. No adjustment was made for Unit Appreciation Rights exercised prior to January 20, 1995, since prior to such date, the Company's market price still reflected the value of its interest in Equus, which was spun-off at that time.

The number of stock appreciation rights outstanding, that were exercisable, but not exercised prior to October 19, 1998, was reduced as a result of a 1 for 5 reverse unit split. On June 13, 2000, 7,500 units of appreciation rights were granted in connection with the Employee's Unit Incentive Plan. In addition, during 2000, no rights were exercised while 110,600 were either terminated, forfeited, or cancelled. As a result of the forfeiture, a credit to compensation expense in the amount of $162,814 was recognized in 2000. Compensation expense recognized by the Company for awards and exercises totaled approximately $285,000 and $8,000 in 1999 and 1998, respectively.

As of December 31, 2000, the dates that the 28,600 outstanding Unit Appreciation Rights become vested, and their expiration dates are as follows:

	Rights Expiring		
Rights Vest and Exercisable at:	May 15, 2004	August 13, 2007	June 13, 2010
December 31, 2000	11,160	6,000	---
January 1, 2001	---	---	2,500
August 13, 2001	---	2,000	---
January 1, 2002	---	---	2,500
August 13, 2002	---	2,000	---
January 1, 2003	---	---	2,500
	11,160	10,000	7,500

Warrants

In 1993, warrants to purchase 20,000 IGC units were issued to an investment-banking firm in connection with a "highly confident letter" relating to proposed Virginia racetrack financing. The warrants had an exercise price of $5.30 per warrant and expire on September 30, 2003. The warrant agreement requires, in the event of a distribution of units, the number of warrants would be adjusted so the warrant holder would receive units in the distributed entity. Therefore, the warrant holder upon exercise of the warrants would also be entitled to shares of ACPT. At the time of exercise, IGC would be required to purchase the ACPT shares on the open market at the existing trading price. As there is no way to estimate whether the warrants will be exercised or when, no adjustments have been made to the accompanying financial statements for the contingency related to the purchase of the ACPT shares.

Warrants to purchase 150,000 Class A Units of IGC were issued to Banc One in 1997 as additional consideration for making their loan to the Company in August 1997. Due to the Distribution, these warrants have been replaced with warrants to purchase ACPT shares.

(11) RETIREMENT AND PROFIT SHARING PLANS

IGC established a retirement plan (the "Retirement Plan") effective January 1, 1988 for non-union employees of IGC. In 1992, union employees were added to the plan. Employees are eligible to participate in the Retirement Plan when they have completed a minimum employment period of generally one year. IGC's contributions to the Retirement Plan for eligible employees were equal to 4% of basic salaries and wages for 2000, 1999 and 1998 that were not in excess of the U.S. Social Security taxable wage base, plus 8% of salaries that exceeded the U.S. Social Security taxable wage base. Employees' salaries in excess of $170,000 for 2000 and $160,000 for 1999 and 1998 were excluded from the calculation of contributions. Payments are made also to the Retirement Plan from IGC contributions to a profit sharing plan, as described below, and from voluntary contributions by employees. Contributions to the Retirement Plan were $81,600, $75,000 and $208,000 for the years ended December 31, 2000, 1999 and 1998, respectively.

In 1987, IGC established an incentive compensation plan (the "Profit Sharing Plan") based on net income of the Company. No contributions were made for 2000, 1999 or 1998.

(12) INCOME TAXES

IGC is a partnership and accordingly is not subject to U.S. taxes. These financial statements do not contain provision for Federal or state income taxes for 2000. All Federal and state income tax liability and/or tax benefits are passed through to the individual partners in accordance with the Agreement and the Internal Revenue Code.

IGC had been grandfathered through 1997 as a non-tax paying public partnership. Such grandfathering was based on guidelines outlined in the Omnibus Budget Reconciliation Act of 1987 allowing publicly traded partnerships existing as of December 17, 1987 not to be taxed as corporations as long as a substantial new line of business is not added. Beginning in 1998, however, IGC could be taxed as a corporation unless at least 90% of IGC's gross income is derived from qualifying "passive type" sources such as interest, dividends and real property income. IGC was in compliance with these requirements as of December 31, 2000. If IGC is not in compliance with the 90% test in any given taxable year, it will be taxed as a corporation at statutory corporate rates and those taxes could be substantial.

As of December 31, 2000, IGC continues to qualify as a non-tax paying public partnership.

The reconciliation between net (loss) income per books and net taxable income (loss) is as follows:

	December 31, 1998		
	(In thousands, except for per unit amounts)		
	Total		Per Unit
Net income (loss) per books	$ 518		$ 0.25
Built-in gain allocable to Predecessors:			
Current	(3,761)		(1.83)
Deferred	(359)		(0.17)
Difference in income or losses from subsidiary partnerships	(1,650)		(0.80)
Differences in treatment of corporate subsidiaries	(3,912)		(1.90)

Capitalization of general and administrative expenses under the Uniform				
Capitalization Rules		247		0.12
Differences in deferred income		(87)		(0.04)
Difference in cost of sales due to interest related to the acquisition of				
land, deducted for tax purposes		399		0.19
Deferred income taxes		(178)		(0.09)
Losses from restructuring		(211)		(0.10)
Differences in wetland litigation costs		(529)		(0.26)
Gain on contribution of assets and liabilities to corporations (spin-off)		3,000		1.46
Other book to tax reconciling items, none of which is individually significant		787		0.38
Net taxable (loss) income per partnership federal return (a)		$ (5,736)		$ (2.79)

(a) In conjunction with the Distribution, IGC's liability to pay income taxes for liabilities incurred prior to the Distribution date was assumed by ACPT. Accordingly, the Company recorded a provision for income taxes through the Distribution date for all taxable income prior to October 5, 1998 and has recorded a receivable from ACPT to reflect the obligation of ACPT to pay those taxes.

(13) FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107 requires the disclosure of the fair value of financial instruments. Whenever possible the estimated fair value has been determined using quoted market information as of December 31, 2000. The estimated fair value information presented is not necessarily indicative of amounts the Company could realize currently in the market since the Company may be unable to sell such instruments due to contractual restrictions or the lack of an established market. The estimated market values have not been updated since December 31, 2000; therefore, current estimates of fair value may differ significantly from amounts presented. Below is a summary of significant methodologies used in estimating fair values at December 31, 2000.

Cash and cash equivalents: includes cash and securities with maturities of less than 90 days, which are valued at their carrying value.

Receivables: includes interest-bearing notes receivable. Fair value is based on the present value of the notes discounted at current market rates.

Recourse debt: consists of instruments in which the certain of the Company's real estate assets are used as collateral. The fair value of mortgage notes is based on the current market rate for similar borrowings.

Loan Payable: Consists of a note payable that has been used to fund operating capital requirements. The note is subject to an interest ceiling. The fair value of this note is based on current market rates for similar borrowings.

Notes Payable and Capital Leases: Consist of operating lines of credit and several miscellaneous notes. Advances on the lines of credit are priced at a specific rate plus a spread. The carrying value of the lines of credit is estimated to be

market value since the interest rate adjusts with the market. The miscellaneous notes payable are priced at current market rates for similar borrowings.

The following table summarizes the fair value of the Company's financial instruments (in thousands) as of December 31, 2000:

Fair Value of Financial Instruments (In thousands)					
	As of December 31,				
	2000			1999	
	Carrying Value	Fair Value		Carrying Value	Fair Value
Cash and Cash Equivalents	$728	$728		$503	$503
Notes Receivable	$7,305	$5,159		$8,154	$5,837
Recourse Debt	$1,474	$1,466		$2,654	$2,634
Notes Payable	$6,577	$6,573		$2,248	$2,280
Loan Payable	$5,074	$2,476		$3,026	$1,408

(14) QUARTERLY SUMMARY (UNAUDITED)

IGC's quarterly results are summarized as follows:

	Year Ended December 31, 2000				
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total for Year
	(In thousands, except per Unit amounts)				
Revenues	$ 872	$ 607	$ 287	$ 1,187	$ 2,953
Loss before taxes and minority interest	(117)	(461)	(726)	(934)	(2,238)
Loss from discontinued operations	(446)	(138)	(923)	(225)	(1,732)
Minority Interest	-	-	1	2	3
Net loss	(563)	(599)	(1,650)	(1,161)	(3,973)
Basic and fully diluted net loss per Unit	(0.27)	(0.29)	(0.79)	(0.56)	(1.91)

	Year Ended December 31, 1999				
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total for Year

(In thousands, except per Unit amounts)

Revenues	$ 872	$ 607	$ 287	$ 526	$ 2,292
Loss before taxes and minority interest	(390)	(949)	(225)	(1,758)	(3,322)
Loss from discontinued operations	(159)	(258)	(488)	(316)	(1,221)
Net loss	(549)	(1,207)	(713)	(2,074)	(4,543)
Basic and fully diluted net loss per Unit	(0.26)	(0.58)	(0.34)	(1.01)	(2.19)

(15) SEGMENT INFORMATION

IGC's three reportable segments are waste technology development activities conducted by IWT and CWT, commercial and residential land development and other miscellaneous activities, and homebuilding operations conducted by AFH, which have been discontinued. Refer to note 3 for further information on AFH.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The following presents the segment information for the years ended December 31, 2000, 1999 and 1998 (in thousands):

	IWT/CWT	Land and Other	Home Building (discontinued)	Puerto Rico	Inter-Segment	Total
2000						
Total Revenues	$ -	$ 2,953	$ 9,926	$ -	$ -	$ 12,879
Interest income	-	569	11	-	-	580
Interest expense	-	907	12	-	-	919
Depreciation and amortization	-	57	42	-	-	99
Loss before minority interest	-	(2,238)	(1,732)	-	-	(3,970)
Net loss	-	(2,241)	(1,732)	-	-	(3,973)
Total assets	3,240	56,832	645	-	(24,846)	35,871
Additions to long-lived assets	1,445	1,181	-	-	-	2,626
1999						
Total Revenues	$ -	$ 2,445	$ 9,944	$ -	$ -	$ 12,389
Interest income	-	1,057	80	-	-	1,137
Interest expense	-	357	45	-	-	402
Depreciation and amortization	2	61	74	-	-	137

Net loss	(1,305)	(2,017)	(1,221)	-	-	(4,543)
Total assets	3,134	54,510	7,283	-	(23,664)	41,263
Additions to long-lived assets	2,028	1,460	-	-	-	3,488
1998						
Total Revenues	$ -	$ 15,304	$ 7,482	$ 12,168	$ (2,006)	$ 32,948
Interest income	-	1,681	103	504	(1,242)	1,046
Interest expense	19	2,285	33	683	(390)	2,630
Depreciation and amortization	10	1,390	9	110	-	1,519
Income taxes	-	-	-	740	-	740
(Loss) Income before minority						
interest	(1,253)	2,185	(929)	2,186	(485)	1,704
Net (loss) income	(1,253)	1,445	(929)	1,740	(485)	518
Total assets	3,701	39,611	6,697	-	(9,745)	40,264
Additions to long-lived assets	1,638	5,150	-	5,015	-	11,803

INTERSTATE GENERAL COMPANY L.P.
REAL ESTATE AND ACCUMULATED DEPRECIATION - SCHEDULE III
AS OF DECEMBER 31, 2000
(In Thousands)

Property Description	Encumbrances	Initial Cost to Company		Cost Capitalized subsequent to acquisition	Gross Amount at which carried at close of period	Accumulated depreciation	Date constructed	Depreciable Life
		Land	Building and Improvements					
Coachman's Landing Apartments	$ 5,656	$ 572	$ 6,218	$ 235	$ 7,025	$ 1,871	09/05/89	Bldg - 40 yrs
Garden Apartments								Bldg Equip - 5/7 yrs
St. Charles, Maryland								
Chastleton Apartments	$ 21,613	$ 2,630	$ 22,828	$ 550	$ 26,008	$ 8,472	11/07/86	Bldg - 40 yrs
High Rise Apartments								Bldg Equip - 5/10 yrs

Washington, DC								
Total Properties	$ 27,269	$ 3,202	$ 29,046	$ 785	$ 33,033	$ 10,343		
Gross Carrying Amount Reconciliation: (In Thousands)								
Coachman's Landing Apartments				Chastleton Apartments				
Balance at January 1, 2000		$ 7,038		Balance at January 1, 2000			$ 26,028	
Additions during 2000:				Additions during 2000:				
Improvements	$ 61			Improvements		$ 24		
Deductions during 2000:				Deductions during 2000:				
Retirements	$ 74			Retirements		$ 44		
Balance at December 31, 2000		$ 7,025		Balance at December 31, 2000			$ 26,008	

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS

The Board of Directors of IGC's managing general partner, Interstate General Management Corporation ("IGMC"), is as follows:

Name	Age	Office
James J. Wilson	67	Chairman, Director and Chief Executive Officer

Mark Augenblick	54	Director, Chief Operating Officer
James R. Treptow	54	Director
Ernst Ringle	68	Director
John H. Gibbons	72	Director

The following are the executive officers of IGC as of December 31, 2000:

Name	Age	Office
James J. Wilson	67	Chairman, Chief Executive Officer
Mark Augenblick	54	President, Chief Operating Officer
Paul H. Dillon	40	Vice President, Chief Financial Officer
Francis C. Campbell	60	President, IWT and CWT (wholly owned subsidiaries of IGC)
Larry F. Liddle	57	Vice President, IWT and CWT (wholly owned subsidiaries of IGC

Term of Office.

Directors of IGMC are elected annually in April by action of the directors then holding office. Under the IGC Partnership Agreement, IBC has the right to designate one-third of the directors of IGMC as long as IBC continues as a General Partner of IGC. As practicable, an additional one-third are to be persons who are neither affiliates of IGC nor existing officers or employees of IGC, any General Partner or any of their affiliates. The remaining directors are to be persons who are officers of IGC. Messrs. Treptow, Ringle, and Gibbons currently serve as the unaffiliated directors. Mr. James J. Wilson serves as the IBC director designate.

James J. Wilson

has been Chairman of the Board of IGMC since its inception in 1986. He also served as its President from 1986-1996. He is the founder of IGC and has been Chief Executive Officer of IGC and its predecessors since its inception in 1957, and was President from 1957-1994. He was named IGC Chairman in 1994. He is the founder of IBC and its predecessors, and has served as IBC's Chairman of the Board and Chief Executive Officer since 1957 and as President from 1957-1994. Mr. Wilson holds a degree in civil engineering from Manhattan College in New York City.

Mark Augenblick

became a Director of IGMC and Vice Chairman of the Company in March 1998. Prior to joining the Company, Mr. Augenblick was a partner in the Washington, D.C. law firm, Shaw, Pittman, Potts and Trowbridge, where he practiced for twenty-seven years. Mr. Augenblick received his B.A. from Brown University and his J.D. from Columbia University Law School.

John H. Gibbons

was appointed a Director of IGMC in June 2000. He is currently a Senior Fellow with the National Academy of Engineering and a Special Advisor to the U.S. Under Secretary of State for Global Affairs. Prior to that he served as the Science Adviser to the President and Vice President on matters of science and technology. He has represented the U.S. Government in major multilateral and bilateral meetings in such countries as Russia, Japan, China, and among the G-7 nations. Mr. Gibbons' other positions, to name a few, include that of Director, Office of Technology, U.S. Congress; Director, Energy, Environment and Recourses Center; Professor of Physics, University of Tennessee; and Director, Environmental Program, Oak Ridge National Laboratory. He has received numerous Honors and Awards in science, technology, and engineering. He holds a Ph.D. in Physics from Duke University, and has received six honorary Doctorates from different Universities.

James R. Treptow was appointed a Director of IGMC in December 1999. He is President and Chief Executive Officer of Magellan Resources. Prior to that he was responsible as the company owner or co-owner for the financing and development of forty-five commercial real estate projects located in Texas, California, Georgia, Louisiana and Virginia, totaling approximately 9 million square feet with an aggregate market value of approximately $1.2 billion. Mr. Treptow holds a degree in Industrial Management and Finance from the University of Texas at Austin.

Ernst Ringle was appointed a Director of IGMC in December 1999. He is a retired President and Chief Executive Officer of Noell, Inc., an engineering and plant construction company. Prior to joining Noell's parent company, Preussag Noell, he was Vice President of Stone and Webster International Corporation. He previously held senior engineering and construction management positions with Motor Columbus AG of Switzerland and Chas. T. Main of the U.S., among others. Mr. Ringle holds a degree in civil engineering from the University of Kaiserslautern in Germany. He is fluent in English, German, Spanish, and proficient in French and Portuguese.

ITEM 11. EXECUTIVE COMPENSATION

Summary Compensation Table.

The following information is furnished with respect to the Chief Executive Officer and each of the other five most highly compensated Executive Officers of the Company (collectively, the "Executive Officers").

					Long-Term Compensation	
	Annual Compensation				Awards	
Name & Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compensation ($) (2)	Securities Underlying Options/ SAR's #	All Other Compensation ($) (1)
James J. Wilson (3)	2000	500,200	-	-	-	10,552
Chairman & Chief	1999	500,200	-	-	-	9,896
Executive Officer	1998	500,200	-	-	-	10,064
Mark Augenblick	2000	411,400	-	-	-	51,352
Vice-Chairman &	1999	411,400	-	-	-	48,696
President	1998	292,508	-	-	-	-
Paul H. Dillon	2000	99,775	-	-	-	4,167
Vice President & CFO	1999	23,250	2,000	-	-	-
	1998	-	-	-	-	-
Francis Campbell	2000	185,400	-	-	-	8,125
President	1999	175,200	-	-	-	9,896
IWT/CWT	1998	156,450	-	-	-	9,764
Larry Liddle	2000	115,400	-	-	-	5,000
Vice President	1999	110,200	-	-	-	5,896
IWT/CWT	1998	102,700	-	-	-	5,464

(1) Reflects IGC's contributions to Retirement Plan discussed below, and Director's fees from IGC and Equus.

(2) Represents the difference between the price paid for shares of the Company's stock obtained by exercising stock options and the fair market value of the stock

at the date of purchase.

(3) In October 1998, Mr. Wilson entered into a consulting agreement with American Rental Management Company (a subsidiary of ACPT) providing for an annual consulting fee of $500,000 per year for a two-year period, then $200,000 per year for an eight-year period. Mr. Wilson's consulting fee is paid directly to IGC, which in turn, pays Mr. Wilson.

Employment Agreements.

Mr. Augenblick entered into a four year employment agreement with the Company commencing March 23, 1998. The agreement provides for a compensation package totaling $450,000, which is comprised of a salary and directors' fees, plus shares in Interstate Waste Technologies and Caribe Waste Technologies, a financing bonus and completion bonus based on the number and size of waste facilities developed, certain fringe benefits, death or disability benefits, and severance pay for the unexpired term of the contract.

Mr. Dillon entered into a one-year employment agreement effective January 1, 2000. The agreement was renewed January 1, 2001 and renews annually thereafter, unless terminated by either party. The agreement provides for a base salary of $100,000 in 2000, and $125,000 in 2001, certain fringe benefits, stock appreciation rights, and severance pay for the unexpired term of the contract.

Mr. Campbell's employment agreement with the Company renewed for one year commencing October 1, 1999. The agreement provides for a base salary of $175,000, a financing bonus and completion bonus based on the number and size of waste facilities developed, certain fringe benefits, death or disability benefits, and severance pay for the unexpired term of the contract.

Mr. Liddle's employment agreement with the Company renewed for one year commencing October 1, 1999. The agreement provides for a base salary of $110,000, a financing bonus and completion bonus based on the number and size of waste facilities developed, certain fringe benefits, death or disability benefits, and severance pay for the unexpired term of the contract.

Directors

. Directors of the Managing General Partner who do not receive salaries from the Company or affiliates receive directors' fees established by the Board of Directors of the Managing General Partner. These directors are compensated at a rate of $5,000 per quarter, $1,400 per meeting and out of pocket travel reimbursements for meeting attendance. During 2000, the directors' fees totaled $150,000, all of which were paid as of December 31, 2000.

IBC indemnifies the directors of the Managing General Partner against any liability (including legal fees and expenses) arising out of their serving in such capacities, except for liabilities arising out of the gross negligence or willful misconduct of such directors.

Unit Options and Unit Appreciation Rights

. IGC's employees, including its directors and officers, are eligible to participate in the Unit Incentive Plan (the "Employees Plan"). Under the Employees Plan, a committee composed of the independent directors of IGMC (the "Committee") awards Unit options ("Options") or Unit Appreciation Rights ("Rights") to employees and officers on

the basis of their performance. The Rights entitle the holder to receive upon vesting, an amount payable in cash, Class A units of the Company, other property or some combination thereof, as determined by the Committee. The amount received upon exercise is determined based on the excess of the fair market value of the Company's Units on the exercise date, (plus 50% of the fair market value of Equus Units on the exercise date for Rights granted prior to 1995), over the base price of the Right specified in the individual rights agreements. Please refer to page 44 for further information.

Long-Term Incentive Plan

. IGC has established an incentive compensation plan (the "Profit Sharing Plan") pursuant to which IGC awards annual cash bonuses to officers and employees in reasonable amounts reflecting their contributions to the Company. The persons to receive bonuses and the amounts of such bonuses are approved by the unaffiliated directors of IGMC. Under the Profit Sharing Plan, a portion of each bonus, keyed by the compensation committee to a percentage of the employees' salary, is contributed on behalf of the employee to the retirement plan discussed below. No contributions were made to the Profit Sharing Plan during 2000, 1999 or 1998.

Retirement Plan

. IGC maintains a retirement plan (the "Retirement Plan") for eligible employees of the Company. Employees are generally eligible to participate when they complete one year of service. Contributions to the Retirement Plan in 2000, 1999 and 1998 were in amounts equal to 4% of base salaries and wages not in excess of the U.S. Social Security taxable wage base, and 8% of salaries (limited to $170,000 for 2000, and $160,000 for 1999 and 1998) which exceeded that wage base. Additional contributions to the Retirement Plan can be made pursuant to the Profit Sharing Plan.

SECURITY OWNERSHIP OF CERTAIN UNIT HOLDERS AND MANAGEMENT

ITEM 12.

The following table sets forth certain information regarding the Units that were beneficially owned on March 1, 1999 (i) by each person who is known by the general partners to beneficially own more than 5% of the outstanding units of the Company, (ii) by named executive officers of a general partner, and (iii) by all executive officers of the Company and directors of the general partners as a group. Except where noted, the address for the beneficial owner is 222 Smallwood Village Center, St. Charles, Maryland, 20602.

	Beneficial Ownership (1)		
Name of Beneficial Owner	Number of IGC Units		Percent
James J. Wilson (2)	6,135		0.3
Mark Augenblick	0		0
Paul H. Dillon	0		0
Francis C. Campbell	0		0
Larry Liddle	0		0

All executive officers of IGC and			
directors of IGMC as a group	6,135		0.3
Bessemer Interstate Corporation			
245 Peachtree Center, Avenue #804			
Atlanta, GA 30303	104,442		5.1
Interstate Business Corporation			
222 Smallwood Village Center			
St. Charles, MD 20602	606,103		29.78
Wilson Securities Corporation			
222 Smallwood Village Center			
St. Charles, MD 20602	315,296		15.49

(1) The beneficial ownership of Units is determined on the basis of Units directly and indirectly owned by executive officers of IGC and directors of IGMC and Units to be issued to IGC officers under options that are exercisable within the next 60 days.

(2) Includes 20 IGC Units (0%) held by his wife, Barbara A. Wilson.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information responding to this item appears in Note 7 to the Company's Consolidated Financial Statements included in Item 8 of this report.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

1. Financial Statements

a. The following financial statements of Interstate General Company, L.P. are contained herein:

Report of Independent Public Accountants

Consolidated Statements of Income for the years ended December 31, 2000, 1999, and 1998

Consolidated Balance Sheets as of December 31, 2000 and 1999

Consolidated Statements of Changes in Partners' Capital for the years ended December 31, 2000, 1999, and 1998

Consolidated Statements of Cash Flows for the years ended December 31, 2000, 1999, and 1998

Notes to Consolidated Financial Statements for the years ended December 31, 2000, 1999, and 1998

b. The following financial statements of Brandywine Investment Associates, L.P. are included as Exhibit 99.15 herewith:

Statement of Income (Loss) for the years ended December 31, 2000, 1999 and 1998

Balance Sheet for the years ended December 31, 2000 and 1999

Statement of Changes in Partners' Capital for the years ended December 31, 2000, 1999 and 1998

Statement of Cash Flows for the years ended December 31, 2000, 1999 and 1998

Notes to Financial Statements for the year ended December 31, 2000

2. Financial Statement Schedules

The following financial statements' schedules are contained herein:

Schedule III: Real Estate and Accumulated Depreciation

3. Exhibits

Exhibits required by Securities and Exchange Commission, Section 601 of Regulation S-K.

Exhibit No.		Description of Exhibit	Reference
3	(a)	Third Amended and Restated Agreement of Limited Partnership of Interstate General Company L.P.	Exhibit 3 (a) to Amendment No. 3 to Registration Statement No. 33-10636 on Form S-1, filed February 11, 1987 (Form "S-1")
	(b)	First Amendment to Third Amended and Restated Agreement of Limited Partnership of Interstate General Company L.P.	Exhibit 3 (b) to 1987 10-K
	(c)	Second Amendment to Third Amended and Restated Agreement of Limited Partnership of Interstate General Company L.P.	Exhibit 3 (c) to 1988 10-K

	(d)	Amended and Restated Certificate of Limited Partnership of Interstate General Company L.P.	Exhibit 3 (b) to Form S-1
	(e)	Certificate of Incorporation of Interstate General Management Corporation	Exhibit 3 (c) to Form S-1
	(f)	Bylaws of Interstate General Management Corporation, as amended	Exhibits 3 (d) and 3 (1) to Form S-1
	(g)	Certificate of Incorporation of Interstate Business Corporation (formerly Interstate St. Charles, Inc.) as amended	Exhibit 3 (g) to Form S-1
	(h)	Bylaws of Interstate Business Corporation (formerly Interstate St. Charles, Inc.) as amended February 4, 1986	Exhibit 3 (h) to Form S-1
	(i)	Amendment to Bylaws of Interstate General Management Corporation dated November 10, 1988	Exhibit 3 (i) to 1988 10-K
4	(a)	Form of beneficial assignment certificate representing Units	Exhibit 4 (a) to Form S-1
	(b)	Form of certificate evidencing limited partnership interest	Exhibit 4 (b) to Form S-1
	(c)		Exhibit 4 (c) to Form S-1

		Certificate of Incorporation of Interstate Management Title Company dated September 19, 1986	
	(d)	Bylaws of Interstate Management Title Company dated September 25, 1986	Exhibit 4 (d) to Form S-1
	(e)	Amendment to Certificate of Incorporation of Interstate Management Title Company dated December 31, 1986	Exhibit 4 (e) to Form S-1
10.		Material Contracts	
	(a)	Employment Agreement with Edwin L. Kelly	Exhibit 10 (a) to Form 10-Q for the quarter ended June 30, 1994
	(b)	Amendment to Employment Agreement between Interstate General Company L.P. and Edwin L. Kelly dated May 20, 1994	Exhibit 10 (a) for Form 10-Q for the quarter ended June 30, 1995
	(c)	Second Amendment to Employment Agreement between Interstate General Company L.P. and Edwin L. Kelly dated May 20, 1994	Exhibit 10 (b) for Form 10-Q for the quarter ended June 30, 1996
	(d)	Third Amendment to Employment Agreement between Interstate General Company L.P. and Edwin L. Kelly dated May 20, 1994	Exhibit 10 (l) to 1996 10-K

	(e)	Employment Agreement between Interstate General Company L.P. and James J. Wilson dated January 15, 1996	Exhibit 10 (j) to 1995 10-K
	(f)	Employment Agreement between Interstate Waste Technologies, Inc. and Francis C. Campbell dated September 1, 1996	Exhibit 10 (a) to Form 10-Q for the quarter ended September 30, 1996
	(g)	Employment Agreement between Interstate General Company L.P. and Mark Augenblick dated March 11, 1998	Exhibit 10 (g) to 1997 10-K
	(h)	Employment Agreement between Interstate General Company L.P. and Benjamin L. Poole dated December 7, 1999	Exhibit 10 (h) to 1998 10-K
	(i)	Employment Agreement between Interstate General Company L.P. and Larry F. Liddle dated October 1, 1998	Exhibit 10 (i) to 1998 10-K
	(j)	Employment Agreement between Interstate General Company L.P. and Francis C. Campbell dated October 1, 1998	Exhibit 10 (i) to 1998 10-K
	(k)	Indemnity Agreement among Interstate General Business Corporation, Interstate St. Charles, Inc. and each director and officer of Interstate General Management Corporation	Exhibit 10 (f) to Form S-1

	(l)	Unit Incentive Plan for Directors, Amended and Restated, dated March 17, 1995	Exhibit 10 (i) to 1994 10-K
	(m)	Unit Incentive Plan for Employees, Amended and Restated, dated March 17, 1985	Exhibit 10 (j) to 1994 10-K
	(n)	Amended and Restated Certificate and Agreement of Limited Partnership of St. Charles Associates Limited Partnership dated March 14, 1985	Exhibit 10 (11) to Form S-1
	(o)	Amended and Restated Certificate and Agreement of Limited Partnership of Interstate General Properties Limited Partnership, S.E. dated December 31, 1986	Exhibit 10 (j) to Form S-1
	(p)	Second Amended and Restated Certificate and Agreement of Limited Partnership of Interstate General Properties Limited Partnership, S.E. dated December 31, 1986	Exhibit 10 (kk) to Form S-1
	(q)	Third Amendment to Second Amended and Restated Certificate and Agreement of Limited Partnership of Interstate General Properties Limited Partnership, S.E. dated February 16, 1990	Exhibit 10 (kk) to 1989 10-K
	(r)	Fourth Amendment to Second Amended and Restated Certificate and Agreement of Limited Partnership of Interstate General	Exhibit 10 (lll) to 1991 10-K

		Properties Limited Partnership, S.E. dated June 29, 1981	
	(s)	Fifth Amendment to Second Amended and Restated Certificate and Agreement of Limited Partnership of Interstate General Properties Limited Partnership, S.E., dated June 29, 1981	Exhibit 10 (mmm) to 1991 10-K
	(t)	Sixth Amendment to Second Amended and Restated Certificate and Agreement of Limited Partnership of Interstate General Properties Limited Partnership, S.E. dated April 1, 1998	Exhibit 10 (a) to Form 10-Q for the quarter ended March 31, 1998
	(u)	Partnership Agreement for Fox Chase Apartments General Partnership as amended January 29, 1986	Exhibit 10 (p) to Form S-1
	(v)	Amendment to Partnership Agreement for Fox Chase Apartments General Partnership dated February 10, 1987	Exhibit 10 (mm) to Form S-1
	(w)	Withdrawal, Mutual Release and Indemnification Agreement and Amendment to Fox Chase General Partnership Agreement dated August 20, 1993	Exhibit 10 (q) to 1993 10-K
	(x)	Partnership Agreement for Wakefield Third Age Associates Limited Partnership dated July 1, 1985	Exhibit 10 (r) to Form S-1

	(y)	Partnership Agreement for Wakefield Terrace Associates Limited Partnership dated July 1, 1985	Exhibit 10 (t) to Form S-1
	(z)	Partnership Agreement for Headen House Associates Limited Partnership dated July 1, 1985	Exhibit 10 (v) to Form S-1
	(aa)	Partnership Agreement for Palmer Apartments Associates Limited Partnership dated July 1, 1985	Exhibit 10 (w) to Form S-1
	(bb)	Partnership Agreement for Chastleton Apartments Associates dated May 1, 1986	Exhibit 10 (dd) to Form S-1
	(cc)	Partnership Agreement for New Forest Apartments General Partnership dated November 18, 1986	Exhibit 10 (ff) to Form S-1
	(dd)	First Amendment to the General Partnership Agreement of New Forest Apartments General Partnership dated February 24, 1987	Exhibit 10 (ii) to 1988 10-K
	(ee)	Second Amendment to the General Partnership Agreement of New Forest Apartments General Partnership dated December 19, 1988	Exhibit 10 (hh) to 1988 10-K

	(ff)	Withdrawal, Mutual Release and Indemnification Agreement and Amendment to New Forest Apartments General Partnership Agreement dated August 20, 1993	Exhibit 10 (z) to 1993 10-K
	(gg)	Limited Partnership Agreement and Amended and Restated Limited Partnership Certificate of Coachman's Limited Partnership dated June 2, 1988	Exhibit 10 (zz) to 1988 10-K
	(hh)	Management Services Agreements between Interstate General Properties Limited Partnership and National General Corporation (3 separate agreements)	Exhibit 10 (k) to Form S-1
	(ii)	Property Management Agreement between National General Corporation and Interstate General Corporation and Interstate General Properties Limited Partnership as amended March 30, 1986	Exhibit 10 (oo) to Form S-1
	(jj)	Management Service Agreement between Interstate General Company L.P. and Coachman's Limited Partnership dated May 2, 1988	Exhibit 10 (jj) to 1989 10-K
	(kk)	Amendment to Management Service Agreement between Interstate General Company L.P. and Coachman's Limited Partnership dated January 1, 1993	Exhibit 10 (hh) to 1993 10-K
	(ll)		Exhibit 10 (zzz) to 1992 10-K

		Management Agreement by and between Interstate Properties and Interstate St. Charles, Inc. (El Monte), dated January 5, 1987	
	(mm)	First Amendment to Management Agreement by and between Interstate General Properties and Interstate Business Corporation (El Monte), dated January 4, 1988	Exhibit 10 (aaaaa) to 1992 10-K
	(nn)	Second Amendment to Management Agreement by and between Interstate General Properties and Interstate Business Corporation (El Monte), dated December 31, 1992	Exhibit 10 (bbbbb) to 1992 10-K
	(oo)	Management Agreement by and between Interstate General Properties and Interstate St. Charles, Inc. (Santa Maria Shopping Center), dated January 5, 1987	Exhibit 10 (ccccc) to 1992 10-K
	(pp)	First Amendment to Management Agreement by and between Interstate General Properties Limited Partnership and Interstate Business Corporation (Santa Maria Shopping Center), dated January 4, 1988	Exhibit 10 (ddddd) to 1992 10-K
	(qq)	Second Amendment to Management Agreement by and between Interstate General Properties Limited Partnership S.E. and Interstate Business Corporation and Santa Maria Associates S.E., dated December	Exhibit 10 (eeeee) to 1992 10-K

		28, 1990	
	(rr)	Two (2) Property Management Agreements between Interstate General Properties Limited Partnership, S.E. and Capitol Park Associates as amended December 31, 1984	Exhibit 10 (aa) to Form S-1
	(ss)	Lease for office space between Interstate General Business Corporation and Smallwood Village Associates Limited Partnership dated May 21, 1981	Exhibit 10 (r) to Form S-1
	(tt)	Lease for office space between Interstate General Business Corporation and Smallwood Village Associates Limited Partnership dated June 15, 1981	Exhibit 10 (m) to Form S-1
	(uu)	Lease Amendment to Lease for commercial space between Smallwood Village Associates Limited Partnership and Interstate General Company L.P. dated October 1, 1991	Exhibit 10 (c) to Form 10-Q for the quarter ended September 30, 1995
	(vv)	Lease Amendment II to Lease for commercial space between Smallwood Village Associates Limited Partnership and Interstate General Company L.P. dated September 5, 1995	Exhibit 10 (d) to Form 10-Q for the quarter ended September 30, 1995
	(ww)	Store Lease between Interstate General Business Corporation and Smallwood Village Associates	Exhibit 10 (fff) to 1991 10-K

		Limited Partnership dated April 1, 1988	
	(xx)	Store Lease between Smallwood Village Associates Limited Partnership and Interstate General Company L.P. dated December 1, 1987	Exhibit 10 (e) to Form 10-Q for the quarter ended September 30, 1995
	(yy)	Lease Amendment to Store Lease between Smallwood Village Associated Limited Partnership and Interstate General Company, L.P. dated February 1, 1989	Exhibit 10 (f) to Form 10-Q for the quarter ended September 30, 1995
	(zz)	Lease Amendment II to Store Lease between Smallwood Village Associates Limited Partnership and Interstate General Company, L.P. dated December 1, 1992	Exhibit 10 (g) to Form 10-Q for the quarter ended September 30, 1995
	(aaa)	Lease Amendment III to Store Lease between Smallwood Village Associates Limited Partnership and Interstate General Company, L.P. dated September 30, 1994	Exhibit 10 (h) to Form 10-Q for the quarter ended September 30, 1995
	(bbb)	Lease Amendment IV to Store Lease between Smallwood Village Associates Limited Partnership and Interstate General Company, L.P. dated September 5, 1995	Exhibit 10 (i) to Form 10-Q for the quarter ended September 30, 1995
	(ccc)	Office Lease between Smallwood Village Associates Limited Partnership and Interstate General Company, L.P. for Smallwood Village Center dated August 25,	Exhibit 10 (a) to Form 10-Q for the quarter ended September 30, 1995

		1995	
	(ddd)	Amendment to Office Lease between Smallwood Village Associates Limited Partnership and Interstate General Company, L.P. for Smallwood Village Center dated September 5, 1995	Exhibit 10 (b) to Form 10-Q for the quarter ended September 30, 1995
	(eee)	Fourth Amendment to Interstate General Company, L.P. Retirement Plan dated July 1, 1992	Exhibit 10 (yyyy) to 1992 10-K
	(fff)	Fifth Amendment to Interstate General Company, L.P. Retirement Plan dated June 5, 1995	Exhibit 10 (b) to Form 10-Q for the quarter ended June 30, 1995
	(ggg)	Agreement Regarding Partnership Interest in Chastleton Apartment Associates dated January, 1987	Exhibit 10 (nn) to Form S-1
	(hhh)	Stockholders Agreement among Interstate General Company, L.P., Interstate General Business Corporation and Interstate St. Charles, Inc. dated as of December 31, 1986	Exhibit 10 (gg) to Form S-1
	(iii)	License Agreement among Interstate General Company, L.P., Interstate General Business Corporation, and Interstate St. Charles, Inc. dated as of December 31, 1986	Exhibit 10 (qq) to Form S-1
	(jjj)		Exhibit 10 (rr) to Form S-1

		Amendment to License Agreement among Interstate General Company, L.P., Interstate General Business Corporation and Interstate St. Charles, Inc. dated as of February 9, 1987	
	(kkk)	Unitholders Agreement among Interstate General Business Corporation, Interstate St. Charles, Inc., and Interstate Properties Trust dated as of February 9, 1987	Exhibit 10 (rr) to Form S-1
	(lll)	Agreement dated March 15, 1990 among Interstate General Company, L.P., Interstate Business Corporation, and Interstate General Properties Limited Partnership, S.E.	Exhibit 10 (ddd) to 1990 10-K
	(mmm)	Management Service Agreement between Interstate General Business Corporation and Chastleton Apartments Associates as amended February 26, 1987	Exhibit 10 (ee) to Form S-1 Amendment Exhibit 10 (ee) to 1989 10-K
	(nnn)	Amendment to February 26, 1987 Management Service Agreement between Interstate General Business Corporation and Chastleton Apartments Associates dated January 1, 1993	Exhibit 10 (bbb) to 1993 10-K
	(ooo)	Property Management Agreement between Interstate General Properties Limited Partnership, S.E. and G.L. Limited Partnership as amended September 30, 1985 and as amended March 1, 1989	Exhibit 10 (z) to Form S-1 Amendment Exhibit 10 (z) to 1989 10-K

	(ppp)	Amendment to Property Management Agreement between Interstate General Properties Limited Partnership, S.E. and G.L. Limited Partnership dated January 1, 1993	Exhibit 10 (ddd) to 1993 10-K
	(qqq)	Warrant Agreement among HDA Management Corporation, Housing Development Associates, S.E. and Banco Popular De Puerto Rico as Warrant Agent dated December 15, 1993	Exhibit 10.3 to the S-4
	(rrr)	Limited Partnership Agreement of Equus Gaming Company, L.P. dated August 1, 1994	Exhibit 10 (d) to Form 10-Q for the quarter ended June 30, 1994
	(sss)	First Amendment to the Limited Partnership Agreement of Equus Gaming Company, L.P. dated August 1, 1994	Exhibit 10 (e) to Form 10-Q for the quarter ended June 30, 1994
	(ttt)	Second Amendment to the Limited Partnership Agreement of Equus Gaming Company, L.P. dated August 1, 1994	Exhibit 10 (f) to Form 10-Q for the quarter ended June 30, 1994
	(uuu)	Third Amendment to the Limited Partnership Agreement of Equus Gaming Company, L.P.	Exhibit 3.4 to the Registration Statement on Form S-11 of Equus Gaming Company, L.P., Registration No. 33-82750 (the "Equus S-11")
	(vvv)	Registration Rights Agreement with respect to the Warrants dated December 15, 1993, among HDAMC, HDA, Oppenheimer and	Exhibit 10.4 to the S-4

		Company, Inc. and The Argosy Securities Group, L.P.	
	(www)	Amended and Restated Management Agreement dated December 15, 1993, between Interstate General Properties Limited Partnership, S.E. and HDA	Exhibit 10.6 to the S-4
	(xxx)	Master Support and Services Agreement dated December 9, 1994, between Interstate General Company, L.P. and Equus Gaming Company, L.P.	Exhibit 10.20 to the Equus S-11
	(yyy)	Consulting Agreement dated December 15, 1993, between El Comandante Operating Company and Interstate General Properties Limited Partnership, S.E.	Exhibit 10.21 to the Equus S-11
	(zzz)	Amended and Restated Registration Rights Agreement with Respect to the Warrants dated December 12, 1994, among HDAMC, HDA, Oppenheimer and Company, Inc., the Argosy Securities Group, L.P., and Equus Gaming Company, L.P.	Exhibit 10.29 to the Equus S-11
	(aaaa)	Agreement of Purchase and Sale between Interstate General Company, L.P. and Interstate Business Corporation dated December 30, 1994 for the Partnership Interests in:	Exhibit 10 (dddd) to 1994 10-K
			New Forest Apartments General Partnership Headen House Associates Limited Partnership

			Fox Chase Apartments General Partnership Palmer Apartments Associates Wakefield Terrace Associates Wakefield Third Age Associates
	(bbbb)	Agreement of Purchase and Sale between Interstate Business Corporation and Interstate General Company, L.P. dated June 12, 1996 for the Partnership Interests in:	Exhibit 10 (a) to Form 10-Q for the Quarter ended June 30, 1996
			Wakefield Terrace Associates Wakefield Third Age Associates Palmer Apartments Associates Headen House Associates Limited Partnership
	(cccc)	Employment Agreement between Interstate General Company, L.P. and Paul H. Dillon dated January 1, 2000	Exhibit 10 (a) to Form 10-Q for the Quarter ended June 30, 2000
	(dddd)	Occupancy Agreement between Interstate General Company, L.P., and Pace Carbon Fuels, L.L.C., parties to Sublease dated April 5, 2000	Exhibit 10 (b) to Form 10-Q for the Quarter ended June 30, 2000
	(eeee)	Lease Agreement between Interstate General Company, L.P. and Smallwood Village Associates, L.P. dated October 24, 2000	Exhibit 10 (a) to Form 10-Q for the Quarter ended June 30, 2000

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, there-unto duly authorized.

	INTERSTATE GENERAL COMPANY, L.P.	
	By:	Interstate General Management Corporation
		Managing General Partner
Dated: March 21, 2001	By:	/s/ James J. Wilson
		James J. Wilson
		Chairman, Chief Executive Officer, and Director
Dated: March 21, 2001	By:	/s/ Mark Augenblick
		Mark Augenblick
		Vice Chairman, President, and Director
Dated: March 21, 2001	By:	/s/ Paul H. Dillon
		Paul H. Dillon
		Vice President, Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant, in the capacities and on the dates indicated:

Signature	Title	Date
/s/ James J. Wilson		March 21, 2001
James J. Wilson	Chairman, Chief Executive Officer, and Director	

/s/ Mark Augenblick		March 21, 2001
Mark Augenblick	President, Vice Chairman, and Director	
/s/ Paul H. Dillon		March 21, 2001
Paul H. Dillon	Vice President and Controller	
/s/ James R. Treptow		March 21, 2001
James R. Treptow	Director	
/s/ Ernst Ringle		March 21, 2001
Ernst Ringle	Director	
/s/ John H. Gibbons		March 21, 2001
John H. Gibbons	Director	

000000;">
5,617

$
6,533

$
4,304

Net income per share — Basic
$
0.52

$
0.61

$
0.41

Weighted average shares outstanding — Basic	10,756	10,710	10,572
Net income per share — Diluted	$ 0.51	$ 0.58	$ 0.38
Weighted average shares outstanding — Diluted	10,917	11,278	11,286

See accompanying notes to consolidated financial statements.

KEY TRONIC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

	Fiscal Year Ended		
	July 1, 2017	July 2, 2016	June 27, 2015
Comprehensive income (loss):			
Net income	$5,617	$6,533	$4,304
Other comprehensive income (loss):			
Unrealized gain (loss) on hedging instruments, net of tax	4,798	(2,810)	(7,166)
Comprehensive income (loss)	$10,415	$3,723	$(2,862)

Other comprehensive income (loss) for fiscal years 2017, 2016, and 2015 is reflected net of tax provision (benefit) of approximately $2.5 million, $(1.4) million and $(3.7) million, respectively.
See accompanying notes to consolidated financial statements.

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KEY TRONIC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Fiscal Year Ended		
	July 1, 2017	July 2, 2016	June 27, 2015
Operating activities:			
Net income	$5,617	$6,533	$4,304
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	7,232	6,162	5,910
Amortization of deferred loan costs	17	—	—
Excess tax benefit from exercise of stock options	—	(402)	(50)
Provision for obsolete inventory	496	757	520
Provision for warranty	68	95	115
(Recovery of) provision for doubtful accounts	(10)	38	97
Loss on disposal of assets	101	—	70
Share-based compensation expense	692	764	732
Deferred income taxes	(471)	(1,313)	(1,517)
Changes in operating assets and liabilities, net of acquisition:			
Trade receivables	(3,505)	11,136	(2,080)
Inventories	4,920	(16,169)	(14,708)
Other assets	636	1,739	(4,249)
Accounts payable	(5,889)	(2,561)	17,999
Accrued compensation and vacation	434	104	(283)
Other liabilities	(913)	(2,303)	807
Cash provided by operating activities	9,425	4,580	7,667
Investing activities:			
Payment for acquisition, net of cash acquired	—	—	(47,964)
Purchases of property and equipment	(9,307)	(13,277)	(8,808)
Proceeds from sale of fixed assets	834	7,612	8,641
Cash used in investing activities	(8,473)	(5,665)	(48,131)
Financing activities:			
Payment of financing costs	(221)	(113)	(62)
Proceeds from issuance of long term debt	3,919	—	35,000
Repayments of long term debt	(5,435)	(5,000)	(3,750)
Borrowings under revolving credit agreement	161,240	197,568	137,987
Repayments of revolving credit agreement	(160,978)	(191,126)	(126,356)
Proceeds from accounts receivable transfer agreement	—	—	1,116
Payments towards accounts receivable transfer agreement	—	—	(8,969)
Excess tax benefit from exercise of stock options	—	402	50
Proceeds from exercise of stock options	—	—	17
Tax withholding from exercise of share-based compensation	(122)	—	—
Cash (used in) provided by financing activities	(1,597)	1,731	35,033
Net (decrease) increase in cash and cash equivalents	(645)	646	(5,431)
Cash and cash equivalents, beginning of period	1,018	372	5,803
Cash and cash equivalents, end of period	$373	$1,018	$372
Supplemental cash flow information:			
Interest payments	$2,238	$2,308	$1,221
Income tax payments, net of refunds	$1,799	$813	$3,274

See accompanying notes to consolidated financial statements.

KEY TRONIC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(In thousands)

	Shares	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, June 28, 2014	10,547	$44,151	$57,091	$ 2,403	$ 103,645
Net income	—	—	4,304	—	4,304
Unrealized loss on hedging instruments, net	—	—	—	(7,166)	(7,166)
Exercise of stock options	5	17	—	—	17
Exercise of stock appreciation rights	223	—	—	—	—
Shares withheld for taxes	(69)	(814)	—	—	(814)
Share-based compensation	—	732	—	—	732
Excess tax benefit from share-based compensation	—	50	—	—	50
Balances, June 27, 2015	10,706	$44,136	$61,395	$ (4,763)	$ 100,768
Net income	—	—	6,533	—	6,533
Unrealized loss on hedging instruments, net	—	—	—	(2,810)	(2,810)
Exercise of stock appreciation rights	28	—	—	—	—
Shares withheld for taxes	(9)	(75)	—	—	(75)
Share-based compensation	—	764	—	—	764
Excess tax benefit from share-based compensation	—	402	—	—	402
Balances, July 2, 2016	10,725	$45,227	$67,928	$ (7,573)	$ 105,582
Net income	—	—	5,617	—	5,617
Unrealized gain on hedging instruments, net	—	—	—	4,798	4,798
Exercise of stock appreciation rights	49	—	—	—	—
Shares withheld for taxes	(14)	(122)	—	—	(122)
Share-based compensation	—	692	—	—	692
Balances, July 1, 2017	10,760	$45,797	$73,545	$ (2,775)	$ 116,567

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

Business

Key Tronic Corporation and subsidiaries (the Company) is engaged in electronic manufacturing services (EMS) for original equipment manufacturers (OEMs) and also manufactures keyboards and other input devices. The Company's headquarters are located in Spokane Valley, Washington with manufacturing operations in Oakdale, Minnesota; Fayetteville, Arkansas; Corinth, Mississippi; and foreign manufacturing operations in Juarez, Mexico; and Shanghai, China.

Principles of Consolidation

The consolidated financial statements include the Company and its wholly owned subsidiaries in the United States, Mexico and China. Intercompany balances and transactions have been eliminated during consolidation.

Reclassifications

Certain prior period reclassifications were made to conform with the current period presentation. These reclassifications had no effect on reported income, comprehensive income (loss), cash flows, total assets, or shareholders' equity as previously reported.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates include the allowance for doubtful receivables, the provision for obsolete and non-saleable inventories, deferred tax assets and liabilities, uncertain tax positions, valuation of goodwill, impairment of long-lived assets, medical self-funded insurance liability, long-term incentive compensation accrual, the provision for warranty costs, the fair value of stock appreciation rights granted under the Company's share-based compensation plan and purchase price allocation of acquired businesses. Due to uncertainties with respect to the assumptions and estimates, actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers investments with an original maturity of three months or less to be cash equivalents. Cash equivalents are carried at cost, which approximates fair value. The Company may have cash and cash equivalents at financial institutions that are in excess of federally insured limits from time to time.

Allowance for Doubtful Accounts

The Company evaluates the collectability of accounts receivable and records an allowance for doubtful accounts, which reduces the receivables to an amount that management reasonably estimates will be collected. A specific allowance is recorded against receivables considered to be impaired based on the Company's knowledge of the financial condition of the customer. In determining the amount of the allowance, the Company considers several factors including the aging of the receivables, the current business environment and historical experience. After all attempts to collect a receivable have failed, the receivable is written off against the allowance.

Inventories

Inventories are stated at the lower of cost or net realizable value. Cost is determined principally using the first-in, first-out (FIFO) method. Customer orders are based upon forecasted quantities of product manufactured for shipment over defined periods. Raw material inventories are purchased to fulfill these customer requirements. Within these arrangements, customer demands for products frequently change, sometimes creating excess and obsolete inventories. The Company regularly reviews raw material inventories by customer for both excess and obsolete quantities. Wherever possible, the Company attempts to recover its full cost of excess and obsolete inventories from customers or, in some cases, through other markets. When it is determined that the Company's carrying cost of such excess and obsolete inventories cannot be recovered in full, a charge is taken against income for the difference between the carrying cost and the estimated realizable amount. We also reserve for inventory related to specific customers covered by lead-time assurance agreements when those customers are experiencing financial difficulties or reimbursement is not reasonably assured.

Property, Plant and Equipment

Property, plant and equipment are carried at cost and depreciated using straight-line methods over the expected useful lives of the assets. Repairs and maintenance costs are expensed as incurred.

Business Combinations

The Company recognizes the assets acquired and liabilities assumed in business combinations on the basis of their fair values at the date of acquisition. We assess the fair value of assets, including intangible assets, using a variety of methods and each asset is measured at fair value from the perspective of a market participant. The method used to estimate the fair values of intangible assets incorporates significant assumptions regarding the estimates a market participant would make in order to evaluate an asset, including a market participant's use of the asset and the appropriate discount rates for a market participant. Assets recorded from the perspective of a market participant that are determined to not have economic use for us are expensed immediately. Any excess purchase price over the fair value of the net tangible and intangible assets acquired is allocated to goodwill. Transaction costs and restructuring costs associated with a business combination are expensed as incurred.

Impairment of Goodwill

The Company records intangible assets that are acquired individually or with a group of other assets in the financial statements at acquisition. In accordance with ASC 350, Goodwill and Other Intangible Assets, goodwill is not amortized but is required to be reviewed for impairment at least annually or when events or circumstances indicate that carrying value may exceed fair value. The Company tests goodwill by first performing a qualitative analysis ("Step 0") to determine if it is more likely than not that the fair value of the reporting unit is greater than its carrying value. If the Company determines that it is not more likely than not that the fair value of the reporting unit is greater than its carrying value, the Company calculates the fair value of the reporting unit and compares the fair value of the reporting unit to its carrying value ("Step 1"). If the carrying value of the reporting unit exceeds the fair value, goodwill is potentially impaired and the second step ("Step 2") of the impairment test must be performed. In the second step, the Company compares the implied fair value of the goodwill, as defined by ASC 350, to the carrying amount to determine the impairment loss, if any.

The Company performed its annual qualitative Step 0 analysis as of April 2, 2017 and determined a Step 1 analysis was necessary due to market conditions. Based on the results of the Step 1 analysis, the Company concluded that the fair value of the reporting unit was greater than the carrying value of the reporting unit based on a methodology that utilized both an income approach and a market approach. We considered valuation factors including the Company's market capitalization, future discounted cash flows and an estimated control premium based upon a review of comparable market transactions. Our consideration of discounted future cash included assumptions regarding growth rates and margins based on our historical trends. In addition, we applied a market discount rate calculated based upon an analysis of companies similar in size. The estimated fair value of the reporting unit exceeded the carrying value by approximately 20%. We will continue to monitor our market capitalization and impairment indicators.

Impairment of Long-lived Assets

The Company, using its best estimates based on reasonable and supportable assumptions and projections, reviews assets for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable. Impaired assets are reported at the lower of cost or fair value.

Accrued Warranty

An accrual is made for expected warranty costs, with the related expense recognized in cost of goods sold. Management reviews the adequacy of this accrual quarterly based on historical analyses and anticipated product returns.

Self-funded Insurance

The Company self-funds its domestic employee health plans. The Company contracts with a separate administrative service company to supervise and administer the programs and act as its representative. The Company reduces its risk under this self-funded platform by purchasing stop-loss insurance coverage for high dollar individual claims. In addition, if the aggregate annual claims amount to more than 125 percent of expected claims for the plan year this insurance will also pay those claims amounts exceeding that level.

The Company estimates its exposure for claims incurred but not paid at the end of each reporting period and uses historical claims data supplied by the Company's broker to estimate its self-funded insurance liability. This liability is subject to a total limitation that varies based on employee enrollment and factors that are established at each annual contract renewal. Actual claims experience may differ from the Company's estimates. Costs related to the administration of the plan and related claims are expensed as incurred.

Revenue Recognition

Sales revenue from manufacturing is recognized upon shipment of the manufactured product per contractual terms. Upon shipment, title transfers and the customer assumes risks and rewards of ownership of the product. The price to the buyer is fixed or determinable and recoverability is reasonably assured. Unless specifically stated in contractual terms, there are no formal customer acceptance requirements or further obligations related to the manufacturing services; if any such requirements exist, then sales revenue is recognized at the time when such requirements are completed and such obligations are fulfilled. Revenue is recorded net of estimated returns of manufactured product based on management's analysis of historical returns.

Revenues and associated costs from engineering design, development services and tooling, which are performed under contract of short term durations, are recognized only after the completed performance of the service. Revenue from engineering design, development services and tooling represented approximately 2.1 percent, 1.7 percent and 2.5 percent of total revenue in fiscal years 2017, 2016, and 2015, respectively.

Shipping and Handling Fees

The Company classifies costs associated with shipping and handling fees as a component of cost of goods sold. Customer billings related to shipping and handling fees are reported as revenue.

Research, Development and Engineering

Research, development and engineering expenses include unreimbursed EMS costs as well as design and engineering costs associated with the production of EMS programs. Research, development and engineering costs are expensed as incurred.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences and benefits attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis, as well as operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences and carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities for a change in tax rates is recognized in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more likely than not to be realized.

We utilize a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments based on new assessments and changes in estimates and which may not accurately forecast actual outcomes. Our policy is to recognize interest and penalties related to the underpayment of income taxes as a component of income tax provision. To date, we have not incurred charges for interest or penalties in relation to the underpayment of income taxes. The tax years 1997 through the present remain open to examination by the major U.S. taxing jurisdictions to which we are subject. Refer to Note 6 for further discussions.

Derivative Instruments and Hedging Activities

The Company has entered into foreign currency forward contracts and an interest rate swap which are accounted for as cash flow hedges in accordance with ASC 815, Derivatives and Hedging. The effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (AOCI) and is reclassified into earnings in the same period in which the underlying hedged transaction affects earnings. The derivative's effectiveness represents the change in fair value of the hedge that offsets the change in fair value of the hedged item.

The Company uses derivatives to manage the variability of foreign currency fluctuations of expenses in our Mexico facilities and interest rate risk associated with certain borrowings under the Company's debt arrangement. The foreign currency forward contracts and interest rate swaps have terms that are matched to the underlying transactions being hedged. As a result, these transactions fully offset the hedged risk and no ineffectiveness has been recorded.

The Company's foreign currency forward contracts and interest rate swaps potentially expose the Company to credit risk to the extent the counterparties may be unable to meet the terms of the agreement. The Company minimizes such

risk by seeking high quality counterparties. The Company's counterparties to the foreign currency forward contracts and interest rate swaps are major banking institutions. These institutions do not require collateral for the contracts, and the Company believes that the risk of the counterparties failing to meet their contractual obligations is remote. The Company does not enter into derivative instruments for trading or speculative purposes.

Earnings Per Common Share

Basic earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is computed by dividing net income by the combination of other potentially dilutive weighted average common shares and the weighted average number of common shares outstanding during the period using the treasury stock method. The computation assumes the proceeds from the exercise of stock options were used to repurchase common shares at the average market price during the period. The computation of diluted earnings per common share does not assume conversion, exercise, or contingent issuance of common stock equivalent shares that would have an anti-dilutive effect on earnings per share.

Foreign Currency Transactions

The functional currency of the Company's subsidiaries in Mexico and China is the U.S. dollar. Realized foreign currency transaction gains and losses for local currency denominated assets and liabilities are included in cost of goods sold.

Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable and current liabilities reflected on the balance sheets at July 1, 2017 and July 2, 2016, reasonably approximate their fair value. The Company had an outstanding balance on the line of credit of $18.3 million as of July 1, 2017 and $18.1 million as of July 2, 2016, with a carrying value that reasonably approximates the fair value. The Company had an outstanding balance on the term loan of $21.3 million as of July 1, 2017 and $26.3 million as of July 2, 2016, with a carrying value that reasonably approximates the fair value. The equipment term loan is estimated to be $3.5 million as of July 1, 2017, with a carrying value that reasonably approximates the fair value. As of July 2, 2016, the Company did not have a balance under the equipment term loan.

Share-based Compensation

The Company's incentive plan may provide for equity and liability awards to employees in the form of stock options, stock appreciation rights, restricted stock, restricted stock units, stock awards, stock units, performance shares, performance units, and other stock-based or cash-based awards. Compensation cost is recognized on a straight-line basis over the requisite employee service period, which is generally the vesting period, and is included in cost of goods sold, research, development and engineering, and selling, general, and administrative expenses. Share-based compensation is recognized only for those awards that are expected to vest, with forfeitures estimated at the date of grant based on historical experience and future expectations.

Restructuring

Periodically the Company may consolidate excess facilities in order to maximize efficiencies and reduce its costs. In connection with these activities, we recognize restructuring charges for employee termination costs, exit costs and long-lived asset impairment when applicable.

The recognition of these restructuring charges require that we make certain judgments and estimates regarding the nature, timing and amount of costs associated with the planned exit activity. To the extent our actual results differ from our estimates and assumptions, we may be required to revise the estimates of future liabilities, requiring the recognition of additional restructuring charges or the reduction of liabilities already recognized. Such changes to previously estimated amounts may be material to the consolidated financial statements. At the end of each reporting period, we evaluate the remaining accrued balances to ensure that no excess accruals are retained and the utilization of the provisions are for their intended purpose in accordance with developed exit plans.

Newly Adopted and Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09 (ASU 2014-09), Revenue from Contracts with Customers. The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under current guidance. This may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Additionally, disclosures required for revenue recognition will include qualitative and quantitative information about contracts with customers, significant judgments and changes in judgments, and assets recognized from costs to obtain or fulfill a contract. Such disclosures are more extensive than what is required under existing GAAP. In August 2015, the FASB issued an amendment to defer the effective date of ASU 2014-09 for all entities by one year. This Update is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The Company has assessed that the impact of the new guidance will result in a change of the Company's revenue recognition model for electronics manufacturing services from "point in time" upon physical delivery to an "over time" model and believes this transition may have a material impact on the Company's consolidated financial statements upon adoption primarily as it will recognize an increase in contract assets for unbilled receivables with a corresponding reduction in finished goods and work-in-progress inventory. The Company has commenced implementation in accordance with the planned effective date and such efforts are ongoing. Companies have the option of using either a full or modified retrospective approach in applying this standard. The Company has not yet concluded upon its selection of the transition method.

In July 2015, the FASB issued final guidance that simplifies the subsequent measurement of inventory for which cost is determined by methods other than last-in first-out (“LIFO”) and the retail inventory method. For inventory within the scope of the new guidance, entities will be required to compare the cost of inventory to only one measure, its net realizable value, and not the three measures required by the existing guidance. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The new guidance should not change how entities initially measure the cost of inventory. The guidance will be effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company adopted this guidance during the second quarter of fiscal year 2017 and it had no impact on our financial statements.

In February 2016, the FASB issued Accounting Standards Update 2016-02 (ASU 2016-02), Leases which supersedes ASC 840 Leases and creates a new topic, ASC 842 Leases. This update requires lessees to recognize a lease asset and a lease liability for all leases, including operating leases, with a term greater than 12 months on its balance sheet. The update also expands the required quantitative and qualitative disclosures surrounding leases. This update is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, with earlier adoption permitted. This update will be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Upon initial evaluation, the Company believes the new guidance will have a material impact on its consolidated balance sheets when adopted. The Company is currently assessing the timing of adoption.

In March 2016, the FASB issued Accounting Standards Update 2016-09 (ASU 2016-09), Improvements to Employee Share-Based Payment Accounting. This update simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This update is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with earlier adoption permitted. The Company prospectively adopted this ASU during the first quarter of fiscal year 2017. As a result, excess tax benefits are recorded in income tax expense instead of a component of shareholders’ equity and excess tax benefits are no longer broken out on the consolidated statement of cash flows beginning in fiscal year 2017.

In August 2016, the FASB issued Accounting Standards Update 2016-15 (ASU 2016-15), Classification of Certain Cash Receipts and Cash Payments. This update provides guidance on how to record eight specific cash flow issues. This update is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted and a retrospective transition method to each period should be presented. The Company early adopted this guidance during the second quarter of fiscal year 2017 and it had no impact on our consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update 2017-04, Simplifying the Test for Goodwill Impairment. Under the new standard, goodwill impairment would be measured as the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying value of goodwill. This ASU eliminates existing guidance that requires an entity to determine goodwill impairment by calculating the implied fair value of goodwill by hypothetically assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. This update is effective prospectively to impairment tests beginning June 28, 2020, with early adoption permitted. The Company would apply this guidance to applicable impairment tests after the adoption date. The Company is currently evaluating the effect of this update on its consolidated financial statements.
In May 2017, the FASB issued Accounting Standards Update 2017-09, Compensation - Stock Compensation. This update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. This update is effective for fiscal years beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating the effect of this update on its consolidated financial statements.

Fiscal Year

The Company operates on a 52/53 week fiscal year. Fiscal years end on the Saturday nearest June 30. As such, fiscal years 2017, 2016, and 2015, ended on July 1, 2017, July 2, 2016, and June 27, 2015, respectively. Fiscal year 2017 and 2015 were 52 week years whereas fiscal year 2016 was a 53 week year.

2. INVENTORIES

The components of inventories consist of the following (in thousands):

	July 1, 2017	July 2, 2016
Finished goods	$12,244	$13,384
Work-in-process	20,596	18,988
Raw materials and supplies	68,750	74,634
	$101,590	$107,006

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of the following:

	Life	July 1, 2017	July 2, 2016
	(in years)	(in thousands)	
Land	—	$2,940	$2,940
Buildings and improvements	3 to 30	23,158	23,737
Equipment	1 to 10	57,848	53,095
Furniture and fixtures	3 to 5	3,512	2,924
		87,458	82,696
Accumulated depreciation		(56,962)	(54,771)
		$30,496	$27,925

4. LONG-TERM DEBT

On September 3, 2014, the Company entered into a five-year term loan in the amount of $35.0 million used to acquire all of the outstanding shares of CDR Manufacturing, Inc. (dba Ayrshire Electronics). The term loan requires quarterly payments of $1.25 million through June 15, 2019, with a final payment of the remaining outstanding balance on August 31, 2019. The Company had an outstanding balance of $21.3 million and $26.3 million under the term loan as of July 1, 2017 and July 2, 2016, respectively.

On August 6, 2015, the Company entered into a First Amendment to the amended and restated credit agreement extending the limit on our line of credit facility to $45.0 million as evidenced by the Second Replacement Revolving Note. The agreement specifies that the proceeds of the revolving line of credit be used primarily for working capital and general corporate purposes. The line of credit is secured by substantially all of the assets of the Company and matures on August 31, 2019 at which time all outstanding balances are payable. As of July 1, 2017, the Company had an outstanding balance under the credit facility of $18.3 million, $0.4 million in outstanding letters of credit and $26.3 million available for future borrowings. As of July 2, 2016, the Company had an outstanding balance under the credit facility of $18.1 million, $0.4 million in outstanding letters of credit and $26.5 million available for future borrowings.

On December 28, 2016, the Company entered into an equipment term loan agreement in the amount of $3.9 million in order to further invest in production equipment. The equipment term loan is collateralized by production equipment. Under this loan agreement, equal quarterly payments of approximately $0.2 million commenced on March 31, 2017 and will continue through the maturity of the equipment term loan on June 30, 2021. Amortization of the debt issuance costs is reported as interest expense on the consolidated income statement. As of July 1, 2017, the Company had an outstanding balance of $3.5 million. The Company did not have a balance as of July 2, 2016. The Company has available an additional $2.1 million which can be borrowed in the future under this agreement.

Borrowings under the revolving line of credit, term loan and equipment term loan bear interest at either a “Base Rate” or a “Fixed Rate,” as elected by the Company. The base rate is the higher of the Wells Fargo Bank prime rate, daily one month London Interbank Offered Rate (LIBOR) plus 1.5%, or the Federal Funds rate plus 1.5%. The fixed rate is LIBOR plus 1.75%, LIBOR plus 2.0% or LIBOR plus 2.25% depending on the level of the Company’s trailing four quarters Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). The interest rates on the outstanding debt as of July 1, 2017 range from 3.22% - 4.25% compared to 2.45% - 3.50% as of July 2, 2016.

Debt maturities as of July 1, 2017 for the next five years and thereafter are as follows (in thousands):

Fiscal Years Ending	Amount
2018	$5,871
2019	5,871
2020	30,455
2021	871
2022	—
Total debt	$43,068
Unamortized debt issuance costs	$(119)
Long-term debt, net of debt issuance costs	$42,949

The Company must comply with certain financial covenants, including a cash flow leverage ratio, an asset coverage ratio and a fixed charge coverage ratio. The credit agreement requires the Company to maintain a minimum profit threshold, limits the maximum capital lease expenditures and restricts the Company from declaring or paying dividends in cash or stock without prior bank approval. The Company is in compliance with all financial covenants for all periods presented.

5. TRADE ACCOUNTS RECEIVABLE PURCHASE PROGRAMS

Sale Programs

The Company utilizes an Account Purchase Agreement with Wells Fargo Bank, N.A. ("WFB") which allows the Company to sell and assign to WFB and WFB may purchase from Company the accounts receivable of certain Company customers in a maximum aggregate amount outstanding of $20.0 million. This agreement may be cancelled at any time by either party. The Company also has an Account Purchase Agreement with Orbian Financial Services (“Orbian”). This agreement allows the Company to sell accounts receivable of certain customers to Orbian and the agreement may be cancelled at any time by either party.

Total accounts receivables sold during the twelve months ended July 1, 2017 and July 2, 2016 was approximately $86.5 million and $78.0 million, respectively. Accounts receivables sold and not yet collected was approximately $1.6 million and $1.7 million as of July 1, 2017 and July 2, 2016, respectively. The receivables that were sold were removed from the consolidated balance sheets and the cash received is reflected as cash provided by operating activities in the consolidated statements of cash flows.

6. INCOME TAXES

Income tax provision consists of the following:

	Fiscal Year Ended		
	July 1, 2017	July 2, 2016	June 27, 2015
	(in thousands)		
Current income tax provision:			
United States	$1,231	$1,014	$1,701
Foreign	1,206	1,960	975
	2,437	2,974	2,676
Deferred income tax benefit:			
United States	(539)	(1,285)	(1,486)
Foreign	(259)	(71)	(194)
	(798)	(1,356)	(1,680)
Total income tax provision	$1,639	$1,618	$996

The Company has gross tax credit carryforwards of approximately $8.2 million at July 1, 2017. Included in total tax credits carryforwards is approximately $7.4 million in research and development (R&D) tax credits.

Management also has reviewed its other deferred tax assets for purposes of determining whether or not a valuation allowance may be required. A valuation allowance against these deferred tax assets is required if it is more likely than not that some of the deferred tax assets will not be realized. Based on the Company’s profitability and estimated future repatriations from foreign subsidiaries, it has been determined that it is more likely than not that the deferred tax assets will be realized.

Management has reviewed and updated as necessary estimates of future repatriations of the undistributed earnings of its foreign subsidiaries. Based on this analysis, management expects to repatriate a portion of the foreign undistributed earnings based on increased sales growth driving additional U.S. capital requirements, cash requirements for potential acquisitions and to potentially implement certain tax strategies. No foreign earnings were repatriated from either foreign subsidiary during fiscal 2017 or 2016. The Company currently estimates that future repatriations from foreign subsidiaries will approximate $13.4 million. As such, as earnings are recognized in the United States, the Company would be subject to U.S. federal and state income taxes and potential withholding taxes are estimated to be approximately $6.6 million. Both the domestic tax and estimated withholding tax have been recorded as part of deferred taxes as of July 1, 2017. All other unremitted foreign earnings are expected to remain permanently reinvested for planned fixed asset purchases in foreign locations.

The Company has not provided for U.S. income taxes or foreign withholding taxes on approximately $15.0 million of earnings from foreign subsidiaries which are permanently reinvested outside the U.S. The unrecognized net tax provision, after netting U.S. federal and state income tax and any related foreign tax credits, would be approximately $2.3 million associated with these earnings.

During the second quarter of fiscal year 2017, the Company signed a unilateral advance pricing agreement (APA) with the Large Taxpayer Division of Mexico's Servicio de Administración Tributaria (SAT) under an elective framework that has been agreed to by the U.S. and Mexican authorities. The APA is part of a larger program affecting hundreds of U.S. companies with maquiladora operations in Mexico. The general impact of the APA is to increase margins between the maquiladora and U.S. parent company, shifting profits to Mexico from the U.S.

As a result of the APA, the Company recognized an increased tax liability in Mexico of approximately $0.4 million related to the calendar years 2014-2016. However, the increased costs to the U.S. resulted in a reduced tax liability of approximately $0.4 million in the U.S. during fiscal year 2017. The overall net impact of the APA is therefore estimated to not be material to the Company's consolidated financial results. The estimated increased liabilities in Mexico and related offsetting tax benefit in the U.S. were recorded during the second quarter of fiscal year 2017. The APA was finalized during the fourth quarter of fiscal year 2017.

Further, the resulting impact of the APA resulted in approximately $1.8 million of additional earnings being recognized in Mexico. The Company has reevaluated its repatriation assumptions and based on new customer growth in Mexico and related required capital expenditures, it is assumed that 50% of the additional $1.8 million in earnings will be permanently reinvested in Mexico.

The Company's effective tax rate differs from the federal tax rate as follows:

	Fiscal Year Ended		
	July 1, 2017	July 2, 2016	June 27, 2015
	(in thousands)		
Federal income tax provision at statutory rates	$2,467	$2,771	$1,802
State income taxes, net of federal tax effect	175	250	133
Foreign tax rate differences	(156)	(442)	(80)
Effect of income tax credits	(738)	(1,254)	(1,085)
Effect of repatriation of foreign earnings, net	199	(161)	(80)
Other	(308)	454	124
Transaction costs	—	—	182
Income tax provision	$1,639	$1,618	$996

The domestic and foreign components of income before income taxes were:

	Fiscal Year Ended		
	July 1, 2017	July 2, 2016	June 27, 2015
	(in thousands)		
Domestic	$3,553	$2,228	$3,395
Foreign	3,703	5,923	1,905
Income before income taxes	$7,256	$8,151	$5,300

Deferred income tax assets and liabilities consist of the following at:

	July 1, 2017	July 2, 2016
	(in thousands)	
Deferred tax assets:		
Tax credit carryforwards, net	$4,164	$4,056
Foreign subsidiaries - future tax credits	840	840
Inventory	840	508
Accruals	4,020	4,270
Mark-to-market adjustments	1,443	4,043
Other	28	86
Deferred income tax assets	$11,335	$13,803
Deferred tax liabilities:		
Foreign subsidiaries – unremitted earnings	(2,288)	(2,098)
Fixed assets	(456)	(1,025)
Identifiable intangibles	(1,308)	(1,613)
Other	(302)	(85)
Deferred income tax liabilities	$(4,354)	$(4,821)
Net deferred income tax assets	$6,981	$8,982
Balance sheet caption reported in:		
Long-term deferred income tax asset	$6,981	$8,982
Net deferred income tax asset	$6,981	$8,982

Uncertain Tax Positions

The Company has R&D tax credits that approximate $7.4 million that have 20 year carryforwards before expiring. The Company's R&D tax credits expire in various fiscal years from 2021 to 2036. The Company also has alternative minimum tax credits, which do not expire, approximating $726,000.

As of July 1, 2017, the Company had unrecognized tax benefits of $3.9 million related to its gross R&D tax credits. The unrecognized tax benefits relate to certain R&D tax credits generated from 1999 to 2016.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	Fiscal Year Ended		
	July 1, 2017	July 2, 2016	June 27, 2015
	(in thousands)		
Beginning Balance	$3,760	$3,446	$3,072
Additions based on tax positions related to the current year	187	314	374
Ending Balance	$3,947	$3,760	$3,446

The increase from the prior year is due to additional R&D credits that were recorded in 2017 as discussed above. Management does not anticipate any material changes to this amount during the next 12 months.

The Company recognizes interest accrued related to unrecognized tax benefits and penalties in its income tax provision. The Company has not recognized any interest or penalties in the fiscal years presented in these financial statements. The Company is subject to income tax in the U.S. federal jurisdiction, various state jurisdictions, Mexico and China. Certain years remain subject to examination but there are currently no ongoing exams in any taxing jurisdictions.

7. EARNINGS PER SHARE

Basic earnings per share (EPS) is calculated by dividing net income (the numerator) by the weighted-average number of common shares outstanding (the denominator) during the period. Diluted EPS is computed by including both the weighted-average number of shares outstanding and any dilutive common share equivalents in the denominator. The following table presents a reconciliation of the denominator and the number of antidilutive common share awards that were not included in the diluted earnings per share calculation. These antidilutive securities occur when equity awards outstanding have an option price greater than the average market price for the period:

	Fiscal Year Ended (in thousands, except per share information)		
	July 1, 2017	July 2, 2016	June 27, 2015
Net income	$ 5,617	$ 6,533	$ 4,304
Weighted average shares outstanding– basic	10,756	10,710	10,572
Effect of dilutive common stock awards	161	568	714
Weighted average shares outstanding – diluted	10,917	11,278	11,286
Earnings per share – basic	$ 0.52	$ 0.61	$ 0.41
Earnings per share – diluted	$ 0.51	$ 0.58	$ 0.38
Antidilutive SARs not included in diluted earnings per share	892	442	208

8. STOCK OPTION AND BENEFIT PLANS

The Company's incentive plan provides for equity and liability awards to employees and non-employee directors in the form of stock options, stock appreciation rights (SARs), restricted stock, restricted stock units, stock awards, stock units, performance shares, performance units, and other stock-based or cash-based awards. Compensation cost is recognized on a straight-line basis over the requisite employee service period, which is generally the vesting period, and is recorded as employee compensation expense in cost of goods sold, research, development and engineering, and selling, general and administrative expenses. Share-based compensation is recognized only for those awards that are expected to vest, with forfeitures estimated at the date of grant based on historical experience and future expectations. In addition to service conditions, these SARs contain a performance condition. The additional performance condition is based upon the achievement of Return on Invested Capital (ROIC) goals relative to a peer group. All awards with performance conditions are measured over the vesting period and are charged to compensation expense over the requisite service period based on the number of shares expected to vest. The SARs cliff vest after a three-year period from date of grant and expire five years from date of grant.

On October 28, 2016, the Company granted 10,000 SARs under the 2010 Incentive Plan to certain key employees and outside directors at a strike price of $8.04 and a grant date fair value of $2.30, as of July 1, 2017, 10,000 remain outstanding. The grant date fair value for the awards granted during fiscal year 2017, were estimated using the Black Scholes option valuation method with the following weighted average assumptions as of October 28, 2016:

	Fiscal Year 2017
	October 28, 2016
Expected dividend yield	—%
Risk – free interest rate	1.63%
Expected volatility	33.43%
Expected life	4.00

On July 26, 2016, the Company granted 242,500 SARs under the 2010 Incentive Plan to certain key employees and outside directors at a strike price of $8.18 and a grant date fair value of $2.42, as of July 1, 2017, 242,500 remain outstanding. The grant date fair value for the awards granted during fiscal year 2017, were estimated using the Black Scholes option valuation method with the following weighted average assumptions as of July 26, 2016:

	Fiscal Year 2017
	July 26, 2016
Expected dividend yield	—%
Risk – free interest rate	0.93%
Expected volatility	36.13%
Expected life	4.00

On July 29, 2015, the Company granted 248,166 SARs under the 2010 Incentive Plan to certain key employees and outside directors at a strike price of $10.26 and a grant date fair value of $3.65, as of July 1, 2017, 233,333 remain outstanding. The grant date fair value for the awards granted during fiscal year 2016, were estimated using the Black Scholes option valuation method with the following weighted average assumptions as of July 29, 2015:

	Fiscal Year 2016
	July 29, 2015
Expected dividend yield	—%
Risk – free interest rate	1.39%
Expected volatility	43.66%
Expected life	4.00

On October 31, 2014, the Company granted 213,166 SARs under the 2010 Incentive Plan to certain key employees and outside directors at a strike price of $8.22 and a grant date fair value of $3.04, as of July 1, 2017, 205,833 remain outstanding. The grant date fair value for the awards granted during fiscal year 2016, were estimated using the Black Scholes option valuation method with the following weighted average assumptions as of October 31, 2014:

	Fiscal Year 2015
	October 31, 2014
Expected dividend yield	—%
Risk – free interest rate	1.39%
Expected volatility	45.67%
Expected life	4.00

Subsequent to July 1, 2017, the Company granted 272,500 SARs with a strike price of $7.26 and a grant date fair value of $1.89.

Share-based compensation expense is recognized only for those awards that are expected to vest, with forfeitures estimated at the date of grant based on the Company’s historical experience and future expectations. This forfeiture rate will be revised, if necessary, in subsequent periods if actual forfeitures differ from the amount estimated. Share-based compensation expense for fiscal years ended July 1, 2017, July 2, 2016 and June 27, 2015 was $0.7 million, $0.8 million and $0.7 million, respectively.

The Black-Scholes option valuation model is used by the Company for estimating the fair value of SARs. Option valuation models require the input of highly subjective assumptions, particularly for the expected term and expected stock price volatility. Changes in these assumptions can materially affect the fair value estimates.

The intrinsic value for stock options and SARs exercised in fiscal years 2017, 2016 and 2015 was $0.4 million, $0.2 million and $1.9 million, respectively.

As of July 1, 2017, total unrecognized compensation expense related to nonvested share-based compensation arrangements was approximately $0.8 million. This expense is expected to be recognized over a weighted-average period of 1.54 years.

The following table summarizes the Company's Options and SARs activity for all plans from June 28, 2014 through July 1, 2017:

	SARs Available For Grant	SARs Outstanding	Aggregate Intrinsic Value (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)
Balances, June 28, 2014	69,002	1,065,928	$ 4,096	$ 7.01	1.8
Shares authorized	1,000,000			—	
SARs granted	(213,166)	213,166		8.22	
SARs forfeited	—	—		—	
Options/SARs exercised	—	(465,263)	1,877	5.84	
Balances, June 27, 2015	855,836	813,831	$ 2,312	$ 7.99	2.5
Shares authorized	—				
SARs granted	(248,166)	248,166		10.26	
SARs forfeited	26,999	(26,999)		9.48	
SARs exercised	—	(63,333)	165	4.56	
Balances, July 2, 2016	634,669	971,665	$ 339	$ 8.75	2.4
Shares authorized	—				
SARs granted	(252,500)	252,500		8.17	
SARs forfeited	12,166	(12,166)		8.60	
SARs exercised	—	(127,000)	385	4.77	
Balances, July 1, 2017	394,335	1,084,999	$ —	$ 9.09	2.3
Exercisable at July 1, 2017		393,333	$ —	$ 9.43	0.6

Additional information regarding SARs outstanding and exercisable as of July 1, 2017, is as follows:

Range of Exercise Prices	Number Outstanding	Weighted Avg. Remaining Contractual Life (yrs.)	Weighted Avg. Exercise Price	Number Exercisable	Weighted Avg. Exercise Price
$4.40 – $7.90	192,500	0.1	$ 7.44	192,500	$ 7.44
7.91 – 9.91	458,333	3.3	8.19	—	—
9.92 – 11.34	434,166	2.2	10.76	200,833	11.34
$4.40 to $11.34	1,084,999	2.3	$ 9.09	393,333	$ 9.43

The Company has defined contribution plans available to U.S. employees who have attained age 21. Company contributions to the plans were approximately $0.6 million, $0.6 million, and $0.6 million during fiscal years 2017, 2016 and 2015, respectively.

9. COMMITMENTS AND CONTINGENCIES

Leases: As of July 1, 2017, July 2, 2016 and June 27, 2015, the Company did not have any property and equipment financed under capital leases. As of July 1, 2017, the Company has operating leases for certain equipment and production facilities, which expire at various dates during the next eight years.

Future minimum payments under non-cancelable operating leases at July 1, 2017, are summarized as follows (in thousands):

Fiscal Years Ending	Operating Leases
2018	$ 6,847
2019	3,979
2020	1,873
2021	1,014
2022	325
Thereafter	854
Total minimum lease payments	$ 14,892

Rental expense under operating leases was approximately $7.8 million, $6.6 million, and $3.8 million during fiscal years 2017, 2016 and 2015, respectively.

Warranty Costs: The Company provides warranties on certain product sales, and allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires the Company to make estimates of product return rates and expected costs to repair or to replace the products under warranty. The Company establishes warranty reserves based on historical warranty costs for each product line combined with liability estimates based on the prior twelve months' sales activities. As of July 1, 2017 and July 2, 2016, the reserve for warranty costs was approximately $32,000 and $30,000, respectively.

If actual return rates and/or repair and replacement costs differ significantly from estimates, adjustments to recognize additional cost of sales may be required in future periods. Warranty expense for fiscal years 2017, 2016 and 2015 was related to workmanship claims on keyboards and certain EMS products.

Litigation: During the second quarter of fiscal year 2017, the Company commenced the arbitration process with a former customer related to approximately $9 million in inventory purchased, cancellation fees, and other carrying costs we believe should be reimbursed by this former customer based on the terms of the manufacturing agreement. The Company is actively working through the arbitration process and expects further clarity on the resolution of this matter, whether through negotiations or a scheduled hearing by the end of the calendar year. The Company has not accrued for any potential gains or losses related to this claim and legal costs are being expensed as incurred. The ultimate disposition of these matters could have a material effect on our consolidated financial position, results of operations or cash flows.

Indemnification Rights: Under the Company's bylaws, the Company's directors and officers have certain rights to indemnification by the Company against certain liabilities that may arise by reason of their status or service as directors or officers. The Company maintains director and officer insurance, which may cover certain liabilities arising from its obligation to indemnify its directors and officers and former directors in certain circumstances.

10. FAIR VALUE MEASUREMENTS

The Company has adopted ASC 820, Fair Value Measurements, which defines fair value, establishes a framework for assets and liabilities being measured and reported at fair value and expands disclosures about fair value measurements. There are three levels of fair value hierarchy inputs used to value assets and liabilities which include: Level 1 – inputs are quoted market prices for identical assets or liabilities; Level 2 – inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and Level 3 – inputs are unobservable inputs for the asset or liability. There have been no changes in the fair value methodologies used at July 1, 2017 and July 2, 2016.

The following table summarizes the fair value of assets (liabilities) of the Company’s derivatives that are required to be measured on a recurring basis as of July 1, 2017 and July 2, 2016 (in thousands):

	July 1, 2017			
	Level 1	Level 2	Level 3	Total Fair Value
Financial Assets:				
Foreign currency forward contracts & swaps	$—	$1,010	$—	$1,010
Financial Liabilities:				
Interest rate swaps	$—	$(103)	$—	$(103)
Foreign currency forward contracts & swaps	$—	$(5,112)	$—	$(5,112)

	July 2, 2016			
	Level 1	Level 2	Level 3	Total Fair Value
Financial Assets:				
Foreign currency forward contracts	—	136	—	$136
Financial Liabilities:				
Interest rate swaps	$—	$(498)	$—	$(498)
Foreign currency forward contracts & swaps	$—	$(11,112)	$—	$(11,112)

The Company currently has forward contracts and swaps to hedge known future cash outflows for expenses denominated in the Mexican peso and an interest rate swap to mitigate risk associated with certain borrowings under the Company’s debt arrangement. These contracts are measured on a recurring basis based on the foreign currency spot rates and forward rates quoted by banks or foreign currency dealers. These contracts are marked to market using level 2 input criteria every period with the unrealized gain or loss, net of tax, reported as a component of shareholders’ equity in accumulated other comprehensive income (loss), as they qualify for hedge accounting.

The carrying values of cash and cash equivalents, accounts receivable and current liabilities reflected on the balance sheets at July 1, 2017 and July 2, 2016, reasonably approximate their fair value. The Company’s long-term debt primarily consists of a revolving line of credit, a term loan and an equipment term loan. These borrowings bear interest at either a “Base Rate” or a “Fixed Rate,” as elected by the Company. Each of these rates is a variable floating rate dependent upon current market conditions and the Company’s current credit risk as discussed in footnote 4.

As a result of the determinable market rate for our revolving line of credit, term loan and equipment term, they are classified within Level 2 of the fair value hierarchy. The discounted cash flow of the revolving line of credit is estimated to be $18.3 million as of July 1, 2017 and $18.1 million as of July 2, 2016, with a carrying value that reasonably approximates the fair value. The discounted cash flow of the term loan is estimated to be $21.3 million as of July 1, 2017 and $26.3 million as of July 2, 2016, with a carrying value that reasonably approximates the fair value. The discounted cash flow of the equipment term loan is estimated to be $3.5 million as of July 1, 2017, with a carrying value that reasonably approximates the fair value. As of July 2, 2016, the Company did not have a balance under the equipment term loan.

11. DERIVATIVE FINANCIAL INSTRUMENTS

As of July 1, 2017, the Company had outstanding foreign currency forward contracts and swaps with a total notional amount of $55.7 million. The maturity dates for these contracts and swaps extend through September 2019. As of July 1, 2017, the net amount of unrealized loss expected to be reclassified into earnings within the next 12 months is approximately $2.8 million. During the fiscal year ended July 1, 2017, the Company entered into $6.7 million of foreign currency forward contracts and settled $20.5 million of such contracts. During the fiscal year ended July 2, 2016, the Company entered into $25.9 million of foreign currency forward contracts and settled $21.5 million of such contracts. During the fiscal year ended June 27, 2015, the Company entered into $23.1 million of foreign currency forward contracts and settled $20.5 million of such contracts.

As of July 1, 2017, the aggregate notional amount of the Company’s outstanding foreign currency contracts and swaps along with their unrealized gains (losses) are expected to mature as summarized below (in thousands):

Quarter Ending	Notional Contracts and Swaps in MXN	Notional Contracts and Swaps in USD	Estimated Fair Value
September 30, 2017	$76,192	$ 5,395	$(1,218)
December 30, 2017	$88,558	$ 6,162	$(1,370)
March 31, 2018	$90,812	$ 5,713	$(864)
June 30, 2018	$95,500	$ 5,811	$(774)
September 29, 2018	$90,443	$ 5,301	$(588)
December 29, 2018	$125,328	$ 6,746	$(298)
March 30, 2019	$137,944	$ 6,979	$33
June 29, 2019	$142,947	$ 6,828	$350
September 28, 2019	$148,468	$ 6,740	$627

On October 1, 2014, the Company entered into an interest rate swap contract with an effective date of September 1, 2015 and a termination date of September 3, 2019, with a notional amount of $25.0 million related to the borrowings outstanding under the term loan. The interest rate swap pays the Company variable interest at the one month LIBOR rate, and the Company pays the counter party a fixed interest rate. The fixed interest rate for the contract is 1.97% that replaces the one month LIBOR rate component of our contractual interest to be paid to WFB as part of our term loan. Based on the terms of the interest rate swap contract and the underlying borrowings outstanding under the term loan, the interest rate contract was determined to be effective, and thus qualifies as a cash flow hedge. As of July 1, 2017 and July 2, 2016, the remaining notional balance of this swap was $14.5 million and $20.5 million, respectively.

The following table summarizes the fair value of derivative instruments in the Consolidated Balance Sheets as of July 1, 2017 and July 2, 2016 (in thousands):

Derivatives Designated as Hedging Instruments	Balance Sheet Location	July 1, 2017 Fair Value	July 2, 2016 Fair Value
Foreign currency forward contracts & swaps	Other long-term assets	$1,010	$ 136
Foreign currency forward contracts & swaps	Other current liabilities	$(4,226)	$ (4,670)
Foreign currency forward contracts & swaps	Other long-term liabilities	$(886)	$ (6,442)
Interest rate swaps	Other long-term assets	$—	$ —
Interest rate swaps	Other current liabilities	$(81)	$ (264)
Interest rate swaps	Other long-term liabilities	$(22)	$ (234)

The following table summarizes the gain (loss) on derivative instruments, net of tax, on the Consolidated Statements of Income for the fiscal year 2017 (in thousands):

Derivatives Designated as Hedging Instruments	Classification of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	AOCI Balance as of July 2, 2016	Effective Portion Recorded In	Effective Portion Reclassified From AOCI Into	AOCI Balance as of July 1, 2017

			AOCI	Income	
Forward contracts & swaps	Cost of sales	$ (7,245)	$ (600)	$ 5,138	$ (2,707)
Interest rate swap	Interest expense	(328)	14	246	(68)
Total		$ (7,573)	$ (586)	$ 5,384	$ (2,775)

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The following table summarizes the gain (loss) on derivative instruments, net of tax, on the Consolidated Statements of Income for the fiscal year 2016 (in thousands):

Derivatives Designated as Hedging Instruments	Classification of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	AOCI Balance as of June 27, 2015	Effective Portion Recorded In AOCI	Effective Portion Reclassified From AOCI Into Income	AOCI Balance as of July 2, 2016
Forward contracts & swaps	Cost of sales	$ (4,487)	$ (6,939)	$ 4,181	$ (7,245)
Interest rate swap	Interest expense	(276)	(348)	296	(328)
Total		$ (4,763)	$ (7,287)	$ 4,477	$ (7,573)

The following table summarizes the gain (loss) on derivative instruments, net of tax, on the Consolidated Statements of Income for the fiscal year 2015 (in thousands):

Derivatives Designated as Hedging Instruments	Classification of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	AOCI Balance as of June 28, 2014	Effective Portion Recorded In AOCI	Effective Portion Reclassified From AOCI Into Income	AOCI Balance as of June 27, 2015
Forward contracts	Cost of sales	$ 2,403	$ (7,208)	$ 318	$ (4,487)
Interest rate swap	Interest expense	—	(276)	—	(276)
Total		$ 2,403	$ (7,484)	$ 318	$ (4,763)

As of July 1, 2017, the Company does not have any foreign exchange contracts with credit-risk-related contingent features. The Company is subject to the risk of fluctuating interest rates from our line of credit and foreign currency risk resulting from our China operations. The Company does not currently manage these risk exposures by using derivative instruments.

12. ENTERPRISE-WIDE DISCLOSURES

Operating segments are defined in ASC Topic 280, Segment Reporting as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Company’s chief operating decision maker is its Chief Executive Officer. As of July 1, 2017, the Company operates and internally manages a single operating segment, Electronics Manufacturing Services as this is the only discrete financial information that is regularly reviewed by the chief operating decision maker. This segment provides integrated electronic and mechanical engineering, assembly, sourcing and procurement, logistics, and new product testing for our customers.

Products and Services

Of the revenues for the years ended July 1, 2017, July 2, 2016, and June 27, 2015, EMS sales and services were $466.6 million, $483.3 million and $432.1 million, respectively. Keyboard sales for the years ended July 1, 2017, July 2, 2016, and June 27, 2015 were $1.2 million, $1.7 million and $1.9 million, respectively.

Geographic Areas

Net sales and long-lived assets (property, plant, and equipment) by geographic area for the years ended and as of July 1, 2017, July 2, 2016 and June 27, 2015 are summarized in the following table. Net sales set forth below are based on the shipping destination. Long-lived assets information is based on the physical location of the asset.

	Fiscal Year Ended (in thousands)		
	2017	2016	2015
Geographic net sales:			
Domestic (U.S.)	$361,886	$347,552	$301,891
Foreign	105,911	137,413	132,106
Total	$467,797	$484,965	$433,997
Long-lived assets:			
United States	$8,988	$11,406	$8,969

Mexico	20,878	15,756	17,156
China	630	763	849
Total	$30,496	$27,925	$26,974

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Percentage of net sales made to customers located in the following countries:

	Fiscal Year Ended		
	2017	2016	2015
United States	77%	72%	70%
Canada	1	7	10
Other foreign countries [(a)]	22	21	20
Total	100%	100%	100%

(a) No other individual foreign country accounted for 10% or more of the foreign sales in fiscal years 2017, 2016 or 2015.

Significant Customers

The percentage of net sales to and trade accounts receivables from significant customers were as follows:

	Percentage of Net Sales Fiscal Year			Percentage of Trade Accounts Receivable Fiscal Year	
	2017	2016	2015	2017	2016
Customer A	18%	18%	17%	30%	24%

13. QUARTERLY FINANCIAL DATA (Unaudited)

	Fiscal Year Ended July 1, 2017			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in thousands, except per share amounts)			
Net sales	$117,135	$118,517	$113,601	$118,544
Gross profit	9,709	9,612	9,139	9,840
Income before income taxes	2,201	1,995	1,283	1,777
Net income	1,792	1,528	961	1,336
Earnings per common share-basic	$0.17	$0.14	$0.09	$0.12
Earnings per common share-diluted	$0.16	$0.14	$0.09	$0.12
Weighted average shares outstanding				
Basic	10,748	10,758	10,759	10,760
Diluted	10,922	10,968	10,957	10,856

	Fiscal Year Ended July 2, 2016			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in thousands, except per share amounts)			
Net sales	$126,209	$116,403	$118,448	$123,905
Gross profit	8,919	9,110	9,955	10,841
Income before income taxes	1,247	1,882	2,137	2,885
Net income	817	1,787	1,783	2,146
Earnings per common share-basic	$0.08	$0.17	$0.17	$0.20
Earnings per common share-diluted	$0.07	$0.16	$0.16	$0.20
Weighted average shares outstanding				
Basic	10,706	10,710	10,711	10,714
Diluted	11,391	11,418	11,068	10,966

14. ACQUISITION

On September 3, 2014, the Company acquired all of the outstanding stock of Ayrshire, resulting in Ayrshire becoming a wholly owned subsidiary of the Company. Ayrshire provides printed circuit board assembly and other electronic manufacturing services to a diversified customer base through manufacturing facilities operated by Ayrshire or its subsidiaries in Minnesota, Arkansas, Mississippi, and Kentucky and through a sheltered maquiladora facility in Reynosa, Mexico. The Reynosa, Mexico operations were moved to the Company's existing facility in Juarez, Mexico shortly after acquisition. During the second quarter of fiscal year 2017, the Company closed the Harrodsburg, Kentucky facility in order to improve operating efficiencies. The remaining programs from the Kentucky facility were transferred to other facilities. This acquisition expanded our printed circuit board assembly capacity, total revenue, and added to and diversified our customer base with the addition of many new multi-national companies. The total cash payment of approximately $48.0 million was funded through borrowings on our term loan, revolving line of credit, and cash on hand. The Company incurred approximately $775,000 of costs related to due diligence.

The following table summarizes the purchase price paid for Ayrshire and the fair value of the assets acquired and liabilities assumed as of the date of acquisition (in thousands):

	Estimated Fair Values At September 3, 2014
Purchase Price Paid	$ 48,010
Cash Acquired	(46)
Purchase Price, Net of Cash Received	$ 47,964
Cash	$ 46
Accounts Receivable	21,211
Inventories	21,772
Other Current Assets	1,013
Property, Plant and Equipment	7,823
Favorable Leases	2,941
Customer Relationships	2,833
Non-Compete Agreements	196
Goodwill	8,217
Other Assets	42
Accounts Payable	(11,070)
Accrued Salaries and Wages	(2,188)
Other Current Liabilities	(2,408)
Deferred Tax Liability	(2,418)
Fair Value of Assets Acquired	$ 48,010

The Ayrshire acquisition was accounted for using the acquisition method of accounting whereby the total purchase price is allocated to tangible and intangible assets and liabilities based on their fair values on the date of acquisition. The Company determined the purchase price allocations on the acquisition based on estimates of the fair values of the assets acquired and liabilities assumed.

The following summary pro forma condensed consolidated financial information reflects the Ayrshire acquisition as if it had occurred on June 30, 2013 for purposes of the statements of income. This summary pro forma information is not necessarily representative of what the Company’s results of operations would have been had this acquisition in fact occurred on June 30, 2013 and is not intended to project the Company’s results of operations for any future period.

Pro forma condensed consolidated financial information for the year ended June 27, 2015 (in thousands):

	Fiscal Year Ended (unaudited) June 27, 2015
Net sales	$ 457,475
Net income	$ 4,136

It is impracticable to determine the revenue and net income related to the Ayrshire acquisition as certain customer programs have been transferred to the Company’s Juarez facilities.

15. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company recorded goodwill in connection with the Ayrshire and Sabre acquisitions resulting primarily from the synergies that resulted from the Company's acquisitions and the assembled workforce. The goodwill is not amortized for financial accounting purposes. The goodwill from the acquisitions is not deductible for tax purposes. As of July 1, 2017 and July 2, 2016, goodwill was recorded at $10.0 million.

The components of acquired intangible assets are as follows (in thousands):

	July 1, 2017			
	Amortization Period in Years	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Other intangible assets:				
Non-Compete Agreements	3 - 5	$ 568	$ (483)	$ 85
Customer Relationships	10	4,803	(1,590)	3,213
Favorable Lease Agreements	4 - 7	2,941	(1,439)	1,502
Total		$ 8,312	$ (3,512)	$ 4,800

	July 2, 2016			
	Amortization Period in Years	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Other intangible assets:				
Non-Compete Agreements	3 - 5	$ 568	$ (343)	$ 225
Customer Relationships	10	4,803	(1,110)	3,693
Favorable Lease Agreements	4 - 7	2,941	(931)	2,010
Total		$ 8,312	$ (2,384)	$ 5,928

Amortization expense related to intangible assets was approximately $1.1 million for the years ended July 1, 2017 and July 2, 2016, respectively.

Aggregate amortization expense related to existing intangible assets by fiscal year is currently estimated to be as follows (in thousands):

Fiscal Years Ending	Amount
2018	$ 1,073
2019	818
2020	783
2021	784
2022	531
Thereafter	811
Total amortization expense	$ 4,800

Item 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None

Item 9A: CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

It is the responsibility of our management to establish, maintain, and monitor disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934 are recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms. Additionally, these disclosure controls include controls and procedures that are designed to accumulate and communicate the information required to be disclosed to our Company’s Chief Executive Officer and Chief Financial Officer, allowing for timely decisions regarding required disclosures. As of the end of the period covered by this report, our management carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(f). Based on our assessment, we believe that as of July 1, 2017, the Company’s disclosure controls and procedures are effective based on that criteria.

Management’s Report on Internal Control over Financial Reporting

Our management has the responsibility to establish and maintain adequate internal controls over our financial reporting, as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934. Our internal controls are designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our external financial statements in accordance with generally accepted accounting principles (GAAP).

Due to inherent limitations of any internal control system, management acknowledges that there are limitations as to the effectiveness of internal controls over financial reporting and therefore recognize that only reasonable assurance can be gained from any internal control system. Accordingly, our internal control system may not detect or prevent material misstatements in our financial statements and projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and participation of management, including the Chief Executive Officer and Chief Financial Officer, we have performed an assessment of the effectiveness of our internal controls over financial reporting as of July 1, 2017. This assessment was based on the criteria established in Internal Control-Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment, we believe that as of July 1, 2017, the Company’s internal control over financial reporting is effective based on that criteria.

The effectiveness of the Company's internal control over financial reporting as of July 1, 2017 has been audited by BDO USA LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Changes in Internal Control over Financial Reporting

There have been no significant changes in our internal controls over financial reporting during our fourth fiscal quarter ended July 1, 2017 that have materially affected, or are reasonable likely to materially affect, the Company’s internal control over financial reporting (as defined in Exchange Act Rules 13a – 15(f) and 15d – 15(f)).

Report of Independent Registered Public Accounting Firm
Board of Directors and Stockholders
Key Tronic Corporation
Spokane Valley, Washington

We have audited Key Tronic Corporation's internal control over financial reporting as of July 1, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Key Tronic Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A “Management's Report on Internal Control over Financial Reporting”. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Key Tronic Corporation maintained, in all material respects, effective internal control over financial reporting as of July 1, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Key Tronic Corporation as of July 1, 2017 and July 2, 2016, and the related consolidated statements of income, comprehensive income (loss), shareholders' equity, and cash flows for each of the three years in the period ended July 1, 2017 and our report dated September 8, 2017, expressed an unqualified opinion thereon.

/s/ BDO USA, LLP
Spokane, Washington
September 8, 2017

Item 9B: OTHER INFORMATION

None

PART III

Item 10: DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Directors of the Registrant

Information on the nominees for election as Directors of the Company is incorporated by reference from the Company's definitive proxy statement for the 2017 Annual Meeting of Shareholders to be filed pursuant to Regulation 14A under the Exchange Act no later than 120 days after the end of the Company's 2017 fiscal year.

Executive Officers of the Registrant

This information is included in a separate item captioned "Executive Officers of the Registrant" in Item 1 of Part 1 of this report pursuant to Instruction G(3) of Form 10-K and Instruction 3 to Item 401(b) of Regulation S-K.

Compliance with Section 16(a) of the Exchange Act:

Incorporated by reference to Key Tronic Corporation's 2017 Proxy Statement to Shareholders.

Code of Conduct

The Board of Directors has adopted a written Code of Conduct which applies to its directors and employees, including its executive officers. The Code of Conduct is available on the Company's website at www.keytronic.com. The Company intends to disclose on its website any amendments to or waivers of the Code of Conduct.

Item 11: EXECUTIVE COMPENSATION

Information appearing under the caption "Executive Compensation" in the Company's 2017 Proxy Statement is incorporated herein by this reference.

Item 12: SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth the aggregate information for the Company's equity compensation plans in effect as of July 1, 2017.

EQUITY COMPENSATION PLAN INFORMATION

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights (a)	Weighted-average exercise price of outstanding options, warrants, and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a) (c)
Equity compensation plans approved by security holders[1]	1,084,999	$ 9.09	394,335
Equity compensation plans not approved by security holders	—	$ —	—
Total	1,084,999	$ 9.09	394,335

(1) Included are the 1,200,000 shares subject to the 2010 Plan, the issuance of which were approved by the shareholders at the 2010 Annual Meeting. During the 2015 Annual Meeting, an additional 1,000,000 shares were approved. As a result of the shareholder approval, the Company made the decision to amend the cash-settled SARs granted during fiscal year 2010 to stock-settled SARs effective October 21, 2011.

Information under the caption "Beneficial Ownership of Securities" in the Company's 2017 Proxy Statement is incorporated herein by this reference.

Item 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE
Information appearing under the caption “Related Person Transactions”, “Compensation Committee Interlocks and Insider Participation”, and “Directors’ Independence” in the Company’s 2017 Proxy Statement is incorporated herein by this reference.
Item 14: PRINCIPAL ACCOUNTING FEES AND SERVICES
Information appearing under the caption “Principal Accountant Fees and Services” in the Company’s 2017 Proxy Statement is incorporated herein by this reference.
PART IV
Item 15: EXHIBITS AND FINANCIAL STATEMENT SCHEDULES
(a) 1. FINANCIAL STATEMENTS

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2. SCHEDULES
II. Consolidated Valuation and Qualifying Accounts 64

Other schedules are omitted because of the absence of conditions under which they are required, or because required information is given in the financial statements or notes thereto.

3. EXHIBITS

Exhibit No.	Description
3.1	Articles of Incorporation, incorporated by reference to the Exhibit 3.1 to the Company's form 10-K filed with the SEC for the year ended July 1, 1995 (File No. 2-83898)
3.2	Bylaws, as amended, incorporated by reference to the Exhibit 3 (iii) to the Company's Form 10-K for the year ended July 1, 1995 (File No. 2-83898)
10.1*	Amended and Restated 1990 Stock Option Plan for Non-Employee Directors, as amended, incorporated by reference to the Company's 1997 Proxy Statement dated October 10, 1997 (Proposal 2)
10.2*	1995 Executive Stock Option Plan, incorporated by reference to the Company's 1995 Proxy Statement, pages 19-22 (Proposal 3)
10.3*	2000 Employee Stock Option Plan, incorporated by reference to the Exhibits to the Company's Form 10-Q for the quarter ended January 1, 2000
10.4*	Officers' Employment Contracts, incorporated by reference to the Company's 1998 Proxy Statement, pages 10 and 11
10.5*	Addenda to Officers' Employment Contracts, incorporated by reference to Exhibits to the Company's Form 10-Q for the quarter ended January 1, 2000
10.6*	Description of Retention Bonus Plan, incorporated by reference to the Exhibits to the Company's 10-Q for the quarter ended December 28, 2002
10.7*	Addenda to Officers' Employment Contracts, incorporated by reference to Exhibits to the Company's Form 10-K for the year ended June 29, 2002
10.8	Promise to execute a Purchase and Sale Agreement with Key Safety Systems de Mexico, S.A. de C.V., incorporated by reference to the Exhibit to the Company's Form 8-K filed April 26, 2005
10.9	Summary of material terms and conditions of the Purchase and Sale Agreement with Key Safety Systems de Mexico, S.A. de C.V., incorporated by reference to the Exhibit to the Company's Form 8-K filed June 6, 2005
10.10*	Summary of Key Tronic Corporation Long Term Incentive Compensation Plan, incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed September 27, 2005

10.11*	Summary of Key Tronic Corporation Incentive Compensation Plan, incorporated by reference to Exhibit 10.23 to the Company's Form 10-K for the year ended July 2, 2005
10.12*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2007 and Fiscal Years 2007 – 2009 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company's Form 8-K filed July 28, 2006
10.13	Summary of material terms and conditions of the Purchase and Sale Agreement with Todenko Mexico S.A. de C.V., incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed October 12, 2006
10.14	Summary of material terms and conditions of the Purchase and Sale Agreement with Todenko Mexico S.A. de C.V., incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed November 20, 2006
10.15	Summary of material terms and conditions of the Sale and Purchase Agreement with Adevco Corporation, incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed January 5, 2007
10.16	Summary of Second Amendment to Agreement of Sale and Purchase Agreement with Adevco Corporation, incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed April 11, 2007
10.17*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2008 and Fiscal Years 2008-2010 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company's Form 8-K filed July 27, 2007
10.18*	Summary of Incentive Compensation Plan Performance Goals and Target payments for Fiscal Year 2009 and Fiscal Years 2009 – 2011 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company's Form 8-K filed July 24, 2008
10.19*	Summary of Incentive Compensation Plan Performance Goals and Target payments for Fiscal Year 2010 and Fiscal Years 2010 – 2012 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company's Form 8-K filed July 23, 2009
10.20	Financing Agreement with Wells Fargo Bank, N.A., incorporated by reference to the Exhibits to the Company's Form 8-K filed on August 24, 2009
10.21*	2010 Incentive Plan, incorporated by reference to Exhibit 10.36 to the Company's Form 10-K for the year ended July 3, 2010
10.22*	Employment Contract with Douglas G. Burkhardt, incorporated by reference to Exhibit 10.37 to the Company's Form 10-K for the year ended July 3, 2010
10.23	Summary of material terms and conditions of the Purchase and Sale Agreement with Autopartes Y Arneses de Mexico S.A. de C.V., incorporated by reference to Exhibit 10.38 to the Company's Form 10-K for the year ended July 3, 2010
10.24*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2011 and Fiscal Years 2011 – 2013 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company's Form 8-K filed July 23, 2010
10.25*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2012 and Fiscal Years 2012 – 2014 Long Term Incentive Plan Performance Measures and Awards incorporated by

reference to the Company's Form 8-K filed August 2, 2011

10.26*	Amendment to Employment Contract of Craig D. Gates, dated August 23, 2011; of Ronald F. Klawitter, dated August 23, 2011 and of Douglas G. Burkhardt dated September 6, 2011; incorporated by reference to the Exhibits to the Company’s Form 10-K for the year ended July 2, 2011 filed on September 12, 2011
10.27	Second Loan Modification Agreement to the Credit Agreement with Wells Fargo Bank, N.A., incorporated by reference to the Exhibits to the Company’s Form 8-K filed on February 2, 2012
10.28*	Amendment to Employment Contract of Craig D. Gates, dated May 10, 2012, incorporated by reference to the Exhibits to the Company’s Form 10-Q filed on May 14, 2012
10.29*	Amendment to Employment Contract of Douglas G. Burkhardt dated May 10, 2012; incorporated by reference to the Exhibits to the Company’s Form 10-Q filed on May 14, 2012
10.30*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2013 and Fiscal Years 2013 – 2015 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company’s Form 8-K filed August 7, 2012
10.31*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2014 and Fiscal Years 2014 – 2016 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company’s Form 8-K filed August 6, 2013
10.32*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2015 and Fiscal Years 2015 – 2017 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company’s Form 8-K filed August 1, 2014
10.33	Summary of material terms and conditions of the Stock Purchase Agreement with CDR Manufacturing and Amended and Restated Credit Agreement with Wells Fargo Bank, N. A. incorporated by reference to the Company’s Form 8-K filed September 9, 2014
10.34*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2016 and Fiscal Years 2016 – 2018 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company’s Form 8-K filed July 30, 2015
10.35	First Amendment to Amended and Restated Credit Agreement with Wells Fargo Bank, National Association, incorporated by reference to the Company's Form 8-K filed August 11, 2015
10.36	Second Replacement Revolving Line of Credit Note with Wells Fargo Bank, National Association, incorporated by reference to the Company's Form 8-K filed August 11, 2015
10.37*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2017 and Fiscal Years 2017 – 2019 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company’s Form 8-K filed July 29, 2016
10.38*	Summary of Incentive Compensation Plan Performance Goals and Target Payments for Fiscal Year 2018 and Fiscal Years 2018 – 2020 Long Term Incentive Plan Performance Measures and Awards incorporated by reference to the Company’s Form 8-K filed August 22, 2017
21	Subsidiaries of Registrant, submitted herewith
23.1	Consent of Independent Registered Public Accounting Firm, submitted herewith

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer, submitted herewith

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer, submitted herewith

32.1 Section 1350 Certification of Chief Executive Officer, submitted herewith

32.2 Section 1350 Certification of Chief Financial Officer, submitted herewith

101.INS XBRL Instance Document **

101.SCH XBRL Taxonomy Extension Schema Document **

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document **

101.DEF XBRL Taxonomy Extension Definition Linkbase Document **

101.LAB XBRL Taxonomy Extension Label Linkbase Document **

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document **

* Management contract or compensatory plan or arrangement

** Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities and Exchange Act of 1934, as amended and otherwise are not subject to liability under those sections.

SCHEDULE II
KEY TRONIC CORPORATION AND SUBSIDIARIES
CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS
FISCAL YEARS ENDED JULY 1, 2017, JULY 2, 2016, AND JUNE 27, 2015

	Fiscal Year Ended		
	2017	2016	2015
	(in thousands)		
Allowance for Obsolete Inventory			
Balance at beginning of year	$1,113	$417	$332
Provisions	496	757	520
Dispositions	(303)	(61)	(435)
Balance at end of year	$1,306	$1,113	$417
Allowance for Doubtful Accounts			
Balance at beginning of year	$135	$97	$—
Provisions	(10)	38	97
Write-offs	(41)	—	—
Balance at end of year	$84	$135	$97

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: September 8, 2017

KEY TRONIC CORPORATION

By: /s/ Craig D. Gates
Craig D. Gates, President and Chief Executive Officer
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

/s/ Craig D. Gates Craig D. Gates Director and President and Chief Executive Officer (Principal Executive Officer)	September 8, 2017 Date
/s/ Brett R. Larsen Brett R. Larsen Executive Vice President of Administration, Chief Financial Officer and Treasurer (Principal Financial Officer)	September 8, 2017 Date
/s/ Ronald F. Klawitter Ronald F. Klawitter, Director	September 8, 2017 Date
/s/ James R. Bean James R. Bean, Director	September 8, 2017 Date
/s/ Yacov A. Shamash Yacov A. Shamash, Director	September 8, 2017 Date
/s/ Patrick Sweeney Patrick Sweeney, Director and Chairman of the Board	September 8, 2017 Date