

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2019

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

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INDEPENDENT AUDITORS' REPORT

To the Member

Morristown Development Urban Renewal Phase II, LLC

Report on the Financial Statements

We have audited the accompanying financial statements of Morristown Development Urban Renewal Phase II, LLC (the "Company"), which comprise the balance sheet as of December 31, 2019, and the related statements of operations, changes in member's capital and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2019, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Marcum LLP

New York, NY
September 17, 2020

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

BALANCE SHEET

DECEMBER 31, 2019

Assets

Rental Property

Land and land improvements	\$ 10,985,014
Building and building improvements	46,440,578
Furniture, fixtures and equipment	<u>1,592,896</u>
	59,018,488
Less: accumulated depreciation	<u>2,526,774</u>

Rental Property, Net \$ 56,491,714

Other Assets

Cash	655,380
Restricted cash	126,183
Accounts receivable	11,411
Prepaid expenses and other assets	<u>423,158</u>

Total Assets \$ 57,707,846

Liabilities and Member's Capital

Liabilities

Mortgage loan payable, net	\$ 39,913,469
Accounts payable and accrued expenses	143,554
Accrued interest	107,571
Interest rate swap liability	2,549,215
Tenants' security deposits	121,722
Prepaid rent	<u>181,833</u>

Total Liabilities \$ 43,017,364

Commitments

Member's Capital 14,690,482

Total Liabilities and Member's Capital \$ 57,707,846

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

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2019

Revenues

Rental income	\$ 3,803,405
Reimbursement income	93,312
Parking and other income	<u>345,608</u>

Total Revenues \$ 4,242,325

Expenses

Payment in lieu of taxes (annual service charge)	537,797
Utilities	213,653
Repairs and maintenance	294,032
General and administrative	76,968
Management fees	108,526
Insurance	53,263
Professional fees	126,589
Advertising and marketing	110,792
Cleaning	32,761
Payroll	332,131
Depreciation	1,553,368
Casualty loss expense	33,583
Bad debt expense	3,040
Interest expense	1,969,250
Unrealized loss on interest rate swap	<u>2,549,215</u>

Total Expenses 7,994,968

Net Loss \$ (3,752,643)

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

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

STATEMENT OF CHANGES IN MEMBER'S CAPITAL

FOR THE YEAR ENDED DECEMBER 31, 2019

Balance - January 1, 2019	\$ 19,519,342
Contributions	1,038,783
Distributions	(2,115,000)
Net loss	<u>(3,752,643)</u>
Balance - December 31, 2019	<u><u>\$ 14,690,482</u></u>

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

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2019

Cash Flows From Operating Activities

Net loss	\$ (3,752,643)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation	1,553,368
Amortization of debt issuance costs	368,822
Unrealized loss on interest rate swap	2,549,215
Bad debt expense	3,040
Changes in operating assets and liabilities:	
Accounts receivable	27,003
Prepaid expenses and other assets	171,948
Accounts payable and accrued expenses	(264,519)
Accrued interest	(46,885)
Tenants' security deposits	46,772
Prepaid rent	<u>78,420</u>

Net Cash Provided by Operating Activities \$ 734,541

Cash Flows Used in Investing Activities

Additions to rental property	(256,743)
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Cash Flows From Financing Activities

Payoff of loan payable	(38,782,215)
Proceeds from mortgage payable	40,187,000
Debt issuance costs	(312,421)
Contributions from member	1,038,783
Distributions to member	<u>(2,115,000)</u>

Net Cash Provided by Financing Activities 16,147

Net Change in Cash and Restricted Cash 493,945

Cash and Restricted Cash - Beginning 287,618

Cash and Restricted Cash - Ending \$ 781,563

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

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2019

Supplemental Disclosure of Cash Flow Information

Cash paid during the year for interest	\$ 1,647,313
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Supplemental Disclosure of Non-Cash Financing Activities

Write off of financing costs	\$ 784,673
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Reconciliation of Cash and Restricted Cash:

Cash	\$ 655,380
Restricted Cash	<u>126,183</u>

Cash and Restricted Cash - Ending	<u><u>\$ 781,563</u></u>
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The accompanying notes are an integral part of these financial statements.

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2019

NOTE 1 – NATURE OF OPERATIONS

Morristown Development Urban Renewal Phase II, LLC (the “Company”) is a Delaware limited liability company formed on October 5, 2012 for the purpose of acquiring, constructing and operating a 185-unit apartment building containing approximately 159,000 net rentable square feet located in Morristown, New Jersey (the “Property”). The sole member of the Company is Morristown Development Phase II, LLC (“Member”).

The Company will continue perpetually, unless terminated earlier pursuant to the terms of its Operating Agreement.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

USE OF ESTIMATES

The Company’s records are maintained on the accrual basis of accounting for financial reporting purposes. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. The most significant estimates relate to the depreciable life of property, realizability of accounts receivable and recoverability of rental property. Actual results could differ from those estimates.

RENTAL PROPERTY

Rental property is stated at cost less accumulated depreciation. Ordinary repairs and maintenance are expensed as incurred; major replacements and betterments, which improve or extend the life of the asset are capitalized. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets. Building and building improvements are depreciated over 40 years, land improvements over 20 years and furniture, fixtures and equipment are being depreciated over 5 years. For the year ended December 31, 2019, depreciation expense was \$1,553,368.

On a periodic basis, management assesses whether there are any indicators that the value of the real estate property may be impaired. A property’s value is impaired if management’s estimate of the aggregate future cash flows (undiscounted and without interest charges) to be generated by the property are less than the carrying value of the property. To the extent impairment has occurred, the loss shall be measured as the excess of the carrying amount of the property over the estimated fair value of the property. Management does not believe that the value of the Property is impaired.

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2019

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CONCENTRATION OF CREDIT RISK

The Company maintains cash at financial institutions that may from time to time exceed federally insured amounts. The Company periodically assesses the financial conditions of the institutions and believes that the risk of any loss is minimal.

RESTRICTED CASH

Restricted cash is comprised of a reserve for environmental guarantees and tenants' security deposits established pursuant to the respective leases.

ACCOUNTS RECEIVABLE

Accounts receivable are reflected net of allowance for doubtful accounts. The Company evaluates its accounts receivable on an individual tenant basis and establishes an allowance for doubtful accounts based on its evaluation of outstanding overdue accounts. At December 31, 2019, there was no allowance for doubtful accounts. The Company considers its accounts receivable balance to be collectible in full.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company uses interest rate swaps in order to reduce the effect of interest rate fluctuations on the Company's variable rate financing. The Company is potentially exposed to credit loss in the event of non-performance by counterparties; however, due to the counterparties' credit rating, the Company does not anticipate that the counterparties will fail to meet their obligations. Derivatives that are not hedges must be adjusted to fair value through earnings. The Company records the interest rate swaps at fair value with changes in fair value recorded in earnings.

DEBT ISSUANCE COSTS

Debt issuance costs represent costs incurred in connection with obtaining long-term debt and are recorded as a direct deduction of the related obligation on the accompanying balance sheet. Debt issuance costs are amortized over the term of the related debt obligation and included in interest expense on the accompanying statement of operations.

RENTAL INCOME

Rental income is recognized as earned under operating leases, which are generally short term. Parking income is recorded in accordance with the lease agreements and included with other income. As of December 31, 2019, approximately 83% of the residential units were occupied.

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2019

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RENTAL INCOME (CONTINUED)

Reimbursable expenses incurred by the Company relate to the operation and maintenance of the Property and are charged to the tenants and included in reimbursement income in the accompanying statement of operations.

ADVERTISING

Advertising costs are expensed as incurred.

INCOME TAXES

No provision for income taxes is necessary in the financial statements of the Company because the Company is a single member limited liability company and is a disregarded entity for federal and state income tax purposes.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENT

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. The guidance requires that the statement of cash flows explain the change during the period in the total of cash and amounts generally described as restricted cash. As a result, entities will no longer present transfers between these items on the statement of cash flows. The Company adopted the guidance on January 1, 2019 and has included restricted cash with cash when reconciling the beginning-of-period and end-of-period total amounts on the statement of cash flows.

NOTE 3 – MORTGAGE LOAN PAYABLE

CONSTRUCTION LOAN

On March 29, 2016, the Company entered into a construction loan agreement with TD Bank, N.A. and The Provident Bank (the “Lenders”) in the maximum loan amount of \$40,187,000 (the “Construction Loan”). The Construction Loan was due to mature on September 29, 2019 with two extension options through September 29, 2020 and March 29, 2021.

The Construction Loan required interest only payments through maturity at a rate equal to (1) LIBOR plus 2.25% or (2) U.S. Prime Rate plus 1.00%, as determined. The interest rate could have been reduced to LIBOR plus 2.00% once the Company reached a debt service coverage ratio of 1.25:1.00.

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2019

NOTE 3 – MORTGAGE LOAN PAYABLE (CONTINUED)

MORTGAGE LOAN

The Construction Loan was refinanced on January 7, 2019 with TD Bank, N.A. (the “Mortgage Loan”) for \$40,187,000 with a maturity date of December 1, 2026. The Mortgage Loan requires interest only payments through maturity at a rate of LIBOR plus 1.40%. The interest rate was 3.11% as of December 31, 2019.

For the year ended December 31, 2019, the Company incurred interest expense of \$1,500,040, of which \$107,571 was unpaid and included in accrued interest on the accompanying balance sheet.

The Company is required to maintain a debt service coverage ratio (“DSCR”) of not less than 1.20:100. At December 31, 2019, the required minimum DSCR was met.

In connection with the Mortgage Loan, the Company entered into an interest rate swap agreement (the “Swap”), effectively swapping the variable portion of the floating rate for a fixed rate of 2.593% on a notional of up to \$40,187,000. The Swap matures on December 1, 2026, in accordance with the agreement. At December 31, 2019, the fair value of the Swap was a liability in the amount of \$2,549,215. For the year ended December 31, 2019, the Company incurred \$100,388 of interest expense related to the Swap.

The Mortgage Loan is collateralized by the Property and guaranteed by PRISA II LHC, LLC, an affiliate of the Member.

Mortgage loan payable consists of the following as of December 31, 2019:

Principal balance	\$ 40,187,000
Less: unamortized debt issuance costs	<u>(273,531)</u>
Mortgage loan payable, net of unamortized debt issuance costs	<u>\$ 39,913,469</u>

NOTE 4 – FAIR VALUE MEASUREMENT

All financial instruments of the Company are reflected in the accompanying balance sheet at amounts which reasonably approximate their fair values based upon interpretation of available market information and valuation methodologies.

Fair value is determined using a hierarchy which groups investments into three levels, based on the markets in which the assets are traded, if any, and the observability of the assumptions used to determine fair value. These levels are as follows:

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2019

NOTE 4 – FAIR VALUE MEASUREMENT (CONTINUED)

Level 1 – Fair value is based on unadjusted quoted prices for identical investments traded in active markets as of the reporting date.

Level 2 – Pricing inputs other than quoted prices included within Level 1, which are either directly or indirectly observable as of the reporting date. Fair values are obtained from third party pricing services for comparable investments, quoted prices for identical investments in markets that are not active, or inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 – Pricing inputs that are unobservable for the investment and includes situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require significant management judgment or estimation. Fair values are derived from other valuation methodologies, including pricing models, discounted cash flow models and similar techniques.

The input values used in the Company's fair value measurement of the interest swap are obtained from observable market data, therefore, classified as Level 2 under the fair value hierarchy. The estimated fair value is based on discounting future cash flows at interest rates that management believes reflect the risks associated with debt instruments of similar risk and duration.

Disclosure about fair value of financial instruments is based on pertinent information available to management as of December 31, 2019. Although management is not aware of any factors that would significantly affect the fair value amounts, current estimates of fair value presented herein are not necessarily indicative of the amounts the Company could realize on disposition of the financial instruments.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgement, and considers factors specific to the asset or liability. The interest rate swap is valued within level 2 of the valuation hierarchy for the year ended December 31, 2019 as follows:

	Level I	Level II	Level III	Total
Interest rate swap liability	\$ --	\$ 2,549,215	\$ --	\$ 2,549,215

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2019

NOTE 4 – FAIR VALUE MEASUREMENT (CONTINUED)

There were no transfers in or out of Level 3 or between Level 1 and 2 investments during the year ended December 31, 2019.

NOTE 5 – COMMITMENTS

FINANCIAL AGREEMENT

The Company is party to a financial agreement (the “Agreement”) with the Town of Morristown (the “Town”) whereby the improvements to the land on which the Property is constructed are exempt from real estate taxes for a period of 30 years commencing on June 11, 2018. In lieu of real estate taxes, an Annual Service Charge (“ASC”), as defined, is charged during the term of the Agreement. Land taxes are exempt; however, land tax payments are applied as a credit against the ASC.

The ASC is equal to the greater of the Minimum Annual Service Charge or 10.5% of Annual Gross Revenues (“AGR”), which excludes parking revenue as defined, for each of years 1-12; the greater of 10.5% of AGR or 20% of the amount of taxes otherwise due for each of years 13-15; the greater of 12.5% of AGR or 20% of the amount of taxes otherwise due for each of years 16-17; the greater of 12.5% of AGR or 40% of the amount of taxes otherwise due for each of years 18-22; the greater of 12.5% of AGR or 60% of the amount of taxes otherwise due for each of years 23-25; and the greater of 13.5% of AGR or 60% of the amount of taxes otherwise due for year 26; and the greater of 13.5% of AGR or 80% of the amount of taxes otherwise due for each of years 27-30. The Company is also required to pay to the Town an Administrative Fee equal to 2% of the Annual Service Charge.

For the year ended December 31, 2019, the Company paid an ASC of \$537,797. The Company is also obligated to pay the Town excess profits in accordance with the provisions of N.J.S.A. 40A:20-1.

Minimum annual payments due under the Agreement as of December 31, 2019 are as follows:

2020	\$ 265,200
2021	265,200
2022	265,200
2023	265,200
2024	265,200
Thereafter	<u>6,216,984</u>
	<u>\$ 7,542,984</u>

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2019

NOTE 5 – COMMITMENTS (CONTINUED)

EXCESS PROFITS

During the period of tax exemption granted under the Agreement, the Company is obligated to pay the Town excess profits in accordance with the provisions of the Long-Term Tax Exemption Law (“N.J.S.A. 40A:20-1”). The Company is subject to a limitation on its profits, which requires any profits, in excess of the Allowable Net Profits, as defined in the Agreement, to be remitted to the Town as an additional service charge.

Allowable Net Profit is defined as the amount arrived at by applying the Allowable Profit Rate (the “Rate”) to the Total Project Costs, as defined. The Rate, under the provision of the N.J.S.A. 40A:20-1 is the greater of 12% or 1.25%, plus the annual interest rate payable on the Company’s initial permanent mortgage financing. The Rate was determined by management to be 12% per annum. The Total Project Costs were \$61,826,000. For the year ended December 31, 2019, no excess profits were due.

The calculation of allowable net profit and excess profit (loss) under N.J.S.A. 40A:20-1 is as follows:

Total Gross Revenues	\$ 4,242,325
Total Expenses	7,994,968
Adjustment to Expenses:	
Depreciation	(1,553,368)
Amortization of debt issuance costs	(368,822)
Allowable amortization of project costs	<u>2,060,867</u>
Adjusted Expenses	<u>8,133,645</u>
Net Loss in accordance with N.J.S.A. 40A:20-1	(3,891,320)
Less: allowable annual net profit	<u>7,419,120</u>
Excess Loss	(11,310,440)
Excess Loss - Beginning	<u>(10,297,445)</u>
Excess Loss - Ending	<u>\$ (21,607,885)</u>

MORRISTOWN DEVELOPMENT URBAN RENEWAL PHASE II, LLC

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2019

NOTE 6 – MANAGEMENT AGREEMENT

Pursuant to a management agreement dated April 13, 2018, the Company is required to pay Mill Creek Residential a management fee equal to the greater of \$8,500 monthly or 2.5% of gross collected operating revenues. For the year ended December 31, 2019, the Company incurred management fees of \$108,526.

In addition, the Company is required to reimburse Mill Creek Residential for the costs of employees' salaries and benefits. The Property is known as the Modera55 and has a sister property named Modera44. In accordance with the agreement, the cost of employees' salaries and benefits who work on both properties were allocated 40% for the Modera55 and 60% for Modera44. For the year ended December 31, 2019, the Company incurred \$332,131 of payroll expense, of which \$20,571 is unpaid and included in accounts payable and accrued expenses on the accompanying balance sheet.

NOTE 7 – RELATED PARTY TRANSACTIONS

The Company obtains insurance coverage from an affiliate of Prudential. For the year ended December 31, 2019, the Company was charged \$53,263 by this affiliate. The insurance cost was reimbursed back to Prudential.

NOTE 8 – SUBSEQUENT EVENTS

Subsequent to year-end, the virus COVID-19, which was having a serious impact in Asia and Europe reached the US and has been spreading throughout the country. The virus has had a significant impact on the current economic conditions. As such, the operations of our tenants may be negatively impacted, and affect their ability to meet obligations in the near term. The long-term impact on the economy and tenancy is unknown. However, the effects could have a material impact on our operations, and we will continue to monitor the COVID-19 situation closely.

The Company evaluated all events and transactions that occurred after December 31, 2019 up through September 17, 2020, the date these financial statements were available for issue. During this period, other than as noted above, the Company did not have any material subsequent events.