



The Highlands 2 LLLP

**Financial Statements with Report of Independent Auditors
December 31, 2022 and 2021**

THE HIGHLANDS 2 LLLP

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NOVOGRADAC
& COMPANY LLP®

Report of Independent Auditors

To the Partners of
The Highlands 2 LLLP:

Opinion

We have audited the accompanying financial statements of The Highlands 2 LLLP, a Colorado limited liability limited partnership, which comprise the balance sheets as of December 31, 2022 and 2021, and the related statements of operations, changes in partners' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Highlands 2 LLLP as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of The Highlands 2 LLLP and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Change in Accounting Principle

As discussed in Note 2 to the financial statements, The Highlands 2 LLLP adopted accounting standards changes related to accounting for and disclosing leasing arrangements. Our opinion is not modified with respect to this matter.

Responsibilities of Management 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about The Highlands 2 LLLP's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Highlands 2 LLLP's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about The Highlands 2 LLLP's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedules of Expenses is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Disclaimer of Opinion on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The Schedules of Cash Distribution (Unaudited), which is the responsibility of management, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Norogardac & Company LLP

San Francisco, California
April 14, 2023

THE HIGHLANDS 2 LLLP**BALANCE SHEETS**

December 31, 2022 and 2021

	<u>2022</u>	<u>2021</u>
ASSETS		
Cash and cash equivalents	\$ 180,102	\$ 612,975
Restricted cash	259,038	238,107
Rental property, net	14,190,621	14,644,770
Deferred charges, net	<u>98,268</u>	<u>107,201</u>
Total assets	<u>\$ 14,728,029</u>	<u>\$ 15,603,053</u>
LIABILITIES AND PARTNERS' EQUITY		
Liabilities:		
Accounts payable	\$ 6,022	\$ 8,344
Tenant deposits held in trust	50,923	52,014
Prepaid rent	1,157	-
Accrued interest	611,568	481,781
Due to related parties:		
Due to affiliate	37,200	16,307
GP asset management fee payable	5,464	5,227
Asset management fee payable	5,796	5,239
Developer fee payable	244,589	532,648
Long-term debt, net	<u>3,368,057</u>	<u>3,568,297</u>
Total liabilities	4,330,776	4,669,857
Partners' equity	<u>10,397,253</u>	<u>10,933,196</u>
Total liabilities and partners' equity	<u>\$ 14,728,029</u>	<u>\$ 15,603,053</u>

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

THE HIGHLANDS 2 LLLP
STATEMENTS OF OPERATIONS
For the years ended December 31, 2022 and 2021

	<u>2022</u>	<u>2021</u>
REVENUE		
Rental revenue	\$ 572,831	\$ 554,432
Vacancies and concessions	<u>(11,566)</u>	<u>(13,155)</u>
Net rental income	561,265	541,277
Other revenue	<u>47,657</u>	<u>46,481</u>
Total revenue	608,922	587,758
OPERATING EXPENSES		
Salaries and employee benefits	107,426	53,141
Repairs and maintenance	39,597	57,192
Utilities	76,516	90,455
Property management fee	42,611	41,143
Insurance	37,387	37,919
General and administrative	<u>166,209</u>	<u>156,929</u>
Total operating expenses	<u>469,746</u>	<u>436,779</u>
Net operating income	139,176	150,979
OTHER INCOME AND (EXPENSES)		
Interest income	493	146
Asset management fee	(5,796)	(5,308)
GP asset management fee	(5,464)	(5,308)
Interest expense	(201,270)	(213,964)
Depreciation	(454,149)	(454,149)
Amortization	<u>(8,933)</u>	<u>(8,933)</u>
Net other income and (expenses)	<u>(675,119)</u>	<u>(687,516)</u>
NET LOSS	<u>\$ (535,943)</u>	<u>\$ (536,537)</u>

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

THE HIGHLANDS 2 LLLP
STATEMENTS OF CHANGES IN PARTNERS' EQUITY
For the years ended December 31, 2022 and 2021

	General Partner	Limited Partner	Total Partners' Equity
	<u> </u>	<u> </u>	<u> </u>
Balance, January 1, 2021	\$ 9	\$ 11,469,724	\$ 11,469,733
Net loss	<u>(54)</u>	<u>(536,483)</u>	<u>(536,537)</u>
Balance, December 31, 2021	(45)	10,933,241	10,933,196
Net loss	<u>(54)</u>	<u>(535,889)</u>	<u>(535,943)</u>
Balance, December 31, 2022	<u>\$ (99)</u>	<u>\$ 10,397,352</u>	<u>\$ 10,397,253</u>

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

THE HIGHLANDS 2 LLLP
STATEMENTS OF CASH FLOWS
For the years ended December 31, 2022 and 2021

	<u>2022</u>	<u>2021</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (535,943)	\$ (536,537)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	454,149	454,149
Amortization	8,933	8,933
Interest expense - debt issuance costs	3,219	3,219
Changes in assets and liabilities		
Accounts payable	(2,322)	5,649
Tenant deposits held in trust	(1,091)	4,213
Prepaid rent	1,157	(964)
Accrued interest	129,787	114,312
Due to affiliate	20,893	1,226
GP asset management fee payable	237	(4,773)
Asset management fee payable	557	239
Net cash provided by operating activities	<u>79,576</u>	<u>49,666</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of developer fee payable	(288,059)	(75,353)
Payment of long-term debt	<u>(203,459)</u>	<u>(17,306)</u>
Net cash (used in) provided by financing activities	<u>(491,518)</u>	<u>(92,659)</u>
Net change in cash, cash equivalents and restricted cash	(411,942)	(42,993)
Cash, cash equivalents and restricted cash at beginning of the period	<u>851,082</u>	<u>894,075</u>
Cash, cash equivalents and restricted cash at end of the period	<u><u>\$ 439,140</u></u>	<u><u>\$ 851,082</u></u>
Cash and cash equivalents	\$ 180,102	\$ 612,975
Restricted cash	<u>259,038</u>	<u>238,107</u>
Total cash, cash equivalents and restricted cash	<u><u>\$ 439,140</u></u>	<u><u>\$ 851,082</u></u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for interest	<u><u>\$ 68,264</u></u>	<u><u>\$ 96,433</u></u>

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

THE HIGHLANDS 2 LLLP
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2022 and 2021

1. General

The Highlands 2 LLLP (the “Partnership”) is a Colorado limited liability limited partnership formed in January 14, 2016, for the purposes of acquiring, financing, owning, constructing, rehabilitating, maintaining, improving, operating, leasing and, if appropriate or desirable, selling or otherwise disposing of the apartment complex in a manner consistent with the requirements of Code Section 42. The apartment complex is a 72-unit, multifamily rental housing development in Grand Junction, Colorado, for low to moderate-income residents. Pursuant to the Amended and Restated Agreement of Limited Partnership dated February 27, 2018 (the “Partnership Agreement”), the Partnership shall continue in full force and effect until December 31, 2095. The Partnership may be dissolved prior to such date if certain events occur, which are outlined in the Partnership Agreement.

The Project has qualified and been allocated low-income housing tax credits pursuant to the Internal Revenue Code Section 42, which regulates the use of the complex as to occupant eligibility and unit gross rent, among other requirements. The Project must meet the provisions of these regulations during each of 15 consecutive years in order to continue to qualify to receive the tax credits. Failure to comply with occupant eligibility and/or unit gross rent, or to correct noncompliance within a specified time period could result in recapture of the previously taken low-income housing tax credits plus interest. Such potential noncompliance may require an adjustment to the contributed capital by the limited partners. All units within this Project are subject to the rent restrictions and qualified tenant restrictions as required by the Low Income Housing Tax Credit Program.

Pursuant to the Partnership Agreement, income or loss of the Partnership is allocated 99.99% to Wells Fargo Affordable Housing Community Development Corporation (the “Investor Limited Partner”) and 0.01% to The Grand Junction Housing Authority (the “General Partner”). The Partnership is generating low-income housing tax credits, which will be allocated in the same manner. Allocation of gain or loss from a sale of the Project, if applicable, is subject to different terms, as described in the Partnership Agreement.

The Investor Limited Partner is required to provide capital contributions to the Partnership totaling \$12,373,763, subject to adjustments based on the amount of low-income housing tax credits allocated to the Project in addition to other occurrences as more fully explained in the Partnership Agreement. As of December 31, 2022 and 2021, the Investor Limited Partner has provided cumulative contributions of \$12,443,559.

2. Summary of significant accounting policies and nature of operations

Basis of accounting

The Partnership prepares its financial statements on the accrual basis of accounting consistent with accounting principles generally accepted in the United States of America.

Cash and cash equivalents

Cash and cash equivalents include all cash balances on deposit with financial institutions and highly liquid investments with a maturity of three months or less at the date of acquisition.

Restricted cash is not considered cash and cash equivalents, and includes cash held with financial institutions for refunds of tenant security deposits, funding of operating deficits, and funding of repairs or improvements to the buildings which extend their useful lives.

Concentration of credit risk

The Partnership maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits. The Partnership has not experienced any losses in such accounts. The Partnership has not experienced any losses in such accounts.

THE HIGHLANDS 2 LLLP
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2022 and 2021

2. Summary of significant accounting policies and nature of operations (continued)

Accounts receivable

The Partnership recognizes credit losses on tenant accounts receivable as realized. Tenant accounts receivable are recorded at gross amount, less an allowance for doubtful accounts. If amounts become uncollectible, they are charged to operations in the period in which that determination is made. The allowance for doubtful accounts was \$0 and \$7,312, respectively, as of December 31, 2022 and 2021.

Capitalization and depreciation

Land, buildings, land improvements, and equipment and furnishings are recorded at cost. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated service lives using the straight-line method. Improvements are capitalized and expenditures for maintenance and repairs are charged to expense as incurred. Upon disposal of depreciable property, the appropriate property accounts are reduced by the related costs and accumulated depreciation. The resulting gain or loss is reflected in the statements of operations. The estimated useful lives are as follows:

	<u>Years</u>
Building and improvements	40
Land improvements	20
Equipment and furnishings	10

Impairment of long-lived assets

The Partnership reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount of the asset to the future net undiscounted cash flows expected to be generated and any estimated proceeds from the eventual disposition. If the long-lived assets are considered to be impaired, the impairment to be recognized is measured at the amount by which the carrying amount of the asset exceeds the fair value as determined from an appraisal, discounted cash flow analysis, or other valuation technique. There were no impairment losses recognized during 2022 and 2021.

Income taxes

Income taxes on Partnership income are levied on the partners at the partner level. Accordingly, all profits and losses of the Partnership are recognized by each partner on its respective tax return.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the Partnership to report information regarding its exposure to various tax positions taken by the Partnership. The Partnership has determined whether any tax positions have met the recognition threshold and has measured the Partnership's exposure to those tax positions. Management believes that the Partnership has adequately addressed all relevant tax positions and that there are no unrecorded tax liabilities. Federal and state tax authorities generally have the right to examine and audit the previous three years of tax returns filed. Any interest or penalties assessed to the Partnership are recorded in operating expenses. No interest or penalties from federal or state tax authorities were recorded in the accompanying financial statements.

Tax credit fees

The Partnership is amortizing tax credit fees on the straight-line basis over the related tax credit compliance period of 15 years.

THE HIGHLANDS 2 LLLP
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2022 and 2021

2. Summary of significant accounting policies and nature of operations (continued)

Debt issuance costs

The Partnership amortizes debt issuance costs using the straight-line method over the life of the respective loan. The use of the straight-line method rather than the effective interest method has no material effect on the financial statements.

Revenue recognition for tenant leases and tenant charges

The Partnership is the lessor of the Project and accounts for tenant leases as operating leases. The Partnership determines if a contract is a lease or contains a lease at inception. At the commencement of an operating lease, no income is recognized; subsequently, lease payments received are recognized on a straight-line basis. Rental revenue attributable to tenant leases is recorded when due from residents, generally upon the first day of each month. Leases are for periods of up to one year, with rental payments due monthly. Other revenue includes fees for late payments, cleaning, damages, laundry facilities and other tenant charges and is recorded when earned. Advance receipts of revenue are deferred and classified as liabilities until earned.

Advertising

Advertising costs are expensed as incurred.

Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America 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.

Economic concentrations

The Partnership operates one property in Grand Junction, Colorado. Future operations could be affected by changes in the economic or other conditions in that geographical area or by changes in federal low-income housing subsidies or the demand for such housing.

Subsequent events

Subsequent events have been evaluated through April 14, 2023, which is the date the financial statements were available to be issued, and there are no subsequent events requiring disclosure.

Change in accounting principle

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Codification ("ASC") 842, *Leases* ("FASB ASC 842") to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet by lessees and the disclosure of key information about leasing arrangements.

FASB ASC 842 was adopted January 1, 2022, and any adjustment necessary, if any, was recognized through a cumulative effect adjustment, with certain practical expedients available. Lease disclosures for the year ended December 31, 2021 are made under prior lease guidance in FASB ASC 840.

With respect to tenant leases, FASB ASC 842 did not have a material impact on the financial statements.

THE HIGHLANDS 2 LLLP
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2022 and 2021

3. Restricted cash

As of December 31, 2022 and 2021, restricted cash was comprised of the following:

	<u>2022</u>	<u>2021</u>
Tenants' security deposits	\$ 52,235	\$ 51,325
Operating reserves	137,772	137,372
Replacement reserves	<u>69,031</u>	<u>49,410</u>
Total restricted cash	<u>\$ 259,038</u>	<u>\$ 238,107</u>

4. Rental property, net

As of December 31, 2022 and 2021, the Partnership's rental property, net consisted of the following:

	<u>2022</u>	<u>2021</u>
Land	\$ 573,120	\$ 573,120
Building	13,699,803	13,699,803
Land improvements	762,147	762,147
Equipment and furnishings	<u>735,463</u>	<u>735,463</u>
Total rental property	15,770,533	15,770,533
Less: accumulated depreciation	<u>(1,579,912)</u>	<u>(1,125,763)</u>
Rental property, net	<u>\$ 14,190,621</u>	<u>\$ 14,644,770</u>

5. Deferred charges, net

As of December 31, 2022 and 2021, the Partnership's deferred charges, net consisted of the following:

	<u>2020</u>	<u>2019</u>
Tax credit fees	\$ 134,000	\$ 134,000
Less: accumulated amortization	<u>(35,732)</u>	<u>(26,799)</u>
Deferred charges, net	<u>\$ 98,268</u>	<u>\$ 107,201</u>

6. Long-term debt, net

Note payable – Bank of Colorado

On February 27, 2018, the Partnership entered into a construction loan with Bank of Colorado ("BOC") in the initial amount of \$10,500,000 (the "Construction Loan"), bearing interest at a rate equal to 4.00% per annum. Interest only payments were due monthly through maturity on December 1, 2019, at which time all outstanding principal and accrued interest shall be due and payable. The Maturity date was extended to March 1, 2020. The loan was repaid on February 26, 2020.

The Construction Loan was converted to the permanent phase on February 26, 2020 in the principal amount of \$700,000 (the "Permanent Loan"), bearing fixed interest at a rate of 5.750% per annum. Monthly payments of principal and interest of \$3,916.37 are due monthly beginning April 1, 2020. The permanent loan matures on February 26, 2050. For the years ended December 31, 2022 and 2021, interest expense was \$38,754 and \$40,391, respectively.

THE HIGHLANDS 2 LLLP
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2022 and 2021

6. Long-term debt, net (continued)

Note payable – Bank of Colorado, net consists of the following as of December 31,

	<u>2022</u>	<u>2021</u>
Principal balance	\$ 682,270	\$ 689,271
Less: unamortized debt issuance costs	<u>(45,604)</u>	<u>(48,823)</u>
Note payable – Bank of Colorado, net	<u>\$ 636,666</u>	<u>\$ 640,448</u>

Debt issuance costs on the above loans are being amortized over the life of the loan. For the years ended December 31, 2022 and 2021, the effective interest rate was 6.12% and 6.30%, respectively. For the years ended December 31, 2022 and 2021, amortization expense of debt issuance costs was \$3,219.

Note payable - CHFA

On February 26, 2020, the Partnership entered into a promissory note with Colorado Housing Finance Authority (“CHFA”) in the principal amount of \$500,000. The loan bears interest at 3% per annum and matures on March 1, 2037. As of December 31, 2022 and 2021, outstanding principal was \$470,523 and \$481,499, respectively. For the years ended December 31, 2022 and 2021, interest expense was \$13,453 and \$14,596, respectively.

Grand Junction Housing Authority – Sponsor Loan

On February 27, 2018, the Partnership entered into a loan with GJHA in the initial amount of \$309,230. The loan bears interest at a rate equal to 5%. No payments are due until maturity on February 27, 2058, at which time all outstanding principal and accrued interest shall be due and payable. The amount of the loan drawn and outstanding as of December 31, 2022 and 2021, was \$309,230. Outstanding interest as of December 31, 2022 and 2021 was \$82,414 and \$63,764, respectively. For the years ended December 31, 2022 and 2021, interest expense was \$18,650 and \$17,761, respectively.

Grand Junction Housing Authority – FHLB Loan

On February 27, 2018, the Partnership entered into a loan with GJHA in the initial amount of \$700,000. The loan bears interest at a rate equal to 5%. No payments are due until maturity on February 27, 2058, at which time all outstanding principal and accrued interest shall be due and payable. The amount of the loan drawn and outstanding as of December 31, 2022 and 2021 was \$700,000. Outstanding interest as of December 31, 2022 and 2021 was \$150,855 and \$110,338, respectively. For the years ended December 31, 2022 and 2021, interest expense was \$40,517 and \$38,588, respectively.

Grand Junction Housing Authority – CDOH Loan

On February 27, 2018, the Partnership entered into a loan with GJHA in the initial amount of \$864,000. The loan bears interest at a rate equal to 5%. No payments are due until maturity on February 27, 2058, at which time all outstanding principal and accrued interest shall be due and payable. The amount of the loan drawn and outstanding as of December 31, 2022 and 2021 was \$864,000. Outstanding interest as of December 31, 2022 and 2021 was \$229,151 and \$177,097, respectively. For the years ended December 31, 2022 and 2021, interest expense was \$52,054 and \$49,593, respectively.

THE HIGHLANDS 2 LLLP
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2022 and 2021

6. Long-term debt, net (continued)

Grand Junction Housing Authority – Land Loan

On February 27, 2018, the Partnership entered into a loan with GJHA in the initial amount of \$573,120 for the purchase of the land from GJHA. The loan bears interest at a rate equal to 5%. No payments are due until maturity on February 27, 2058, at which time all outstanding principal and accrued interest shall be due and payable. Outstanding principal as of December 31, 2022 and 2021 was \$387,638 and \$573,120, respectively. Outstanding interest as of December 31, 2022 and 2021 was \$145,789 and \$118,180, respectively. For the years ended December 31, 2022 and 2021, interest expense was of \$27,609 and \$32,919, respectively.

Annual principal on the notes payable is due as follows:

Year ended December 31:

2023	\$	18,755
2024		19,430
2025		20,363
2026		21,228
2027		22,133
Thereafter		<u>3,311,752</u>
Total	\$	<u><u>3,413,661</u></u>

7. Related party transactions

Developer fee

The Partnership entered into a development agreement with Grand Junction Housing Authority for a developer fee in the amount of \$1,699,103. It is anticipated that the developer fee payable will be paid from available cash flow. The entire developer fee has been capitalized into the cost of the rental property as of December 31, 2019 and is required to be paid in entirety on or before July 16, 2024. The payable shall bear interest at the long-term Applicable Federal Rate compounded annually, as defined in the agreement. As of December 31, 2022 and 2021, developer fee earned was \$1,699,103, developer fee payable was \$244,589 and \$532,648, respectively, and accrued interest was \$3,359 and \$12,402, respectively. For the years ended December 31, 2022 and 2021, interest expense was \$7,014 and \$16,897, respectively.

Property management fee

The Partnership entered into a management agreement with the General Partner under which the Partnership is obligated to pay a management fee equal to 7 percent of gross rental receipts of the Project. Management fees incurred and paid under this agreement was \$42,611 and \$41,143, respectively, as of December 31, 2022 and 2021.

Asset management fee

Commencing on January 1, 2019, the Partnership is required to pay the Investor Limited Partner a cumulative annual Asset Management Fee in the amount of \$5,000. The fee is payable out of cash flow, as defined in the Partnership Agreement, and must be paid before payments are made to the General Partner. The fee increases each year by an inflation factor of three percent (3%). For the years ended December 31, 2022 and 2021, \$5,796 and \$5,308, respectively, has been incurred, and as of December 31, 2022 and 2021, \$5,796 and \$5,239, respectively, remains payable.

THE HIGHLANDS 2 LLLP
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2022 and 2021

7. Related party transactions (continued)

GP asset management fee

Commencing on January 1, 2017, the Partnership is required to pay the General Partner a cumulative annual GP asset management fee in the amount of \$5,000. The fee is payable out of cash flow, as defined in the Partnership Agreement. The fee increases each year by an inflation factor of three percent (3%). For the years ended December 31, 2022 and 2021, \$5,464 and \$5,308, respectively, has been incurred, and as of December 31, 2022 and 2021, \$5,464 and \$5,227, respectively, remains payable.

Notes payable - related party

The Partnership financed the Project, in part, with four 5 percent notes payable from the General Partner (see Note 6). The Partnership has a fifth note with the General Partner as detailed above for the Developer Fee.

Common area charges

McMahon Homeowners' Association (the "HOA"), of which the General Partner is a member, controls and operates a portion of the Project that is shared by another low-income housing tax credit apartment complex that is owned by an affiliate of the General Partner. The HOA charges the Partnership its proportional share of the HOA's operating expenses. For the years ended December 31, 2022 and 2021, the Partnership incurred and paid \$107,266 and \$98,993, respectively, in dues to the HOA, which is included in general and administrative on the accompanying Statements of Operations.

Due to affiliate

The General Partner is periodically reimbursed for various office expenses, caretaker payroll and benefits, and other maintenance costs incidental to the operations of the Project. For the years ended December 31, 2022 and 2021, the Partnership owed the General Partner \$37,200 and \$16,307, respectively, for these expenses.

8. Real estate taxes

The Partnership is eligible for an annual real estate tax exemption. During 2022 and 2021, the Partnership had an exemption from real estate taxes.

9. Commitments and contingencies

Land Use Restriction Agreement (LURA) - The Partnership entered into a LURA with CHFA as a condition to receiving an allocation of low-income housing tax credits. Under this agreement, the Partnership must continuously comply with IRC Section 42 and other applicable sections of the IRC. The agreement places occupancy restrictions on rents and the minimum percent of units that shall be occupied by individuals or families whose income meets the requirements set under IRC Section 42. If the Partnership fails to comply with this agreement or with the IRC, it may be ineligible for low-income housing tax credits, and the partners may be required to recapture a portion of the tax credits previously claimed on their income tax returns. In addition, noncompliance may require an adjustment to the contributed capital of the Investor Limited Partner. The Partnership is obligated to certify tenant eligibility.

THE HIGHLANDS 2 LLLP
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2022 and 2021

10. Low-income housing tax credits

The Partnership expects to generate an aggregate of \$12,500,000 of federal low-income housing tax credits ("Tax Credits"). Generally, such credits become available for use by its partners pro-rata over a ten-year period, which began in 2019. The year in which the credit period begins is determined on a building-by-building basis within the Partnership. In order to qualify for these credits, the Project must comply with various federal and state requirements. These requirements include, but are not limited to, renting to low-income tenants at rental rates which do not exceed specified percentages of area median gross income for the first 15 years of operation. The Partnership has also agreed to maintain and operate the Project as low-income housing for an additional 25 years beyond the initial 15 year compliance period. Because the Tax Credits are subject to compliance with certain requirements, there can be no assurance that the aggregate amount of Tax Credits will be realized and failure to meet all such requirements or to correct noncompliance within a specified time period may result in generating a lesser amount of Tax Credits than expected in future years and/or recapture of Tax Credits previously allocated. A reduction of future credits or recapture would require credit deficit payments to the Investor Limited Partner under the terms of the Partnership Agreement.

11. Vulnerability – Impact of COVID- 19

The severity of the impact of COVID-19 on the Partnership's operations will depend on a number of factors, including, but not limited to, the duration and severity of the pandemic and the extent and severity of the impact on the Partnership's tenants, all of which are uncertain and cannot be predicted. The Partnership's future results could be adversely impacted by delays in rent collections. Management is unable to predict with absolute certainty the impact of COVID-19 on its financial condition, results of operations or cash flows.

SUPPLEMENTARY INFORMATION

THE HIGHLANDS 2 LLLP
SCHEDULES OF EXPENSES
For the years ended December 31, 2022 and 2021

	<u>2022</u>	<u>2021</u>
Salaries and employee benefits		
Salaries - administrative	\$ 65,277	\$ 40,615
Salaries - service coordinator	19,161	-
Health insurance and other benefits	21,489	11,790
Workmen's compensation insurance	1,499	736
Total salaries and employee benefits	<u>\$ 107,426</u>	<u>\$ 53,141</u>
Repairs and maintenance		
Exterminating	\$ 94	\$ 90
Grounds	579	1,667
Allocated labor and contracts	31,999	48,604
Supplies	6,546	5,494
Other repairs and maintenance	379	1,337
Total repairs and maintenance	<u>\$ 39,597</u>	<u>\$ 57,192</u>
Utilities		
Electricity	\$ 31,049	\$ 47,979
Water and sewer	28,483	27,931
Trash removal	4,774	4,800
Gas	12,210	9,745
Total utilities	<u>\$ 76,516</u>	<u>\$ 90,455</u>
General and administrative		
Advertising and marketing	\$ -	\$ 419
Professional fees	10,471	17,724
Accounting fees - internal	30,694	21,177
Rent	946	666
Bad debt	4,838	7,312
Office expenses	11,994	10,638
Dues to McMahon	107,266	98,993
Total general and administrative	<u>\$ 166,209</u>	<u>\$ 156,929</u>
Interest expense		
Bank of Colorado - permanent loan	\$ 38,754	\$ 40,391
Colorado Housing and Finance Authority	13,453	14,596
Grand Junction Housing Authority - Sponsor Loan	18,650	17,761
Grand Junction Housing Authority - CDOH Loan	52,054	49,593
Grand Junction Housing Authority - Land Loan	27,609	32,919
Grand Junction Housing Authority - FHLB Loan	40,517	38,588
Grand Junction Housing Authority - developer fee payable	7,014	16,897
Amortization of debt issuance costs	3,219	3,219
Total interest expense	<u>\$ 201,270</u>	<u>\$ 213,964</u>

See report of independent auditors

THE HIGHLANDS 2 LLLP
SCHEDULES OF CASH AVAILABLE FOR DISTRIBUTION (UNAUDITED)
December 31, 2022 and 2021

Distribution of Cash Flow

Pursuant to the Partnership Agreement, cash flow of the Partnership shall be distributed in the following order of priority:

1. To the Investor Limited Partner, an amount equal to the unpaid credit adjuster payments
2. To the Investor Limited Partner, to repay any loans made to the Partnership
3. To the Investor Limited Partner, to pay the asset management fee
4. To fund the operating reserve until the balance is \$137,118
5. To the General Partner to pay the GP asset management fee
6. To repay any amounts owed with respect to the developer fee payable
7. To the General Partner to repay any unpaid portion of any operating deficit loans and any deferred management fees
8. To pay interest and principal on the Fourth Mortgage Loan until paid in full
9. To pay interest and principal on the Fifth Mortgage CDOH Housing Trust Fund Loan until paid in full
10. To pay interest and principal on the Sixth Mortgage Land Loan until paid in full
11. Any balance, 99.99% shall be distributed to the Investor Limited Partner and 0.01% to the General Partner

	<u>2022</u>	<u>2021</u>
Total Revenue		
Net rental income	\$ 561,265	\$ 541,277
Other income	47,657	46,481
Interest income (excluding partnership reserves)	28	38
Change in prepaid rent	<u>1,157</u>	<u>(964)</u>
Total Operating Revenue	610,107	586,832
Operating expenses	469,746	436,779
Change in account payable	2,322	(5,649)
Replacement reserve deposits	19,096	18,540
Required debt service (Bank of Colorado)	46,996	46,996
Required debt service (CHFA)	<u>25,296</u>	<u>25,297</u>
Total Expenses	<u>563,456</u>	<u>521,963</u>
Net Cash Flow	<u>\$ 46,651</u>	<u>\$ 64,869</u>
Available cash	\$ 46,651	\$ 64,869
Less: Amount available for Investor Limited Partner for asset management fee	(5,796)	(5,239)
Less: Amount available for General Partner for GP asset management fee	(5,464)	(5,227)
Less: Payments on developer fee payable and interest	<u>(35,391)</u>	<u>(54,403)</u>
Remaining cash	<u>\$ -</u>	<u>\$ -</u>

See report of independent auditors