

Highlands Real Estate Investors, LLC
HUD Project No. 023-22126

Report on Financial Statements

For the year ended December 31, 2022

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

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Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Mortgagor's Certification

As of December 31, 2022

I hereby certify that I have examined the accompanying financial statements and supplementary information of Highlands Real Estate Investors, LLC, HUD Project No. 023-22126 and, to the best of my knowledge and belief, the same are accurate and complete.

By: _____

Cindy Cross

Assistant Secretary

Telephone Number: (423) 472-9585

Independent Auditor's Report

To the Member
Highlands Real Estate Investors, LLC
Cleveland, Tennessee

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Highlands Real Estate Investors, LLC, which comprise the balance sheet as of December 31, 2022, and the related statements of operations, changes in member's deficit and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of Highlands Real Estate Investors, LLC, as of December 31, 2022, 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.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Highlands Real Estate Investors, LLC and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, and for 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 Highlands Real Estate Investors, LLC's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

Auditor's 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 auditor's 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 GAAS and *Government 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 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 GAAS and *Government 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 Highlands Real Estate Investors, LLC'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 Highlands Real Estate Investors, LLC'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.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The HUD required financial data templates are presented for purposes of additional analysis and are 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 supplementary information on pages 17 to 30 is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 17, 2023, on our consideration of Highlands Real Estate Investors, LLC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Highlands Real Estate Investors, LLC's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Highlands Real Estate Investors, LLC's internal control over financial reporting and compliance.

Elliott Davis, LLC

Chattanooga, Tennessee
March 17, 2023

Taxpayer Identification Number:
57-0381582

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Balance Sheet

As of December 31, 2022

Assets

Current assets

Cash	\$ 19,968
Prepaid expenses	<u>36,106</u>
Total current assets	<u>56,074</u>

Restricted deposits and funded reserves

Escrow deposits	151,316
Reserve for replacements	<u>467,372</u>
Total restricted deposits and funded reserves	<u>618,688</u>

Rental property

Land and improvements	855,781
Buildings	9,442,718
Building equipment (portable)	<u>1,103,373</u>
	11,401,872
Accumulated depreciation	<u>(7,558,422)</u>
Net rental property	<u>3,843,450</u>

Total assets \$ 4,518,212

Liabilities and Member's Deficit

Current liabilities

Mortgage payable - current maturities	\$ 318,704
Miscellaneous current liabilities	<u>133,062</u>
Total current liabilities	451,766

Long-term mortgage payable, net

Total liabilities 7,548,460
8,000,226

Commitments and contingencies

Member's deficit

(3,482,014)

Total liabilities and member's deficit \$ 4,518,212

See Notes to the Financial Statements

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Statement of Operations

For the year ended December 31, 2022

Revenue

Rental	\$ 856,202
Interest	<u>1,440</u>
Total revenue	<u>857,642</u>

Expenses

Administrative	5,453
Operating and maintenance	33,646
Taxes and insurance	167,937
Financial (including interest of \$208,290)	<u>249,117</u>
Total cost of operations before depreciation	<u>456,153</u>

Income before depreciation	401,489
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Depreciation	<u>442,766</u>
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Net loss	\$ <u><u>(41,277)</u></u>
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See Notes to the Financial Statements

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Statement of Changes in Member's Deficit

For the year ended December 31, 2022

Member's deficit, January 1, 2022	\$ (3,423,474)
Distributions	(41,200)
Contributions	23,937
Net loss	<u>(41,277)</u>
Member's deficit, December 31, 2022	\$ <u><u>(3,482,014)</u></u>

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Statement of Cash Flows

For the year ended December 31, 2022

Operating activities

Rental receipts	\$ 856,202
Interest receipts	<u>1,440</u>
Total receipts	<u>857,642</u>

Administrative expenses paid	(5,453)
Operating and maintenance paid	(19,216)
Real estate taxes paid	(104,032)
Property insurance paid	(63,805)
Miscellaneous taxes and insurance paid	(100)
Interest paid on first mortgage	(195,980)
Mortgage insurance premium paid	<u>(39,389)</u>
Total disbursements	<u>(427,975)</u>

Net cash flows from operating activities 429,667

Investing activities

Net purchase of fixed assets	<u>(91,739)</u>
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Net cash flows from investing activities (91,739)

Financing activities

Mortgage principal payments	(311,152)
Distributions	(41,200)
Contributions	<u>18,384</u>

Net cash flows from financing activities (333,968)

Net change in cash and restricted cash 3,960

Cash and restricted cash, beginning of year 634,696

Cash and restricted cash, end of year \$ 638,656

Supplemental schedule of noncash investing and financing activities

Change in net purchases of fixed assets included in miscellaneous current liabilities	\$ 115,759
Conversion of miscellaneous current liabilities to member's deficit	\$ 5,553

See Notes to the Financial Statements

Highlands Real Estate Investors, LLC**HUD Project No. 023-22126*****Statement of Cash Flows******For the year ended December 31, 2022***

Reconciliation of net loss to net cash flows from operating activities:

Net loss	\$ (41,277)
Adjustments to reconcile net loss to net cash flows from operating activities:	
Depreciation	442,766
Noncash interest expense related to debt issuance costs	12,310
Changes in operating assets and liabilities:	
Prepaid expenses	1,438
Miscellaneous current liabilities	<u>14,430</u>
Net cash flows from operating activities	\$ <u><u>429,667</u></u>

See Notes to the Financial Statements

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Notes to Financial Statements

December 31, 2022

Note 1. Organization

Highlands Real Estate Investors, LLC (the Company) was formed as a member-managed limited liability company under the laws of the State of Tennessee on May 18, 2010. On October 25, 2012, the project was refinanced under Section 232 of the National Housing Act administered by the U.S. Department of Housing and Urban Development. The project consists of a 168 bed nursing home facility located in Fitchburg, Massachusetts, that is subleased to a related entity currently operating under the name of The Highlands. The terms of the lease are described in Note 6.

Note 2. Summary of Significant Accounting Policies

The significant accounting policies and procedures followed by the Company are as follows:

Basis of accounting:

The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Cash:

The Company maintains cash at a financial institution which may exceed federally insured amounts at times and which may at times significantly exceed balance sheet amounts due to outstanding checks.

Distributions:

Cash distributions are limited by agreements between the Company and the U.S. Department of Housing and Urban Development (HUD) to the extent of surplus cash as defined by HUD.

Escrow deposits:

Escrow deposits consist of funds required to be maintained under the Regulatory Agreement for real estate taxes, hazard insurance and mortgage insurance premiums.

Reserve for replacements:

Reserve for replacements consists of funds required to be maintained under the Regulatory Agreement for purchases, repairs and maintenance of rental property.

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Notes to Financial Statements

December 31, 2022

Note 2. Summary of Significant Accounting Policies, Continued

Rental property:

Rental property is carried at cost less accumulated depreciation. Depreciation is provided for in amounts sufficient to charge the cost of depreciable assets to operations over their estimated service lives by use of the straight-line method for financial reporting purposes. For income tax purposes, accelerated lives and methods are used.

Construction and renovation projects undertaken by Highlands Medical Investors, LLC (the Lessee and the Company's sole member), a company under common ownership, are recorded by the Lessee at cost until the related project is completed and placed in service, at which time the costs are transferred to the Company. Costs related to construction and renovation projects that are approved and released from the replacement reserve by HUD are transferred at the time of the release. Depreciation is deferred until the construction and renovation are complete.

Impairment of long-lived assets:

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of would be reported at the lower of the carrying amount or fair value less costs to sell. During the year ended December 31, 2022, the Company recognized no impairment loss.

Debt issuance costs:

Debt issuance costs consist of the costs for acquiring financing and are recognized as a discount to long-term mortgage payable. The costs are amortized over the term of the mortgage loan using the effective interest method. Amortization of the costs is included in interest expense. For the year ended December 31, 2022, amortization totaled \$12,310. Amortization for each of the five ensuing years through December 31, 2027, is approximately \$11,800 to \$9,800.

Income taxes:

The Company is a disregarded entity for federal income tax purposes based on its legal status as a single member limited liability company and files its state income tax return as a pass-through entity. As such, the Company is not subject to income taxes. Rather, all items of taxable income, deductions and tax credits are passed through to and reported by the member on its income tax return. Accordingly, these financial statements do not reflect a provision for income taxes.

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Notes to Financial Statements

December 31, 2022

Note 2. Summary of Significant Accounting Policies, Continued

Income taxes, continued:

The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the positions will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50% likely of being realized upon settlement with the applicable taxing authority. As of December 31, 2022, the Company has not recognized liabilities for uncertain tax positions or associated interest and penalties.

Rental income:

Rent is recognized on a straight-line basis over the life of the lease. Rental payments received in advance are deferred until earned. The lease between the Company and its tenant is an operating lease.

Estimates and uncertainties:

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 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. Actual results could differ from those estimates.

Subsequent events:

The Company has evaluated subsequent events for potential recognition and disclosure through March 17, 2023, the date the financial statements were available to be issued.

Recently issued accounting pronouncements:

In February 2016, the Financial Accounting Standards Board amended the Leases topic of the Accounting Standards Codification to require all leases with lease terms over 12 months to be capitalized by lessees as a right-of-use asset and lease liability on the balance sheet at the date of lease commencement. Leases are classified as either finance leases or operating leases as defined in the amendment. This distinction is relevant for the pattern of expense recognition for lessees or rental revenue recognition for lessors in the income statement.

The Company elected the “package of practical expedients” under the transition guidance within Topic 842, in which the Company does not reassess (1) the historical lease classification, (2) whether any existing contracts at transition are or contain leases, or (3) the initial direct costs for any existing leases.

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Notes to Financial Statements

December 31, 2022

Note 2. Summary of Significant Accounting Policies, Continued

Recently issued accounting pronouncements, continued:

The Company has made an accounting policy election to account for lease and non-lease components in its contracts as a single lease component. The non-lease components typically represent escrow requirements and certain operating costs reimbursed by the Lessee, such as real estate taxes, property taxes and insurance, which are variable in nature and recorded as rental revenue in the period earned.

The amendment was effective for fiscal years beginning after December 15, 2021, and the Company adopted the amendment as of January 1, 2022. The adoption of the amendment did not have a material effect on the Company's financial statements.

Note 3. Cash and Restricted Cash

Cash and restricted cash as of December 31, 2022, consist of the following:

Cash	\$ 19,968
Escrow deposits	151,316
Reserve for replacements	<u>467,372</u>
Total cash and restricted cash	<u>\$ 638,656</u>

Note 4. Mortgage Payable

The mortgage is insured by the Federal Housing Administration (FHA) and is collateralized by a mortgage note on the rental property. The note bears interest at the rate of 2.40 percent per annum. Principal and interest are payable by the Company in monthly installments of \$42,261 through maturity on November 1, 2042.

Under agreements with the mortgage lender and FHA, the Company is required to make monthly escrow deposits for taxes, insurance and replacement of project assets, and is subject to restrictions as to operating policies, rental charges, operating expenditures and distributions to its member.

The liability of the Company under the mortgage note is limited to the underlying value of the real estate collateral plus other amounts deposited with the lender.

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Notes to Financial Statements

December 31, 2022

Note 4. Mortgage Payable, Continued

Aggregate annual maturities of the mortgage payable over each of the next five years and thereafter are as follows:

Year ending

December 31, 2023	\$ 318,704
December 31, 2024	326,437
December 31, 2025	334,358
December 31, 2026	342,472
December 31, 2027	350,782
Thereafter	<u>6,323,909</u>
	7,996,662
Unamortized debt issuance costs	<u>(129,498)</u>
Net mortgage payable	<u>\$ 7,867,164</u>

Note 5. Related Party Transactions

The Company has a payable to the Lessee of \$133,062. The Lessee purchases all fixed assets and incurs all repair and maintenance costs on behalf of the Company. Costs that are expected to be reimbursed from the replacement reserve are recorded by the Company as a payable to the Lessee. Costs that are not reimbursed from the replacement reserve are recorded by the Company as contributions of equity from the member. When approved withdrawals from the replacement reserve are received by the Company, the Company disburses the amount of the replacement reserve withdrawal to the Lessee to settle the payable amount recorded. Because the Company is not permitted by HUD to make requests for withdrawals more often than quarterly (unless an emergency exists), the payable to the Lessee is included in miscellaneous current liabilities.

The Company has obtained its property insurance through Leader Care, Inc., a company under common ownership. During the year ended December 31, 2022, insurance premiums totaling \$63,805 were incurred and expensed.

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Notes to Financial Statements

December 31, 2022

Note 6. Operating Lease - Related Party

The Company leases property and equipment to Highlands Medical Investors, LLC. The operating lease allows the facility to be used for the operations of a licensed Medicare and Medicaid certified skilled nursing home facility and ancillary uses, as defined. The initial lease term is for a period of thirty-five years and will renew automatically for successive periods of one year unless canceled by either party. The monthly lease income is equal to the aggregate of required monthly mortgage principal and interest payments plus related escrow requirements multiplied by a factor of 1.05, and reimbursement of certain operating costs. During the year ended December 31, 2022, the Company received \$856,202 in lease payments from the Lessee, which exceeded debt service costs paid of \$801,993, which includes principal, interest, tax and insurance escrows, and replacement reserve deposits. Minimum future rental income under the noncancelable operating lease is as follows:

Year ending

December 31, 2023	\$ 838,330
December 31, 2024	838,330
December 31, 2025	838,330
December 31, 2026	838,330
December 31, 2027	838,330
Thereafter	<u>12,435,219</u>
	<u>\$ 16,626,869</u>

In a prior year, the Lessee entered into an operating sub-lease agreement to lease office space to Physician OnSite, Inc., a related party, for a term of one year, renewable annually. The current annual rent is \$3,060.

Note 7. Concentration of Risk

The ability of the Company to meet its required debt service payments is contingent upon the Lessee's ability to make monthly rental payments.

The Company maintains its replacement reserve and escrow accounts with CFG Community Bank. At times, these balances may exceed the federal insurance limits; however, the Company has not experienced any losses with respect to its bank balances in excess of government provided insurance. Management believes that no significant concentration of credit risk exists with respect to the reserve and escrow balances as of December 31, 2022.

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Notes to Financial Statements

December 31, 2022

Note 8. Commitments and Contingencies

Life Care Centers of America, Inc. (LCCA) is related to and manages the Company and the nursing facility operations of the Lessee. LCCA also owns and manages numerous other nursing facilities throughout the country.

The facilities owned and managed by LCCA operate in industries that are extensively regulated. As such, in the ordinary course of business, they are continuously subject to state and federal regulatory scrutiny, supervision and control. Such regulatory scrutiny often includes inquiries, investigations, examinations, audit, site visits and surveys, some of which are non-routine. In addition to being subject to direct regulatory oversight of state and federal regulatory agencies, these industries are frequently subject to the regulatory supervision of fiscal intermediaries. If a provider is found by a court of competent jurisdiction to have engaged in improper practices, it could be subject to civil, administrative or criminal fines, penalties or restitutionary relief, and reimbursement authorities could also seek the suspension or exclusion of the provider or individual from participation in their program. LCCA and the Company believe that there has been, and will continue to be, an increase in governmental investigations of long-term care providers, particularly in the area of Medicare/Medicaid false claims, as well as an increase in enforcement actions resulting from these investigations. Adverse determinations in legal proceedings or governmental investigations currently asserted against LCCA and related entities or arising in the future could have a material adverse effect on LCCA's and the Company's financial position, results of operations and cash flows.

The 2019 novel coronavirus (or COVID-19) has adversely affected, and could continue to adversely affect economic activity globally, nationally and locally. Additionally, it has negatively impacted census and demand for the Lessee's (a related party) services and increased the Lessee's costs. These conditions have adversely affected the Company's cash flows, financial condition, and results of operations. The Lessee at this time does not know how long it will take to recover from its decline in census, which has resulted in lost revenues, nor how long it will take to stabilize increases in operating costs associated with COVID-19. The extent of the continued adverse impact of the COVID-19 outbreak on the Lessee and its impact on the Company cannot be predicted at this time.

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Balance Sheet Data

As of December 31, 2022

Assets		
Account No.		
Current assets		
1120	Cash - operations	\$ 19,968
1200	Prepaid expenses	<u>36,106</u>
1100T	Total current assets	<u>56,074</u>
Restricted deposits and funded reserves		
1310	Escrow deposits	151,316
1320	Replacement reserve	<u>467,372</u>
1300T	Total deposits	<u>618,688</u>
Rental property		
1410	Land	855,781
1420	Buildings	9,442,718
1440	Building equipment (portable)	<u>1,103,373</u>
1400T	Total fixed assets	11,401,872
1495	Accumulated depreciation	<u>(7,558,422)</u>
1400N	Net fixed assets	<u>3,843,450</u>
1000T	Total assets	<u>\$ 4,518,212</u>

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Balance Sheet Data

As of December 31, 2022

Liabilities and Member's Deficit		
Account No.		
	<i>Current liabilities</i>	
2170	Mortgage payable - first mortgage (short term)	\$ 318,704
2190	Miscellaneous current liabilities	<u>133,062</u>
2122T	Total current liabilities	<u>451,766</u>
	<i>Long-term liabilities</i>	
2320	Mortgage payable - first mortgage (long term)	<u>7,548,460</u>
2300T	Total long-term liabilities	<u>7,548,460</u>
2000T	Total liabilities	8,000,226
3130	<i>Member's deficit</i>	<u>(3,482,014)</u>
2033T	Total liabilities and member's deficit	\$ <u><u>4,518,212</u></u>

Highlands Real Estate Investors, LLC**HUD Project No. 023-22126****Statement of Operations Data****For the year ended December 31, 2022**

Account No.

Rental revenue		
5195	Lease revenue (nursing home or Section 232 - B&C or AL)	\$ <u>856,202</u>
5100T	Total rent revenue	<u>856,202</u>
5152N	Net rental revenue	<u>856,202</u>
Financial revenue		
5440	Revenue from investments - replacement reserve	<u>1,440</u>
5400T	Total financial revenue	<u>1,440</u>
5000T	Total revenue	<u>857,642</u>
Expenses		
Administrative		
6340	Legal expense - project	893
6350	Audit expense	4,250
6351	Bookkeeping fees/Accounting services	<u>310</u>
6263T	Total administrative expenses	<u>5,453</u>
Operating and maintenance		
6590	Miscellaneous operating and maintenance expenses	<u>33,646</u>
6500T	Total operating and maintenance expenses	<u>33,646</u>
Taxes and insurance		
6710	Real estate taxes	104,032
6720	Property and liability insurance (hazard)	63,805
6790	Miscellaneous taxes, licenses, permits and insurance	<u>100</u>
6700T	Total taxes and insurance	<u>167,937</u>
Financial		
6820	Interest on first mortgage payable	208,290
6850	Mortgage insurance premium/service charge	<u>40,827</u>
6800T	Total financial expenses	<u>249,117</u>
6000T	Total cost of operations before depreciation	<u>456,153</u>
5060T	Income before depreciation	<u>401,489</u>
Depreciation		
6600	Depreciation expense	<u>442,766</u>
	Total depreciation	<u>442,766</u>
5060N	Operating loss	<u>(41,277)</u>
	Total expenses	<u>898,919</u>
3250	Net loss	\$ <u>(41,277)</u>

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Statement of Operations Data

For the year ended December 31, 2022

Account No.

S1000-010	Total first mortgage principal payments required during the audit period (12 monthly payments). This applies to all direct loans and HUD-held and HUD-insured first mortgages.	\$ <u>311,152</u>
S1000-020	The total of 12 monthly reserve for replacement deposits required during the audit period even if deposits have been temporarily waived or suspended.	\$ <u>95,508</u>
S1000-030	Replacement reserves, or residual receipts and releases which are included as expense items on this Profit and Loss statement.	\$ <u>17,425</u>

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Statement of Member's Equity (Deficit) Data

For the year ended December 31, 2022

Account No.

S1100-010	Member's deficit, January 1, 2022	\$ (3,423,474)
S1200-420	Distributions	(41,200)
S1200-430	Contributions	18,384
S1100-030	Other changes in equity:	
S1100-040	Conversion of miscellaneous current liabilities to member's deficit	5,553
3250	Net loss	<u>(41,277)</u>
3130	Member's deficit, December 31, 2022	\$ <u><u>(3,482,014)</u></u>

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Statement of Cash Flows Data

For the year ended December 31, 2022

Account No.

	Operating activities	
S1200-010	Rental receipts	\$ 856,202
S1200-020	Interest receipts	<u>1,440</u>
S1200-040	Total receipts	<u>857,642</u>
S1200-050	Administrative expenses paid	(5,453)
S1200-110	Operating and maintenance paid	(19,216)
S1200-120	Real estate taxes paid	(104,032)
S1200-140	Property insurance paid	(63,805)
S1200-150	Miscellaneous taxes and insurance paid	(100)
S1200-180	Interest paid on first mortgage	(195,980)
S1200-210	Mortgage insurance premium paid	<u>(39,389)</u>
S1200-230	Total disbursements	<u>(427,975)</u>
S1200-240	Net cash provided by operating activities	<u>429,667</u>
	Investing activities	
S1200-245	Net deposits to mortgage escrow account	(685)
S1200-250	Net deposits to reserve for replacements account	(4,375)
S1200-330	Net purchase of fixed assets	<u>(91,739)</u>
S1200-350	Net cash used in investing activities	<u>(96,799)</u>
	Financing activities	
S1200-360	Principal payments - first mortgage	(311,152)
S1200-420	Distributions	(41,200)
S1200-430	Contributions	<u>18,384</u>
S1200-460	Net cash used in financing activities	<u>(333,968)</u>
S1200-470	Net decrease in cash	(1,100)
S1200-480	Cash, beginning year	<u>21,068</u>
S1200T	Cash, end of year	<u>\$ 19,968</u>

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Statement of Cash Flows Data

For the year ended December 31, 2022

Account No.

Reconciliation of net loss to net cash provided by operating activities:

3250	Net loss	\$ <u>(41,277)</u>
	Adjustments to reconcile net loss to net cash provided by operating activities:	
6600	Depreciation expense	442,766
S1200-486	Amortization of debt issuance costs	12,310
	Changes in operating assets and liabilities:	
S1200-520	Prepaid expenses	<u>1,438</u>
		<u>456,514</u>
S1200-601	Other adjustments to reconcile net loss to net cash provided by operating activities:	
S1200-602	Miscellaneous current liabilities	<u>14,430</u>
	Total other adjustments	<u>14,430</u>
	Total adjustments	<u>470,944</u>
S1200-610	Net cash provided by operating activities	\$ <u>429,667</u>
S1200-620	Supplemental schedule of non cash investing and financing activities	
	Change in net purchases of fixed assets included in miscellaneous current liabilities	\$ 115,759
	Conversion of miscellaneous current liabilities to member's deficit	\$ 5,553

Highlands Real Estate Investors, LLC**HUD Project No. 023-22126*****Reserve for Replacements******For the year ended December 31, 2022***

Account No.

1320P	Balance at January 1, 2022	\$	462,997
1320DT	Total monthly deposits		95,508
1320INT	Interest on replacement reserve accounts		1,440
1320WT	Approved withdrawals		(90,373)
1320OWT	Other withdrawals:		
1320OWT-010	Project capital needs assessment		<u>(2,200)</u>
1320	Balance at December 31, 2022	\$	<u><u>467,372</u></u>
1320R	Deposits suspended or waived		No

Highlands Real Estate Investors, LLC**HUD Project No. 023-22126*****Computation of Surplus Cash (Annual)******As of December 31, 2022***

Account No.

S1300-010	Cash	\$	19,968
1135	Accounts receivable - HUD		<u>-</u>
S1300-040	Total cash		<u>19,968</u>
S1300-050	Accrued mortgage interest payable		-
S1300-060	Delinquent mortgage principal payments		-
S1300-070	Delinquent deposits to reserve for replacements		-
S1300-075	Accounts payable due within 30 days		-
S1300-080	Loans and notes payable due within 30 days		-
S1300-090	Deficient tax, insurance or MIP escrow deposits		-
S1300-100	Accrued expenses - not escrowed		-
2210	Prepaid revenue		-
2191	Tenant security deposits liability		-
S1300-110	Other current obligations		<u>-</u>
S1300-140	Total current obligations		<u>-</u>
S1300-150	Surplus cash (deficiency)	\$	<u>19,968</u>
S1300-200	Amount available for distribution during next fiscal period	\$	<u>19,968</u>

Highlands Real Estate Investors, LLC**HUD Project No. 023-22126****Computation of Surplus Cash (Mid-Year)****As of June 30, 2022**

Account No.

		<u>June 30, 2022</u>
S1400-010	Semi-annual period ended	
S1400-020	Cash	\$ 20,208
S1400-030	Tenant subsidy due for semi-annual period	-
S1400-040	Other	-
S1400-050	Total cash	<u>20,208</u>
S1400-060	Accrued mortgage interest payable	-
S1400-070	Delinquent mortgage principal payments	-
S1400-080	Delinquent deposits to reserve for replacements	-
S1400-090	Accounts payable due within 30 days	-
S1400-100	Loans and notes payable due within 30 days	-
S1400-110	Deficient tax, insurance or MIP escrow deposits	-
S1400-120	Accrued expenses - not escrowed	-
S1400-130	Prepaid revenue	-
S1400-140	Tenant security deposits liability	-
S1400-150	Other current obligations	-
S1400-180	Total current obligations	<u>-</u>
S1400-190	Surplus cash (deficiency)	\$ <u>20,208</u>
S1400-240	Amount available for distribution during next fiscal period	\$ <u>20,208</u>

Highlands Real Estate Investors, LLC**HUD Project No. 023-22126***Schedule of Changes in Fixed Asset Accounts**For the year ended December 31, 2022*

	Balance January 1, 2022	Additions	Deletions	Balance December 31, 2022
Land	\$ 855,781	\$ -	\$ -	\$ 855,781
Buildings	9,330,013	112,705	-	9,442,718
Building equipment (portable)	<u>1,009,217</u>	<u>94,793</u>	<u>637</u>	<u>1,103,373</u>
Total fixed assets	<u>\$ 11,195,011</u>	<u>\$ 207,498</u>	<u>\$ 637</u>	<u>\$ 11,401,872</u>
Accumulated depreciation	<u>\$ 7,116,293</u>	<u>\$ 442,766</u>	<u>\$ 637</u>	<u>\$ 7,558,422</u>
Total net book value				<u>\$ 3,843,450</u>

Highlands Real Estate Investors, LLC**HUD Project No. 023-22126***Schedule of Changes in Fixed Asset Accounts**For the year ended December 31, 2022*

Fixed Asset Detail**Additions to Buildings**

Item and quantity	Amount
Flooring	\$ 76,895
LC Design administrative costs	5,919
Security systems and fire alarm equipment	11,604
Water heating, filtration and plumbing equipment	<u>18,287</u>
	<u><u>\$ 112,705</u></u>

Additions to Building Equipment (Portable)

Item and quantity	Amount
Beds, mattresses and bedding supplies	\$ 5,986
Computers and office equipment	28,720
Food service equipment	33,670
Furniture and accessories	2,450
Health and medical equipment	5,519
HVAC equipment	854
Mobility equipment	6,999
Rehabilitation and therapy equipment	<u>10,595</u>
	<u><u>\$ 94,793</u></u>

Deletions from Building Equipment (Portable)

Item and quantity	Amount
Computers and office equipment	\$ <u>637</u>
	<u><u>\$ 637</u></u>

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Detail of Accounts

For the year ended December 31, 2022

Detail of Accounts - Balance Sheet

Miscellaneous current liabilities (Account No. 2190)

Payable to Lessee - replacement reserve reimbursements	\$ <u>133,062</u>
	\$ <u><u>133,062</u></u>

Detail of Accounts - Statement of Operations

Miscellaneous operating and maintenance expenses (Account No. 6590)

Plant minor equipment	\$ 31,446
Administrative other services	<u>2,200</u>
	\$ <u><u>33,646</u></u>

Highlands Real Estate Investors, LLC**HUD Project No. 023-22126***Other Information**For the year ended December 31, 2022*

Related Party Transaction Detail (Account No. S3100-200)

Entity name	<u>Amount Paid</u>
Leader Care, Inc. - property insurance	\$ <u>63,805</u>



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

To the Member
Highlands Real Estate Investors, LLC
Cleveland, Tennessee

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Highlands Real Estate Investors, LLC, which comprise the balance sheet as of December 31, 2022, and the related statements of operations, changes in member's deficit, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 17, 2023.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Highlands Real Estate Investors, LLC's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Highlands Real Estate Investors, LLC's internal control. Accordingly, we do not express an opinion on the effectiveness of Highlands Real Estate Investors, LLC's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses or significant deficiencies may exist that were not identified.

Report on Compliance and Other Matters

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

Purpose of this Report

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

A handwritten signature in black ink that reads "Elliott Davis, LLC". The signature is written in a cursive, flowing style.

Chattanooga, Tennessee
March 17, 2023

**Independent Auditor's Report on Compliance for the Major HUD Program and
Report on Internal Control Over Compliance Required By the
*Consolidated Audit Guide for Audits of HUD Programs***

To the Member
Highlands Real Estate Investors, LLC
Cleveland, Tennessee

Report on Compliance for the Major HUD Program

Opinion on the Major HUD Program

We have audited Highlands Real Estate Investors, LLC's compliance with the compliance requirements described in the *Consolidated Audit Guide for Audits of HUD Programs* (the audit guide) that could have a direct and material effect on Highlands Real Estate Investors, LLC's major U.S. Department of Housing and Urban Development (HUD) program for the year ended December 31, 2022. Highlands Real Estate Investors, LLC's major HUD program is the refinance of the project under Section 232 of the National Housing Act administered by the U.S. Department of Housing and Urban Development. The related direct and material compliance requirements for the major HUD program include: mortgage status, replacement reserve, distributions to owners, equity skimming, cash receipts, cash disbursements, management functions, unauthorized change of ownership/acquisition of liabilities, unauthorized loans of project funds and leased nursing homes.

In our opinion, Highlands Real Estate Investors, LLC complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major HUD program for the year ended December 31, 2022.

Basis for Opinion on the Major HUD Program

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (GAAS); the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards*); and the audit guide. Our responsibilities under those standards and the audit guide are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of Highlands Real Estate Investors, LLC and to meet our other ethical responsibilities, in accordance with relevant ethical requirements related to our audit. We believe that our audit provides a reasonable basis for our opinion on compliance for the major HUD program. Our audit does not provide a legal determination of Highlands Real Estate Investors, LLC's compliance.

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, regulations, rules and provisions of contracts or grant agreements applicable to its HUD programs.

Auditor's Responsibilities for the Audit of Compliance

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on Highlands Real Estate Investors, LLC's compliance based on our audit. 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 GAAS, *Government Auditing Standards*, and the audit guide will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material, if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about Highlands Real Estate Investors, LLC's compliance with the requirements of the major HUD program as a whole.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and the audit guide, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, 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 Highlands Real Estate Investors, LLC's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of Highlands Real Estate Investors, LLC's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with the audit guide, but not for the purpose of expressing an opinion on the effectiveness of Highlands Real Estate Investors, LLC's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Report on Internal Control Over Compliance

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

Our consideration of internal control over compliance was for the limited purpose described in the Auditor's Responsibilities for the Audit of Compliance section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies may exist that were not identified.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

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

A handwritten signature in black ink that reads "Elliott Davis, LLC". The signature is written in a cursive, flowing style.

Chattanooga, Tennessee
March 17, 2023

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Schedule of Findings, Questioned Costs and Recommendations

For the year ended December 31, 2022

Our audit disclosed no findings that are required to be reported herein under the *Consolidated Audit Guide for Audits of HUD Programs*.

Highlands Real Estate Investors, LLC

HUD Project No. 023-22126

Schedule of the Status of Prior Audit Findings, Questioned Costs and Recommendations For the year ended December 31, 2022

1. Audit Report dated March 23, 2022, for the year ended December 31, 2021, issued by Elliott Davis, LLC.

The audit disclosed no findings that are required to be reported herein under the *Consolidated Audit Guide for Audits of HUD Programs*.

2. Audit Reports issued by the HUD Office of Inspector General or other federal agencies or contract administrators during the period covered by this audit.

There were no reports issued by the HUD Office of Inspector General or other federal agencies or contract administrators during the period covered by this audit.

3. HUD management reports issued during the period covered by this audit.

There were no letters or reports issued by HUD management during the period covered by this audit.

Auditor's Transmittal Letter

S3200-005	Audit Firm ID (UII)	56051
S3200-010	Audit Firm	Elliott Davis, LLC
S3200-020	Lead Auditor First Name	Renee
S3200-040	Lead Auditor Last Name	Ford
S3200-050	Auditor Street Address Line 1	629 Market Street
S3200-060	Auditor Street Address Line 2	Suite 100
S3200-070	Auditor City	Chattanooga
S3200-080	Auditor State	Tennessee
S3200-090	Auditor Zip Code	37402
S3200-100	Auditor Zip Code Extension	4890
S3200-110	Telephone Number	423-756-7100
S3200-120	Audit Firm TIN	57-0381582
S3200-130	Date of Independent Auditor's Report	March 17, 2023