

HIGHLANDS REAL ESTATE INVESTORS, LLC

Financial Statements and Supplementary Information

HUD Project No. 023-22126

December 31, 2023

(With Independent Auditors' Report Thereon)

The logo for LBMC, consisting of the letters "LBMC" in white, sans-serif font, centered within a solid blue rectangular background.

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

December 31, 2023

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: Highlands Medical, Inc.

Its: Corporate Manager

By: _____

J. Stephen Ziegler

Vice President

Telephone Number: (423) 472-9585



Independent Auditors' Report

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

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of Highlands Real Estate Investors, LLC, which comprise the balance sheet as of December 31, 2023, 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 financial statements present fairly, in all material respects, the financial position of Highlands Real Estate Investors, LLC as of December 31, 2023, 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 *Auditors' 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 the 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.

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 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 accompanying supplementary information shown on pages 16 to 29 is presented for the 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 GAAS. In our opinion, the information 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 20, 2024, 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 solely 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.

LBMC, PC

Knoxville, Tennessee
March 20, 2024

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Balance Sheet

December 31, 2023

Assets

Current assets:

Cash	\$ 21,740
Accounts receivable - related party	72
Prepaid expenses	<u>34,632</u>
Total current assets	<u>56,444</u>

Restricted deposits and funded reserves:

Escrow deposits	171,209
Reserve for replacements	<u>430,244</u>
Total restricted deposits and funded reserves	<u>601,453</u>

Rental property:

Land and improvements	855,781
Buildings	9,559,517
Building equipment (portable)	<u>1,144,856</u>
	11,560,154
Accumulated depreciation	<u>(7,967,017)</u>
Net rental property	<u>3,593,137</u>
Total assets	<u>\$ 4,251,034</u>

Liabilities and Member's Deficit

Current liabilities:

Accounts payable	\$ 72
Mortgage payable - current maturities	326,437
Miscellaneous current liabilities	<u>145,835</u>
Total current liabilities	472,344

Long-term mortgage payable, net	<u>7,233,860</u>
Total liabilities	7,706,204

Member's deficit	<u>(3,455,170)</u>
Total liabilities and member's deficit	<u>\$ 4,251,034</u>

See accompanying notes to the financial statements.

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Statement of Operations

For the year ended December 31, 2023

Revenue:

Rental	\$ 898,794
Interest	<u>8,099</u>
Total revenue	<u>906,893</u>

Expenses:

Administrative	5,657
Operating and maintenance	38,472
Taxes and insurance	190,818
Financial (including interest of \$200,266)	<u>239,521</u>

Total cost of operations before depreciation	<u>474,468</u>
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Income before depreciation	432,425
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Depreciation	<u>457,689</u>
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Net loss	<u><u>\$ (25,264)</u></u>
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See accompanying 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, 2023

Member's deficit, January 1, 2023	\$ (3,482,014)
Distributions	(40,265)
Contributions	92,373
Net loss	<u>(25,264)</u>
Member's deficit, December 31, 2023	\$ <u>(3,455,170)</u>

See accompanying 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, 2023

Cash flows from operating activities:

Rental receipts	\$ 898,722
Interest receipts	<u>8,099</u>
Total receipts	<u>906,821</u>

Administrative expenses paid	(5,585)
Operating and maintenance paid	(5,459)
Real estate taxes paid	(100,452)
Property insurance paid	(90,266)
Miscellaneous taxes and insurance paid	(100)
Interest paid on first mortgage	(188,429)
Mortgage insurance premium paid	<u>(37,781)</u>
Total disbursements	<u>(428,072)</u>
Net cash provided by operating activities	<u>478,749</u>

Cash flows from investing activities:

Net purchase of rental property	<u>(135,243)</u>
Net cash used in investing activities	<u>(135,243)</u>

Cash flows from financing activities:

Mortgage principal payments	(318,704)
Distributions	<u>(40,265)</u>
Net cash used in financing activities	<u>(358,969)</u>
Net change in cash and restricted cash	(15,463)

Cash and restricted cash, beginning of year	<u>638,656</u>
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Cash and restricted cash, end of year	<u>\$ 623,193</u>
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Supplemental disclosures of cash flow information:

Change in net purchases of rental property included in miscellaneous current liabilities	<u>\$ 74,070</u>
Conversion of miscellaneous current liabilities to member's deficit	<u>\$ 92,373</u>

See accompanying notes to the financial statements.

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Statement of Cash Flows (Continued)

For the year ended December 31, 2023

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

Net loss	\$ (25,264)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation	457,689
Noncash interest expense related to debt issuance costs	11,837
Loss on disposal of rental property	1,937
Changes in operating assets and liabilities:	
Accounts receivable - related party	(72)
Prepaid expenses	1,474
Accounts payable	72
Miscellaneous current liabilities	<u>31,076</u>
Net cash provided by operating activities	\$ <u>478,749</u>

See accompanying notes to the financial statements.

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Notes to the Financial Statements

December 31, 2023

(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 ("HUD"). The project consists of a 168 bed nursing home facility located in Fitchburg, Massachusetts, that is leased to a related entity operating under the name of The Highlands. The terms of the lease are described in Note (6).

As a limited liability company, each member's liability is generally limited to the member's investment in the Company.

(2) Summary of significant accounting policies

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

(a) 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 ("GAAP").

(b) 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.

(c) Distributions

Cash distributions are limited by agreements between the Company and HUD to the extent of surplus cash as defined by HUD.

(d) Receivables

Receivables are charged against an allowance for credit losses when they are deemed uncollectible. As of December 31, 2023, management has deemed all accounts to be collectible.

(e) 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.

(f) 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.

Notes to the Financial Statements (Continued)

December 31, 2023

(g) 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 Operator of the facility, the "Lessee" and the Company's sole member) 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.

(h) 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, 2023, the Company recognized no impairment loss.

(i) 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.

(j) 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.

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, 2023, the Company has not recognized liabilities for uncertain tax positions or associated interest and penalties.

Notes to the Financial Statements (Continued)

December 31, 2023

(k) 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.

The Company accounts for lease and non-lease components in its contracts as a single lease component. 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.

(l) Estimates and uncertainties

The preparation of financial statements in accordance with GAAP 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.

(m) Subsequent events

The Company has evaluated subsequent events for potential recognition and disclosure through March 20, 2024, the date the financial statements were available to be issued.

(3) Cash and restricted cash

Cash and restricted cash as of December 31, 2023, consist of the following:

Cash	\$ 21,740
Escrow deposits	171,209
Reserve for replacements	<u>430,244</u>
Total cash and restricted cash	<u>\$ 623,193</u>

(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.

As of December 31, 2023, debt issuance costs related to the mortgage payable, net of accumulated amortization, totaled \$117,661. Debt issuance costs are being amortized over the life of the mortgage payable using an effective interest rate of 2.55 percent.

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Notes to the Financial Statements (Continued)

December 31, 2023

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.

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

<u>Year</u>	<u>Amount</u>
2024	\$ 326,437
2025	334,358
2026	342,472
2027	350,782
2028	359,294
Thereafter	<u>5,964,615</u>
	7,677,958
Unamortized debt issuance costs	<u>(117,661)</u>
Net mortgage payable	\$ <u>7,560,297</u>

(5) Related party transactions

The Company has a payable to the Lessee of \$145,835 as of December 31, 2023. The Lessee purchases all rental property 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.

As of December 31, 2023, the Company also has a receivable from the Lessee for additional rental revenue to reimburse legal fees of \$72, which is included in accounts receivable - related party.

The Company has obtained its property insurance through Leader Care, Inc., a company under common ownership. During the year ended December 31, 2023, insurance premiums totaling \$90,266 were incurred and expensed.

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Notes to the Financial Statements (Continued)

December 31, 2023

(6) Operating lease - related party

The Company leases property and equipment to Highlands Medical Investors, LLC, the Company's sole member. 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 which commenced on October 25, 2012 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, 2023, the Company received \$898,722 in lease payments from the Lessee, which exceeded debt service costs paid of \$840,156, which includes principal, interest, tax and insurance escrows, and replacement reserve deposits. Minimum future rental income under the noncancelable operating lease is as follows:

<u>Year</u>	<u>Amount</u>
2024	\$ 890,930
2025	890,930
2026	890,930
2027	890,930
2028	890,930
Thereafter	<u>12,324,535</u>
	<u>\$ 16,779,185</u>

(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 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, 2023.

(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 United States.

Notes to the Financial Statements (Continued)

December 31, 2023

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 government regulatory scrutiny, supervision, and control. Such regulatory scrutiny often involves inquiries, investigations, examinations, audits, 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. In addition, reimbursement authorities could 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 involving Medicare and Medicaid false claims, as well as an increase in enforcement actions resulting from these investigations. The Company's costs to defend and resolve any such investigations may be significant. Adverse determinations in legal proceedings or regulatory investigations currently asserted, or arising in the future, against LCCA and related entities could have a material adverse effect on LCCA's and the Company's financial condition, results of operations and cash flows.

The operations of the Company are also subject to the administrative and governmental directives, rules and regulations of federal, state, and local regulatory agencies including, but not limited to, HUD. New or changed directives, rules or regulations could occur with little or inadequate funding to pay for the related cost, including the additional administrative burden, to comply with a change which could impact the Company materially in the near term.

LCCA and any of its consolidated variable interest entities (VIE) may be involved in various lawsuits, claims, investigations, and proceedings that arise in the ordinary course of business. Certain of these matters may include speculative claims for substantial or indeterminate amounts of damages which may require significant costs to defend and resolve. A liability is recorded when LCCA and VIE believe that it is both (i) probable that a loss has been incurred and (ii) the amount of said loss can be reasonably estimated. Significant professional judgment is required to determine both the probability and the estimated amount of loss. During the years ending December 31, 2020 and 2021, LCCA was named as a co-defendant in twenty-seven lawsuits pertaining to COVID-19 which were filed against a VIE, of which LCCA is the management agent. Neither LCCA nor VIE has definitively concluded that an unfavorable outcome is probable. However, the amount or reasonably estimated amount of possible loss could have a material adverse effect on LCCA and VIE including their financial condition, results of operations, and cash flows. Although the outcome of litigation is inherently uncertain, the legal costs alone required to defend twenty-six of the lawsuits will exceed the limits of VIE's insurance policy for calendar year 2020. Therefore, if one or more of the pending legal matters were to be resolved unfavorably against VIE for amounts exceeding expectations and insurance policy limits, the financial condition, results of operations, and cash flows of LCCA and VIE could be materially and adversely affected.

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Balance Sheet Data

December 31, 2023

Assets

Account No.

Current assets:

1120	Cash - operations	\$ 21,740
1130	Tenant/member accounts receivable	72
1200	Prepaid expenses	<u>34,632</u>
1100T	Total current assets	<u>56,444</u>

Restricted deposits and funded reserves:

1310	Escrow deposits	171,209
1320	Replacement reserve	<u>430,244</u>
1300T	Total deposits	<u>601,453</u>

Rental property:

1410	Land	855,781
1420	Buildings	9,559,517
1440	Building equipment (portable)	<u>1,144,856</u>
1400T	Total fixed assets	11,560,154
1495	Accumulated depreciation	<u>(7,967,017)</u>
1400N	Net fixed assets	<u>3,593,137</u>
1000T	Total assets	<u>\$ 4,251,034</u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Balance Sheet Data (Continued)

December 31, 2023

Liabilities and Member's Deficit

Account No.

Current liabilities:

2110	Accounts payable - operations	\$ 72
2170	Mortgage payable - first mortgage (short term)	326,437
2190	Miscellaneous current liabilities	<u>145,835</u>
2122T	Total current liabilities	<u>472,344</u>

Long-term liabilities:

2320	Mortgage payable - first mortgage (long-term)	<u>7,233,860</u>
2300T	Total long-term liabilities	<u>7,233,860</u>
2000T	Total liabilities	7,706,204

3130	Member's deficit	<u>(3,455,170)</u>
2033T	Total liabilities and member's deficit	<u>\$ 4,251,034</u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Statement of Operations Data

For the year ended December 31, 2023

Account No.

Rental revenue:

5195	Lease revenue (nursing home or Section 232 - B&C or AL)	\$ <u>898,794</u>
5100T	Total rent revenue	<u>898,794</u>
5152N	Net rental revenue	<u>898,794</u>

Financial revenue:

5440	Revenue from investments - replacement reserve	8,070
5490	Revenue from investments - miscellaneous	<u>29</u>
5400T	Total financial revenue	<u>8,099</u>
5000T	Total revenue	<u>906,893</u>

Expenses:

Administrative:

6340	Legal expense - project	967
6350	Audit expense	4,400
6351	Bookkeeping fees/Accounting services	<u>290</u>
6263T	Total administrative expenses	<u>5,657</u>

Operating and maintenance:

6590	Miscellaneous operating and maintenance expenses	<u>38,472</u>
6500T	Total operating and maintenance expenses	<u>38,472</u>

Taxes and insurance:

6710	Real estate taxes	100,452
6720	Property and liability insurance (hazard)	90,266
6790	Miscellaneous taxes, licenses, permits and insurance	<u>100</u>
6700T	Total taxes and insurance expenses	<u>190,818</u>

Financial:

6820	Interest on first mortgage payable	200,266
6850	Mortgage insurance premium/service charge	<u>39,255</u>
6800T	Total financial expenses	<u>239,521</u>
6000T	Total cost of operations before depreciation	<u>474,468</u>
5060T	Income before depreciation	432,425
6600	<i>Depreciation</i>	<u>457,689</u>
5060N	Operating loss	<u>(25,264)</u>
3250	Net loss	\$ <u><u>(25,264)</u></u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Statement of Operations Data (Continued)

For the year ended December 31, 2023

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>318,704</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>-</u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Statement of Member's Deficit Data

For the year ended December 31, 2023

Account No.

S1100-010	Member's deficit, January 1, 2023	\$ (3,482,014)
S1200-420	Distributions	(40,265)
S1100-030	Other changes in deficit:	
S1100-040	Conversion of miscellaneous current liabilities to member's deficit	92,373
3250	Net loss	<u>(25,264)</u>
3130	Member's deficit, December 31, 2023	<u>\$ (3,455,170)</u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Statement of Cash Flows Data

For the year ended December 31, 2023

Account No.		
	<i>Cash flows from operating activities:</i>	
S1200-010	Rental receipts	\$ 898,722
S1200-020	Interest receipts	<u>8,099</u>
S1200-040	Total receipts	<u>906,821</u>
S1200-050	Administrative expenses paid	(5,585)
S1200-110	Operating and maintenance paid	(5,459)
S1200-120	Real estate taxes paid	(100,452)
S1200-140	Property insurance paid	(90,266)
S1200-150	Miscellaneous taxes and insurance paid	(100)
S1200-180	Interest paid on first mortgage	(188,429)
S1200-210	Mortgage insurance premium paid	<u>(37,781)</u>
S1200-230	Total disbursements	<u>(428,072)</u>
S1200-240	Net cash provided by operating activities	<u>478,749</u>
	<i>Cash flows from investing activities:</i>	
S1200-245	Net deposits to mortgage escrow account	(19,893)
S1200-250	Net withdrawals from reserve for replacements account	37,128
S1200-330	Net purchase of fixed assets	<u>(135,243)</u>
S1200-350	Net cash used in investing activities	<u>(118,008)</u>
	<i>Cash flows from financing activities:</i>	
S1200-360	Principal payments - first mortgage	(318,704)
S1200-420	Distributions	<u>(40,265)</u>
S1200-460	Net cash used in financing activities	<u>(358,969)</u>
S1200-470	Net increase in cash	1,772
S1200-480	Cash, beginning of year	<u>19,968</u>
S1200T	Cash, end of year	<u>\$ 21,740</u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Statement of Cash Flows Data (Continued)

For the year ended December 31, 2023

Account No.		
	<i>Reconciliation of net loss to net cash provided by operating activities:</i>	
3250	Net loss	\$ <u>(25,264)</u>
	Adjustments to reconcile net loss to net cash provided by operating activities:	
6600	Depreciation	457,689
S1200-486	Amortization of debt issuance costs	11,837
	Changes in operating assets and liabilities:	
S1200-500	Accounts receivable	(72)
S1200-520	Prepaid expenses	1,474
S1200-540	Accounts payable	<u>72</u>
		<u>471,000</u>
S1200-600	Other adjustments to reconcile net loss to net cash provided by operating activities:	
S1200-602	Loss on disposal of fixed assets	1,937
S1200-602	Miscellaneous current liabilities	<u>31,076</u>
	Total other adjustments	<u>33,013</u>
	Total adjustments	<u>504,013</u>
S1200-610	Net cash provided by operating activities	\$ <u><u>478,749</u></u>
S1200-620	<i>Supplemental disclosures of cash flow information:</i>	
	Change in net purchases of fixed assets included in miscellaneous current liabilities	\$ <u><u>74,070</u></u>
	Conversion of miscellaneous current liabilities to member's deficit	\$ <u><u>92,373</u></u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Reserve for Replacements

For the year ended December 31, 2023

Account No.

1320P	Balance at January 1, 2023	\$ 467,372
1320DT	Total monthly deposits	95,508
1320INT	Interest on replacement reserve accounts	8,070
1320WT	Approved withdrawals	<u>(140,706)</u>
1320	Balance at December 31, 2023	\$ <u><u>430,244</u></u>
1320R	Deposits suspended or waived indicator	No

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Computation of Surplus Cash (Annual)

December 31, 2023

Account No.

S1300-010	Cash	\$ 21,740
1135	Accounts receivable - HUD	-
S1300-040	Total cash	<u>21,740</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	72
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:	
S1300-120	Franchise/excise tax payable	-
S1300-140	Total current obligations	<u>72</u>
S1300-150	Surplus cash (deficiency)	\$ <u>21,668</u>
S1300-200	Amount available for distribution during next fiscal period	\$ <u>21,668</u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Computation of Surplus Cash (Mid-Year)

June 30, 2023

Account No.

		June 30, 2023
S1400-010	Semi-annual period ended	
S1400-020	Cash	\$ 20,827
S1400-030	Tenant subsidy due for semi-annual period	-
S1400-040	Other	-
S1400-050	Total cash	<u>20,827</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	520
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>520</u>
S1400-190	Surplus cash (deficiency)	\$ <u>20,307</u>
S1400-240	Amount available for distribution during next fiscal period	\$ <u>20,307</u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Schedule of Changes in Fixed Asset Accounts

For the year ended December 31, 2023

	Balance January 1, 2023	Additions	Deletions	Balance December 31, 2023
Land	\$ 855,781	\$ -	\$ -	\$ 855,781
Buildings	9,442,718	119,078	2,279	9,559,517
Building equipment (portable)	<u>1,103,373</u>	<u>90,235</u>	<u>48,752</u>	<u>1,144,856</u>
Total fixed assets	\$ <u>11,401,872</u>	\$ <u>209,313</u>	\$ <u>51,031</u>	11,560,154
Accumulated depreciation	\$ <u>7,558,422</u>	\$ <u>457,689</u>	\$ <u>49,094</u>	<u>7,967,017</u>
Total net book value				\$ <u>3,593,137</u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Schedule of Changes in Fixed Asset Accounts (Continued)

For the year ended December 31, 2023

Fixed asset detail:

<u>Item</u>	<u>Amount</u>
Additions to buildings:	
Doors, hardware and installation	\$ 6,737
Flooring	66,059
LC Design administrative costs	16,851
Water heater, filtration and plumbing equipment	23,575
Audio and video equipment	3,482
Drain pump - kitchen sink	<u>2,374</u>
	<u><u>\$ 119,078</u></u>
Deletions from buildings:	
Flooring	<u><u>\$ 2,279</u></u>
Additions to building equipment (portable):	
Audio and video equipment	\$ 41,280
Computers and office equipment	26,954
Food service equipment	7,039
Health and medical equipment	2,989
Laundry equipment and appliances	2,192
Maintenance and housekeeping equipment	1,689
Rehabilitation and therapy equipment	7,114
Restroom equipment and accessories	<u>978</u>
	<u><u>\$ 90,235</u></u>
Deletions from building equipment (portable):	
Beds, mattresses and bedding supplies	\$ 156
Computers and office equipment	42,149
Food service equipment	3,291
Health and medical equipment	2,206
Maintenance and housekeeping equipment	<u>950</u>
	<u><u>\$ 48,752</u></u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Detail of Accounts

As of and for the year ended December 31, 2023

Detail of accounts - balance sheet:

Miscellaneous current liabilities (Account No. 2190)

Payable to Lessee - replacement reserve reimbursements	\$ <u>145,835</u>
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Detail of accounts - statement of operations:

Miscellaneous operating and maintenance expenses (Account No. 6590)

Plant repairs and maintenance	\$ 25,934
Plant minor equipment	10,601
Loss on disposal of fixed assets	<u>1,937</u>
	\$ <u>38,472</u>

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Other Information

For the year ended December 31, 2023

Related party transaction detail (Account No. S3100-200)

Amount Paid

Entity name:

Leader Care, Inc. - property insurance

\$ 90,266



**Independent Auditors' 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 the 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, 2023, 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 20, 2024.

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.

L B M C, P C

Knoxville, Tennessee
March 20, 2024



Independent Auditors' Report on Compliance for the Major HUD Program and 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 "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, 2023. 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 HUD. 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, 2023.

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; and the Guide. Our responsibilities under those standards and the Guide are further described in the *Auditors' 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 the audit evidence we have obtained is sufficient and appropriate to provide a 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 with the requirements referred to above.

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 Highlands Real Estate Investors, LLC's HUD programs.

Auditors' 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 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 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 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 *Auditors' 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 Guide. Accordingly, this report is not suitable for any other purpose.

LBMC, PC

Knoxville, Tennessee
March 20, 2024

HIGHLANDS REAL ESTATE INVESTORS, LLC

HUD Project No. 023-22126

Schedule of Findings, Questioned Costs and Recommendations

For the year ended December 31, 2023

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, 2023

1. Audit Report dated March 17, 2023, for the year ended December 31, 2022, 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.

Auditors' Transmittal Letter

S3200-005	Audit Firm ID (UII)	09331
S3200-010	Audit Firm	LBMC, PC
S3200-020	Lead Auditor First Name	Mark
S3200-040	Lead Auditor Last Name	Waters
S3200-050	Auditor Street Address Line 1	2095 Lakeside Centre Way
S3200-060	Auditor Street Address Line 2	Suite 220
S3200-070	Auditor City	Knoxville
S3200-080	Auditor State	Tennessee
S3200-090	Auditor Zip Code	37922
S3200-100	Auditor Zip Code Extension	
S3200-110	Telephone Number	865-691-9000
S3200-120	Audit Firm TIN	62-1199757
S3200-130	Date of Independent Auditors' Report	March 20, 2024