

PALACIO DORADO, LLC
(A New York Limited Liability Company)

FINANCIAL STATEMENTS AS OF
DECEMBER 31, 2019 AND 2018

TANNER & ASSOCIATES CPA LLC

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Members of
Palacio Dorado, LLC:

We have audited the accompanying financial statements of **Palacio Dorado, LLC** (a New York limited liability corporation), which comprise the statements of financial position as of **December 31, 2019 and 2018**, and the related statements of operations, changes in members' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

TANNER & ASSOCIATES CPA LLC

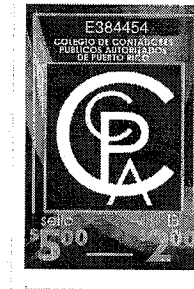
CERTIFIED PUBLIC ACCOUNTANTS

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Palacio Dorado, LLC** as of **December 31 2019 and, 2018**, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Tanner & Co.

TANNER & ASSOCIATES CPA LLC
License Number 240
San Juan, Puerto Rico
April 7, 2020



STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2019 AND 2018

ASSETS

CURRENT ASSETS

	2019	2018
Cash - operations	\$ 189,922	\$ 95,232
Accounts receivable	7,628	10,697
Prepaid expenses	4,030	103,241
Total current assets	<u>201,580</u>	<u>209,170</u>

DEPOSITS HELD IN TRUST-FUNDED

Tenant's security deposits	<u>14,583</u>	<u>6,276</u>
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RESTRICTED DEPOSITS AND FUNDED RESERVES

Hazard insurance escrow	51,668	-
Operating deficit reserve	136,261	-
Debt service reserve	46,149	-
Reserve for replacement	61,135	-
Total deposits	<u>295,213</u>	<u>-</u>

PROPERTY AND EQUIPMENT

Building	17,080,486	16,517,366
Site Improvements	1,027,991	1,027,991
Building equipment - fixed	873,812	872,692
Building equipment - portable	178,655	178,655
Furniture, Fixture and equipment	16,310	12,951
Total property and equipment	19,177,254	18,609,655
Less - Accumulated depreciation	<u>(757,897)</u>	<u>(108,741)</u>
Property and equipment - net	<u>18,419,357</u>	<u>18,500,914</u>

OTHER ASSETS

Deferred tax credit fees	253,386	253,386
Accumulated amortization - tax credit fees	<u>(19,708)</u>	<u>(2,815)</u>
Total other assets	<u>233,678</u>	<u>250,571</u>
Total assets	<u><u>\$ 19,164,411</u></u>	<u><u>\$ 18,966,931</u></u>

STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2019 AND 2018

LIABILITIES

CURRENT LIABILITIES

	2019	2018
Accounts payable and accrued expenses	\$ 86,143	\$ 136,084
Retainage payable	-	1,282,587
First mortgage loan - current portion (Interim construction loan in 2018)	9,218	6,766,336
Total current liabilities	95,361	8,185,007

TENANTS' DEPOSITS HELD IN TRUST

16,383	6,276
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LONG-TERM LIABILITIES

First mortgage loan	990,782	-
Second mortgage loan	914,291	824,040
Accrued interest - second mortgage loan	119,924	69,563
Developer fees	288,198	1,789,700
Due to affiliates	278,613	307,777
Total long-term liabilities	2,591,808	2,991,080
Total liabilities	2,703,552	11,182,363

MEMBERS' CAPITAL

Capital contributions	17,924,000	8,122,000
Accumulated deficit	(1,463,141)	(337,432)
Total members' capital	16,460,859	7,784,568
Total liabilities and members' capital	\$ 19,164,411	\$ 18,966,931

**STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018**

	2019	2018
<u>REVENUES</u>		
Rent revenue	\$ 76,706	\$ 2,243
Tenants' housing assistance payments	375,376	11,257
Total rental revenue	452,082	13,500
<u>VACANCIES AND CONCESSIONS</u>		
Vacancies and rental concession	(10,209)	(713)
Total vacancies and concessions	(10,209)	(713)
Net rental revenues	441,873	12,787
<u>OTHER REVENUES</u>		
Tenant charges and other income	8,603	-
Total revenues	450,476	12,787
<u>EXPENSES</u>		
Administrative expenses	165,824	23,825
Utilities	50,739	-
Operating and maintenance	97,476	7,229
Taxes and insurance	125,167	850
Interest and financial expenses	413,069	112,326
TOTAL COST OF OPERATIONS BEFORE DEPRECIATION	852,275	144,230
OPERATING INCOME (LOSS) BEFORE DEPRECIATION, AMORTIZATION AND OTHER EXPENSES	(401,799)	(131,443)
DEPRECIATION	649,156	108,742
AMORTIZATION	16,893	2,815
OPERATING LOSS BEFORE OTHER EXPENSES	(1,067,848)	(243,000)
<u>OTHER EXPENSES</u>		
Asset management fees	7,500	22,500
Interest - second mortgage loan	50,361	55,563
Total other expense	57,861	78,063
NET LOSS	\$ (1,125,709)	\$ (321,063)

The accompanying notes are an integral part of these statements.

PALACIO DORADO LLC
(A Delaware Limited Liability Company)

STATEMENTS OF CHANGES IN MEMBERS' CAPITAL
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	Managing Member 0.01%	Investor Member 99.99%		Total 100%
	Accumulated Deficit	Capital Contributions	Accumulated Deficit	
BALANCE , December 31, 2017	\$ (2)	\$ 1,805,000	\$ (16,367)	\$ 1,788,631
CAPITAL CONTRIBUTIONS	-	6,317,000		6,317,000
NET LOSS	(32)	-	(321,031)	(321,063)
BALANCE , December 31, 2018	(34)	8,122,000	(337,398)	7,784,568
CAPITAL CONTRIBUTIONS	-	9,802,000		9,802,000
NET LOSS	(113)	-	(1,125,596)	(1,125,709)
BALANCE , December 31, 2019	<u>\$ (147)</u>	<u>\$ 17,924,000</u>	<u>\$ (1,462,994)</u>	<u>\$ 16,460,859</u>

The accompanying notes are an integral part of these statements.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	<u>2019</u>	<u>2018</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (1,125,709)	\$ (321,063)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities-		
Depreciation	649,156	108,742
Amortization	16,893	2,815
Increase (decrease) in operating assets accounts-		
Accounts receivable	3,069	(10,697)
Prepaid expenses	99,211	(103,241)
Tenant deposit held in trust	(8,307)	(6,276)
Increase (decrease) in operating liability accounts-		
Accounts payable and accrued expenses	(49,941)	(1,078,611)
Interest - second mortgage loan	50,361	55,563
Tenant deposit held in trust	10,107	6,529
Total adjustments	<u>770,549</u>	<u>(1,025,176)</u>
Net cash provided by (used in) operating activities	<u>(355,160)</u>	<u>(1,346,239)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Disbursements from (deposits to) funded reserves:		
Hazard insurance escrow	(51,668)	-
Operating deficit reserve	(136,261)	-
Debt service reserve	(46,149)	-
Reserve for replacement	(61,135)	-
Cash paid for purchase of property and equipment	<u>(3,351,688)</u>	<u>(6,751,057)</u>
Net cash used in investing activities	<u>(3,646,901)</u>	<u>(6,751,057)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Capital contributions	9,802,000	6,317,000
Payments (to) from affiliates	(29,164)	18,624
Proceeds from (payments to) interim construction loan	(5,766,336)	1,542,455
Proceeds from second mortgage loan	<u>90,251</u>	<u>299,797</u>
Net cash provided by (used in) financing activities	<u>4,096,751</u>	<u>8,177,876</u>
NET CHANGE IN CASH	94,690	80,580
CASH, beginning of year	<u>95,232</u>	<u>14,652</u>
CASH, end of year	<u>\$ 189,922</u>	<u>\$ 95,232</u>
<u>SUPPLEMENTAL CASH FLOW DATA</u>		
Interest paid	<u>\$ 364,499</u>	<u>\$ 163,453</u>
Income tax paid	<u>\$ -</u>	<u>\$ -</u>

The accompanying notes are an integral part of these statements.

PALACIO DORADO, LLC
(A New York Limited Liability Company)

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

(1) Organization and summary of significant accounting policies

Organization

Palacio Dorado, LLC (the "Company") is a New York limited liability company organized on February 28, 2014, as a real estate development limited liability company to acquire, develop and manage a low-income housing development located in Toa Alta, Puerto Rico, known as Palacio Dorado (the "Project"), with assigned tax credit allocation number 2015-015.

The Project will consist of one hundred and three (103) residential units. The Project will provide affordable housing to eligible low-income tenants.

The Company's members are also eligible for certain low income housing tax credits pursuant to the US Internal Revenue Code ("Section 42"), which regulates the use of the project as to tenant eligibility and gross rental fees, among other requirements. The project's building must meet the provisions of these regulations during each of the fifteen consecutive years of its compliance period, in order to remain qualified to receive the tax credits.

Summary of significant accounting policies

Basis of presentation

The Company's fiscal year ends on December 31st of each year. All references to years in these notes to financial statements represent calendar years then ended, unless otherwise noted. Management has evaluated subsequent events through April 7, 2020, the date which the financial statements were available to be issued.

Accounting method

The financial statements have been prepared on the accrual basis following accounting principle generally accepted in the United States of America (US GAAP).

Impairment of long-lived assets

The Company reviews long-lived assets (presently its land and construction in process costs) for impairment whenever events or changes in circumstances indicate that the carrying value of such asset may not be recoverable. Recoverability of assets to be held and used (the fair value) is measured by a comparison of the recorded historical book value to future net cash flows which is expected to be generated by the asset. If such asset is considered to be impaired, the impairment recognized is measured by the amount by which the historical book value of the asset exceeds its fair value. The recording of an impairment loss has not been necessary.

Property and equipment

Property and equipment are recorded at cost. Expenditures for maintenance and repairs are charged to expenses as incurred while major renewals and betterments are capitalized. Upon disposal of depreciable property, the appropriate property accounts are reduced by the related

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NOTES TO FINANCIAL STATEMENTS
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costs and accumulated depreciation. The resulting gains and losses are reflected in the statement of operations.

Depreciation will be provided using the straight-line method over the estimated useful lives of the assets, as set forth below:

<u>Asset Category</u>	<u>Useful Life</u>
Building	35 years
Equipment and furniture and fixture	5 and 10 years

Concentration of credit risk

The only financial instrument that potentially exposes the Company to concentration of credit risk is its bank account. The Company maintains an account at a high quality financial institution. While the Company attempts to limit any financial exposure, its deposit balance may, at times, exceed federally insured limits. The Company has not experienced any losses on such account.

Puerto Rico and U.S. income taxes

The Company is not subject to income taxes in the United States. In Puerto Rico, it operates as a pass-through entity under the provisions of the Internal Revenue Code for a New Puerto Rico (Puerto Rico Revenue Code 2011). Accordingly, the entity is not subject to the payment of taxes on its net income. The distributive shares of its annual income, or loss, is required to be currently reported as income or loss by each member. Therefore, no income tax expense or liability is recorded by the Company.

The Company follows accounting standards relating to accounting for uncertainty in income taxes. Management assesses whether there are any uncertain tax positions which may give rise to income tax liabilities at the entity level and determines if there are matters requiring recognition in the accompanying financial statements. The Company files income tax returns in the U.S. and the Commonwealth of Puerto Rico. With few exceptions, the Company could be subject to income tax examinations by tax authorities of its income tax returns for up to three years after the filing date of its income tax return (4 years for Puerto Rico income tax returns).

Use of estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements.

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

(2) Rental assistance subsidies

The Project will lease its rental units to very-low and low-income individuals in Dorado, Puerto Rico. The property is operated subject to a Section 8 Housing Choice Voucher Program Housing Assistance Agreement with Puerto Rico Department of Housing ("PRDH"). Under this program, tenant eligibility and referrals to the Project are administered and under the responsibility of PRHD. Tenant assistance payments are made to the Project from funds assigned to PRDH from the Section 8 Housing Choice Voucher Program.

The Company's operations are concentrated in the low-income families tenant real estate market. In addition, the Company operates in a heavily regulated environment. The operations of the Company are subject to the administrative directives, rules and regulations of federal and local regulatory agencies. Such administrative directives, rules and regulations are subject to change by an act of Congress or an administrative change mandated by the applicable agencies. Such changes may occur with short notice or inadequate funding to pay for the related cost, including the additional administrative burden, to comply with a change.

(3) Replacement reserve

Pursuant to the Amended and Restated Operating Agreement (AROA) and the mortgage loan agreement described in Note 8, the Company established a reserve for working capital needs, improvement and replacements of project assets. The replacement reserve will receive a monthly deposit of not less than \$2,575 for a total of \$30,900 per year, with total deposits increasing by 2% each subsequent year.

(4) Operating reserve

Pursuant to the AROA and the mortgage loan agreement described in Note 8, the established an operating reserve of \$136,258 to meet operating expenses in excess of available operating revenues.

(5) Insurance reserve

Pursuant to the AROA and the mortgage loan agreement in Note 8, the Company established an insurance reserve to fund the payment insurance premiums.

(6) Debt service reserve

Pursuant to the AROA and the mortgage loan agreement in Note 8, the Company established a debt service reserve of \$46,148 to fund debt service shortfalls and operating deficits.

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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

(7) Additional Reserves

Pursuant to the Amended and Restated Operating Agreement (AROA), the Company is also required to establish a Lease-up Reserve of \$76,500 to mitigate any disruption in rental cash flows. The amount shall be funded with the Rental Achievement Installment.

(8) Interim Construction Loan

The Company has obtained an interim construction loan granted by Banco Popular de Puerto Rico, with a maximum approved amount of \$18,159,600 in aggregate with \$9,100,000 available for disbursement at any time, bearing interest at 7.5%. This loan was converted during 2019 to a \$1,000,000 to a permanent loan payable in 360 monthly installments and bearing interest at 7.5%. This loan is secured by a first mortgage lien on the Company's project.

The following are the future principal maturities on the above mortgage loan for each of the next five (5) years and thereafter:

<u>Year</u>	<u>Amount</u>
2020	\$ 9,218
2021	9,934
2022	10,705
2023	11,536
2024	12,432
Thereafter	<u>946,175</u>
Total mortgage payable	\$ 1,000,000
Less short term portion	<u>(9,218)</u>
Long term portion	<u>\$ 990,782</u>

The loan agreement includes certain non-financial covenants with which the Company needs to comply. As of December 31, 2019, management was not aware of any violations of the covenants.

(9) Management fees

The Company entered into a management agreement with Executive Homeseach & Realty Services, Inc., the management agent, for the management of the housing project. The management agent is entitled to receive management fees computed at 7% of the annual gross revenues of the project commencing immediately upon the date of each individual units' occupancy. The original term of the housing management agreement is for 5 years, and provides for automatic additional renewals.

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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

(10) Capital contributions, ownership percentages and allocation of profit and losses

The following are the members' names, their respective ownership percentages and capital contributions as of December 31, 2019. Profits and losses are allocated in accordance with their percentage interest, except for certain special allocations contained in the Amendment to Amended and Restated Operating Agreement (AROA):

Members' Names	Ownership %	Total Contributions Required Per AROA	Contributions Paid	Downward Adjuster	Contributions Receivable
Managing Member					
Palacio Dorado Development Inc.	0.010%	\$ 100	\$ -	\$ -	\$ 100
Investor Member					
R4 PDPR Acquisition LLC	99.99%	18,049,000	17,924,000	125,000	-
Total members' capital	100.00%	\$ 18,049,100	\$ 17,924,000	\$ 125,000	\$ 100

(11) Related party transaction

(a) Deferred development fee

The Developer is entitled to receive a development fee of \$2,270,975 for services provided to the Company in connection with the development and construction of the project. This fee is earned as the project's development progressed based on the terms of the Development Agreement. The development fee will be paid from development sources and any unpaid fee, if any, will be paid from net cash flow, in accordance with the AROA.

(b) Supervisory management fee

The Company shall pay an annual supervisory management fee equal to 5% of Gross Income Collected as defined in the AROA to the Managing Member on a non-cumulative non-compounded basis for its services of supervising the management of the Project.

(c) Second mortgage loan

The Company has entered into a \$915,600 second mortgage agreement with a related party for the construction of the 103 units' housing project in Dorado Puerto Rico bearing interest at 6% and is secured by the Company's rental property. Accrued interest is paid only to the extent provided by Cash Flow as defined in the Mortgage Note. The notes, and any unpaid accrued interest, are due on October 2056.

PALACIO DORADO, LLC
(A New York Limited Liability Company)

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

(d) Annual local administrative fee and lease up fee

The Company shall pay to the Investor Member an annual local administrative fee and a one-time lease up fee of \$7,500 and \$16,411, respectively, for its services of monitoring the operations and the lease-up of the Project.

(12) Cash distributions

As agreed to by the Members, the Net Cash Flow available for distribution (as defined) shall be distributed as follows:

- (a) To the Investor Member, as payment of any unpaid but accrued Annual Local Administrative Fees
- (b) To replenish the Operating Reserve to the Minimum Balance.
- (c) To repay any loan payable to any Member, including Voluntary Loans, other than loans payable to the Managing Member or its Affiliates, applied first to accrued interest and then to principal
- (d) To the Management Agent, an amount equal to any accrued and unpaid Deferred Management Fees pursuant to Section 4.6.1 of the AROA.
- (e) To the Developer, an amount equal to all accrued but unpaid interest and principal in respect of the Deferred Development Fee, applied first to accrued interest and then to principal.
- (f) For repayment of the HOME Loan.
- (g) To repay any loan payable to the Managing Member or its affiliates, including Voluntary Loans, but other than loans otherwise payable pursuant to the Section 7.4 of the AROA, applied first to accrued interest and then to principal.
- (h) To the Person making an Operating Deficit Loan, to the extent of 50% of the remaining Cash Flow, an amount equal to the unpaid balance of any Operating Deficit Loan, made by such Person.
- (i) 10% of any Cash Flow available shall be distributed to the Investor Member
- (j) The remaining balance to pay the Supervisory Management Fee and the Managing Member

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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Notwithstanding the foregoing, Excess Development Cash Flow prior to the period of Rental Achievement shall be applied in the priorities set forth in Sections 7.4.1(i) and (ii) and then to the payment of the Lease-up Fee. Cash Flow in excess of the Excess Development Cash Flow shall be applied as set forth in Section 7.4.1 (i) through (xi) of the AROA

(13) Development and operation guarantees

The AROA requires a Development and Operation Guaranty whereby the Managing Member will be responsible for the timely development/construction and operation of the project in compliance with all federal, state and local laws; and to pay all excess development costs. Any development costs paid by the Managing Member shall not be repaid by the Company, nor shall such amount be treated as a capital contribution of the Managing Member.

(14) Contingency and commitments

The Project's Low-Income Housing Tax Credits are contingent on its ability to maintain compliance with the provisions of Section 42 of the US Internal Revenue Code. Failure to maintain compliance with such requirements as to occupant eligibility, unit gross rents, or to correct noncompliance within a specified time period, could result in recapture of previously taken tax credits, plus interest.

The Company has entered into a land lease agreement with an affiliate to serve as the construction site of the 103 unit Project. The lease is for a term of 99 years commencing on October 2016 and for an aggregate amount of \$1.

(15) Low-income housing tax credits

The Company received a total U.S low income housing tax credit reservation of \$19,998,000 which will grant in equal installments throughout a ten-year period. The credit to be granted during the project's first year of operations will be calculated based on the weighted average coverage of occupancy of units during that year.

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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

As of December 31, 2019 the estimated expected availability of the tax credits is as follows:

<u>Year Ended December 31,</u>	<u>Amount</u>
2019	\$ 1,807,273
2020	1,999,800
2021	1,999,800
2022	1,999,800
2023	1,999,800
2024	1,999,800
2025	1,999,800
2026	1,999,800
2027	1,999,800
2028	1,999,800
2029	192,527
	<u>\$ 19,998,000</u>