

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

☒ Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended September 30, 2021

Or

☐ Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Transition Period from -----to-----

Commission File Number: **000-54295**

Sterling Real Estate Trust
d/b/a Sterling Multifamily Trust
(Exact name of registrant as specified in its charter)

North Dakota
(State or other jurisdiction of incorporation or organization)

90-0115411
(I.R.S. Employer Identification No.)

4340 18th Ave S., Suite 200, Fargo, North Dakota
(Address of principal executive offices)

58103
(Zip Code)

(701) 353-2720
(Registrant's telephone number, including area code)

1711 Gold Drive South, Suite 100, Fargo, North Dakota
(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class: | Trading Symbol | Name of each exchange on which registered: |
|---|----------------|--|
| Common Shares, par value \$0.01 per share | N/A | N/A |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input checked="" type="checkbox"/> | Smaller reporting company | <input type="checkbox"/> |
| Emerging growth company | <input type="checkbox"/> | | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at November 8, 2021 |
|---|---------------------------------|
| Common Shares of Beneficial Interest, \$0.01 par value per share | 10,357,118.45 |

STERLING REAL ESTATE TRUST AND SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2021 (UNAUDITED) AND DECEMBER 31, 2020

| | September 30, 2021 | December 31, 2020 |
|---|-----------------------|----------------------|
| | (in thousands) | |
| ASSETS | | |
| Real estate investments | | |
| Land and land improvements | \$ 125,333 | \$ 119,088 |
| Building and improvements | 755,294 | 712,560 |
| Construction in progress | 10,804 | 13,640 |
| Real estate investments | 891,431 | 845,288 |
| Less accumulated depreciation | (174,088) | (160,575) |
| Real estate investments, net | 717,343 | 684,713 |
| Cash and cash equivalents | 22,168 | 11,716 |
| Restricted deposits | 10,879 | 15,919 |
| Investment in unconsolidated affiliates | 15,147 | 9,659 |
| Notes receivable | 5,456 | 2,026 |
| Assets held for sale | — | 831 |
| Lease intangible assets, less accumulated amortization | 6,519 | 7,367 |
| Other assets, net | 10,888 | 10,798 |
| | | |
| Total Assets | \$ 788,400 | \$ 743,029 |
| LIABILITIES | | |
| Mortgage notes payable, net | \$ 462,150 | \$ 421,278 |
| Dividends payable | 7,543 | 7,447 |
| Tenant security deposits payable | 5,174 | 4,908 |
| Lease intangible liabilities, less accumulated amortization | 856 | 994 |
| Liabilities related to assets held for sale | — | 5 |
| Accrued expenses and other liabilities | 15,761 | 16,869 |
| Total Liabilities | 491,484 | 451,501 |
| | | |
| COMMITMENTS and CONTINGENCIES - Note 13 | | |
| | | |
| SHAREHOLDERS' EQUITY | | |
| Beneficial interest | 115,468 | 109,366 |
| Noncontrolling interest | | |
| Operating partnership | 179,582 | 181,621 |
| Partially owned properties | 2,198 | 2,346 |
| Accumulated other comprehensive loss | (332) | (1,805) |
| Total Shareholders' Equity | 296,916 | 291,528 |
| | | |
| | \$ 788,400 | \$ 743,029 |

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE INCOME
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2021 AND 2020 (UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---------------------------------------|-----------|---------------------------------------|-----------|
| | 2021 | 2020 | 2021 | 2020 |
| | (in thousands, except per share data) | | (in thousands, except per share data) | |
| Income from rental operations | | | | |
| Real estate rental income | \$ 33,053 | \$ 30,866 | \$ 96,736 | \$ 91,593 |
| Expenses | | | | |
| Expenses from rental operations | | | | |
| Operating expenses | 14,184 | 12,142 | 37,956 | 35,639 |
| Real estate taxes | 3,489 | 3,160 | 10,123 | 9,463 |
| Depreciation and amortization | 5,551 | 5,328 | 16,634 | 15,826 |
| Interest | 4,671 | 4,187 | 13,261 | 12,761 |
| | 27,895 | 24,817 | 77,974 | 73,689 |
| Administration of REIT | 1,007 | 972 | 3,267 | 3,218 |
| Total expenses | 28,902 | 25,789 | 81,241 | 76,907 |
| Income from operations | 4,151 | 5,077 | 15,495 | 14,686 |
| Other income | | | | |
| Equity in (losses) income of unconsolidated affiliates | (67) | 125 | (183) | 363 |
| Other income | 1,085 | 64 | 1,574 | 333 |
| Gain on sale of real estate investments | — | — | 1,710 | 1,456 |
| Gain on involuntary conversion | 549 | — | 1,236 | 52 |
| | 1,567 | 189 | 4,337 | 2,204 |
| Net income | \$ 5,718 | \$ 5,266 | \$ 19,832 | \$ 16,890 |
| Net income (loss) attributable to noncontrolling interest: | | | | |
| Operating Partnership | 3,753 | 3,450 | 12,861 | 11,046 |
| Partially owned properties | (139) | (28) | (148) | (15) |
| Net income attributable to Sterling Real Estate Trust | \$ 2,104 | \$ 1,844 | \$ 7,119 | \$ 5,859 |
| Net income attributable to Sterling Real Estate Trust per common share, basic and diluted | \$ 0.21 | \$ 0.19 | \$ 0.71 | \$ 0.61 |
| Comprehensive income: | | | | |
| Net income | \$ 5,718 | \$ 5,266 | \$ 19,832 | \$ 16,890 |
| Other comprehensive gain (loss) - change in fair value of interest rate swaps | (66) | (17) | 1,473 | (2,125) |
| Comprehensive income | 5,652 | 5,249 | 21,305 | 14,765 |
| Comprehensive income attributable to noncontrolling interest | 3,571 | 3,411 | 13,661 | 9,641 |
| Comprehensive income attributable to Sterling Real Estate Trust | \$ 2,081 | \$ 1,838 | \$ 7,644 | \$ 5,124 |
| Weighted average Common Shares outstanding, basic and diluted | 10,215 | 9,740 | 10,095 | 9,638 |

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2021 (UNAUDITED)

| | Common Shares | Paid-in Capital | Accumulated Distributions in Excess of Earnings | Total Beneficial Interest | Noncontrolling Interest | | Accumulated Comprehensive Income (Loss) | Total |
|---|------------------|--------------------|--|---------------------------------|----------------------------|-------------------------------|---|------------|
| | | | | | Operating Partnership | Partially Owned Properties | | |
| (in thousands) | | | | | | | | |
| BALANCE AT DECEMBER 31, 2020 | 9,855 | \$ 139,105 | (\$ 29,739) | \$ 109,366 | \$ 181,621 | \$ 2,346 | (\$ 1,805) | \$ 291,528 |
| Shares/units redeemed | (41) | (777) | - | (777) | (628) | - | - | (1,405) |
| Dividends and distributions declared | - | - | (2,642) | (2,642) | (4,835) | - | - | (7,477) |
| Dividends reinvested - stock dividend | 89 | 1,686 | - | 1,686 | - | - | - | 1,686 |
| Issuance of shares under optional purchase plan | 65 | 1,307 | - | 1,307 | - | - | - | 1,307 |
| Change in fair value of interest rate swaps | - | - | - | - | - | - | 2,384 | 2,384 |
| Net income | - | - | 2,052 | 2,052 | 3,753 | 31 | - | 5,836 |
| BALANCE AT MARCH 31, 2021 | 9,968 | \$ 141,321 | (\$ 30,329) | \$ 110,992 | \$ 179,911 | \$ 2,377 | \$ 579 | \$ 293,859 |
| Contribution of assets in exchange for the issuance of noncontrolling interest shares | - | - | - | - | 890 | - | - | 890 |
| Shares/units redeemed | (15) | (292) | - | (292) | (1,853) | - | - | (2,145) |
| Dividends and distributions declared | - | - | (2,672) | (2,672) | (4,821) | - | - | (7,493) |
| Dividends reinvested - stock dividend | 88 | 1,679 | - | 1,679 | - | - | - | 1,679 |
| Issuance of shares under optional purchase plan | 41 | 820 | - | 820 | - | - | - | 820 |
| Change in fair value of interest rate swaps | - | - | - | - | - | - | (845) | (845) |
| Net income (loss) | - | - | 2,963 | 2,963 | 5,355 | (40) | - | 8,278 |
| BALANCE AT JUNE 30, 2021 | 10,082 | \$ 143,528 | (\$ 30,038) | \$ 113,490 | \$ 179,482 | \$ 2,337 | (\$ 266) | \$ 295,043 |
| Contribution of assets in exchange for the issuance of noncontrolling interest shares | - | - | - | - | 1,993 | - | - | 1,993 |
| Shares issued under trustee compensation plan | 3 | 57 | - | 57 | - | - | - | 57 |
| Shares/units redeemed | (6) | (105) | - | (105) | (810) | - | - | (915) |
| Dividends and distributions declared | - | - | (2,707) | (2,707) | (4,836) | - | - | (7,543) |
| Dividends reinvested - stock dividend | 92 | 1,743 | - | 1,743 | - | - | - | 1,743 |
| Issuance of shares under optional purchase plan | 44 | 886 | - | 886 | - | - | - | 886 |
| Change in fair value of interest rate swaps | - | - | - | - | - | - | (66) | (66) |
| Net income (loss) | - | - | 2,104 | 2,104 | 3,753 | (139) | - | 5,718 |
| BALANCE AT SEPTEMBER 30, 2021 | 10,215 | \$ 146,109 | (\$ 30,641) | \$ 115,468 | \$ 179,582 | \$ 2,198 | (\$ 332) | \$ 296,916 |

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Continued)
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2020 (UNAUDITED)

| | Common Shares | Paid-in Capital | Accumulated Distributions in Excess of Earnings | Total Beneficial Interest | Noncontrolling Interest | | Accumulated Comprehensive Income (Loss) | Total |
|---|------------------|--------------------|--|---------------------------------|----------------------------|-------------------------------|---|------------|
| | | | | | Operating Partnership | Partially Owned Properties | | |
| (in thousands) | | | | | | | | |
| BALANCE AT DECEMBER 31, 2019 | 9,436 | \$ 131,261 | (\$ 28,888) | \$ 102,373 | \$ 174,221 | \$ 2,416 | \$ 37 | \$ 279,047 |
| Contribution of assets in exchange for the issuance of noncontrolling interest shares | - | - | - | - | 9,031 | - | - | 9,031 |
| Shares/units redeemed | (38) | (696) | - | (696) | (541) | - | - | (1,237) |
| Dividends and distributions declared | - | - | (2,527) | (2,527) | (4,831) | - | - | (7,358) |
| Dividends reinvested - stock dividend | 87 | 1,584 | - | 1,584 | - | - | - | 1,584 |
| Issuance of shares under optional purchase plan | 62 | 1,203 | - | 1,203 | - | - | - | 1,203 |
| Change in fair value of interest rate swaps | - | - | - | - | - | - | (1,486) | (1,486) |
| Net income (loss) | - | - | 1,813 | 1,813 | 3,419 | (5) | - | 5,227 |
| BALANCE AT MARCH 31, 2020 | 9,547 | \$ 133,352 | (\$ 29,602) | \$ 103,750 | \$ 181,299 | \$ 2,411 | (\$ 1,449) | \$ 286,011 |
| Shares/units redeemed | (57) | (1,039) | - | (1,039) | (209) | - | - | (1,248) |
| Dividends and distributions declared | - | - | (2,544) | (2,544) | (4,828) | - | - | (7,372) |
| Dividends reinvested - stock dividend | 88 | 1,608 | - | 1,608 | - | - | - | 1,608 |
| Issuance of shares under optional purchase plan | 32 | 611 | - | 611 | - | - | - | 611 |
| Change in fair value of interest rate swaps | - | - | - | - | - | - | (622) | (622) |
| Net income | - | - | 2,202 | 2,202 | 4,177 | 18 | - | 6,397 |
| BALANCE AT JUNE 30, 2020 | 9,610 | \$ 134,532 | (\$ 29,944) | \$ 104,588 | \$ 180,439 | \$ 2,429 | (\$ 2,071) | \$ 285,385 |
| Shares issued under trustee compensation plan | 3 | 64 | - | 64 | - | - | - | 64 |
| Shares/units redeemed | (6) | (118) | - | (118) | (183) | - | - | (301) |
| Dividends and distributions declared | - | - | (2,577) | (2,577) | (4,825) | - | - | (7,402) |
| Dividends reinvested - stock dividend | 90 | 1,644 | - | 1,644 | - | - | - | 1,644 |
| Issuance of shares under optional purchase plan | 40 | 765 | - | 765 | - | - | - | 765 |
| Change in fair value of interest rate swaps | - | - | - | - | - | - | (17) | (17) |
| Net income (loss) | - | - | 1,844 | 1,844 | 3,450 | (28) | - | 5,266 |
| BALANCE AT SEPTEMBER 30, 2020 | 9,737 | \$ 136,887 | (\$ 30,677) | \$ 106,210 | \$ 178,881 | \$ 2,401 | (\$ 2,088) | \$ 285,404 |

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2021 AND 2020 (UNAUDITED)

| | Nine Months Ended September 30, | |
|--|------------------------------------|------------------|
| | 2021 | 2020 |
| | (in thousands) | |
| OPERATING ACTIVITIES | | |
| Net income | \$ 19,832 | \$ 16,890 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Gain on sale of real estate investments | (1,710) | (1,456) |
| Gain on involuntary conversion | (1,236) | (52) |
| Equity in loss (income) of unconsolidated affiliates | 183 | (363) |
| Distributions of earnings of unconsolidated affiliates | 174 | 363 |
| Allowance for uncollectible accounts receivable | 502 | 52 |
| Depreciation | 15,665 | 14,716 |
| Amortization | 971 | 1,095 |
| Amortization of debt issuance costs | 402 | 463 |
| Effects on operating cash flows due to changes in | | |
| Other assets | (1,160) | 2,389 |
| Tenant security deposits payable | 298 | 380 |
| Accrued expenses and other liabilities | (1,081) | 1,511 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 32,840 | 35,988 |
| INVESTING ACTIVITIES | | |
| Purchase of real estate investment properties | (35,893) | (11,622) |
| Capital expenditures and tenant improvements | (13,629) | (24,662) |
| Proceeds from sale of real estate investments and non-real estate investments | 5,590 | 5,483 |
| Proceeds from involuntary conversion | 4,095 | 1,077 |
| Proceeds from sale of joint venture interest | — | — |
| Investment in unconsolidated affiliates | (5,845) | (1,170) |
| Distributions in excess of earnings received from unconsolidated affiliates | — | 239 |
| Notes receivable issued net of payments received | (3,430) | (743) |
| NET CASH USED IN INVESTING ACTIVITIES | (49,112) | (31,398) |
| FINANCING ACTIVITIES | | |
| Payments for financing, debt issuance | (700) | (349) |
| Payments on investment certificates and subordinated debt | (25) | (50) |
| Principal payments on special assessments payable | — | (290) |
| Proceeds from issuance of mortgage notes payable and subordinated debt | 71,530 | 26,135 |
| Principal payments on mortgage notes payable | (30,360) | (15,249) |
| Proceeds from issuance of shares under optional purchase plan | 3,013 | 2,579 |
| Shares/units redeemed | (4,465) | (2,786) |
| Dividends/distributions paid | (17,309) | (17,012) |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 21,684 | (7,022) |
| NET CHANGE IN CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS | 5,412 | (2,432) |
| CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS AT BEGINNING OF PERIOD | 27,635 | 17,382 |
| CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS AT END OF PERIOD | \$ 33,047 | \$ 14,950 |
| CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS AT END OF PERIOD | | |
| Cash and cash equivalents | \$ 22,168 | \$ 6,499 |
| Restricted deposits | 10,879 | 8,451 |
| TOTAL CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS, END OF PERIOD | \$ 33,047 | \$ 14,950 |

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2021 AND 2020 (UNAUDITED)

| | Nine Months Ended September 30, | |
|---|------------------------------------|-----------|
| | 2021 | 2020 |
| | (in thousands) | |
| SCHEDULE OF CASH FLOW INFORMATION | | |
| Cash paid during the period for interest, net of capitalized interest | \$ 12,812 | \$ 12,381 |
| SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES | | |
| Dividends reinvested | \$ 5,108 | \$ 4,836 |
| Dividends declared and not paid | 2,707 | 2,577 |
| UPREIT distributions declared and not paid | 4,836 | 4,825 |
| Shares issued pursuant to trustee compensation plan | 57 | 64 |
| Acquisition of assets in exchange for the issuance of noncontrolling interest units in UPREIT | 2,883 | 9,031 |
| Increase in land improvements due to increase in special assessments payable | 204 | 72 |
| Unrealized gain (loss) on interest rate swaps | 1,473 | (2,125) |
| Acquisition of assets through assumption of debt and liabilities | 569 | 538 |
| Capitalized interest and real estate taxes related to construction in progress | 200 | 524 |

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2021 AND 2020 (UNAUDITED)

(Dollar amounts in thousands, except share and per share data)

NOTE 1 - ORGANIZATION

Sterling Real Estate Trust d/b/a Sterling Multifamily Trust (“Sterling”, “the Trust” or “the Company”) is a registered, but unincorporated business trust organized in North Dakota in December 2002. Sterling has elected to be taxed as a Real Estate Investment Trust (“REIT”) under Sections 856-860 of the Internal Revenue Code.

Sterling previously established an Operating Partnership (“Sterling Properties, LLLP” or the “Operating Partnership”) and transferred all of its assets and liabilities to the operating partnership in exchange for general partnership units. As the general partner of Sterling Properties, LLLP, Sterling has management responsibility for all activities of the Operating Partnership. As of September 30, 2021 and December 31, 2020, Sterling owned approximately 35.89% and 35.03%, respectively, of the Operating Partnership.

NOTE 2 – PRINCIPAL ACTIVITY AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2020, which have previously been filed with the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been omitted from this report on Form 10-Q pursuant to the rules and regulations of the SEC.

The results for the interim periods shown in this report are not necessarily indicative of future financial results. In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments necessary to present fairly our consolidated financial statements as of and for the three and nine months ended September 30, 2021. These adjustments are of a normal recurring nature.

For a complete set of the Company’s significant accounting policies, refer to Note 2 of the Company’s Annual Report on Form 10-K for the year ended December 31, 2020.

Principles of Consolidation

The consolidated financial statements include the accounts of Sterling, Sterling Properties, LLLP, and wholly-owned limited liability companies. All significant intercompany transactions and balances have been eliminated in consolidation.

As of September 30, 2021, the Trust owned approximately 35.89% of the partnership interests (“OP Units”) of the Operating Partnership. The remaining OP Units, consisting exclusively of limited partner interests, are held by persons who contributed their interests in properties to the Operating Partnership in exchange for OP Units. Under the partnership agreement, these persons have the right to tender their OP Units for redemption to the Operating Partnership at any time following a specified restricted period for cash equal to the fair value of an equivalent number of common shares of the Trust. In lieu of delivering cash, however, the Trust, as the Operating Partnership’s general partner, may, at its option, choose to acquire any OP Units so tendered by issuing common shares in exchange for the tendered OP Units. If the Trust so chooses, its common shares will be exchanged for OP Units on a one-for-one basis. This one-for-one exchange ratio is subject to adjustment to prevent dilution. With each such exchange or redemption, the Trust’s percentage ownership in the Operating Partnership will increase. In addition, whenever the Trust issues common or other classes of its shares, it contributes the net proceeds it receives from the issuance to the Operating Partnership and the Operating Partnership issues to the Trust an equal number of OP Units or other partnership interests having preferences and rights that mirror the

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2021 AND 2020 (UNAUDITED)

(Dollar amounts in thousands, except share and per share data)

preferences and rights of the shares issued. This structure is commonly referred to as an umbrella partnership REIT or “UPREIT.”

Additionally, we evaluate the need to consolidate affiliates based on standards set forth in the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 810, Consolidation (“ASC 810”). In determining whether we have a requirement to consolidate the accounts of an entity, management considers factors such as our ownership interest, our authority to make decisions and contractual and substantive participating rights of the limited partners and shareholders, as well as whether the entity is a variable interest entity (“VIE”) for which we have both: a) the power to direct the activities of the VIE that most significantly impact the entity’s economic performance, and b) the obligation to absorb losses or the right to receive benefits from the VIE that could be potentially significant to the VIE. The Trust will consolidate the operations of a joint venture if the Trust determines that it is the primary beneficiary of a variable interest entity (VIE) and has substantial influence and control of the entity.

In instances where the Trust determines that it is not the primary beneficiary of a VIE and the Trust does not control the joint venture but can exercise influence over the entity with respect to its operations and major decisions, the Trust will use the equity method of accounting. Under the equity method, the operations of a joint venture will not be consolidated with the Trust’s operations but instead its share of operations will be reflected as equity in earnings (loss) of unconsolidated entity on its consolidated statements of operations and comprehensive loss. Additionally, the Trust’s net investment in the joint venture will be reflected as investment in unconsolidated entity on the consolidated balance sheets. See Note 5 for additional details regarding variable interest entities where the Trust uses the equity method of investing.

The Operating Partnership meets the criteria as a variable interest entity (“VIE”). The Trust’s sole significant asset is its investment in the Operating Partnership. As a result, substantially all of the Trust’s assets and liabilities represent those assets and liabilities of the Operating Partnership. All of the Trust’s debt is an obligation of the Operating Partnership, and the Trust guarantees the unsecured debt obligations of the Operating Partnership

Use of Estimates

The preparation of consolidated financial statements in conformity 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. Estimates and assumptions also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Real Estate Investments

Real estate investments are recorded at cost less accumulated depreciation. Ordinary repairs and maintenance are expensed as incurred.

The Trust allocates the purchase price of each acquired investment property accounted for as an asset acquisition based upon the estimated acquisition date fair value of the individual assets acquired and liabilities assumed, which generally include (i) land, (ii) building and other improvements, (iii) in-place lease value intangibles, (iv) acquired above and below market lease intangibles, and (v) assumed financing that is determined to be above or below market, if any. Transaction costs related to acquisitions accounted for as asset acquisitions are capitalized as incurred and included as a cost of the building in the accompanying balance sheet.

For tangible assets acquired, including land, building and other improvements, the Trust considers available comparable market and industry information in estimating fair value on the acquisition date. Key factors considered in the calculation of fair value of both real property and intangible assets include the current market rent values, “dark” periods (building in

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2021 AND 2020 (UNAUDITED)

(Dollar amounts in thousands, except share and per share data)

vacant status), direct costs estimated with obtaining a new tenant, discount rates, escalation factors, standard lease terms, and tenant improvement costs.

Furniture and fixtures are stated at cost less accumulated depreciation. Expenditures for renewals and improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Furniture and fixtures are included in the accompanying consolidated balance sheets. Expenditures for routine maintenance and repairs, which do not add to the value or extend useful lives, are charged to expense as incurred.

Depreciation is provided for over the estimated useful lives of the individual assets using the straight-line method over the following estimated useful lives:

| | |
|-----------------------------------|-----------|
| Buildings and improvements | 40 years |
| Furniture, fixtures and equipment | 5-9 years |

The Trust's investment properties are reviewed for potential impairment indicators on each property, at the end of each reporting period or whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Based on evaluation, there were no impairment losses during the nine months ended September 30, 2021 and 2020.

Federal Income Taxes

We have elected to be taxed as a REIT under the Internal Revenue Code, as amended. A REIT calculates taxable income similar to other domestic corporations, with the major difference being a REIT is entitled to a deduction for dividends paid. A REIT is generally required to distribute each year at least 90% of its taxable income. If it chooses to retain the remaining 10% of taxable income, it may do so, but it will be subject to a corporate tax on such income. REIT shareholders are taxed on REIT distributions of ordinary income in generally the same manner as they are taxed on other corporate distributions.

We intend to continue to qualify as a REIT and, provided we maintain such status, will not be taxed on the portion of the income that is distributed to shareholders. In addition, we intend to distribute all of our taxable income; therefore, no provisions or liabilities for income taxes have been recorded in the financial statements.

We follow FASB ASC Topic 740, *Income Taxes*, to recognize, measure, present and disclose in our consolidated financial statements uncertain tax positions that we have taken or expect to take on a tax return. As of September 30, 2021 and December 31, 2020 we did not have any liabilities for uncertain tax positions that we believe should be recognized in our consolidated financial statements. We are no longer subject to Federal and State tax examinations by tax authorities for years before 2017.

Revenue Recognition

We record base rents on a straight-line basis. The monthly base rent income according to the terms of our leases is adjusted with the purpose that average monthly rent is recorded for each tenant over the term of its lease. The straight-line rent adjustment increased revenue by \$167 and decreased revenue \$31 for the three months ended September 30, 2021 and 2020, respectively. The straight-line rent adjustment increased revenue by \$359 and decreased revenue by \$169 for the nine months ended September 30, 2021 and 2020, respectively. The straight-line receivable balance included in receivables on the consolidated balance sheets as of September 30, 2021 and December 31, 2020 was \$3,377 and \$3,012, respectively. We receive payments for expense reimbursements from substantially all our multi-tenant commercial tenants throughout the year based on estimates.

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Reclassifications

Certain reclassifications considered necessary for a fair presentation have been made to the prior period financial statements in order to conform to the current year presentation. These reclassifications have not changed the results of operations or equity.

NOTE 3 – SEGMENT REPORTING

We report our results in two reportable segments: residential and commercial properties. Our residential properties include multifamily properties. Our commercial properties include retail, office, industrial, restaurant and medical properties. We assess and measure operating results based on net operating income (“NOI”), which we define as total segment income from rental operations less total segment expenses from rental operations (which consist of real estate taxes, property management fees, utilities, repairs and maintenance, insurance and direct administrative costs). We believe NOI is an important measure of operating performance even though it should not be considered an alternative to net income or cash flow from operating activities. NOI is unaffected by financing, depreciation, amortization and certain general and administrative expenses.

Segment Revenues and Net Operating Income

The revenues and net operating income for the reportable segments (residential and commercial) are summarized as follows for the three and nine months ended September 30, 2021 and 2020, along with reconciliations to the consolidated financial statements. Segment assets are also reconciled to Total Assets as reported in the consolidated financial statements.

| | Three months ended September 30, 2021 | | | Three months ended September 30, 2020 | | |
|---------------------------------|--|-------------------|------------------|--|-------------------|------------------|
| | Residential | Commercial | Total | Residential | Commercial | Total |
| | (in thousands) | | | (in thousands) | | |
| Income from rental operations | \$ 27,838 | \$ 5,215 | \$ 33,053 | \$ 24,858 | \$ 6,008 | \$ 30,866 |
| Expenses from rental operations | 15,352 | 2,321 | 17,673 | 13,506 | 1,796 | 15,302 |
| Net operating income | <u>\$ 12,486</u> | <u>\$ 2,894</u> | <u>\$ 15,380</u> | <u>\$ 11,352</u> | <u>\$ 4,212</u> | <u>\$ 15,564</u> |
| Depreciation and amortization | | | 5,551 | | | 5,328 |
| Interest | | | 4,671 | | | 4,187 |
| Administration of REIT | | | 1,007 | | | 972 |
| Other (income) expense | | | (1,567) | | | (189) |
| Net income | | | <u>\$ 5,718</u> | | | <u>\$ 5,266</u> |

| | Nine months ended September 30, 2021 | | | Nine months ended September 30, 2020 | | |
|---------------------------------|---|-------------------|------------------|---|-------------------|------------------|
| | Residential | Commercial | Total | Residential | Commercial | Total |
| | (in thousands) | | | (in thousands) | | |
| Income from rental operations | \$ 80,028 | \$ 16,708 | \$ 96,736 | \$ 73,234 | \$ 18,359 | \$ 91,593 |
| Expenses from rental operations | 42,564 | 5,515 | 48,079 | 39,978 | 5,124 | 45,102 |
| Net operating income | <u>\$ 37,464</u> | <u>\$ 11,193</u> | <u>\$ 48,657</u> | <u>\$ 33,256</u> | <u>\$ 13,235</u> | <u>\$ 46,491</u> |
| Depreciation and amortization | | | 16,634 | | | 15,826 |
| Interest | | | 13,261 | | | 12,761 |
| Administration of REIT | | | 3,267 | | | 3,218 |
| Other income | | | (4,337) | | | (2,204) |
| Net income | | | <u>\$ 19,832</u> | | | <u>\$ 16,890</u> |

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Segment Assets and Accumulated Depreciation

| As of September 30, 2021 | Residential | Commercial (in thousands) | Total |
|--|--------------------|--------------------------------------|-------------------|
| Real estate investments | \$ 688,151 | \$ 203,280 | \$ 891,431 |
| Accumulated depreciation | (129,054) | (45,034) | (174,088) |
| | <u>\$ 559,097</u> | <u>\$ 158,246</u> | <u>717,343</u> |
| Cash and cash equivalents | | | 22,168 |
| Restricted deposits | | | 10,879 |
| Investment in unconsolidated affiliates | | | 15,147 |
| Notes receivable | | | 5,456 |
| Intangible assets, less accumulated amortization | | | 6,519 |
| Other assets, net | | | 10,888 |
| Total Assets | | | <u>\$ 788,400</u> |

| As of December 31, 2020 | Residential | Commercial (in thousands) | Total |
|--|--------------------|--------------------------------------|-------------------|
| Real estate investments | \$ 647,083 | \$ 198,205 | \$ 845,288 |
| Accumulated depreciation | (118,363) | (42,212) | (160,575) |
| | <u>\$ 528,720</u> | <u>\$ 155,993</u> | <u>684,713</u> |
| Cash and cash equivalents | | | 11,716 |
| Restricted deposits | | | 15,919 |
| Investment in unconsolidated affiliates | | | 9,659 |
| Notes receivable | | | 2,026 |
| Assets held for sale | | | 831 |
| Intangible assets, less accumulated amortization | | | 7,367 |
| Other assets, net | | | 10,798 |
| Total Assets | | | <u>\$ 743,029</u> |

NOTE 4 – RESTRICTED DEPOSITS

| | As of September 30, 2021 | As of December 31, 2020 |
|---------------------------------------|-------------------------------------|------------------------------------|
| | (in thousands) | |
| Tenant security deposits | \$ 5,034 | \$ 4,730 |
| Real estate tax and insurance escrows | 1,491 | 2,058 |
| Replacement reserves | 2,090 | 2,137 |
| Other funded reserves | 2,264 | 6,994 |
| | <u>\$ 10,879</u> | <u>\$ 15,919</u> |

Included in other funded reserves are insurance proceeds of \$2,264 that were received during the nine months ended September 30, 2021, and are held in an escrow reserve account per the agreement set in place with various lenders. Funds will be released as construction costs related to the insurance claims are incurred. No such proceeds were received as of December 31, 2020.

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NOTE 5 – INVESTMENT IN UNCONSOLIDATED AFFILIATES

| Unconsolidated Affiliates | Date Acquired | Trust Ownership Interest | Total Investment in Unconsolidated Affiliates |
|----------------------------------|--------------------------|---|--|
| Banner Building | 2007 | 66.67% | \$ 60 |
| Grand Forks INREIT, LLC | 2003 | 50% | 2,508 |
| SE Savage, LLC | 2019 | 60% | 2,925 |
| SE Maple Grove, LLC | 2019 | 60% | 2,886 |
| SE Rogers, LLC | 2020 | 60% | 3,013 |
| ST Oak Cliff, LLC | 2021 | 70% | 3,075 |
| SE Brooklyn Park, LLC | 2021 | 60% | 680 |
| | | | <u>\$ 15,147</u> |

The Operating Partnership owns a 66.67% interest as tenant in common in an office building with approximately 75,000 square feet of commercial rental space in Fargo, North Dakota. The property is encumbered by a first mortgage with a balance at September 30, 2021 and December 31, 2020 of \$6,076 and \$6,232, respectively. The Trust is jointly and severally liable for the full mortgage balance.

The Operating Partnership owns 50% interest as tenant in common through 100% ownership in a limited liability company. The property has approximately 183,000 square feet of commercial space in Grand Forks, North Dakota. The property is encumbered by a non-recourse first mortgage with a balance at September 30, 2021 and December 31, 2020 of \$9,856 and \$10,036, respectively. The Trust is jointly and severally liable for the full mortgage balance.

The Operating Partnership owns a 60% interest in a limited liability company that holds a 190-unit multifamily property. As of September 30, 2021, the Operating Partnership has contributed \$2,077 in cash to the LLC. The LLC is located in Savage, Minnesota, with total assets of \$37,256 and \$27,015 as of September 30, 2021 and December 31, 2020, respectively. The development was completed in the third quarter of 2021. The property is encumbered by a first mortgage with a balance at September 30, 2021 and December 31, 2020, of \$26,210 and \$19,436, respectively. The property is also encumbered by a second mortgage to Sterling Properties, LLLP with a balance at September 30, 2021 of \$4,835. The Trust is jointly and severally liable for the full mortgage balance.

The Operating Partnership owns a 60% interest in a limited liability company that is currently developing a 160-unit multifamily property. As of September 30, 2021, the Operating Partnership has contributed \$2,975 in cash to the LLC. The LLC is located in Maple Grove, Minnesota, with total assets of \$29,424 and \$13,106 as of September 30, 2021 and December 31, 2020, respectively. At its current projection, the development is expected to be completed in the fourth quarter of 2021 and the current project budget approximates \$33,029 of which \$27,907 has been incurred as of September 30, 2021. The property is encumbered by a first mortgage with a balance at September 30, 2021 and December 31, 2020 of \$23,107 and \$5,710, respectively. The Trust is jointly and severally liable for the full mortgage balance.

The Operating Partnership owns a 60% interest in a limited liability company that is currently developing a 165-unit multifamily property. As of September 30, 2021, the Operating Partnership has contributed \$3,089 in cash to the LLC. The LLC holds land located in Rogers, Minnesota, with total assets of \$17,818 and \$4,161 as of September 30, 2021 and December 31, 2020, respectively. At its current projection, the development is expected to be completed in the second quarter of 2022 and the current project budget approximates \$35,042 of which \$16,530 has been incurred as of September 30, 2021. The property is encumbered by a first mortgage that has a balance of \$10,993 at September 30, 2021. There was no balance outstanding related to the first mortgage at December 30, 2020. The Company is jointly and severally liable for the full mortgage balance.

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On August 25, 2021, the Trust purchased a 70% interest in a limited liability company, with a related party. The LLC is currently developing a 318-unit multifamily property. As of September 30, 2021, the Operating Partnership has contributed \$3,075 in cash to the LLC. The entity holds land located in Dallas, Texas with total assets of \$4,653 as of September 30, 2021. At its current projection, the development is expected to be completed in the third quarter of 2023 and the current project budget approximates \$53,138 of which \$4,342 has been incurred as of September 30, 2021. The property is encumbered by a construction mortgage. There was no balance outstanding related to the mortgage at September 30, 2021. The Company is jointly and severally liable for the full mortgage balance.

On September 17, 2021, the Trust purchased a 60% interest in a limited liability company, with an unrelated third party. The LLC is currently developing a 146-unit multifamily property. As of September 30, 2021, the Operating Partnership has contributed \$680 in cash to the LLC. The property is located in Brooklyn Park, Minnesota, with total assets of \$2,371 of September 30, 2021. At its current projection, the development is expected to be completed in the second quarter of 2023 and the current project budget approximates \$32,789 of which \$2,370 has been incurred as of September 30, 2021.

The following is a summary of the financial position of the unconsolidated affiliates at September 30, 2021 and December 31, 2020.

| | September 30, 2021 | December 31, 2020 |
|--|-----------------------|----------------------|
| | (in thousands) | |
| ASSETS | | |
| Real estate investments | \$ 121,916 | \$ 74,991 |
| Accumulated depreciation | (10,563) | (9,692) |
| | 111,353 | 65,299 |
| Cash and cash equivalents | 878 | 249 |
| Restricted deposits | 493 | 384 |
| Other assets, net | 526 | 180 |
| Total Assets | <u>\$ 113,250</u> | <u>\$ 66,112</u> |
| LIABILITIES | | |
| Mortgage notes payable, net | \$ 79,749 | \$ 41,405 |
| Tenant security deposits payable | 97 | 2 |
| Accrued expenses and other liabilities | 8,072 | 6,533 |
| Total Liabilities | <u>\$ 87,918</u> | <u>\$ 47,940</u> |
| SHAREHOLDERS' EQUITY | | |
| Total Shareholders' Equity | <u>\$ 25,332</u> | <u>\$ 18,172</u> |
| Total liabilities and shareholders' equity | <u>\$ 113,250</u> | <u>\$ 66,112</u> |

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The following is a summary of results of operations of the unconsolidated affiliates for the three and nine months ended September 30, 2021

| | Three months ended September 30, | | Nine months ended September 30, | |
|---------------------------------|-------------------------------------|--------|------------------------------------|----------|
| | 2021 | 2020 | 2021 | 2020 |
| | (in thousands) | | (in thousands) | |
| Income from rental operations | \$ 1,296 | \$ 812 | \$ 3,109 | \$ 2,453 |
| Expenses from rental operations | 417 | 182 | 999 | 614 |
| Net operating income | \$ 879 | \$ 630 | \$ 2,110 | \$ 1,839 |
| Depreciation and Amortization | 358 | 172 | 871 | 515 |
| Interest | 644 | 236 | 1,524 | 715 |
| Other Income | (9) | - | (9) | (25) |
| Net (loss) income | \$ (114) | \$ 222 | \$ (276) | \$ 634 |

NOTE 6 - LEASE INTANGIBLES

The following table summarizes the net value of other intangible assets and liabilities and the accumulated amortization for each class of intangible:

| As of September 30, 2021 | Lease Intangibles | Accumulated Amortization | Lease Intangibles, net |
|------------------------------|----------------------|-----------------------------|---------------------------|
| Lease Intangible Assets | | (in thousands) | |
| In-place leases | \$ 16,002 | \$ (10,693) | \$ 5,309 |
| Above-market leases | 2,617 | (1,407) | 1,210 |
| | <u>\$ 18,619</u> | <u>\$ (12,100)</u> | <u>\$ 6,519</u> |
| Lease Intangible Liabilities | | | |
| Below-market leases | \$ (2,555) | \$ 1,699 | \$ (856) |
| As of December 31, 2020 | Lease Intangibles | Accumulated Amortization | Lease Intangibles, net |
| Lease Intangible Assets | | (in thousands) | |
| In-place leases | \$ 19,768 | \$ (13,727) | \$ 6,041 |
| Above-market leases | 2,618 | (1,292) | 1,326 |
| | <u>\$ 22,386</u> | <u>\$ (15,019)</u> | <u>\$ 7,367</u> |
| Lease Intangible Liabilities | | | |
| Below-market leases | \$ (2,957) | \$ 1,963 | \$ (994) |

The estimated aggregate amortization expense for each of the five succeeding fiscal years and thereafter is as follows:

| Years ending December 31, | Intangible Assets | Intangible Liabilities |
|--|----------------------|---------------------------|
| | (in thousands) | |
| 2021 (October 1, 2021 - December 31, 2021) | \$ 273 | \$ 45 |
| 2022 | 987 | 164 |
| 2023 | 849 | 151 |
| 2024 | 849 | 151 |
| 2025 | 849 | 151 |
| Thereafter | 2,712 | 194 |
| | <u>\$ 6,519</u> | <u>\$ 856</u> |

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NOTE 7 – LINES OF CREDIT

We have a \$4,915 variable rate (floating LIBOR plus 2.00%) line of credit agreement with Bremer Bank, which expires in June 2022; and a \$5,000 variable rate (floating LIBOR plus 2.00%) line of credit agreement with Bremer Bank, which expires December 2022. The lines of credit are secured by specific properties. At September 30, 2021, the Bremer line of credit secured two letters of credit totaling \$67, leaving \$9,848 available and unused under the agreements. These operating lines are designed to enhance treasury management activities and more effectively manage cash balances. There were no balances outstanding on either line as of September 30, 2021 or December 31, 2020.

Certain line of credit agreements include covenants that, in part, impose maintenance of certain debt service coverage and debt to net worth ratios on an annual and semi-annual basis.

NOTE 8 - MORTGAGE NOTES PAYABLE

The following table summarizes the Trust's mortgage notes payable.

| | Principal Balance At | |
|---------------------------------------|-----------------------------|---------------------|
| | September 30, | December 31, |
| | 2021 | 2020 |
| | (in thousands) | |
| Fixed rate mortgage notes payable (a) | \$ 457,071 | \$ 415,665 |
| Variable rate mortgage notes payable | 7,210 | 7,446 |
| Mortgage notes payable | 464,281 | 423,111 |
| Less unamortized debt issuance costs | 2,131 | 1,833 |
| | <u>\$ 462,150</u> | <u>\$ 421,278</u> |

(a) Includes \$69,490 and \$43,613 of variable rate mortgage debt that was swapped to a fixed rate at September 30, 2021 and December 31, 2020, respectively.

We are required to make the following principal payments on our outstanding mortgage notes payable for each of the five succeeding fiscal years and thereafter as follows:

| Years ending December 31, | Amount |
|--|-----------------------|
| | (in thousands) |
| 2021 (October 1, 2021 - December 31, 2021) | \$ 5,589 |
| 2022 | 27,983 |
| 2023 | 51,310 |
| 2024 | 20,840 |
| 2025 | 51,244 |
| Thereafter | 307,315 |
| Total payments | <u>\$ 464,281</u> |

NOTE 9 – DERIVATIVES AND HEDGING ACTIVITIES

As part of our interest rate risk management strategy, we have used derivative instruments to manage our exposure to interest rate movements and add stability to interest expense. Interest rate swaps designated as cash flow hedges involve the receipt of variable rate amounts from a counterparty; In exchange, the Trust makes fixed rate payments over the life of the agreement without exchange of the underlying notional amount.

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As of September 30, 2021, the Trust used 10 interest rate swaps to hedge the variable cash flows associated with variable rate debt. Changes in fair value of the derivatives that are designated and qualify as cash flow hedges are recorded in accumulated other comprehensive loss and are reclassified into interest expense as interest payments are made on the Trust's variable rate debt. Over the next twelve months, the Trust estimates that an additional \$869 will be reclassified as an increase to interest expense.

The following table summarizes the Trust's interest rate swaps as of September 30, 2021, which effectively convert one month floating rate LIBOR to a fixed rate:

| Effective Date | Notional | Fixed Interest Rate | Maturity Date |
|------------------|-----------|---------------------|------------------|
| November 1, 2019 | \$ 6,830 | 3.15% | November 1, 2029 |
| November 1, 2019 | \$ 4,746 | 3.28% | November 1, 2029 |
| January 10, 2020 | \$ 3,087 | 3.39% | January 10, 2030 |
| June 11, 2020 | \$ 1,547 | 3.07% | June 15, 2030 |
| June 11, 2020 | \$ 2,997 | 3.07% | June 15, 2030 |
| June 15, 2020 | \$ 1,676 | 2.94% | June 15, 2030 |
| June 15, 2020 | \$ 4,435 | 2.94% | June 15, 2030 |
| July 1, 2020 | \$ 4,879 | 2.79% | June 10, 2030 |
| December 2, 2020 | \$ 12,800 | 2.91% | December 2, 2027 |
| July 1, 2021 | \$ 26,493 | 2.99% | July 1, 2031 |

The following table summarizes the Trust's interest rate swaps that were designated as cash flow hedges of interest rate risk:

| Interest Rate Derivatives | Number of Instruments | | Notional | |
|---------------------------|-----------------------|-------------------|--------------------|-------------------|
| | September 30, 2021 | December 31, 2020 | September 30, 2021 | December 31, 2020 |
| Interest rate swaps | 10 | 9 | \$ 69,490 | \$ 43,613 |

The table below presents the estimated fair value of the Trust's derivative financial instruments as well as their classification in the accompanying consolidated balance sheets. The valuation techniques are described in Note 10 to the consolidated financial statements.

| Derivatives designated as cash flow hedges: | Derivatives | | | |
|---|--|------------|--|------------|
| | September 30, 2021 | | December 31, 2020 | |
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Interest rate swaps | Other assets, net | \$ 524 | Other assets, net | \$ — |
| Interest rate swaps | Accrued expenses and other liabilities | \$ 856 | Accrued expenses and other liabilities | \$ 1,805 |

The carrying amounts of the swaps have been adjusted to their fair value at the end of the quarter. Because of changes in forecasted levels of LIBOR, an asset and a liability for the fair value of the future net payments forecasted under the swap were reported. The interest rate swaps are accounted for as effective hedges in accordance with ASC 815-20 whereby it is recorded at fair value and changes in fair value are recorded to comprehensive income.

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The following table presents the effect of the Trust's derivative financial instruments on the accompanying consolidated statements of operations and other comprehensive loss (income) for the three months ended September 30, 2021 and 2020:

| Derivatives in Cash Flow Hedging Relationships | Amount of (Gain)/Loss Recognized in Other Comprehensive Income on Derivatives | Location of Gain Reclassified from Accumulated other Comprehensive Income (AOCI) into Income | Amount of (Gain)/Loss Reclassified from AOCI into Income |
|--|--|--|--|
| | 2021 | | 2021 |
| Interest rate swaps | \$ 66 | Interest expense | \$ 199 |
| | 2020 | | 2020 |
| Interest rate swaps | \$ 17 | Interest expense | \$ 89 |

The following table presents the effect of the Trust's derivative financial instruments on the accompanying consolidated statements of operations and other comprehensive loss (income) for the nine months ended September 30, 2021 and 2020

| Derivatives in Cash Flow Hedging Relationships | Amount of (Gain)/Loss Recognized in Other Comprehensive Income on Derivatives | Location of Gain Reclassified from Accumulated other Comprehensive Income (AOCI) into Income | Amount of (Gain)/Loss Reclassified from AOCI into Income |
|--|--|--|--|
| | 2021 | | 2021 |
| Interest rate swaps | \$ (1,473) | Interest expense | \$ 433 |
| | 2020 | | 2020 |
| Interest rate swaps | \$ 2,125 | Interest expense | \$ 145 |

Credit-risk-related Contingent Features

The Trust has agreements with each of its derivative counterparties containing a provision whereby, if the Trust defaults on the related indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, the Trust could also be declared in default on its corresponding derivative obligation. The Trust's agreements with each of its derivative counterparties also contain a provision whereby if the Trust consolidates with, merges with or into, or transfers all or substantially all of its assets to another entity, and the creditworthiness of the resulting, surviving or transferee entity, is materially weaker than the Trust's, the counterparty has the right to terminate the derivative obligations. As of September 30, 2021, the termination value of derivatives in a liability position was \$856 and the termination value of derivatives in an asset position was \$524. As of September 30, 2021, the Trust has pledged the properties related to the loans which are hedged as collateral.

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NOTE 10 - FAIR VALUE MEASUREMENT

The following table presents the carrying value and estimated fair value of the Trust's financial instruments:

| | <u>September 30, 2021</u> | | <u>December 31, 2020</u> | |
|-------------------------------|---------------------------|-------------------|--------------------------|-------------------|
| | <u>Carrying Value</u> | <u>Fair Value</u> | <u>Carrying Value</u> | <u>Fair Value</u> |
| | (in thousands) | | | |
| Financial assets: | | | | |
| Notes receivable | \$ 5,456 | \$ 6,642 | \$ 2,026 | \$ 2,117 |
| Derivative assets | \$ 524 | \$ 524 | \$ — | \$ — |
| Financial liabilities: | | | | |
| Mortgage notes payable | \$ 464,281 | \$ 486,276 | \$ 421,278 | \$ 443,100 |
| Derivative liabilities | \$ 856 | \$ 856 | \$ 1,805 | \$ 1,805 |

ASC 820-10 established a three-level valuation hierarchy for fair value measurement. Management uses these valuation techniques to establish the fair value of the assets at the measurement date. These valuation techniques are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect management's assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets;
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable;
- Level 3 – Instruments whose significant inputs are unobservable.

The guidance requires the use of observable market data, when available, in making fair value measurements. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement.

Recurring Fair Value Measurements

The following table presents the Trust's financial instruments, which are measured at fair value on a recurring basis, by the level in the fair value hierarchy within which those measurements fall. Methods and assumptions used to estimate the fair value of these instruments are described after the table.

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|----------------------------------|----------------|----------------|----------------|--------------|
| | (in thousands) | | | |
| <u>September 30, 2021</u> | | | | |
| Derivative assets | \$ — | \$ 524 | \$ — | \$ 524 |
| Derivative liabilities | \$ — | \$ 856 | \$ — | \$ 856 |
| <u>December 31, 2020</u> | | | | |
| Derivative liabilities | \$ — | \$ 1,805 | \$ — | \$ 1,805 |

Derivatives: The fair value of interest rate swaps is determined using a discounted cash flow analysis on the expected future cash flows of the derivative.

The Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered any applicable credit enhancements.

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Fair Value Disclosures

The following table presents the Trust's financial assets and liabilities, which are measured at fair value for disclosure purposes, by the level in the fair value hierarchy within which they fall. Methods and assumptions used to estimate the fair value of these instruments are described after the table.

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|----------------------------------|----------------|----------------|----------------|--------------|
| (in thousands) | | | | |
| <u>September 30, 2021</u> | | | | |
| Mortgage notes payable | \$ — | \$ — | \$ 486,276 | \$ 486,276 |
| Notes receivable | \$ — | \$ — | \$ 6,642 | \$ 6,642 |
| <u>December 31, 2020</u> | | | | |
| Mortgage notes payable | \$ — | \$ — | \$ 443,100 | \$ 443,100 |
| Notes receivable | \$ — | \$ — | \$ 2,117 | \$ 2,117 |

Mortgage notes payable: The Company estimates the fair value of its mortgage notes payable by discounting the future cash flows of each instrument at rates currently offered to the Trust for similar debt instruments of comparable maturities by the Trust's lenders. The rates used range from 3.00% to 3.10% and from 3.25% to 3.35% at September 30, 2021 and December 31, 2020, respectively.

Notes receivable: The Trust estimates the fair value of its notes receivable by discounting future cash flows of each instrument at rates currently offered to the Trust for similar note instruments of comparable maturities by the Trust's lenders. The rates used range from 3.00% to 3.50% and from 3.25% to 3.35% at September 30, 2021 and December 31, 2020, respectively.

NOTE 11 – LEASES

As of September 30, 2021, we derived 83% of our revenues from residential leases that are generally for terms of one year or less. The residential leases may include lease income related items such as parking, storage and non-refundable deposits that we treat as a single lease component because the amenities cannot be leased on their own and the timing and pattern of revenue recognition are the same. The collection of lease payments at lease commencement is probable and therefore we subsequently recognize lease income over the lease term on a straight-line basis. Residential leases are renewable upon consent of both parties on an annual or monthly basis.

As of September 30, 2021, we derived 17% of our revenues from commercial leases primarily under long-term lease agreements. Substantially all commercial leases contain fixed escalations or, in some instances, changes based on the Consumer Price Index, which occur at specified times during the term of the lease. In certain commercial leases, variable lease income, such as percentage rent, is recognized when rents are earned. We recognize rental income and rental abatements from our commercial leases on a straight-line basis over the lease term. Recognition of rental income commences when control of the leased space has been transferred to the tenant.

The Trust's leases contain lease and non-lease components for utility reimbursement from our residents. We have elected to combine lease and non-lease components for all asset classes. The combined components are included in real estate rental income in our consolidated financial statements and are accounted for under ASC 842.

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Lease income related to the Company's operating leases is comprised of the following:

| | Three months ended September 30, 2021 | | |
|---|---------------------------------------|------------------------------|------------------|
| | Residential | Commercial (in thousands) | Total |
| Lease income related to fixed lease payments | \$ 26,748 | \$ 3,879 | \$ 30,627 |
| Lease income related to variable lease payments | — | 1,130 | 1,130 |
| Other (a) | (35) | 174 | 139 |
| Lease Income (b) | <u>\$ 26,713</u> | <u>\$ 5,183</u> | <u>\$ 31,896</u> |

| | Three months ended September 30, 2020 | | |
|---|---------------------------------------|------------------------------|------------------|
| | Residential | Commercial (in thousands) | Total |
| Lease income related to fixed lease payments | \$ 24,080 | \$ 4,630 | \$ 28,710 |
| Lease income related to variable lease payments | — | 1,352 | 1,352 |
| Other (a) | (170) | (36) | (206) |
| Lease Income (b) | <u>\$ 23,910</u> | <u>\$ 5,946</u> | <u>\$ 29,856</u> |

(a) For the three months ended September 30, 2021 and 2020, "other" is comprised of revenue adjustments related to changes in collectability and amortization of above and below market lease intangibles and lease inducements.

(b) Excludes other rental income for the three months ended September 30, 2021 and 2020 of \$1,157 and \$1,010, respectively, which is accounted for under the revenue recognition standard.

| | Nine months ended September 30, 2021 | | |
|---|--------------------------------------|------------------------------|------------------|
| | Residential | Commercial (in thousands) | Total |
| Lease income related to fixed lease payments | \$ 76,722 | \$ 12,531 | \$ 89,253 |
| Lease income related to variable lease payments | — | 3,424 | 3,424 |
| Other (a) | (212) | 432 | 220 |
| Lease Income (b) | <u>\$ 76,510</u> | <u>\$ 16,387</u> | <u>\$ 92,897</u> |

| | Nine months ended September 30, 2020 | | |
|---|--------------------------------------|------------------------------|------------------|
| | Residential | Commercial (in thousands) | Total |
| Lease income related to fixed lease payments | \$ 70,896 | \$ 14,378 | \$ 85,274 |
| Lease income related to variable lease payments | — | 4,064 | 4,064 |
| Other (a) | (512) | (202) | (714) |
| Lease Income (b) | <u>\$ 70,384</u> | <u>\$ 18,240</u> | <u>\$ 88,624</u> |

(a) For the nine months ended September 30, 2021 and 2020, "other" is comprised of revenue adjustments related to changes in collectability and amortization of above and below market lease intangibles and lease inducements.

(b) Excludes other rental income for the nine months ended September 30, 2021 and 2020 of \$3,839 and \$2,969, respectively, which is accounted for under the revenue recognition standard.

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As of September 30, 2021, non-cancelable commercial operating leases provide for future minimum rental income as follows. Residential leases are not included, as the terms are generally for one year or less.

| Years ending December 31, | Amount (in thousands) |
|--|--|
| 2021 (October 1, 2021 - December 31, 2021) | \$ 3,782 |
| 2022 | 15,061 |
| 2023 | 14,474 |
| 2024 | 13,856 |
| 2025 | 13,688 |
| Thereafter | 64,381 |
| | <u>\$ 125,242</u> |

NOTE 12 – RELATED PARTY TRANSACTIONS

Effective January 1, 2021, Alloy Enterprises, Inc. was formed to act as the holding company for Sterling Management, LLC and GOLDMARK Property Management, Inc. In connection with this restructuring transaction, the owners of Alloy Enterprises, Inc. indirectly own Sterling Management, LLC and GOLDMARK Property Management, Inc. Alloy Enterprises, Inc. is owned in part by the Trust's Chief Executive Officer and Trustee Mr. Kenneth P. Regan, by Trustee Mr. James S. Wieland, by President and CIO Joel Thomsen, and by the Chief Financial Officer and Treasurer Erica J. Chaffee. In addition, Mr. Regan serves as the Executive Chairman of the Advisor and GOLDMARK Property Management, Inc., and Messrs. Wieland and Thomsen, and Ms. Chaffee serve on the Board of Governors of the Advisor and the Board of Directors of GOLDMARK Property Management, Inc.

Sterling Management, LLC, (the "Advisor"), is a North Dakota limited liability company formed in November 2002. The Advisor is responsible for managing day-to-day affairs, overseeing capital projects and identifying, acquiring and disposing investments on behalf of the Trust.

GOLDMARK Property Management, Inc., is a North Dakota corporation formed in 1981. GOLDMARK Property Management, Inc. performs property management services for the Trust.

We have a historical and ongoing relationship with Bell Bank. Bell Bank has provided the Trust certain financial services throughout the relationship. Mr. Wieland, a Trustee, also serves as a Board Member of Bell Bank. Further, a family member of Erica J. Chaffee, our Chief Financial Officer, is an employee of Bell Bank. Both Mr. Wieland and Ms. Chaffee could have an indirect material interest in any such engagement and related transactions.

Property Management Fees

During the nine months ended September 30, 2021 and 2020, we paid property management and administrative fees to GOLDMARK Property Management, Inc. of \$9,634 and \$9,518, respectively. Management fees which approximate 5% of net collected rents, account for \$3,862 and \$3,692 of these fees during the nine months ended September 30, 2021 and 2020, respectively. In addition, during the nine months ended September 30, 2021 and 2020, we paid repair and maintenance expenses, and payroll related expenses to GOLDMARK Property Management, Inc. totaling \$5,012 and \$4,849, respectively.

During the nine months ended September 30, 2021, the Trust paid commercial property management fees to our Advisor of \$87. There were no commercial property management fees paid during the nine months ended September 30, 2020 to our advisor. Commercial property management fees are determined on a property by property basis.

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Property management fees are included in operating expenses on the consolidated statement of operations.

Advisory Agreement

We are an externally managed trust and as such, although we have a Board of Trustees and executive officers responsible for our management, we have no paid employees. The Advisor may receive fees related to management of the Trust, acquiring, disposing, or developing real estate property, project management fees, and financing fees related to lending relationships, under the Advisory Agreement, which must be renewed on an annual basis and approved by a majority of the independent trustees. The Advisory Agreement was approved by the Board of Trustees (including all the independent Trustees) on March 24, 2021, and is effective until March 31, 2022.

Effective April , 2021, if the Advisor shares responsibility for providing Development Services with one or more third parties, Advisor's set Development Fee shall be reduced by the fees charged by any such third parties; provided, such adjustment is subject to a 2.5% minimum Advisor's Development Fee. Additionally, in cases where the Advisor is sharing responsibility for providing Development Services, the Development Fee shall be capped at 2.5% of \$20,000,000 (\$500,000).

The below table summarizes the fees incurred and payable to our Advisor.

| | Nine months ended | | Due and Payable at | |
|--------------------|--------------------|--------------------|--------------------|-------------------|
| | September 30, 2021 | September 30, 2020 | September 30, 2021 | December 31, 2020 |
| | Fee | Fee | Payable | Payable |
| | (in thousands) | | | |
| Fee: | | | | |
| Advisory | \$ 2,474 | \$ 2,321 | \$ 285 | \$ 278 |
| Acquisition | \$ 375 | \$ 500 | \$ - | \$ - |
| Disposition | \$ 146 | \$ 143 | \$ - | \$ 175 |
| Financing | \$ 146 | \$ 82 | \$ 5 | \$ - |
| Development | \$ - | \$ - | \$ 79 | \$ 79 |
| Project Management | \$ 409 | \$ 226 | \$ 11 | \$ 51 |

Operating Partnership Units Issued in Connection with Acquisitions

During the nine months ended September 30, 2021, there were no Operating Partnership units issued directly or indirectly, to affiliated entities.

During the nine months ended September 30, 2020, we issued directly or indirectly, 176,000 Operating Partnership units to an entity affiliated with Messrs. Regan and Wieland, two of our trustees, in connection with the acquisition of various properties. The aggregate value of these units was \$3,373.

Commissions

During the nine months ended September 30, 2021 and 2020, we incurred real estate commissions of \$297 and \$583, respectively, to GOLDMARK Commercial Real Estate, Inc., in which Messrs. Regan and Wieland jointly own a controlling interest. As of September 30, 2021 and December 30, 2020, there were no unpaid commissions to GOLDMARK Commercial Real Estate.

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During the nine months ended September 30, 2021 and 2020, we incurred real estate commissions of \$217 and \$308, respectively to GOLDMARK Property Management. As of September 30, 2021 and December 30, 2020, there were no unpaid commissions to GOLDMARK Property Management.

Rental Income

During the nine months ended September 30, 2021 and 2020, we received rental income of \$77 and \$63, respectively, under an operating lease agreement with our Advisor.

During the nine months ended September 30, 2021 and 2020, we received rental income of \$19 and \$43, respectively, under an operating lease agreement with GOLDMARK Commercial Real Estate, Inc.

During the nine months ended September 30, 2021 and 2020, we received rental income of \$224 and \$202, respectively, under operating lease agreements with GOLDMARK Property Management, Inc.

During the nine months ended September 30, 2021 and 2020, we received rental income of \$278 and \$362, respectively, under operating lease agreements with Bell Bank.

Other operational costs

During the nine months ended September 30, 2021 and 2020, the Trust incurred \$187 and \$1,575, respectively, for general costs related to business operations as well as capital expenditures related to construction in progress that were paid to related parties. At September 30, 2021 and December 31, 2020, operational outstanding liabilities were \$62 and \$191, respectively.

During the nine months ended September 30, 2021, the Trust received \$1,000 from related parties, in reimbursement for expenses paid that were associated with capital projects. No reimbursements were received during the nine months ending September 30, 2020.

Debt Financing

At September 30, 2021 and December 31, 2020, the Trust had \$66,915 and \$51,915, respectively, of outstanding principal on loans entered into with Bell Bank. During the nine months ended September 30, 2021 and 2020, the Trust incurred interest expense on debt held with Bell Bank of \$1,511 and \$1,571, respectively. Accrued interest as of September 30, 2021 and December 31, 2020, related to this debt was \$142 and \$121, respectively.

Mezzanine Financing

As of September 30, 2021, Sterling issued \$4,835 in second mortgage financing to SE Savage, LLC. There was no outstanding receivable at December 31, 2020.

During the nine months ended September 30, 2021, the Trust earned interest income of \$103 related to the second mortgage financing to SE Savage, LLC. No interest income was earned during the nine months ended September 30, 2020.

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Insurance Services

On November 1, 2020, the Operating Partnership obtained a traditional insurance policy with Bell Insurance. The policy provides coverage for the Trust's Commercial segment. As of September 30, 2021, total premiums incurred for this policy was \$118. There was no such policy in place with Bell Bank as of September 30, 2020.

Development Arrangements

Effective August 25, 2021, the Operating Partnership purchased a 70% interest in ST Oak Cliff Dallas, LLC. The purpose of the entity is to develop and construct a 318 unit multifamily property located in Dallas, Texas. The 30% owner, TG Oak Cliff Dallas, LLC is owned in part by Kenneth P. Regan, the Trust's Chief Executive Officer and Trustee. Mr. Regan is also a member in Trumont Group, LLC, the developer engaged by ST Oak Cliff Dallas, LLC to oversee the development of the property. Further, Mr. Regan is also a partner in Trumont Construction, LLC, the company who was engaged to oversee the day to day construction operations of the property.

During the nine months ended September 30, 2021, the Trust incurred and paid \$51 in development fees to Trumont Group, LLC. No such fees were paid during the nine months ended September 30, 2020. At September 30, 2021 the Trust owed \$51 in development fees to Trumont Group, LLC. At December 31, 2020, no development fees were owed to Trumont Group, LLC.

During the nine months ended September 30, 2021, the Trust incurred and paid \$12 in construction fees to Trumont Construction, LLC. No such fees were paid during the nine months ended September 30, 2020. At September 30, 2021 the Trust owed \$6 in construction fees to Trumont Construction, LLC. At December 31, 2020, no construction fees were owed to Trumont Construction, LLC.

During the nine months ended September 30, 2021, the Trust incurred and paid \$41 in general construction costs to Trumont Construction, LLC. No such fees were paid during the nine months ended September 30, 2020. At September 30, 2021 and December 31, 2020, no general construction costs were owed to Trumont Construction, LLC.

NOTE 13 - COMMITMENTS AND CONTINGENCIES

Environmental Matters

Federal law (and the laws of some states in which we own or may acquire properties) imposes liability on a landowner for the presence on the premises of hazardous substances or wastes (as defined by present and future federal and state laws and regulations). This liability is without regard to fault or knowledge of the presence of such substances and may be imposed jointly and severally upon all succeeding landowners. If such hazardous substance is discovered on a property acquired by us, we could incur liability for the removal of the substances and the cleanup of the property.

There can be no assurance that we would have effective remedies against prior owners of the property. In addition, we may be liable to tenants and may find it difficult or impossible to sell the property either prior to or following such a cleanup.

Risk of Uninsured Property Losses

We maintain property damage, fire loss, and liability insurance. However, there are certain types of losses (generally of a catastrophic nature) which may be either uninsurable or not economically insurable. Such excluded risks may include war, earthquakes, tornados, certain environmental hazards, and floods. Should such events occur, (i) we might suffer a loss of

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capital invested, (ii) tenants may suffer losses and may be unable to pay rent for the spaces, and (iii) we may suffer a loss of profits which might be anticipated from one or more properties.

Litigation

The Trust is subject, from time to time, to various legal proceedings and claims that arise in the ordinary course of business. While the resolution of such matters cannot be predicted with certainty, management believes, based on currently available information, that the final outcome of such matters will not have a material effect on the financial statements of the Trust.

Significant Risks and Uncertainties

The Trust continues to closely monitor the impact of the COVID-19 pandemic on all aspects of its business and geographies, including how it will impact its tenants and business partners. A number of uncertainties continue to exist at this time, including but not limited to the uncertainty of additional state and/or federal stimulus and the effect of the recent impacts of the COVID-19, delta variant. While the Trust did not incur significant disruptions during the nine months ended September 30, 2021 from the COVID-19 pandemic, the effects of the ongoing COVID-19 pandemic could have material adverse effects on our business and results of operations, so long as COVID-19 continues to impact the U.S. economy in general and multifamily apartment communities in particular. The extent to which the economic disruption associated with the COVID-19 pandemic impacts our business and financial results will depend on future developments, which are highly uncertain and cannot be predicted with confidence, including the scope, severity, and duration of the pandemic, the actions taken to contain the pandemic or mitigate its impact, and the direct and indirect economic effects of the pandemic and containment measures, among others.

NOTE 14 – DISPOSITIONS

During the nine months ended September 30, 2021, the Operating Partnership sold two properties. We sold a retail property located in Waite Park, Minnesota, for a sale price of \$900. Net proceeds received were \$853 and the Trust recognized a gain of \$2 in April 2021. We sold a residential property located in Moorhead, Minnesota, for a sale price of \$4,950. Net proceeds received were \$4,757 and the Trust recognized a gain of \$1,708 in June 2021.

During the nine months ended September 30, 2020, the Operating Partnership sold two properties. We sold a retail property located in Apple Valley, Minnesota, for \$3,670 and recognized a gain of \$1,455 in March 2020. We sold an office property located in St. Cloud, Minnesota, for \$2,050 and recognized a gain of \$1 in May 2020.

NOTE 15 – ACQUISITIONS

| Date | Property Name | Location | Property Type | Units/ Square Footage/ Acres | Purchase Price |
|--------|---------------|-----------|-------------------|---------------------------------------|-------------------|
| 6/1/21 | Flagstone | Fargo, ND | Apartment Complex | 120 units | \$ 7,789 |
| 6/1/21 | Brownstone | Fargo, ND | Apartment Complex | 72 units | 4,392 |
| 6/1/21 | Briar Pointe | Fargo, ND | Apartment Complex | 30 units | 1,936 |
| 7/1/21 | Oxford | Fargo, ND | Apartment Complex | 144 units | 10,227 |
| 7/1/21 | Pinehurst | Fargo, ND | Apartment Complex | 210 units | 15,001 |
| | | | | | <u>\$ 39,345</u> |

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Total consideration given for acquisitions through September 30, 2021 was completed through issuing approximately 144,000 limited partnership units of the Operating Partnership valued at \$20.00 per unit for an aggregate consideration of approximately \$2,883, assumed liabilities of \$569, new debt of \$26,250 and cash of \$9,643. The value of units issued in exchange for property is determined through a value established annually by our Board of Trustees, and reflects the fair value at the time of issuance.

The following table summarizes the fair values of the asset acquisitions, the Trust recorded in conjunction with the acquisitions discussed above, as of the acquisition date:

| | Nine Months Ended September 30, | |
|---|--|-----------------|
| | 2021 | 2020 |
| Land, building, tenant improvements and FF&E | \$ 39,345 | \$ 21,191 |
| Other liabilities | (569) | (538) |
| Net assets acquired | 38,776 | 20,653 |
| Equity/limited partnership unit consideration | (2,883) | (9,031) |
| New loans | (26,250) | (3,225) |
| Net cash consideration | <u>\$ 9,643</u> | <u>\$ 8,397</u> |

NOTE 16 - SUBSEQUENT EVENTS

On October 15, 2021, we paid a dividend or distribution of \$0.2650 per share on our common shares of beneficial interest or limited partnership units, respectively, to common shareholders and limited partnership unit holders of record on September 30, 2021.

On October 1, 2021, the Trust paid off a loan totaling \$1,923. The property is unencumbered as of October 1, 2021.

On October 1, 2021, the Trust contributed \$1,050 in additional equity to Bell Plaza. The Trust holds a 70% investing interest in the property.

On October 8, 2021, the Trust issued \$649 in second mortgage financing to SE Savage, LLC.

On October 8, 2021, the Trust made an additional equity contribution of \$742 to SE Brooklyn Park, LLC.

On October 13, 2021, the Trust made an additional equity contribution of \$385 to ST Oak Cliff Dallas, LLC.

We have evaluated subsequent events through the date of this filing. We are not aware of any other subsequent events which would require recognition or disclosure in the consolidated financial statements.

All dollar amounts in this Form 10-Q in Part I Item 2. through Item 4 and Part II Item 2. are stated in thousands with the exception of share and per share amounts, unless otherwise indicated.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995

Certain statements contained in this section and elsewhere in this Form 10-Q constitute “*forward-looking statements*” within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include but are not limited to: (i) trends affecting our financial condition or results of operations; (ii) our business and growth strategies; (iii) the real estate industry; (iv) our financing plans; and (v) other risks detailed in the Company’s periodic reports filed with the Securities and Exchange Commission. The words “*believe*”, “*expect*”, “*anticipate*”, “*may*”, “*plan*”, “*should*”, and similar expressions identify forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statements were made and are not guarantees of future performance.

Overview

Sterling Real Estate Trust d/b/a Sterling Multifamily Trust (“Sterling”, “the Trust” or “the Company”) is a registered, but unincorporated business trust organized in North Dakota in December 2002. Sterling has elected to be taxed as a Real Estate Investment Trust (“REIT”) under Sections 856-860 of the Internal Revenue Code, which requires that 75% of the assets of a REIT must consist of real estate assets and that 75% of its gross income must be derived from real estate. The net income of the REIT is allocated in accordance with the stock ownership in the same fashion as a regular corporation. Our real estate portfolio consisted of 182 properties containing 10,788 apartment units and approximately 1,612,000 square feet of leasable commercial space as of September 30, 2021. The portfolio has a net book value of real estate investments (cost less accumulated depreciation) of approximately \$717,343, which includes construction in progress. Sterling’s current acquisition strategy and focus is on multifamily apartment properties.

Critical Accounting Estimates

Below are accounting policies and estimates that management believes are critical to the preparation of the unaudited consolidated financial statements included in this Report. Certain accounting policies used in the preparation of these consolidated financial statements are particularly important for an understanding of the financial position and results of operations presented in the historical consolidated financial statements included in this Report. A summary of significant accounting policies is also provided in the aforementioned notes to our consolidated financial statements (see note 2 to the unaudited consolidated financial statements). These policies require the application of judgment and assumptions by management and, as a result, are subject to a degree of uncertainty. Due to this uncertainty, actual results could differ materially from estimates calculated and utilized by management.

Impairment of Real Estate Investments

The Trust's investment properties are reviewed for potential impairment at the end of each reporting period or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. At the end of each reporting period, the Trust separately determines whether impairment indicators exist for each property.

Examples of situations considered to be impairment indicators include, but are not limited to:

- a substantial decline or negative cash flows;
- continued low occupancy rates;
- continued difficulty in leasing space;
- significant financially troubled tenants;
- a change in plan to sell a property prior to the end of its useful life or holding period;
- a significant decrease in market price not in line with general market trends; and
- any other quantitative or qualitative events or factors deemed significant by the Trust's management or Board of Trustees.

If the presence of one or more impairment indicators as described above is identified with respect to an investment property, the asset is tested for recoverability by comparing its carrying value to the estimated future undiscounted cash flows. An investment property is considered to be impaired when the estimated future undiscounted cash flows are less than its current carrying value.

When performing a test for recoverability or estimating the fair value of an impaired investment property, the Trust makes complex or subjective assumptions which include, but are not limited to:

- projected operating cash flows considering factors such as vacancy rates, rental rates, lease terms, tenant financial strength, demographics, holding period and property location;
- projected capital expenditures;
- projected cash flows from the eventual disposition of an operating property using a property specific capitalization rate;
- comparable selling prices; and
- property specific discount rates for fair value estimates as necessary.

To the extent impairment has occurred, the Trust will record an impairment charge calculated as the excess of the carrying value of the asset over its fair value. Based on evaluation, there were no impairment losses during the nine months ended September 30, 2021 and 2020.

There have been no material changes in our Critical Accounting Policies as disclosed in Note 2 to our financial statements for the nine months ended September 30, 2021 included elsewhere in this report.

Principal Business Activity

Sterling currently owns directly and indirectly 182 properties. The Trust's 137 residential properties are located in North Dakota, Minnesota, Missouri and Nebraska and are principally multifamily apartment buildings. The Trust owns 45 commercial properties primarily located in North Dakota with others located in Arkansas, Colorado, Iowa, Louisiana, Michigan, Minnesota, Mississippi, Nebraska and Wisconsin. The commercial properties include retail, office, industrial, restaurant and medical properties. Presently, the Trust's mix of properties is 77.2% residential and 22.8% commercial (based on cost) and total \$717,343 in real estate investments at September 30, 2021. Sterling's current acquisition strategy and primary focus is on multifamily apartment properties. We currently have no plans to actively market our existing commercial properties for sale. We will consider unsolicited offers for purchase of non-multifamily properties on a case by case basis.

| Residential Property | Location | No. of Properties | Units |
|-----------------------------|-----------------|--------------------------|------------------|
| | North Dakota | 117 | 6,954 |
| | Minnesota | 15 | 3,031 |
| | Missouri | 1 | 164 |
| | Nebraska | 4 | 639 |
| | | <u>137</u> | <u>10,788</u> |
| Commercial Property | Location | No. of Properties | Sq. Ft |
| | North Dakota | 20 | 772,000 |
| | Arkansas | 2 | 28,000 |
| | Colorado | 1 | 17,000 |
| | Iowa | 1 | 33,000 |
| | Louisiana | 1 | 15,000 |
| | Michigan | 1 | 12,000 |
| | Minnesota | 12 | 638,000 |
| | Mississippi | 1 | 15,000 |
| | Nebraska | 1 | 19,000 |
| | Wisconsin | 5 | 63,000 |
| | | <u>45</u> | <u>1,612,000</u> |

Results of Operations**Management Highlights**

- Increased revenues from rental operations by \$2,187 or 7.1% for the three months ended September 30, 2021, compared to the same three month period in 2020.
- Increased revenues from rental operations by \$5,143 or 5.6% for the nine months ended September 30, 2021, compared to same nine month period in 2020.
- Acquired five residential properties during the nine months ended September 30, 2021.
- Disposed of one residential and one commercial property during the nine months ended September 30, 2021.
- Declared dividends aggregating \$0.7100 per common share for the nine months ended September 30, 2021.

Results of Operations for the Three Months Ended September 30, 2021 and 2020

| | Three months ended September 30, 2021 | | | Three months ended September 30, 2020 | | |
|--|---------------------------------------|---|-----------------|---------------------------------------|---|-----------------|
| | Residential | Commercial (unaudited) (in thousands) | Total | Residential | Commercial (unaudited) (in thousands) | Total |
| Real Estate Revenues | \$ 27,838 | \$ 5,215 | \$ 33,053 | \$ 24,858 | \$ 6,008 | \$ 30,866 |
| Real Estate Expenses | | | | | | |
| Real Estate Taxes | 2,743 | 746 | 3,489 | 2,486 | 674 | 3,160 |
| Property Management | 3,419 | 540 | 3,959 | 3,100 | 203 | 3,303 |
| Utilities | 1,990 | 350 | 2,340 | 1,776 | 287 | 2,063 |
| Repairs and Maintenance | 6,375 | 654 | 7,029 | 5,351 | 596 | 5,947 |
| Insurance | 825 | 31 | 856 | 793 | 36 | 829 |
| Total Real Estate Expenses | 15,352 | 2,321 | 17,673 | 13,506 | 1,796 | 15,302 |
| Net Operating Income | <u>\$ 12,486</u> | <u>\$ 2,894</u> | <u>15,380</u> | <u>\$ 11,352</u> | <u>\$ 4,212</u> | <u>15,564</u> |
| Interest | | | 4,671 | | | 4,187 |
| Depreciation and amortization | | | 5,551 | | | 5,328 |
| Administration of REIT | | | 1,007 | | | 972 |
| Other income | | | (1,567) | | | (189) |
| Net Income | | | <u>\$ 5,718</u> | | | <u>\$ 5,266</u> |
| Net Income Attributed to: | | | | | | |
| Noncontrolling Interest | | | \$ 3,614 | | | \$ 3,422 |
| Sterling Real Estate Trust | | | \$ 2,104 | | | \$ 1,844 |
| Dividends per share ⁽¹⁾ | | | \$ 0.2650 | | | \$ 0.2647 |
| Earnings per share | | | \$ 0.21 | | | \$ 0.19 |
| Weighted average number of common shares | | | 10,215 | | | 9,740 |

(1) Does not take into consideration the amounts distributed by the Operating Partnership to limited partners.

Revenues

Property revenues of \$33,053 for the three months ended September 30, 2021 increased \$2,187 or 7.1% in comparison to the same period in 2020. Residential property revenues increased \$2,980 and commercial property revenues decreased \$794.

The following table illustrates occupancy percentages for the three month periods indicated:

| | September 30, 2021 | September 30, 2020 |
|-----------------------|-----------------------|-----------------------|
| Residential occupancy | 94.4 % | 93.2 % |
| Commercial occupancy | 78.2 % | 93.6 % |

Residential revenues for the three months ended September 30, 2021 increased \$2,980 or 12.0% in comparison to the same period for 2020. Residential properties acquired since January 1, 2020 contributed approximately \$1,998 to the increase in total residential revenues in the three months ended September 30, 2021. Further, increased lease renewals, resulting in decreased rental incentives contributed to the rental income increase as well as increased rent charges at our stabilized properties. Residential revenues comprised 84.2% of total revenues for the three months ended September 30, 2021 compared to 80.5% of total revenues for the three months ended September 30, 2020.

For the three months ended September 30, 2021 total commercial revenues decreased \$793 or 13.2% in comparison to the same period for 2020. Increased vacancy in the Minneapolis market accounts for \$533 of decreased commercial revenue. Furthermore, the dispositions of two commercial properties account for \$186 of the decreased revenues during the three months ended September 30, 2021. Commercial revenues comprised 15.8% of the total revenues for the three months ended September 30, 2021 compared to 19.5% of total revenues for the three months ended September 30, 2020.

Expenses

Residential expenses from operations of \$15,352 during the three months ended September 30, 2021 increased \$1,846 or 13.7% in comparison to the same period in 2020. The increase was attributed to increased project and upgrades expense of \$599 or 76.6%. The increase is also attributed to increased real estate taxes of \$257 or 10.3%, and utility expense of \$214 or 12.0%, mainly attributed to properties acquired after January 2020. Properties acquired after January 1, 2020, account for \$98 of the property management fees increase during the three months ended September 30, 2021. Actual property management fees continue to approximate 5% of net collected rents.

Commercial expenses from operations of \$2,321 during the three months ended September 30, 2021 increased \$525 or 29.2% in comparison to the same period in 2020. The increase was attributed to increased property management expense of \$337 or 166.0%. This was related to increased advertising and marketing expenses in an office building located in Minneapolis, Minnesota in efforts to lease up vacant space. Furthermore, utility expense increased \$63 or 22.0% and repairs and maintenance expense increased \$58 or 9.7%. A primary factor for reported increased repairs and maintenance expense is due to deferred repairs and maintenance costs that were not able to be performed during the COVID-19 pandemic.

Interest expense of \$4,671 during the three months ended September 30, 2021 increased \$484 or 11.6% in comparison to the same period in 2020. Interest expense related to financing activities increased by \$223 during the three months ended September 30, 2021 as compared to the same period in 2020. The primary reason for increased interest expense on debt is due to increased mortgage balance on the portfolio as a whole. Capitalized interest expense related to construction in progress decreased \$138 during the three months ended September 30, 2021 compared to the same period in 2020. During the three months ended September 30, 2021, interest expense was 14.1% of total revenues.

Depreciation and amortization expense of \$5,551 during the three months ended September 30, 2021 increased \$223 or 4.2% in comparison to the same period in 2020. Properties acquired since January 1, 2020 contributed approximately \$359 to the increase in depreciation expense. Amortization expense will continue to decrease as lease intangibles become fully amortized but will increase upon acquisitions of intangible assets. Depreciation and amortization expense as a percentage of rental income for the three months ended September 30, 2021 and 2020 was 16.8% and 17.3%, respectively.

REIT administration expenses of \$1,007 during the three months ended September 30, 2021 increased \$35 or 3.6% in comparison to the same period in 2020, due to an increase of REIT advisory fees paid.

Other income of \$1,567 during the three months ended September 30, 2021 increased \$1,378 or 729.1% in comparison to the same period in 2020. During the three months ended September 30, 2021 the trust received \$1,000 from related parties, for reimbursement of expenses paid that were associated with capital projects is the primary factor for the increase in other income as compared the same period for 2020. No reimbursements were received during the three months ended September 30, 2020. A gain on involuntary conversion was recognized during the three months ended September 30, 2021 of \$578 that was not recognized during the same period in 2020. This was related to a roof collapse claim that occurred in March 2019 at a commercial property in Fargo, North Dakota.

Results of Operations for the Nine Months Ended September 30, 2021 and 2020

| | Nine months ended September 30, 2021 | | | Nine months ended September 30, 2020 | | |
|--|--------------------------------------|---|-----------|--------------------------------------|---|-----------|
| | Residential | Commercial (unaudited) (in thousands) | Total | Residential | Commercial (unaudited) (in thousands) | Total |
| Real Estate Revenues | \$ 80,028 | \$ 16,708 | \$ 96,736 | \$ 73,234 | \$ 18,359 | \$ 91,593 |
| Real Estate Expenses | | | | | | |
| Real Estate Taxes | 8,025 | 2,098 | 10,123 | 7,433 | 2,030 | 9,463 |
| Property Management | 9,708 | 1,044 | 10,752 | 9,495 | 666 | 10,161 |
| Utilities | 6,648 | 808 | 7,456 | 6,098 | 810 | 6,908 |
| Repairs and Maintenance | 15,819 | 1,478 | 17,297 | 14,572 | 1,508 | 16,080 |
| Insurance | 2,364 | 87 | 2,451 | 2,380 | 110 | 2,490 |
| Total Real Estate Expenses | 42,564 | 5,515 | 48,079 | 39,978 | 5,124 | 45,102 |
| Net Operating Income | \$ 37,464 | \$ 11,193 | 48,657 | \$ 33,256 | \$ 13,235 | 46,491 |
| Interest | | | 13,261 | | | 12,761 |
| Depreciation and amortization | | | 16,634 | | | 15,826 |
| Administration of REIT | | | 3,267 | | | 3,218 |
| Other income | | | (4,337) | | | (2,204) |
| Net Income | | | \$ 19,832 | | | \$ 16,890 |
| Net Income Attributed to: | | | | | | |
| Noncontrolling Interest | | | \$ 12,713 | | | \$ 11,031 |
| Sterling Real Estate Trust | | | \$ 7,119 | | | \$ 5,859 |
| Dividends per share ⁽¹⁾ | | | \$ 0.7950 | | | \$ 0.7941 |
| Earnings per share | | | \$ 0.7100 | | | \$ 0.6100 |
| Weighted average number of common shares | | | 10,095 | | | 9,638 |

(1) Does not take into consideration the amounts distributed by the Operating Partnership to limited partners.

Revenues

Property revenues of \$96,736 for the nine months ended September 30, 2021 increased \$5,143 or 5.6% in comparison to the same period in 2020. Residential property revenues increased \$6,794 and commercial property revenues decreased \$1,651, from the prior year's comparable nine month period.

The following table illustrates occupancy percentages for the nine month periods indicated:

| | September 30, 2021 | September 30, 2020 |
|-----------------------|-----------------------|-----------------------|
| Residential occupancy | 94.1 % | 93.1 % |
| Commercial occupancy | 78.2 % | 93.6 % |

Residential revenues for the nine months ended September 30, 2021 increased \$6,794 or 9.3% in comparison to the same period for 2020. Residential properties acquired since January 1, 2020 contributed approximately \$4,155 to the increase in total residential revenues in the nine months ended September 30, 2021. Increased lease renewals, resulting in decreased rental incentives contributed to the rental income increase, as well as increased rent charges at the stabilized properties. Residential revenues comprised 82.7% of total revenues for the nine months ended September 30, 2021 compared to 80.0% of total revenues for the nine months ended September 30, 2020. The vacancy decrease coincides with an increase in residential occupancy rates for the nine months ended September 30, 2021 of 1.0%.

For the nine months ended September 30, 2021, total commercial revenues decreased \$1,651 or 9.0% in comparison to the same period for 2020. The decrease was primarily attributed to vacant office space in commercial properties located in Minneapolis, Minnesota of \$966, which coincides with the 12.7% year-over-year decrease in commercial occupancy. The disposition of three commercial properties account for \$650 of the decrease to commercial revenues during the nine months

ended September 30, 2021. Commercial revenues comprised 17.3% of the total revenues for the nine months ended September 30, 2021 compared to 20.0% of total revenues for the nine months ended September 30, 2020.

Expenses

Residential expenses from operations of \$42,564 during the nine months ended September 30, 2021 increased \$2,586 or 6.5% in comparison to the same period in 2020. The increase was attributed to increased project and upgrades expense of \$1,135 or 56.3%. The increase is also attributed to increased real estate taxes of \$592 or 8.0%. Properties acquired since January 1, 2020 contributed \$385 to the overall increase in real estate taxes. Further, the increase is attributed to increased utility expense of \$550 or 9.0%, mainly in the Minneapolis, Minnesota and Fargo, North Dakota market.

Commercial expenses from operations of \$5,515 during the nine months ended September 30, 2021 increased \$391 or 7.6% in comparison to the same period in 2020. During the nine months ended September 30, 2021 property management fees increased by \$378 or 56.8%. This was related to increased advertising and marketing expenses in an office building located in Minneapolis, Minnesota in efforts to lease up vacant space.

Interest expense of \$13,261 during the nine months ended September 30, 2021 increased \$500 or 3.9% in comparison to the same period in 2020. Capitalized interest expense related to construction in progress decreased \$329 during the nine months ended September 30, 2021, compared to the same period in 2020, thus increasing the overall interest expense for the nine months ended September 30, 2021 by \$329. Interest expense related to financing activities increased by \$191 during the nine months ended September 30, 2021 as compared to the same period in 2020. The primary reason for increasing interest expense related to debt is due to the increase of mortgage principle of the Trust's debt portfolio. During the nine months ended September 30, 2021, interest expense was 13.7% of total revenues

Depreciation and amortization expense of \$16,634 for the nine months ended September 30, 2021 increased \$808 or 5.1% in comparison to the same period in 2020. Properties acquired since January 1, 2020, contributed approximately \$848 to the increase in depreciation expense. Amortization expense will continue to decrease as lease intangibles become fully amortized but will increase upon acquisitions of intangible assets. Depreciation and amortization expense as a percentage of rental income for the nine months ended September 30, 2021 and 2020 was relatively consistent at 17.2% and 17.3%, respectively.

REIT administration expenses of \$3,267 for the nine months ended September 30, 2021 increased \$49 or 1.5% in comparison to the same period in 2020. The increase is attributed to an increase of REIT advisory fees paid during the year 2021 as compared to 2020.

Other income of \$4,337 for the nine months ended September 30, 2021 increased \$2,133 or 96.8% in comparison to the same period in 2020. The primary reason for the increase is due to insurance claims resulting in recognized gains on involuntary conversion during the nine months ended September 30, 2021 of \$1,183, which did not occur during the same period in 2020. The insurance claims are from a wind storm claim that occurred in June 2019 and roof collapse in March 2019. During the nine months ended September 30, 2021, the Trust received \$1,000 from related parties, in reimbursement for expenses paid that were associated with capital projects is another factor for the increase in other income. The Trust realized gains of \$253 on the sale of real estate investments during the nine months ended September 30, 2021 as compared to the same period in 2020.

COVID-19 Impact

The Trust continues to closely monitor the impact of the COVID-19 pandemic on all aspects of its business and geographies, including how it will impact its tenants and business partners. A number of uncertainties continue to exist at this time, including but not limited to the uncertainty of additional state and/or federal stimulus and the effect of the recent impacts of the COVID-19, delta variant. While the Trust did not incur significant disruptions during the nine months ended September 30, 2021 from the COVID-19 pandemic, the effects of the ongoing COVID-19 pandemic could have material adverse effects on our business and results of operations, so long as COVID-19 continues to impact the U.S. economy in general and multifamily apartment communities in particular. The extent to which the economic disruption associated with the COVID-19 pandemic impacts our business and financial results will depend on future developments, which are highly uncertain and cannot be predicted with confidence, including the scope, severity, and duration of the pandemic, the actions

taken to contain the pandemic or mitigate its impact, and the direct and indirect economic effects of the pandemic and containment measures, among others.

COVID-19 Developments

During the the nine months ended September 30, 2021, the Trust continued to monitor state and federal legislative actions and efforts regarding the eviction moratorium which affects almost all single-family and multifamily rental housing units. The Trust has seen a number of residents complete the sworn statement certifying the qualifications to obtain eviction protection. The Trust is monitoring the collection rates on residents and, at this time is unable to predict, with complete certainty, the impact that the COVID-19 have on its future financial condition, results of operations and cash flows, however, is optimistic that the collection efforts will result in the Trust receiving a substantial amount of delinquent rents due to numerous uncertainties.

The situation surrounding the COVID-19 pandemic remains fluid, and the Trust is actively managing its response in collaboration with residents, commercial tenants, and business partners and assessing potential impacts to financial position and operating results, as well as potential adverse impacts on our business. With legislation related to COVID-19 ever evolving, management remains steadfast in working with residents to apply for rent relief programs to help pay unpaid rents, and be distributed to the properties. As of September 30, 2021, the Trust's Property Management Company's efforts to work with residents and apply for these funds, since the second quarter of 2020, has provided approximately \$2,800 in rent help for our residential portfolio. Management continues to apply for rent help in excess of \$1,000 in relation to the Minnesota residential portfolio and is optimistic that these funds will be received. Our management remains committed to ensuring the safety of team members, residents, and communities, and to maintaining the financial stability of the Trust for the duration of the COVID-19 pandemic.

Construction in Progress and Development Projects

The Trust capitalizes direct and certain indirect project costs incurred during the development period such as construction, insurance, architectural, legal, interest and other financing costs, and real estate taxes. At such time as the development is considered substantially complete, the capitalization of certain indirect costs such as real estate taxes, interest, and financing costs cease, all project-related costs included in construction in process are reclassified to land and building and other improvements.

Construction in progress as of September 30, 2021 consists primarily of construction at several residential properties located in North Dakota, and Missouri, and Trustmark Office Park located in Fargo, North Dakota. The Prairiewood Meadows construction consists of the re-development of one building due to a fire, a new clubhouse for residents, and parking lot repairs. Current expectations are that the projects will be completed in the fourth quarter of 2021 and first quarter of 2022, and the current budget approximates \$3,590, of which \$1,485 has been incurred and is included in construction in progress. The Quail Creek Apartments projects primarily consist of work related to roof repairs and re-development of one building due to a fire. Current expectations are that the project will be completed in the fourth quarter of 2021 and the current budget approximates \$894, of which \$727 has been incurred and is included in construction in progress. The Trustmark construction primarily consists of office demolition and clearing, as well as tenant space remodel and build-outs. Current expectations are that the projects will be completed in the fourth quarter of 2021 and the current project budgets approximate \$5,870 of which \$5,675 has been incurred and is included in construction in progress. Remaining construction in progress projects are primarily related to exterior window and lighting upgrades and new deck systems on multiple residential properties.

Funds From Operations (FFO)

Funds From Operations (FFO) applicable to common shares and limited partnership units means net income (computed in accordance with GAAP), excluding gains (or losses) from sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. Adjustments for unconsolidated partnerships and joint ventures will be calculated to reflect funds from operations on the same basis.

Historical cost accounting for real estate assets implicitly assumes the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors have considered presentations of operating results for real estate companies that use historical cost accounting to be insufficient by themselves. The term Funds From Operations (FFO) was created to address this problem. It was intended to be a standard supplemental measure of REIT operating performance that excluded historical cost depreciation from — or “added back” to — GAAP net income.

Our management believes this non-GAAP measure is useful to investors because it provides supplemental information that facilitates comparisons to prior periods and for the evaluation of financial results. Management uses this non-GAAP measure to evaluate our financial results, develop budgets and manage expenditures. The method used to produce non-GAAP results is not computed according to GAAP, is likely to differ from the methods used by other companies and should not be regarded as a replacement for corresponding GAAP measures. Management encourages the review of the reconciliation of this non-GAAP financial measure to the comparable GAAP results.

Since the introduction of the definition of FFO, the term has come to be widely used by REITs. In the view of National Association of Real Estate Investment Trusts (“NAREIT”), the use of the definition of FFO (combined with the primary GAAP presentations required by the Securities and Exchange Commission) has been fundamentally beneficial, improving the understanding of operating results of REITs among the investing public and making it easier to compare the results of one REIT with another.

While FFO applicable to common shares and limited partnership units are widely used by REITs as performance metrics, all REITs do not use the same definition of FFO or calculate FFO in the same way. The FFO reconciliation presented here is not necessarily comparable to FFO presented by other real estate investment trusts. FFO should also not be considered as an alternative to net income as determined in accordance with GAAP as a measure of a real estate investment trust’s performance, but rather should be considered as an additional, supplemental measure, and should be viewed in conjunction with net income as presented in the consolidated financial statements included in this report. FFO applicable to common shares and limited partnership units does not represent cash generated from operating activities in accordance with GAAP and is not necessarily indicative of sufficient cash flow to fund a real estate investment trust’s needs or its ability to service indebtedness or to pay dividends to shareholders.

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The following tables include calculations of FFO, and the reconciliations to net income, for the three and nine months ended September 30, 2021 and 2020, respectively. We believe these calculations are the most comparable GAAP financial measure (in thousands):

Reconciliation of Net Income Attributable to Sterling to FFO Applicable to Common Shares and Limited Partnership Units

| | Three months ended September 30, 2021 | | Three months ended September 30, 2020 | |
|--|--|---|--|---|
| | Amount | Weighted Avg Shares and Units(1) | Amount | Weighted Avg Shares and Units(1) |
| | | | | |
| | | (unaudited) | | |
| | | (in thousands, except per share data) | | |
| Net Income attributable to Sterling Real Estate Trust | \$ 2,104 | 10,215 | \$ 1,844 | 9,740 |
| Add back: | | | | |
| Noncontrolling Interest - OPU | 3,753 | 18,256 | 3,450 | 18,232 |
| Depreciation & Amortization from continuing operations | 5,551 | | 5,328 | |
| Pro rata share of unconsolidated affiliate depreciation & amortization | 207 | | 95 | |
| Subtract: | | | | |
| Gain on sales of land, depreciable real estate, investment in equity method investee, and change in control of real estate investments | — | | — | |
| Funds from operations applicable to common shares and limited partnership units (FFO) | <u>\$ 11,615</u> | <u>28,471</u> | <u>\$ 10,717</u> | <u>27,972</u> |

| | Nine months ended September 30, 2021 | | Nine months ended September 30, 2020 | |
|---|---|---|---|---|
| | Amount | Weighted Avg Shares and Units(1) | Amount | Weighted Avg Shares and Units(1) |
| | | | | |
| | | (unaudited) | | |
| | | (in thousands, except per share data) | | |
| Net Income attributable to Sterling Real Estate Trust | \$ 7,119 | 10,095 | \$ 5,859 | 9,638 |
| Add back: | | | | |
| Noncontrolling Interest - OPU | 12,861 | 18,236 | 11,046 | 18,170 |
| Depreciation & Amortization from continuing operations | 16,634 | | 15,826 | |
| Pro rata share of unconsolidated affiliate depreciation & amortization | 499 | | 283 | |
| Subtract: | | | | |
| Gain on sale of land, depreciable real estate, investment in equity method investee, and change in control of real estate investments | (1,710) | | (1,456) | |
| Funds from operations applicable to common shares and limited partnership units (FFO) | <u>\$ 35,403</u> | <u>28,331</u> | <u>\$ 31,558</u> | <u>27,808</u> |

Liquidity and Capital Resources

Our principal demands for funds will be for the (i) acquisition of real estate and real estate-related investments, (ii) payment of acquisition related expenses and operating expenses, (iii) payment of dividends/distributions (iv) payment of principal and interest on current and any future outstanding indebtedness, (v) redemptions of our securities under our redemption plans and (vi) capital improvements, development projects, and property related expenditures. Generally, we expect to meet cash needs for the payment of operating expenses and interest on outstanding indebtedness from cash flow from operations. We expect to pay dividends/distributions and any repurchase requests to our shareholders and the unit holders of our Operating Partnership from cash flow from operations; however, we may use other sources to fund dividends/distributions and repurchases, as necessary. We expect to meet cash needs for acquisitions and other real-estate investments from cash flow from operations, net proceeds of share offerings and debt proceeds.

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Evaluation of Liquidity

We continually evaluate our liquidity and ability to fund future operations, debt obligations and any repurchase requests. As part of our analysis, we consider among other items, credit quality of tenants and lease expirations and the effects of the COVID-19 pandemic on its impact on rental income proceeds.

Credit Quality of Tenants

We are exposed to credit risk within our tenant portfolio, which can reduce our results of operations and cash flow from operations if our tenants are unable to pay their rent. Tenants experiencing financial difficulties may become delinquent on their rent or default on their leases and, if they file for bankruptcy protection, may reject our lease in bankruptcy court, resulting in reduced cash flow. This may negatively impact net asset values and require us to incur impairment charges. Even if a default has not occurred and a tenant is continuing to make the required lease payments, we may restructure or renew leases on less favorable terms, or the tenant's credit profile may deteriorate, which could affect the value of the leased asset and could in turn require us to incur impairment charges.

To mitigate credit risk on commercial properties, we have historically looked to invest in assets that we believe are critically important to our tenants' operations and have attempted to diversify our portfolio by tenant, tenant industry and geography. We also monitor all of our properties' performance through review of rent delinquencies as a precursor to a potential default, meetings with tenant management and review of tenants' financial statements and compliance with financial covenants. When necessary, our asset management process includes restructuring transactions to meet the evolving needs of tenants, refinancing debt and selling properties, as well as protecting our rights when tenants default or enter into bankruptcy.

Lease Expirations and Occupancy

Generally our residential leases are for a term of one year or less. The Advisor, with the assistance of our property managers, actively manages our real estate portfolio and begins discussing options with tenants in advance of scheduled lease expirations. In certain cases, we may obtain lease renewals from our tenants; however, tenants may elect to move out at the end of their term. In the cases where tenants elect not to renew, we may seek replacement tenants or try to sell the property.

COVID-19

The Trust does not anticipate COVID-19 will result in a material reduction of our liquidity sources. The Trust anticipates our monthly collection of rent, the economic occupancy rates of our portfolio and rental rates to continue to stabilize to pre-pandemic levels. However, as the pandemic continues to evolve and produce many unknown circumstances, there is potential for rent collections and occupancy rates to vary from anticipated factors, resulting in reduced liquidity sources.

Cash Flow Analysis

Our objectives are to generate sufficient cash flow over time to provide shareholders with increasing dividends and to seek investments with potential for strong returns and capital appreciation throughout varying economic cycles. We have funded 100% of the dividends from operating cash flows. In setting a dividend rate, we focus primarily on expected returns from investments we have already made to assess the sustainability of a particular dividend rate over time.

| | Nine Months Ended September 30, | |
|---|------------------------------------|-------------|
| | 2021 | 2020 |
| | (in thousands) | |
| Net cash flows provided by operating activities | \$ 32,840 | \$ 35,988 |
| Net cash flows used in investing activities | \$ (49,112) | \$ (31,398) |
| Net cash flows provided by (used in) financing activities | \$ 21,684 | \$ (7,022) |

Operating Activities

Our real estate properties generate cash flow in the form of rental revenues, which is reduced by interest payments, direct lease costs and property-level operating expenses. Property-level operating expenses consist primarily of property management fees including salaries and wages of property management personnel, utilities, cleaning, repairs, insurance, security, building maintenance costs, and real estate taxes. Additionally, we incur general and administrative expenses, advisory fees, acquisition and disposition expenses, and financing fees.

Net cash provided by operating activities was \$32,840 and \$35,988 for the nine months ended September 30, 2021 and 2020, respectively, which consists primarily of net income from property operations adjusted for non-cash depreciation and amortization.

Investing Activities

Our investing activities generally consist of real estate-related transactions (purchases and sales of properties) and payments of capitalized property-related costs such as intangible assets.

Net cash used in investing activities was \$49,112 and \$31,398 for the nine months ended September 30, 2021 and 2020, respectively (this does not include the value of UPREIT units issued in connection with investing activities). For the nine months ended September 30, 2021 and 2020, cash flows used in investing activities related specifically to the acquisition of properties and capital expenditures was \$49,522 and \$36,284, respectively. Proceeds of \$4,095 and \$1,077 were received from involuntary conversions during the nine months ended September 30, 2021 and 2020. In addition, proceeds of \$5,590 and \$5,483 were generated from the sales of real estate investments during the nine months ended September 30, 2021 and 2020. For the nine months ended September 30, 2021 and 2020, cash flows used for investment in unconsolidated affiliates was \$5,845 and \$1,170 respectively.

Financing Activities

Our financing activities generally consist of funding property purchases by raising proceeds and securing mortgage notes payable as well as paying dividends, paying syndication costs and making principal payments on mortgage notes payable.

Net cash provided by financing activities was \$21,684 for the nine months ended September 30, 2021. During the nine months ended September 30, 2021, we paid \$17,309 in dividends and distributions, redeemed \$4,465 of shares and units, received \$71,530 from new mortgage notes payable, and made mortgage principal payments of \$30,360. Net cash used in financing activities was \$7,022 for the nine months ended September 30, 2020. For the nine months ended September 30, 2020, we paid \$17,012 in dividends and distributions, redeemed \$2,786 of shares and units, received \$26,135 from new mortgage notes payable, and made mortgage principal payments of \$15,249.

Dividends and Distributions

Common Stock

We declared cash dividends to our shareholders during the period from January 1, 2021 to September 30, 2021 totaling \$8,020 or \$0.7950 per share, of which \$2,818 were cash dividends and \$5,202 were reinvested through the dividend reinvestment plan. The cash dividends were paid with the \$32,840 from our cash flows from operations.

We declared cash dividends to our shareholders during the period from January 1, 2020 to September 30, 2020 totaling \$7,648 or \$0.7941 per share, of which \$2,721 were cash dividends and \$4,927 were reinvested through the dividend reinvestment plan. The cash dividends were paid with the \$35,988 from our cash flows from operations.

We continue to provide cash dividends to our shareholders from cash generated by our operations. The following chart summarizes the sources of our cash used to pay dividends. Our primary source of cash is cash flow provided by operating activities from our investments as presented in our cash flow statement. We also include distributions from unconsolidated affiliates to the extent that the underlying real estate operations in these entities generate cash flow and the gain on sale of properties relates to net profits from the sale of certain properties. Our presentation is not intended to be an alternative to our consolidated statement of cash flows and does not present all sources and uses of our cash.

The following table presents certain information regarding our dividend coverage:

| | Nine Months Ended September 30, | |
|--|------------------------------------|-----------|
| | 2021 | 2020 |
| | (in thousands) | |
| Cash flows provided by operations (includes net income of \$19,832 and \$16,890, respectively) | \$ 32,840 | \$ 35,988 |
| Distributions in excess of earnings received from unconsolidated affiliates | — | 239 |
| Gain (Loss) on sales of real estate and non-real estate investments | 1,710 | 1,456 |
| Dividends declared | (8,020) | (7,648) |
| Excess | \$ 26,530 | \$ 30,035 |

Limited Partnership Units

The Operating Partnership agreement provides that our Operating Partnership will distribute to the partners (subject to certain limitations) cash from operations on a quarterly basis (or more frequently, if we so elect) in accordance with the percentage interests of the partners. We determine the amounts of such distributions in our sole discretion.

For the nine months ended September 30, 2021, we declared distributions totaling \$14,493 to holders of limited partnership units in our Operating Partnership, which we paid on April 15, July 15 and October 15, 2021. Distributions were paid at a rate of \$0.2650 per unit per quarter, which is equal to the per share distribution rate paid to the common shareholders.

For the nine months ended September 30, 2020, we declared quarterly distributions totaling \$14,484 to holders of limited partnership units in our Operating Partnership, which we paid on April 15, July 15 and October 15, 2020. Distributions were paid at a rate of \$0.2647 per unit per quarter, which is equal to the per share distribution rate paid to the common shareholders.

Sources of Dividends and Distributions

For the nine months ended September 30, 2021, we paid aggregate dividends \$7,922, which were paid with cash flows provided by operating activities. Our funds from operations, FFO, was \$35,403. Therefore, our management believes our distribution policy is sustainable over time. For the nine months ended September 30, 2020, we paid aggregate dividends of \$7,536 which were paid with cash flows provided by operating activities. Our FFO was \$31,558 as of the nine months ended September 30, 2020.

Cash Resources

At September 30, 2021, our unrestricted cash resources consisted of cash and cash equivalents totaling approximately \$22,168. Our unrestricted cash reserves can be used for working capital needs and other commitments. In addition, we had unencumbered properties with a gross book value of \$66,641, which could potentially be used as collateral to secure additional financing in future periods.

At September 30, 2021, there was no balance outstanding on our lines of credit. The lines of credit aggregate \$9,915 in total availability and are collateral for two letters of credit totaling \$67, leaving \$9,982 available and unused under the agreements. See Note 7 to the accompanying consolidated financial statements for additional details regarding our line of credit agreements.

The sale of our securities and issuance of limited partnership units of the Operating Partnership in exchange for property acquisitions and sale of additional common or preferred shares is also expected to be a source of long-term capital for us.

During the nine months ended September 30, 2021, we did not sell any common shares in a private placement. During the nine months ended September 30, 2021, we issued 269,000 and 150,000 common shares for \$8,121 under the dividend reinvestment plan, through dividends reinvested and the optional share purchases. During the nine months ended September 30, 2020, we did not sell any common shares in a private placement. During the nine months ended September 30, 2020, we issued 265,000 and 134,000 common shares for \$7,415, under the dividend reinvestment plan, through dividends reinvested and the optional share repurchases, respectively.

During the nine months ended September 30, 2021, we issued 2,883,000 limited partnership units in connection with three of the five properties acquired.

Unconsolidated Affiliate Arrangements

As of September 30, 2021 and December 31, 2020, we had debt obligations related to investments in unconsolidated affiliates of \$81,078 and \$41,405, respectively. The Trust is jointly and severally liable for the full mortgage balance.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The principal material financial market risk to which we are exposed is interest-rate risk. Our exposure to market risk for changes in interest rates relates primarily to refinancing long-term fixed rate obligations, the opportunity cost of fixed rate obligations in a falling interest rate environment and our variable rate lines of credit.

The carrying amount of our interest rate swaps have been adjusted to their fair value at September 30, 2021, resulting in a liability of \$856 and asset of \$524. As of December 31, 2020, the fair value adjustment resulted in a liability of \$1,805.

As much of our outstanding debt is long-term, fixed rate debt, our interest rate risk has not changed significantly from what was disclosed in our Annual Report on Form 10-K for the year ended December 31, 2020 filed with the Securities and Exchange Commission on March 31, 2021.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2021, such disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and is accumulated and communicated to management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls over Financial Reporting

There were no changes in our internal controls over financial reporting that occurred during the third fiscal quarter of 2021 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Sale of Securities

Neither Sterling nor the Operating Partnership issued any unregistered securities during the three months ended September 30, 2021.

Other Sales

During the three months ended September 30, 2021, we did not issue any common shares in exchange for limited partnership units of the Operating Partnership on a one-for-one basis pursuant to redemption requests made by accredited investors pursuant to Section 4 (a) (2) and Rule 506 of Regulation D.

Redemptions of Securities

Set forth below is information regarding common shares and limited partnership units redeemed during the the three months ended September 30, 2021:

| Period | Total Number of Common Shares Redeemed | Total Number of Limited Partner Units Redeemed | Average Price Paid per Common Share/Unit | Total Number of Shares Redeemed as Part of Publicly Announced Plans or Programs | Total Number of Units Redeemed as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares (or Units) that May Yet Be Redeemed Under Publicly Announced Plans or Programs |
|----------------------|--|--|--|---|--|---|
| January 1-31, 2021 | 9,000 | — | \$ 19.00 | 1,371,000 | 899,000 | \$ 7,157 |
| February 1-29, 2021 | 21,000 | 26,000 | \$ 19.00 | 1,392,000 | 925,000 | \$ 6,274 |
| March 1-31, 2021 | 11,000 | 7,000 | \$ 19.00 | 1,403,000 | 932,000 | \$ 5,920 |
| Total | 41,000 | 33,000 | | | | |
| April 1-30, 2021 | 8,000 | 49,000 | \$ 19.00 | 1,411,000 | 981,000 | \$ 4,840 |
| May 1-31, 2021 | 5,000 | 10,000 | \$ 19.00 | 1,416,000 | 991,000 | \$ 4,544 |
| June 1-30, 2021 | 2,000 | 38,000 | \$ 19.00 | 1,418,000 | 1,029,000 | \$ 3,775 |
| Total | 15,000 | 97,000 | | | | |
| July 1-31, 2021 | 5,000 | 26,000 | \$ 19.00 | 1,423,000 | 1,055,000 | \$ 3,179 |
| August 1-31, 2021 | 1,000 | 16,000 | \$ 19.00 | 1,424,000 | 1,071,000 | \$ 2,876 |
| September 1-30, 2021 | — | 1,000 | \$ 19.00 | 1,424,000 | 1,072,000 | \$ 17,860 |
| Total | 6,000 | 43,000 | | | | |

For the three months ended September 30, 2021, we redeemed all shares or units for which we received redemption requests. In addition, for the the three months ended September 30, 2021, all common shares and units redeemed were redeemed as part of the publicly announced plans.

The Amended and Restated Share Redemption Plan permits us to repurchase common shares held by our shareholders and limited partnership units held by partners of our Operating Partnership, up to a maximum amount of \$55,000 worth of shares and units, upon request by the holders after they have held them for at least one year and subject to other conditions and limitations described in the plan. The amount remaining to be redeemed as of September 30, 2021, was \$17,860. The redemption price for such shares and units redeemed under the plan was fixed at \$19.00 per share or unit, which became effective January 1, 2021. The redemption plan will terminate in the event the shares become listed on any national securities exchange, the subject of bona fide quotes on any inter-dealer quotation system or electronic communications network or are the subject of bona fide quotes in the pink sheets. Additionally, the Board, in its sole discretion, may terminate, amend or suspend the redemption plan at any time if it determines to do so is in our best interest.

Item 6. Exhibits.

| <u>Exhibit Number</u> | <u>Title of Document</u> |
|---------------------------|--|
| 31.1 | <u>Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 31.2 | <u>Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32.1 | <u>Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the of the Sarbanes-Oxley Act of 2002.</u> |
| 101 | The following materials from Sterling Real Estate Trust's Quarterly Report on Form 10-Q for the quarter ended September 30, 2021 formatted in iXBRL (Inline eXtensible Business Reporting Language): (i) Consolidated Balance Sheets at September 30, 2021 and December 31, 2020; (ii) Consolidated Statements of Operations and Other Comprehensive Income for the three and nine months ended September 30, 2021 and 2020; (iii) Consolidated Statements of Shareholders' Equity for the three and nine months ended September 30, 2021 and 2020; (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2021 and 2020, and; (v) Notes to Consolidated Financial Statements. |
| 104 | Cover Page Interactive Data File, formatted in iXBRL and contained in Exhibit 101. |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused the report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: November 10, 2021

STERLING REAL ESTATE TRUST

By: /s/ Kenneth P. Regan
Kenneth P. Regan
Chief Executive Officer
(Principal Executive Officer)

By: /s/ Erica J. Chaffee
Erica J. Chaffee
Chief Financial Officer
(Principal Financial and Accounting Officer)

**OFFICER'S CERTIFICATE
PURSUANT TO SECTION 302**

I, Kenneth P. Regan, certify that:

1. I have reviewed this quarterly report on Form 10-Q for Sterling Real Estate Trust.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-5(e) and 15d-15 (e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 10, 2021

By: /s/ Kenneth P. Regan
Chief Executive Officer

**OFFICER'S CERTIFICATE
PURSUANT TO SECTION 302**

I, Erica J. Chaffee, certify that:

1. I have reviewed this quarterly report on Form 10-Q for Sterling Real Estate Trust.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-5(e) and 15d-15 (e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 10, 2021

By: /s/ Erica J. Chaffee
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Sterling Real Estate Trust (the “Company”) on Form 10-Q for the period ended September 30, 2021, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned, in the capacities and on the dates indicated below, hereby certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operation of the Company.

Dated: November 10, 2021

By: /s/ Kenneth P. Regan
Chief Executive Officer

By: /s/ Erica J. Chaffee
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Sterling Real Estate Trust and will be retained by Sterling Real Estate Trust and furnished to the Securities and Exchange Commission or its staff upon request.
