

**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 June 30, 2018

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.)

1711 Gold Drive South, Suite 100, Fargo, North Dakota
(Address of principal executive offices)

58103
(Zip Code)

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

(Former name, former address and formal fiscal year, if changed since last report)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit and post 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	☐	Accelerated filer	☒
Non-accelerated filer	☐	Smaller reporting company	☐
Emerging growth company	☐		

(Do not check if a smaller reporting company)

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 August 3, 2018
Common Shares of Beneficial Interest, \$0.01 par value per share	8,845,663

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 JUNE 30, 2018 (UNAUDITED) AND DECEMBER 31, 2017

	June 30, 2018	December 31, 2017
	(in thousands)	
ASSETS		
Real estate investments, net	\$ 641,801	\$ 648,677
Cash and cash equivalents	13,809	12,490
Restricted deposits	10,507	8,063
Investment in unconsolidated affiliates	2,649	2,772
Due from related party	—	3
Receivables	4,633	5,113
Prepaid expenses	1,666	482
Financing and lease costs, less accumulated amortization of \$1,966 in 2018 and \$1,943 in 2017	706	737
Assets held for sale	4,695	—
Lease intangible assets, less accumulated amortization of \$13,603 in 2018 and \$12,932 in 2017	11,459	13,263
Other assets	5	5
Total Assets	\$ 691,930	\$ 691,605
LIABILITIES		
Mortgage notes payable, net	\$ 393,935	\$ 394,843
Special assessments payable	486	518
Dividends payable	6,682	6,436
Due to related party	666	366
Tenant security deposits payable	4,073	4,038
Subordinated debt	175	175
Lease intangible liabilities, less accumulated amortization of \$1,487 in 2018 and \$1,386 in 2017	1,608	1,776
Accounts payable - trade	2,020	486
Retainage payable	170	16
Liabilities related to assets held for sale	93	—
Fair value of interest rate swaps	42	65
Deferred insurance proceeds	37	1,216
Accrued expenses and other liabilities	6,414	7,895
Total Liabilities	416,401	417,830
COMMITMENTS and CONTINGENCIES - Note 15		
SHAREHOLDERS' EQUITY		
Beneficial interest	93,925	90,816
Noncontrolling interest		
Operating partnership	178,559	179,844
Partially owned properties	3,087	3,180
Accumulated other comprehensive loss	(42)	(65)
Total Shareholders' Equity	275,529	273,775
	\$ 691,930	\$ 691,605

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE INCOME
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2018 AND 2017 (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(in thousands, except per share data)		(in thousands, except per share data)	
Income from rental operations				
Real estate rental income	\$ 27,767	\$ 27,111	\$ 55,385	\$ 53,518
Tenant reimbursements	1,521	1,402	3,133	3,025
	29,288	28,513	58,518	56,543
Expenses				
Expenses from rental operations				
Interest	4,576	4,609	9,076	9,248
Depreciation and amortization	5,283	5,381	10,633	10,744
Real estate taxes	2,898	2,607	5,744	5,203
Property management	3,898	2,991	7,180	6,026
Utilities	2,210	2,048	5,004	4,545
Repairs and maintenance	5,657	4,974	10,194	9,932
Insurance	586	368	1,103	736
Loss on lease terminations	—	31	—	146
	25,108	23,009	48,934	46,580
Administration of REIT				
Administrative expenses	101	133	207	229
Advisory fees	722	704	1,440	1,400
Acquisition and disposition expenses	149	863	149	1,375
Trustee fees	14	19	34	32
Legal and accounting	103	101	413	287
	1,089	1,820	2,243	3,323
Total expenses	26,197	24,829	51,177	49,903
Income from operations	3,091	3,684	7,341	6,640
Other income (expense)				
Equity in income of unconsolidated affiliates	127	157	284	369
Other income	55	26	160	51
Gain on sale of real estate and non-real estate investments	1,084	2,075	1,084	2,052
Gain on change in control of real estate investments	—	2,186	—	2,186
Gain on sale of investment in equity method investee	—	—	—	3
Gain on involuntary conversion	620	162	1,367	189
	1,886	4,606	2,895	4,850
Net income	\$ 4,977	\$ 8,290	\$ 10,236	\$ 11,490
Net income (loss) attributable to noncontrolling interest:				
Operating Partnership	3,376	5,654	6,912	7,883
Partially owned properties	(74)	(46)	(93)	(131)
Net income attributable to Sterling Real Estate Trust	\$ 1,675	\$ 2,682	\$ 3,417	\$ 3,738
Net income per common share, basic and diluted	\$ 0.19	\$ 0.33	\$ 0.39	\$ 0.46
Comprehensive income:				
Net income	\$ 4,977	\$ 8,290	\$ 10,236	\$ 11,490
Other comprehensive gain - change in fair value of interest rate swaps	10	16	23	41
Comprehensive income	4,987	8,306	10,259	11,531
Comprehensive income attributable to noncontrolling interest	3,309	5,619	6,835	7,779
Comprehensive income attributable to Sterling Real Estate Trust	\$ 1,678	\$ 2,687	\$ 3,424	\$ 3,752

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2018 (UNAUDITED)

	Common Shares	Paid-in Capital	Accumulated Distributions in Excess of Earnings	Total Beneficial Interest	Noncontrolling Interest Operating Partnership	Partially Owned Properties	Accumulated Comprehensive Income (Loss)	Total
	(in thousands)							
BALANCE AT DECEMBER 31, 2017	8,488	\$ 113,995	\$ (23,179)	\$ 90,816	\$ 179,844	\$ 3,180	\$ (65)	\$ 273,775
Contribution of assets in exchange for the issuance of noncontrolling interest shares					1,546	—		1,546
Shares/units redeemed	(49)	(858)		(858)	(805)	—		(1,663)
Dividends declared			(4,407)	(4,407)	(8,938)	—		(13,345)
Dividends reinvested - stock dividend	159	2,798		2,798				2,798
Issuance of shares under optional purchase plan	117	2,159		2,159				2,159
Change in fair value of interest rate swaps							23	23
Net income			3,417	3,417	6,912	(93)		10,236
BALANCE AT JUNE 30, 2018	8,715	\$ 118,094	\$ (24,169)	\$ 93,925	\$ 178,559	\$ 3,087	\$ (42)	\$ 275,529

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW S
FOR THE SIX MONTHS ENDED JUNE 30, 2018 AND 2017 (UNAUDITED)

	Six Months Ended June 30,	
	2018	2017
	(in thousands)	
OPERATING ACTIVITIES		
Net income	\$ 10,236	\$ 11,490
Adjustments to reconcile net income to net cash from operating activities		
(Gain) on sale of real estate investments	(1,084)	(2,075)
Loss on sale of non-real estate investments	—	23
(Gain) on change in control of real estate investment	—	(2,186)
(Gain) on involuntary conversion	(1,367)	(189)
Loss on lease terminations	—	146
Equity in income of unconsolidated affiliates	(284)	(369)
Distributions of earnings of unconsolidated affiliates	284	369
Allowance for uncollectible accounts receivable	(706)	—
Depreciation	9,505	9,454
Amortization	1,099	1,258
Amortization of debt issuance costs	338	371
Effects on operating cash flows due to changes in		
Due from related party	3	(24)
Receivables	895	44
Prepaid expenses	(1,184)	(650)
Other assets	—	(76)
Due to related party	300	(397)
Tenant security deposits payable	5	183
Accounts payable - trade	944	(131)
Accrued expenses and other liabilities	(1,966)	(1,276)
NET CASH PROVIDED BY OPERATING ACTIVITIES	17,018	15,965
INVESTING ACTIVITIES		
Purchase of real estate investment properties	(2,979)	(1,925)
Capital expenditures and tenant improvements	(4,548)	(5,499)
Proceeds from sale of real estate investments and non-real estate investments	5,200	4,442
Proceeds from involuntary conversion	330	1,914
Investment in unconsolidated affiliates	—	(20)
Distributions in excess of earnings received from unconsolidated affiliates	124	245
Notes receivable payments received	—	41
NET CASH USED IN INVESTING ACTIVITIES	(1,873)	(802)
FINANCING ACTIVITIES		
Payments for financing, debt issuance and lease costs	(149)	(333)
Principal payments on special assessments payable	(269)	(101)
Proceeds from issuance of mortgage notes payable and subordinated debt	7,064	16,152
Principal payments on mortgage notes payable	(8,223)	(12,252)
Advances on lines of credit	2,964	—
Payments on lines of credit	(2,964)	—
Proceeds from issuance of shares under optional purchase plan	2,159	1,361
Shares/units redeemed	(1,663)	(1,109)
Dividends/distributions paid	(10,301)	(9,620)
NET CASH USED IN FINANCING ACTIVITIES	(11,382)	(5,902)
NET CHANGE IN CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS	3,763	9,261
CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS AT BEGINNING OF PERIOD	20,553	19,270
CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS AT END OF PERIOD	\$ 24,316	\$ 28,531
CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS AT END OF PERIOD		
Cash and cash equivalents	\$ 13,809	\$ 16,580
Restricted deposits	10,507	11,951
TOTAL CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS, END OF PERIOD	\$ 24,316	\$ 28,531

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2018 AND 2017 (UNAUDITED) (Continued)

	Six Months Ended June 30,	
	2018	2017
	(in thousands)	
SCHEDULE OF CASH FLOW INFORMATION		
Cash paid during the period for interest, net of capitalized interest	\$ 9,068	\$ 9,282
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Dividends reinvested	\$ 2,798	\$ 2,546
Dividends declared and not paid	2,217	2,036
UPREIT distributions declared and not paid	4,465	4,340
UPREIT units converted to REIT common shares	—	133
Acquisition of assets in exchange for the issuance of noncontrolling interest units in UPREIT	1,546	14,378
Increase in land improvements due to increase in special assessments payable	251	185
Unrealized gain on interest rate swaps	23	41
Acquisition of assets with new financing	—	3,265
Acquisition of assets through assumption of debt and liabilities	54	1,295
Capitalized interest and real estate taxes related to construction in progress	97	94
Acquisition of assets with accounts payable	752	957

See Notes to Consolidated Financial Statements

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017 (UNAUDITED)

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

NOTE 1 - ORGANIZATION

Sterling Real Estate Trust (“Sterling”, “the Trust” or “the Company”) is a registered, but unincorporated business trust organized in North Dakota in November 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.

Sterling previously established an operating partnership (“Sterling Properties, LLLP”) and transferred all of its assets and liabilities to the operating partnership in exchange for general partnership units. As the general partner, Sterling has management responsibility for all activities of the operating partnership. As of June 30, 2018 and December 31, 2017, Sterling owned approximately 33.18% and 32.64%, 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, 2017, 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. The accompanying consolidated balance sheet as of June 30, 2018 and consolidated statements of operations and other comprehensive income, consolidated statement of shareholders’ equity, and consolidated statements of cash flows for the three and six months ended June 30, 2018 and 2017, as applicable, have not been audited by our independent registered public accounting firm. 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 six months ended June 30, 2018. These adjustments are of a normal recurring nature.

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.

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.

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017 (UNAUDITED)

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

Principal Business Activity

Sterling currently owns directly and indirectly 166 properties. The Trust's 118 residential properties are located in North Dakota, Minnesota, Missouri and Nebraska and are principally multifamily apartment buildings. The Trust owns 48 commercial properties primarily located in North Dakota with others located in Arkansas, Colorado, Iowa, Louisiana, Michigan, Minnesota, Mississippi, Nebraska, Texas and Wisconsin. The commercial properties include retail, office, industrial, restaurant and medical properties. Presently, the Trust's mix of properties is 71.8% residential and 28.2% commercial (based on cost) and total \$641,801 in real estate investments at June 30, 2018. Sterling's current acquisition strategy and focus is solely 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	99	5,951
	Minnesota	16	3,027
	Missouri	1	164
	Nebraska	2	316
		118	9,458

Commercial Property	Location	No. of Properties	Sq. Ft
	North Dakota	20	805,000
	Arkansas	2	29,000
	Colorado	1	13,000
	Iowa	1	33,000
	Louisiana	1	15,000
	Michigan	1	12,000
	Minnesota	14	644,000
	Mississippi	1	15,000
	Nebraska	1	16,000
	Texas	1	7,000
	Wisconsin	5	63,000
		48	1,652,000

Concentration of Credit Risk

Our cash balances are maintained in various bank deposit accounts. The bank deposit amounts in these accounts may exceed federally insured limits at various times throughout the year.

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 and 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.

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017 (UNAUDITED)

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

The Company elected to early adopt ASU 2017-01, Business Combinations, on a prospective basis as of July 1, 2017. This new guidance clarifies the definition of a business and provides a screen to determine when an integrated set of assets and activities is not considered a business and, thus, accounted for as an asset acquisition as opposed to a business combination. Under this new guidance, the Company expects most acquisitions of investment property will meet this screen and, thus, be accounted for as asset acquisitions. The Company allocates the purchase price of each acquired investment property that is accounted for as an asset acquisition based upon the relative 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, (v) any assumed financing that is determined to be above or below market and (vi) the value of customer relationships. Asset acquisitions do not give rise to goodwill and the related transaction costs are capitalized and included with the allocated purchase price. Acquisitions executed prior to our adoption of ASU 2017-01 as of July 1, 2017 were accounted for as business combinations. Transaction costs related to acquisitions accounted for as business combinations were expensed as incurred and included within "Administration of REIT expenses" in the accompanying consolidated statements of operations and other comprehensive income.

For tangible assets acquired, including land, building and other improvements, the Company considers available comparable market and industry information in estimating acquisition date fair value. 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 vacant status), direct costs estimated with obtaining a new tenant, discount rates, escalation factors, standard lease terms, and tenant improvement costs. The Company allocates a portion of the purchase price to the estimated acquired in-place lease value intangibles based on factors available in third party appraisals or cash flow estimates of the property prepared by our internal analysis. These estimates are based upon cash flow projections for the property, existing leases, lease origination costs for similar leases as well as lost rental payments during an assumed lease-up period. The Company also evaluates each acquired lease as compared to current market rates. If an acquired lease is determined to be above or below market, the Company allocates a portion of the purchase price to such above or below market leases based upon the present value of the difference between the contractual lease payments and estimated market rent payments over the remaining lease term. Renewal periods are included within the lease term in the calculation of above and below market lease values if, based upon factors known at the acquisition date, market participants would consider it reasonably assured that the lessee would exercise such options. Fair value estimates used in acquisition accounting, including the discount rate used, require the Company to consider various factors, including, but not limited to, market knowledge, demographics, age and physical condition of the property, geographic location, and size and location of tenant spaces within the acquired investment property.

The portion of the purchase price allocated to acquired in-place lease value intangibles is amortized on a straight-line basis over the life of the related lease as amortization expense. The Company incurred amortization expense pertaining to acquired in-place lease value intangibles of \$503 and \$568 for the three months ended June 30, 2018 and 2017, respectively and \$1,043 and \$1,164 for the six months ended June 30, 2018 and 2017, respectively.

The portion of the purchase price allocated to acquired above and below market lease intangibles is amortized on a straight-line basis over the life of the related lease as an adjustment to real estate rental income. Amortization pertaining to above market lease intangibles of \$55 and \$56 for the three months ended June 30, 2018 and 2017, respectively, was recorded as a reduction to real estate rental income. Amortization pertaining to below market lease intangibles of \$70 and \$71 for the three months ended June 30, 2018 and 2017, respectively, was recorded as an increase to real estate rental income. Amortization pertaining to above market lease intangibles of \$111 and \$113 for the six months ended June 30, 2018 and 2017, respectively, was recorded as a reduction to real estate rental income. Amortization pertaining to below market lease intangibles of \$140 and \$144 for the six months ended June 30, 2018 and 2017, respectively, was recorded as an increase to real estate rental income.

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017 (UNAUDITED)

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

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. 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

Depreciation expense for the three months ended June 30, 2018 and 2017 totaled \$4,738 and \$4,749, respectively. Depreciation expense for the six months ended June 30, 2018 and 2017 totaled \$9,505 and \$9,454, respectively.

The Company's investment properties are reviewed for potential impairment at the end of each reporting period whenever events or changes in circumstances indicate that the carrying value may not be recoverable. At the end of each reporting period, the Company 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 continued low occupancy rate;
- 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 Company's management or board of trustees.

If the presence of one or more impairment indicators as described above is identified at the end of the reporting period or throughout the year 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 Company 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 and lease origination costs;
- 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 Company will record an impairment charge calculated as the excess of the carrying value of the asset over its fair value for impairment of investment properties. Based on evaluation, there were no impairment losses during the six months ended June 30, 2018 and 2017.

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017 (UNAUDITED)

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

Properties Held for Sale

We account for our properties held for sale in accordance with ASC 360, Property, Plant and Equipment (“ASC 360”), which addresses financial accounting and reporting in a period in which a component or group of components of an entity either has been disposed of or is classified as held for sale.

In accordance with ASC 360, at such time as a property is held for sale, such property is carried at the lower of: (1) its carrying amount, or (2) fair value less costs to sell. In addition, a property being held for sale ceases to be depreciated. We classify operating properties as properties held for sale in the period in which all of the following criteria are met:

- management, having the authority to approve the action, commits to a plan to sell the asset;
- the asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets;
- an active program to locate a buyer and other actions required to complete the plan to sell the asset has been initiated;
- the sale of the asset is probable and the transfer of the asset is expected to qualify for recognition as a completed sale within one year;
- the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and
- given the actions required to complete the plan to sell the asset, it is unlikely that significant changes to the plan would be made or that the plan would be withdrawn.

The results of operations of a component of an entity that either has been disposed of or is classified as held-for-sale under the requirements of ASC 360 shall be reported in discontinued operations in accordance with ASC 205, Presentation of Financial Statements (“ASC 205”) if such disposal or classification represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results.

There were two properties classified as held for sale at June 30, 2018. There were no properties classified as held for sale at December 31, 2017. See Note 16.

Construction in Progress

The Company 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 and interest and financing costs cease and all project-related costs included in construction in process are reclassified to land and building and other improvements.

Cash and Cash Equivalents

We classify highly liquid investments with a maturity of three months or less when purchased as cash equivalents.

Investment in Unconsolidated Affiliates

We account for unconsolidated affiliates using the equity method of accounting per guidance established under ASC 323, Investments – Equity Method and Joint Ventures (“ASC 323”). The equity method of accounting requires the investment to be initially recorded at cost and subsequently adjusted for our share of equity in the affiliates’ earnings, contributions and distributions. We evaluate the carrying amount of the investments for impairment in accordance with ASC 323. Unconsolidated affiliates are reviewed for potential impairment if the carrying amount of the investment exceeds its fair

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value. An impairment charge is recorded when an impairment is deemed to be other-than-temporary. To determine whether impairment is other-than-temporary, we consider whether we have the ability and intent to hold the investment until the carrying amount is fully recovered. The evaluation of an investment in an affiliate for potential impairment can require our management to exercise significant judgments. No impairment losses were recorded related to the unconsolidated affiliates for the six months ended June 30, 2018 and 2017.

We use the equity method to account for investments that qualify as variable interest entities where we are not the primary beneficiary and entities that we do not control or where we do not own a majority of the economic interest but have the ability to exercise significant influence over the operations and financial policies of the investee. We will also use the equity method for investments that do not qualify as variable interest entities and do not meet the control requirements for consolidation, as defined in ASC 810. For a joint venture accounted for under the equity method, our share of net earnings and losses is reflected in income when earned and distributions are credited against our investment in the joint venture as received.

In determining whether an investment in a limited liability company or tenant in common is a variable interest entity, we consider: the form of our ownership interest and legal structure; the size of our investment; the financing structure of the entity, including the necessity of subordinated debt; estimates of future cash flows; our and our partner's ability to participate in the decision making related to acquisitions, dispositions, budgeting and financing on the entity; and obligation to absorb losses and preferential returns. As of June 30, 2018, our tenant in common arrangements do not qualify as variable interest entities and do not meet the control requirements for consolidation, as defined in ASC 810.

As of June 30, 2018 and December 31, 2017, the unconsolidated affiliates held total assets of \$23,220 and \$23,466 and mortgage notes payable of \$17,253 and \$17,470, respectively.

The operating partnership is a 50% owner of Grand Forks Marketplace Retail Center as a tenant in common through 100% ownership in a limited liability company. Grand Forks Marketplace Retail Center 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 June 30, 2018 and December 31, 2017 of \$10,558 and \$10,692, respectively. The Company is jointly and severally liable for the full mortgage balance.

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 June 30, 2018 and December 31, 2017 of \$6,695 and \$6,778, respectively. The Company is jointly and severally liable for the full mortgage balance.

Receivables

Receivables consist primarily of amounts due for rent. The receivables are non-interest bearing. Accounts receivable are carried at original amounts billed less an estimate made for doubtful accounts based on a review of outstanding amounts on a quarterly basis and reflect management's best estimate of the amounts that will not be collected. Accounts receivable are written off when collection efforts have been exhausted and they are deemed uncollectible. Recoveries, if any, of receivables previously written off are recorded when received. The receivables are non-interest bearing and are unsecured. As of June 30, 2018, management's estimate of uncollectible accounts receivable was \$706. As of December 31, 2017, management determined no allowance was necessary for uncollectible receivables.

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Financing and Lease Costs

Financing costs have been capitalized and are being amortized over the life of the financing (line of credit) using the effective interest method. Unamortized financing costs are written off when debt is retired before the maturity date and included in interest expense at that time.

Lease costs incurred in connection with new leases have been capitalized and are being amortized over the life of the lease using the straight-line method. We record the amortization of leasing costs in depreciation and amortization on the consolidated statements of operations and comprehensive income. If an applicable lease terminates prior to the expiration of its initial lease term, we write off the carrying amount of the costs to amortization expense.

Debt Issuance Costs

We amortize external debt issuance costs using the effective interest rate method, over the estimated life of the related debt. We record debt issuance costs related to notes and mortgage notes, net of amortization, on our consolidated balance sheets as an offset to their related debt. We record debt issuance costs related to revolving lines of credit on our consolidated balance sheets as financing fees, regardless of whether a balance on the line of credit is outstanding. We record the amortization of all debt issuance costs as interest expense.

Lease Intangible Assets

Lease intangibles are a purchase price allocation recorded on property acquisition. The lease intangibles represent the estimated value of in-place leases, tenant relationships and the value of leases with above or below market lease terms. Lease intangibles are amortized over the term of the related lease.

The carrying amount of intangible assets is regularly reviewed for indicators of impairments in value. Impairment is recognized only if the carrying amount of the intangible asset is considered to be unrecoverable from its undiscounted cash flows and is measured as the difference between the carrying amount and the estimated fair value of the asset. Based on the review, management determined no impairment charges were necessary at June 30, 2018 and December 31, 2017.

Noncontrolling Interest

A noncontrolling interest in a subsidiary (minority interest) is in most cases an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements and separate from the parent company's equity. In addition, consolidated net income is required to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest and the amount of consolidated net income attributable to the parent and the noncontrolling interest are required to be disclosed on the face of the consolidated statements of operations and comprehensive income.

Operating Partnership: Interests in the operating partnership held by limited partners are represented by operating partnership units. The operating partnership's income is allocated to holders of units based upon the ratio of their holdings to the total units outstanding during the period. Capital contributions, distributions, syndication costs, and profits and losses are allocated to noncontrolling interests in accordance with the terms of the operating partnership agreement.

Partially Owned Properties: The Company reflects noncontrolling interests in partially owned properties on the balance sheet for the portion of properties consolidated by the Company that are not wholly owned by the Company. The earnings or losses from those properties attributable to the noncontrolling interests are reflected as noncontrolling interests in partially owned properties in the consolidated statement of operations and comprehensive income.

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Syndication Costs

Syndication costs consist of costs paid to attorneys, accountants, and selling agents, related to the raising of capital. Syndication costs are recorded as a reduction to beneficial and noncontrolling interest.

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 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.

Sterling conducts its business activity as an Umbrella Partnership Real Estate Investment Trust ("UPREIT") through its Operating Partnership – Sterling Properties, LLLP. The Operating Partnership is organized as a limited liability limited partnership. Income or loss is allocated to the partners in accordance with the provisions of the Internal Revenue Code 704(b) and 704(c). UPREIT status allows non-recognition of gain by an owner of appreciated real estate if that owner contributes the real estate to a partnership in exchange for a partnership interest. The conversion of a partnership interest to shares of beneficial interest in the REIT will be a taxable event to the limited partner.

We follow 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 June 30, 2018 and December 31, 2017 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 2014.

The operating partnership has elected to record related interest and penalties, if any, as income tax expense on the consolidated statements of operations and other comprehensive income.

Revenue Recognition

We derive over 95% of our revenues from tenant rents and other tenant-related activities. We lease multifamily units under operating leases with terms of one year or less. Rental income and other property revenues are recorded when due from tenants and recognized monthly as earned pursuant to the terms of the underlying leases. Other property revenues consist primarily of laundry, application and other fees charged to tenants.

We lease commercial space primarily under long-term lease agreements. Commercial tenant rents include base rents, expense reimbursements (such as common area maintenance, real estate taxes and utilities), and a straight-line rent adjustment. We record base rents on a straight-line basis. The monthly base rent income according to the terms of our leases is adjusted so that an average monthly rent is recorded for each tenant over the term of its lease. The straight-line rent adjustment increased revenue by \$19 and \$54 for the three months ended June 30, 2018 and 2017, respectively. The straight-line rent adjustment increased revenue by \$70 and \$127 the six months ended June 30, 2018 and 2017, respectively. The straight-line receivable balance included in receivables on the consolidated balance sheets as of June 30, 2018 and December 31, 2017 was \$3,465 and \$3,586, respectively. We receive payments for expense reimbursements

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from substantially all our multi-tenant commercial tenants throughout the year based on estimates. Differences between estimated recoveries and the final billed amounts, which generally are immaterial, are recognized in the subsequent year.

Earnings per Common Share

Basic earnings per common share is computed by dividing net income available to common shareholders (the “numerator”) by the weighted average number of common shares outstanding (the “denominator”) during the period. Sterling had no dilutive potential common shares as of June 30, 2018 and 2017, and therefore, basic earnings per common share was equal to diluted earnings per common share for both periods.

For the three months ended June 30, 2018 and 2017, Sterling’s denominators for the basic and diluted earnings per common share were approximately 8,720,000 and 8,227,000, respectively. For the six months ended June 30, 2018 and 2017, Sterling’s denominators for the basic and diluted earnings per common share were approximately 8,674,000 and 8,172,000, respectively.

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.

Recent Accounting Pronouncements

In May 2014, the FASB and International Accounting Standards Board issued their final standard on revenue from contracts with customers, which was issued by the FASB as Accounting Standards Update 2014-09, *Revenue from Contracts with Customers*, or ASU 2014-09. ASU 2014-09, which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers, supersedes most current GAAP applicable to revenue recognition and converges U.S. and international accounting standards in this area. The core principle of the new guidance is that revenue shall only be recognized when an entity has transferred control of goods or services to a customer and for an amount reflecting the consideration to which the entity expects to be entitled for such exchange. Additionally, lease contracts are specifically excluded from ASU 2014-09. In July 2015, the FASB decided to defer the effective date for annual reporting periods beginning after December 15, 2017. Early adoption is permitted beginning on the original effective date of periods beginning after December 15, 2016. Upon adoption, ASU 2014-09 allows for full retrospective adoption applied to all periods presented or modified retrospective adoption with the cumulative effect of initially applying the standard recognized at the date of initial application. We have performed a review of the requirements of the new guidance and have identified which of our revenue streams will be within the scope of ASU 2014-09. We have completed an adoption plan which included a review of transactions supporting each revenue stream to determine the impact of accounting treatment under ASU 2014-09, an evaluation of the method of adoption and assessing changes that might be necessary to information technology systems, processes and internal controls to capture new data and address changes in financial reporting. We adopted this standard effective as of January 1, 2018 and have concluded that the adoption of this guidance did not have an impact on our financial position or results of operations. We concluded this standard will have an impact on the disclosure of gain/loss on sale of real estate investments upon the adoption of the update ASU 2014-09, but will not have an impact on “total real estate rental income.”

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which amends existing accounting standards for lease accounting, including by requiring lessees to recognize most leases on the balance sheet and making certain changes to lessor accounting. The standard will take effect for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 with earlier application permitted. In January 2018, the FASB released an exposure

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draft to ASU No. 2016-02 that if issued in its current form would (1) simplify transition requirements for both lessees and lessors by adding an option that would permit an organization to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements and, (2) provide a practical expedient for lessors that would permit lessors to not be required to separate nonlease components from the associated lease components if certain conditions are met. The Company is evaluating the impact of ASU No. 2016-02 on its financial position and results of operations.

In November 2016, the FASB issued ASU No. 2016-18 to require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents will be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 was effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years and early adoption was permitted. The pronouncement requires a retrospective transition method of adoption. We adopted this standard effective January 1, 2018. Upon adoption, the Company included amounts generally described as restricted cash within the beginning-of-period, change and end-of-period total amounts on the statement of cash flows rather than within an activity on the statement of cash flows.

In August 2016, the FASB issued ASU No. 2016-15 to provide guidance for areas where there is diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We adopted this standard effective January 1, 2018 and have concluded that the adoption of this guidance did not have an impact on our financial position or results of operations, since the cumulative earnings approach for distributions received from equity method investees would continue to be utilized.

The new standards must be applied retrospectively to all periods presented in the financial statements. The Company adopted the new standard effective January 1, 2018 and will continue to apply the cumulative earnings approach for distributions received from equity method investees. While overall cash flows did not change, there were changes between cash flow classifications due primarily to restricted deposits. As of June 30, 2017, the following cash flows were reclassified:

	Six Months Ended June 30, 2017		
	As Originally Presented	Reclassification Adjustments	As Presented Herein
	(in thousands)		
Cash Flows from Operating Activities:			
Restricted deposits - tenant security deposits	\$ (203)	\$ 203	\$ —
Restricted deposits - real estate tax and insurance escrow	\$ 905	\$ (905)	\$ —
Net cash provided by operating activities	\$ 16,667	\$ (702)	\$ 15,965
Cash Flows from Investing Activities			
Restricted deposits - exchange escrow	\$ (4,328)	\$ 4,328	\$ —
Restricted deposits - replacement reserves	\$ (1,006)	\$ 1,006	\$ —
Purchase of real estate investment properties	\$ (2,008)	\$ 83	\$ (1,925)
Net cash provided by Investing activities	\$ (6,219)	\$ 5,417	\$ (802)
Cash and cash equivalents, beginning of period	\$ 12,034		
(adjustments for restricted deposits, beginning of period)		\$ 7,236	
Cash and cash equivalents and restricted deposits, beginning of period			\$ 19,270
Cash and cash equivalents, end of period	\$ 16,580		
(adjustments for restricted deposits, end of period)		\$ 11,951	
Cash and cash equivalents and restricted deposits, end of period			\$ 28,531

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Management does not believe that any other recently issued, but not yet effective accounting pronouncements, if adopted, would have a material effect on the accompanying Consolidated Financial Statements.

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 real estate segment revenues less real estate expenses (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. The accounting policies of each segment are consistent with those described in Note 2 of this report.

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 six months ended June 30, 2018 and 2017, 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 June 30, 2018			Three months ended June 30, 2017		
	Residential	Commercial	Total	Residential	Commercial	Total
	(in thousands)			(in thousands)		
Income from rental operations	\$ 22,644	\$ 6,644	\$ 29,288	\$ 21,667	\$ 6,846	\$ 28,513
Expenses from rental operations	13,386	1,863	15,249	11,247	1,741	12,988
Net operating income	<u>\$ 9,258</u>	<u>\$ 4,781</u>	<u>\$ 14,039</u>	<u>\$ 10,420</u>	<u>\$ 5,105</u>	<u>\$ 15,525</u>
Interest			4,576			4,609
Depreciation and amortization			5,283			5,381
Administration of REIT			1,089			1,820
Loss on lease terminations			—			31
Other (income)/expense			(1,886)			(4,606)
Net income			<u>\$ 4,977</u>			<u>\$ 8,290</u>

	Six months ended June 30, 2018			Six months ended June 30, 2017		
	Residential	Commercial	Total	Residential	Commercial	Total
	(in thousands)			(in thousands)		
Income from rental operations	\$ 44,994	\$ 13,524	\$ 58,518	\$ 42,715	\$ 13,828	\$ 56,543
Expenses from rental operations	25,595	3,630	29,225	22,867	3,575	26,442
Net operating income	<u>\$ 19,399</u>	<u>\$ 9,894</u>	<u>\$ 29,293</u>	<u>\$ 19,848</u>	<u>\$ 10,253</u>	<u>\$ 30,101</u>
Interest			9,076			9,248
Depreciation and amortization			10,633			10,744
Administration of REIT			2,243			3,323
Loss on lease terminations			—			146
Other (income)/expense			(2,895)			(4,850)
Net income			<u>\$ 10,236</u>			<u>\$ 11,490</u>

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Segment Assets and Accumulated Depreciation

As of June 30, 2018	Residential	Commercial	Total
	(in thousands)		
Real estate investments	\$ 567,593	\$ 193,199	\$ 760,792
Accumulated depreciation	(83,163)	(35,828)	(118,991)
	<u>\$ 484,430</u>	<u>\$ 157,371</u>	<u>641,801</u>
Cash and cash equivalents			13,809
Restricted deposits and funded reserves			10,507
Investment in unconsolidated affiliates			2,649
Receivables and other assets			6,304
Financing and lease costs, less accumulated amortization			706
Intangible assets, less accumulated amortization			11,459
Total Assets			<u>\$ 691,930</u>

As of December 31, 2017	Residential	Commercial	Total
	(in thousands)		
Real estate investments	\$ 557,309	\$ 202,394	\$ 759,703
Accumulated depreciation	(76,404)	(34,622)	(111,026)
	<u>\$ 480,905</u>	<u>\$ 167,772</u>	<u>648,677</u>
Cash and cash equivalents			12,490
Restricted deposits and funded reserves			8,063
Investment in unconsolidated affiliates			2,772
Receivables and other assets			5,603
Financing and lease costs, less accumulated amortization			737
Intangible assets, less accumulated amortization			13,263
Total Assets			<u>\$ 691,605</u>

NOTE 4 – REAL ESTATE INVESTMENTS

As of June 30, 2018	Residential	Commercial	Total
	(in thousands)		
Land and land improvements	\$ 73,746	\$ 36,466	\$ 110,212
Building and improvements	462,424	155,267	617,691
Furniture, fixtures and equipment	25,491	1,466	26,957
Construction in progress	5,932	—	5,932
	<u>567,593</u>	<u>193,199</u>	<u>760,792</u>
Less accumulated depreciation	(83,163)	(35,828)	(118,991)
	<u>\$ 484,430</u>	<u>\$ 157,371</u>	<u>\$ 641,801</u>

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As of December 31, 2017	Residential	Commercial	Total
		(in thousands)	
Land and land improvements	\$ 73,109	\$ 37,841	\$ 110,950
Building and improvements	457,443	163,087	620,530
Furniture, fixtures and equipment	25,381	1,466	26,847
Construction in progress	1,376	—	1,376
	557,309	202,394	759,703
Less accumulated depreciation	(76,404)	(34,622)	(111,026)
	<u>\$ 480,905</u>	<u>\$ 167,772</u>	<u>\$ 648,677</u>

Construction in progress as of June 30, 2018 consists primarily of development and planning costs associated with phase III of a multifamily apartment community under construction in Bismarck, North Dakota and a project to rebuild a multifamily apartment building destroyed by fire in Omaha, Nebraska. Phase I and II of the Bismarck development are completed and Phase III is still in the planning stages and construction has not yet commenced. The Omaha project has commenced and will consist of one 18-unit building. We have a construction contract of \$2,031 for the Omaha project, of which \$1,907 has been completed to date, including \$170 of retainage which is included in payables at June 30, 2018. The Omaha project was completed in the third quarter of 2018.

NOTE 5 - 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 June 30, 2018	Lease Intangibles	Accumulated Amortization	Lease Intangibles, net
		(in thousands)	
Lease Intangible Assets			
In-place leases	\$ 21,958	\$ (12,360)	\$ 9,598
Above-market leases	3,104	(1,243)	1,861
	<u>\$ 25,062</u>	<u>\$ (13,603)</u>	<u>\$ 11,459</u>
Lease Intangible Liabilities			
Below-market leases	<u>\$ (3,095)</u>	<u>\$ 1,487</u>	<u>\$ (1,608)</u>
 As of December 31, 2017	 Lease Intangibles	 Accumulated Amortization	 Lease Intangibles, net
Lease Intangible Assets		(in thousands)	
In-place leases	\$ 23,080	\$ (11,797)	\$ 11,283
Above-market leases	3,115	(1,135)	1,980
	<u>\$ 26,195</u>	<u>\$ (12,932)</u>	<u>\$ 13,263</u>
Lease Intangible Liabilities			
Below-market leases	<u>\$ (3,162)</u>	<u>\$ 1,386</u>	<u>\$ (1,776)</u>

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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)	
2018 (July 1, 2018 to December 31, 2018)	\$ 1,035	\$ 136
2019	1,854	264
2020	1,429	213
2021	1,132	184
2022	998	164
Thereafter	5,011	647
	<u>\$ 11,459</u>	<u>\$ 1,608</u>

The weighted average amortization period for the intangible assets, in-place leases, above-market leases, and below-market leases acquired as of June 30, 2018 was 6.0 years.

NOTE 6 – LINES OF CREDIT

We have a \$27,000 variable rate (1-month LIBOR plus 2.25%) line of credit agreement with Wells Fargo Bank, which expired in June 2018; subsequent to June 30, 2018 the line of credit was renewed at \$18,300 variable rate (1-month LIBOR plus 2.25%), which expires in June 2021; a \$6,315 variable rate (prime rate less 0.5%) line of credit agreement with Bremer Bank, which expires in November 2019; a \$5,000 variable rate (floating LIBOR plus 2.00%) line of credit agreement with Bremer Bank, which expires June 2022; and a \$3,200 variable rate (LIBOR plus 2.04%) line of credit agreement with Bank of the West, which expires November 2020. The lines of credit are secured by properties in Duluth, Edina, Moorhead and St. Cloud, Minnesota; and Bismarck, Dickinson, Grand Forks and Fargo, North Dakota. At June 30, 2018, there was no balance outstanding on the lines of credit, leaving \$32,815 available and unused under the agreements. Certain of the variable lines of credit have limits on availability based on collateral specific criteria.

Certain line of credit agreements includes covenants that, in part, impose maintenance of certain debt service coverage and debt to net worth ratios. As of June 30, 2018, we were in compliance with all covenants.

NOTE 7 - MORTGAGE NOTES PAYABLE

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

	Principal Balance At	
	June 30, 2018	December 31, 2017
	(in thousands)	
Fixed rate mortgage notes payable (a)	\$ 396,408	\$ 397,567
Less unamortized debt issuance costs	2,473	2,724
	<u>\$ 393,935</u>	<u>\$ 394,843</u>

(a) Includes \$890 and \$913 of variable rate mortgage debt that was swapped to a fixed rate at June 30, 2018 and December 31, 2017, respectively.

As of June 30, 2018, we had 121 mortgage loans with effective interest rates ranging from 3.44% to 7.25% per annum and a weighted average effective interest rate of 4.40% per annum.

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As of December 31, 2017, we had 122 mortgage loans with effective interest rates ranging from 3.44% to 7.25% per annum, and a weighted average effective interest rate of 4.39% per annum.

The majority of the Company's mortgages payable require monthly payments of principal and interest. Certain mortgages require reserves for real estate taxes and certain other costs. Mortgages are secured by the respective properties, assignment of rents, business assets, deeds to secure debt, deeds of trust and/or cash deposits.

Certain mortgage note agreements include covenants that, in part, impose maintenance of certain debt service coverage and debt to net worth ratios. As of June 30, 2018, we were in compliance with all covenants.

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)
2018 (July 1, 2018 to December 31, 2018)	\$ 8,882
2019	25,460
2020	28,144
2021	46,040
2022	31,321
Thereafter	256,561
Total payments	\$ 396,408

NOTE 8 – HEDGING ACTIVITIES

As part of our interest rate risk management strategy, we have used derivative instruments to minimize significant unanticipated earnings fluctuations that may arise from rising variable interest rate costs associated with existing borrowings. To meet these objectives, we entered into an interest rate swap in the notional amount of \$1,294 to provide a fixed rate of 7.25% that matures in April 2020. The swap was issued at approximate market terms and thus no fair value adjustment was recorded at inception.

The carrying amount of the swap has been adjusted to its fair value at the end of the quarter, which because of changes in forecasted levels of LIBOR, resulted in reporting a liability for the fair value of the future net payments forecasted under the swaps. The interest rate swap is accounted for as an effective hedge in accordance with ASC 815-20 whereby it is recorded at fair value and changes in fair value are recorded to accumulated comprehensive income. As of June 30, 2018 and December 31, 2017, we recorded a liability and other accumulated comprehensive loss of \$42 and \$65, respectively.

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NOTE 9 - FAIR VALUE MEASUREMENT

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

	June 30, 2018		December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(in thousands)			
Financial liabilities:				
Mortgage notes payable, net	\$ 393,935	\$ 390,287	\$ 394,843	\$ 396,261
Fair value of interest rate swaps	\$ 42	\$ 42	\$ 65	\$ 65

The carrying values shown in the table are included in the consolidated balance sheets under the indicated captions.

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 Company'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.

	Level 1	Level 2	Level 3	Total
	(in thousands)			
June 30, 2018				
Fair value of interest rate swaps	\$ —	\$ 42	\$ —	\$ 42
December 31, 2017				
Fair value of interest rate swaps	\$ —	\$ 65	\$ —	\$ 65

Fair value of interest rate swaps: The fair value of interest rate swaps is determined using a discounted cash flow analysis on the expected future cash flows of the derivative. This analysis utilizes observable market data including forward yield curves and implied volatilities to determine the market's expectation of the future cash flows of the variable component. The fixed and variable components of the derivative are then discounted using calculated discount factors developed based on the LIBOR swap rate and are aggregated to arrive at a single valuation for the period. The Company also incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements.

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Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of June 30, 2018 and December 31, 2017, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation. As a result, the Company has determined that its derivative valuations in their entirety are classified 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. The Company's derivative instruments are further described in Note 8.

Fair Value Disclosures

The following table presents the Company'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.

	Level 1	Level 2	Level 3	Total
	(in thousands)			
June 30, 2018				
Mortgage notes payable, net	\$ —	\$ —	\$ 390,287	\$ 390,287
December 31, 2017				
Mortgage notes payable, net	\$ —	\$ —	\$ 396,261	\$ 396,261

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 Company for similar debt instruments of comparable maturities by the Company's lenders. Judgment is used in determining the appropriate rate for each of the Company's individual mortgages and notes payable based upon the specific terms of the agreement, including the term to maturity, the quality and nature of the underlying property and its leverage ratio. The rates used range from 4.67% to 4.79% and from 4.20% to 4.52% at June 30, 2018 and December 31, 2017, respectively. The fair value of the Company's matured mortgage notes payable were determined to be equal to the carrying value of the properties because there is no market for similar debt instruments and the properties' carrying value was determined to be the best estimate of fair value as of June 30, 2018 and December 31, 2017. The Company's mortgage notes payable are further described in Note 7.

NOTE 10 – NONCONTROLLING INTEREST OF UNITHOLDERS IN OPERATING PARTNERSHIP

As of June 30, 2018 and December 31, 2017, outstanding limited partnership units totaled 17,555,000 and 17,517,000 respectively. As of June 30, 2018 and 2017, the operating partnership declared distributions of \$4,465 and \$4,340 respectively, to limited partners which were paid on July 16, 2018 and July 17, 2017, respectively. Distributions per unit were \$0.508750 and \$0.4950 during the six months ended June 30, 2018 and 2017, respectively.

During the six months ended June 30, 2018, there were no limited partnership units exchanged for common shares pursuant to redemption requests. During the six months ended June 30, 2017, Sterling exchanged 8,000 common shares for 8,000 limited partnership units held by limited partners, pursuant to redemption requests. The aggregate value of these transactions was \$133.

At the sole and absolute discretion of the limited partnership, and so long our redemption plans exist, and applicable holding periods are met, Limited Partners may request the operating partnership redeem their limited partnership units. The operating partnership may choose to offer the Limited Partner: (i) cash for the redemption or, at the request of the Limited Partner, (2) offer shares in lieu of cash for the redemption on a basis of one limited partnership unit for one Sterling

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common share (the “Exchange Request”). The Exchange Request shall be exercised pursuant to a Notice of Exchange. If the issuance of Sterling common shares pursuant to an Exchange Request will cause the shareholder to exceed the ownership limitations, among other reasons, payment will be made to the Limited Partner in cash. No Limited Partner may exercise an Exchange Request more than twice during any calendar year, and Exchange Requests may not be made for less than 1,000 limited partnership units. If a Limited Partner owns fewer than 1,000 limited partnership units, all of the limited partnership units held by the Limited Partner must be exchanged pursuant to the Exchange Request.

NOTE 11 – REDEMPTION PLANS

Our Board of Trustees has approved redemption plans that enable our shareholders to sell their common shares and the partners of our operating partnership to sell their limited partnership units to us, after they have held the securities for at least one year and subject to other conditions and limitations described in the plans.

Our redemption plans currently provide that the maximum amount that can be redeemed under the plan is \$35,000 worth of securities. Currently, the fixed redemption price is \$17.50 per share or unit under the plans, which price became effective January 1, 2018.

We may redeem securities under the plans provided that the aggregate total has not been exceeded and we have sufficient funds to do so. The plans 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 plans, either or both of them, if it determines to do so in its sole discretion.

During the six months ended June 30, 2018 and 2017, the Company redeemed 49,000 and 31,000 common shares valued at \$858 and \$471. In addition, during the six months ended June 30, 2018 and 2017, the Company redeemed 46,000 and 42,000 units valued at \$805 and \$638.

NOTE 12 – BENEFICIAL INTEREST

We are authorized to issue 100,000,000 common shares of beneficial interest with \$0.01 par value and 50,000,000 preferred shares with \$0.01 par value, which collectively represent the entire beneficial interest of Sterling. As of June 30, 2018 and December 31, 2017, there were 8,715,000 and 8,488,000 common shares outstanding, respectively. We had no preferred shares outstanding as of either date.

Dividends paid to holders of common shares were \$0.508750 per share and \$0.4950 per share for the six months ended June 30, 2018 and 2017, respectively.

NOTE 13 – DIVIDEND REINVESTMENT PLAN

Our Board of Trustees approved a dividend reinvestment plan to provide existing holders of our common shares with a method to purchase additional common shares without payment of brokerage commissions, fees or service charges. On July 20, 2012, we registered with the Securities Exchange Commission 2,000,000 common shares to be issued under the plan on Form S-3D, which automatically became effective on July 20, 2012. On July 11, 2017, we registered with the Securities Exchange Commission an additional 2,000,000 common shares to be issued under the plan on Form S-3D, which automatically became effective on July 11, 2017.

Under this plan, eligible shareholders may elect to have all or a portion (but not less than 25%) of the cash dividends they receive automatically reinvested in our common shares. If an eligible shareholder elects to reinvest cash dividends under the plan, the shareholder may also make additional optional cash purchases of our common shares, not to exceed \$10 per

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fiscal quarter without our prior approval. The purchase price per common share under the plan equals 95% of the estimated value per common share for dividend reinvestments and equals 100% of the estimated value per common share for additional optional cash purchases, as determined by our Board of Trustees. In addition, participants may not, in any calendar year, purchase or receive via transfer more than \$40 in Common Shares derived from the rights granted to Participants. The estimated value per common share was \$18.50 and \$16.50 at June 30, 2018 and December 31, 2017, respectively. See discussion of determination of estimated value in Note 17. Therefore, the purchase price per common share for dividend reinvestments was \$17.58 and \$15.68 and for additional optional cash purchases was \$18.50 and \$16.50 at June 30, 2018 and December 31, 2017, respectively.

The Board, in its sole discretion, may amend, suspend or terminate the plan at any time, without the consent of shareholders, upon a ten-day notice to participants.

In the six months ended June 30, 2018, 159,000 shares were issued pursuant to dividend reinvestments and 117,000 shares were issued pursuant to additional optional cash purchases under the plan. In the six months ended June 30, 2017, 165,000 shares were issued pursuant to dividend reinvestments and 84,000 shares were issued pursuant to additional optional cash purchases under the plan.

NOTE 14 – RELATED PARTY TRANSACTIONS

Property Management Fees

During the six months ended June 30, 2018 and 2017, we paid property management fees to GOLDMARK Property Management in an amount equal to 5% of rents of the properties managed by GOLDMARK. GOLDMARK Property Management is owned in part by Kenneth Regan and James Wieland. For the six months ended June 30, 2018 and 2017, we paid management fees of \$6,409 and \$5,560, respectively, to GOLDMARK Property Management. In addition, during the six months ended June 30, 2018 and 2017, we paid repair and maintenance related payroll and payroll related expenses to GOLDMARK Property Management totaling \$2,581 and \$2,379, respectively.

Board of Trustee Fees

We incurred Trustee fees of \$34 and \$32 during the six months ended June 30, 2018 and 2017, respectively. As of June 30, 2018, and December 31, 2017 we owed our Trustees \$30 and \$23 for unpaid board of trustee fees, respectively. There is no cash retainer paid to Trustees. Instead, we pay Trustees specific amounts for meetings attended.

The plan provides:

Board Chairman – Board Meeting	105 shares/meeting
Trustee – Board Meeting	75 shares/meeting
Committee Chair – Committee Meeting	30 shares/meeting
Trustee – Committee Meeting	30 shares/meeting

Common shares earned in accordance with the plan are calculated on an annual basis. Shares earned pursuant to the Trustee Compensation Plan are issued on or about July 15 for Trustees' prior year of service. Non-independent Trustees are not compensated for their service on the Board or Committees.

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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 following is a brief description of the current fees and compensation that may be received by the Advisor 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 29, 2018, effective January 1, 2018, and amended on June 21, 2018.

Management Fee : 0.35% of our total assets (before depreciation and amortization), annually. Total assets are our gross assets (before depreciation and amortization) as reflected on our consolidated financial statements, taken as of the end of the fiscal quarter last preceding the date of computation. The management fee will be payable monthly in cash or our common shares, at the option of the Advisor, not to exceed one-twelfth of 0.35% of the total assets as of the last day of the immediately preceding month. The management fee calculation is subject to quarterly and annual reconciliations. The management fee may be deferred at the option of the Advisor, without interest.

Acquisition Fee : For its services in investigating and negotiating acquisitions of investments for us, the Advisor receives an acquisition fee of 2.5% of the purchase price of each property acquired, capped at \$375 per acquisition. The total of all acquisition fees and acquisition expenses cannot exceed 6% of the purchase price of the investment, unless approved by a majority of the trustees, including a majority of the independent trustees, if they determine the transaction to be commercially competitive, fair and reasonable to us.

Disposition Fee : For its services in the effort to sell any investment for us, the Advisor receives a disposition fee of 2.5% of the sales price of each property disposition, capped at \$375 per disposition.

Financing Fee : 0.25% of all amounts made available to us pursuant to any loan, refinance (excluding rate and/or term modifications of an existing loan with the same lender), line of credit or other credit facility. The finance fee shall be capped at \$38 per loan, refinance, line of credit or other credit facility.

Development Fee : Based on regressive sliding scale (starting at 5% and declining to 3%) of total project costs, excluding cost of land, for development services requested by us.

Total Cost	Fee	Range of Fee	Formula
0 – 10M	5.0 %	0 – .5M	$0M - 5.0\% \times (TC - 0M)$
10M - 20M	4.5 %	.5 M – .95M	$.50M - 4.5\% \times (TC - 10M)$
20M – 30M	4.0 %	.95 M – 1.35M	$.95M - 4.0\% \times (TC - 20M)$
30M – 40M	3.5 %	1.35 M – 1.70M	$1.35M - 3.5\% \times (TC - 30M)$
40M – 50M	3.0 %	1.70 M – 2.00M	$1.70M - 3.0\% \times (TC - 40M)$

TC = Total Project Cost

Management Fees

During the six months ended June 30, 2018 and 2017, we incurred advisory management fees of \$1,440 and \$1,400 with Sterling Management, LLC, our Advisor. As of June 30, 2018 and December 31, 2017, we owed our Advisor \$483 and \$238, respectively, for unpaid advisory management fees. These fees cover the office facilities, equipment, supplies, and staff required to manage our day-to-day operations. During the six months ended June 30, 2018 and 2017, we reimbursed the Advisor for operating costs totaling \$15 and \$5, respectively.

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Acquisition Fees

During the six months ended June 30, 2018 and 2017, we incurred acquisition fees of \$114 and \$503, respectively, with our Advisor. There were no acquisition fees owed to our Advisor as of June 30, 2018 or December 31, 2017.

Financing Fees

During the six months ended June 30, 2018 and 2017, we incurred financing fees of \$25 and \$54 with our Advisor for loan financing and refinancing activities. As of June 30, 2018, we owed our Advisor \$21 for unpaid financing fees. There were no financing fees owed to our Advisor as of December 31, 2017.

Disposition Fees

During the six months ended June 30, 2018 and 2017, we incurred \$130 and \$110 in disposition fees with our Advisor, respectively. See Note 16. There were no disposition fees owed to our Advisor as of June 30, 2018 or December 31, 2017.

Development Fees

During the six months ended June 30, 2018, there were no development fees incurred with our Advisor. During the six months ended June 30, 2017, we incurred \$344 in development fees incurred with our Advisor. As of both June 30, 2018, and December 31, 2017, we owed our Advisor a total of \$104 for unpaid development fees, of which the entire amount was for unpaid development fees as part of a 10% hold back, respectively.

Operating Partnership Units Issued in Connection with Acquisitions

During the six months ended June 30, 2018, we issued directly or indirectly 42,000 operating partnership units to an entity affiliated with Messr. Regan, one of our trustees, in connection with the acquisition of a property. The aggregate value of these units was \$773.

During the six months ended June 30, 2017, we issued directly or indirectly 402,000 operating partnership units to entities affiliated with Messrs. Regan and Wieland, two of our trustees, and Messr. Swenson, one of our former officers, in connection with the acquisition of various properties. The aggregate value of these units was \$6,425.

Commissions

During the six months ended June 30, 2018, there were no real estate commissions incurred that were owed to GOLDMARK Commercial Real Estate Services, Inc. (f/k/a GOLDMARK SCHLOSSMAN Commercial Real Estate Services, Inc.) which is controlled by Messrs. Regan and Wieland. During the six months ended June 30, 2017, we incurred real estate commissions of \$549 owed to GOLDMARK Commercial Real Estate Services, Inc., which is controlled by Messrs. Regan and Wieland. There were no outstanding commissions owed as of June 30, 2018 and December 31, 2017.

Rental Income

During the six months ended June 30, 2018 and 2017, we received rental income of \$25 and \$23, respectively, under an operating lease agreement with our Advisor.

During the six months ended June 30, 2018 and 2017, we received rental income of \$27 and \$27, respectively, under an operating lease agreement with GOLDMARK Commercial Real Estate Services, Inc.

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During the six months ended June 30, 2018 and 2017, we received rental income of \$115 and \$109, respectively, under operating lease agreements with GOLDMARK Property Management.

Construction Costs

There were no constructions costs incurred during the six months ended June 30, 2018 to GOLDMARK Development, which is controlled by Messrs. Regan and Wieland. As of December 31, 2017, since Phase II of the Bismarck, North Dakota development project's inception through its completion in August 2017, we incurred total costs of \$8,997 related to the construction of a clubhouse and six 6-plex two-story townhomes to GOLDMARK Development. There was no retainage or unpaid construction fees owed to GOLDMARK Development as of June 30, 2018 and December 31, 2017.

NOTE 15 - 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 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 Company 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 Company.

NOTE 16 – DISPOSITIONS

During the six months ended June 30, 2018, the Company entered into two purchase agreements to sell one retail property located in Austin, Texas and one office property located in Bismarck, North Dakota. These properties qualified for held for sale accounting treatment on or prior to June 30, 2018, at which time depreciation and amortization ceased. As such, the assets and liabilities associated with these properties were separately classified as held for sale in the consolidated

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balance sheet as of June 30, 2018. Subsequent to June 30, 2018, the operating partnership sold the retail property in Austin, Texas for approximately \$3,615 and sold the office property in Bismarck, North Dakota for approximately \$4,250.

During the six months ended June 30, 2018, the operating partnership sold an industrial property located in Redwood Falls, Minnesota for approximately \$5,200 and recognized a gain of \$1,084.

During the second quarter ended June 30, 2017, the operating partnership sold the Fargo, North Dakota retail property for approximately \$4,400 and recognized a gain of \$2,072.

The following table presents the assets and liabilities associated with the investment properties held for sale:

	June 30, 2018	December 31, 2017
	(in thousands)	
ASSETS		
Real estate investments	\$ 4,411	\$ —
Receivables	119	—
Financing and lease costs, less accumulated amortization of \$85 in 2018	7	—
Lease intangible assets, less accumulated amortization of \$219 in 2018	158	—
Total Assets	\$ 4,695	\$ —
LIABILITIES		
Special assessments payable	\$ 16	\$ —
Unfavorable leases, less accumulated amortization of \$39 in 2018	28	—
Accounts payable - trade	7	—
Accrued expenses and other liabilities	41	—
Total Liabilities	\$ 92	\$ —

NOTE 17 – ACQUISITIONS

The Company closed on the following acquisitions during the six months ended June 30, 2018:

Date	Property Name	Location	Property Type	Units/ Square Footage/ Acres	Acquisition Price	Prorata Acquisition Price
3/1/18	Thunder Creek Apartments	Fargo, ND	Apartment complex	57 units	\$ 4,460	\$ 4,460 (a)

(a) Acquisition price does not include capitalized costs and adjustments of \$119.

Total consideration given for acquisitions through June 30, 2018 was completed through issuing approximately 84,000 limited partnership units of the operating partnership valued at \$18.50 per unit for an aggregate consideration of approximately \$1,546, assumed liabilities of \$54 and cash of \$2,979. 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.

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The Company closed on the following acquisitions during the six months ended June 30, 2017:

Date	Property Name	Location	Property Type	Units/ Square Footage/ Acres	Acquisition Price	Prorata Acquisition Price
1/10/17	Sargent Apartments	Fargo, ND	Apartment complex	36 units	\$ 1,710	\$ 1,710
1/11/17	Arrowhead Apartments	Grand Forks, ND	Apartment complex	82 units	5,494	5,494
1/17/17	West Oak Apartments	Fargo, ND	Apartment complex	18 units	777	777
1/17/17	Carr Apartments	Fargo, ND	Apartment complex	18 units	828	828
5/1/17	Plumtree Apartments	Fargo, ND	Apartment complex	18 units	907	907
5/1/17	Sunchase Apartments	Fargo, ND	Apartment complex	36 units	1,765	1,765
6/1/17	Essex Apartments	Fargo, ND	Apartment complex	18 units	858	858
6/1/17	Jadestone Apartments	Fargo, ND	Apartment complex	18 units	809	809
6/1/17	Park Circle Apartments	Fargo, ND	Apartment complex	18 units	903	903
					<u>\$ 14,051</u>	<u>\$ 14,051</u>

Total consideration given for acquisitions through June 30, 2017 was completed through issuing approximately 603,000 limited partnership units of the operating partnership valued at \$16.00 per unit for an aggregate consideration of approximately \$9,651, new loans of \$2,392 and cash of \$2,008. 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.

In addition, as of May 1, 2017, the operating partnership acquired the remaining 59.74% ownership interest in a 144 unit property which was previously held as tenant in common (See Note 2). We estimated the property had a fair value of approximately \$10,080. The operating partnership assumed a loan of \$1,295 and issued \$4,727 of limited partnership units for a total purchase price of approximately \$6,022. The Company accounted for this as a business combination and recognized a gain on change in control of real estate investment of \$2,186 in the second quarter of 2017 as a result of remeasuring the carrying value to fair value. The total loan on this property was \$2,167, thus in addition to the portion of the loan assumed from the other tenant in common, the Company also recorded an additional \$872 in new financing related to this acquisition.

The following table summarizes the acquisition date fair values, before prorations, the Company recorded in conjunction with the acquisitions discussed above:

	Six Months Ended June 30,	
	2018	2017
Land, building, tenant improvements and FF&E	\$ 4,579	\$ 14,051
Other liabilities	(54)	-
Net assets acquired	4,525	14,051
Equity/limited partnership unit consideration	(1,546)	(9,651)
New loans	-	(2,392)
Net cash consideration	<u>\$ 2,979</u>	<u>\$ 2,008</u>

Estimated Value of Units/Shares

The Board of Trustees determined an estimate of fair value for the trust shares in the first six months of 2018 and 2017. In addition, the Board of Trustees, acting as general partner for the operating partnership, determined an estimate of fair value for the limited partnership units in the first six months of 2018 and 2017. In determining this value, the Board relied

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upon their experience with, and knowledge about, the Trust's real estate portfolio and debt obligations. The Board typically determines the share price on an annual basis. The trustees determine the price in their discretion and use data points to guide their determination which is typically based on a consensus of opinion. In addition, the Board considers how the price chosen will affect existing share and unit values, redemption prices, dividend coverage ratios, yield percentages, dividend reinvestment factors, and future UPREIT transactions, among other considerations and information.

The Board determined the fair value of the shares and limited partnership units to be \$16.50 per share/unit effective March 29, 2017. The Board determined the fair value of the shares and limited partnership units to be \$18.50 per share/unit effective January 1, 2018.

Determination of price is a matter within the Board's sole discretion. The Trust does not determine price based on any rote formula or specific factors. At this time, no shares are held in street name accounts and the Trust is not subject to FINRA's specific pricing requirements set out in Rule 2340 or otherwise. Thus, the Trust does not employ any specific valuation methodology or formula. Rather, the Board looks to available data and information, which is often adjusted and weighted to comport more closely with the assets held by the Trust at the time of valuation. The principal valuation methodology utilized is the NAV calculation/direct capitalization method. The information made available to the Board is assembled by the Trust's Advisor.

As with any valuation methodology, the methodologies utilized by the Board in reaching an estimate of the value of the shares and limited partnership units are based upon a number of estimates, assumptions, judgments or opinions that may, or may not, prove to be correct. The use of different estimates, assumptions, judgments, or opinions would likely have resulted in significantly different estimates of the value of the shares and limited partnership units. In addition, the Board's estimate of share and limited partnership unit value is not based on the book values of our real estate, as determined by GAAP, as our book value for most real estate is based on the amortized cost of the property, subject to certain adjustments.

Furthermore, in reaching an estimate of the value of the shares and limited partnership units, the Board applied a liquidity discount to one valuation scenario in order to reflect the fact that the shares and limited partnership units are not currently traded on a national securities exchange and did not consider: a discount for debt that may include a prepayment obligation or a provision precluding assumption of the debt by a third party or the costs that are likely to be incurred in connection with an appropriate exit strategy, whether that strategy might be a listing of the limited partnership units or common shares on a national securities exchange or a merger or sale of our portfolio.

NOTE 18 - SUBSEQUENT EVENTS

On July 16, 2018, we paid a dividend or distribution of \$0.254375 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 June 30, 2018.

On July 16, 2018, the operating partnership sold a retail property in Austin, Texas for approximately \$3,615.

On July 20, 2018, the operating partnership sold an office property in Bismarck, North Dakota for approximately \$4,250.

Pending acquisitions and dispositions are subject to numerous conditions and contingencies and there are no assurances that the transactions will be completed.

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.

STERLING REAL ESTATE TRUST AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2018 AND 2017 (UNAUDITED)

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

All dollar amounts in this Form 10-Q in Part I Items 2. through 4 and Part II Items 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

We operate as an Umbrella Partnership Real Estate Investment Trust (UPREIT), which is a REIT that holds all or substantially all of its assets through a partnership which the REIT controls as general partner. Therefore, we hold all or substantially all of our assets through our operating partnership. We control the operating partnership as the sole general partner and own approximately 33.18% of the operating partnership as of June 30, 2018. For purposes of satisfying the asset and income tests for qualification as a REIT for tax purposes, our proportionate shares of the assets and income of our operating partnership are deemed to be assets and income of the trust.

We use this UPREIT structure to facilitate acquisitions of real estate properties. A sale of property directly to a REIT is generally a taxable transaction to the property seller. However, in an UPREIT structure, if a property seller exchanges the property with one of its operating partnerships in exchange for limited partnership units, the seller may defer taxation of gain in such exchange until the seller resells its limited partnership units or exchanges its limited partnership units for the REIT's common stock. By offering the ability to defer taxation, we may gain a competitive advantage in acquiring desired properties over other buyers who cannot offer this benefit. In addition, investing in our operating partnership, rather than directly in Sterling, may be more attractive to certain institutional or other investors due to their business or tax structure. If an investor is interested in making a substantial investment in our operating partnership, our structure provides us the flexibility to accommodate different terms for each investment, while applicable tax laws generally restrict a REIT from charging different fee rates among its shareholders. Finally, if our shares become publicly traded, the former property seller may be able to achieve liquidity for the investment in order to pay taxes.

Operating Partnership

Our operating partnership, Sterling Properties, LLLP, was formed as a North Dakota limited liability limited partnership on April 25, 2003 to acquire, own and operate properties on our behalf. The operating partnership holds a diversified portfolio of multifamily and commercial properties located principally in the upper and central Midwest United States.

As of June 30, 2018, approximately 71.8% of our properties were apartment communities located primarily in North Dakota with others located in Minnesota, Missouri and Nebraska. Most multifamily properties are leased to a variety of tenants under short-term leases.

As of June 30, 2018, approximately 28.2% of our properties were comprised of office, retail, industrial, restaurant and medical commercial property located primarily in North Dakota with others located in Arkansas, Colorado, Iowa, Louisiana, Michigan, Minnesota, Mississippi, Nebraska, Texas and Wisconsin. We have both single and multi-tenant properties in the commercial portfolio, most of which are under long-term leases.

Our real estate portfolio consisted of 166 properties containing 9,458 apartment units and approximately 1,652,000 square feet of leasable commercial space as of June 30, 2018. The portfolio has a net book value of real estate investments (cost less accumulated depreciation) of approximately \$641,801, which includes construction in progress. Sterling's current acquisition strategy and focus is solely on multifamily apartment properties.

Our Board of Trustees and Executive Officers

We operate under the direction of our Board of Trustees, the members of which are accountable to us and our shareholders. Our trustees are elected annually by our shareholders. In addition, the Board has a duty to supervise our relationship with the Advisor and evaluates the performance of and fees paid to the Advisor on an annual basis. The Advisory Agreement was approved by the Board of Trustees (including all the independent trustees), effective January 1, 2018. The agreement currently expires March 31, 2019. Our Board of Trustees has provided investment guidance for the Advisor to follow and must approve each investment recommended by the Advisor. Currently, we have nine members on our board, seven of whom are independent.

Our Advisor

Our external Advisor is Sterling Management, LLC, a North Dakota limited liability company formed on November 14, 2002. Our Advisor, with offices in Fargo, North Dakota, is responsible for managing our day-to-day affairs and for identifying, acquiring and disposing investments on our behalf.

Conflicts of Interest

We are subject to various conflicts of interest arising out of our relationship with our trustees, executive officers, key personnel and our Advisor and its affiliates. Some of the conflicts of interest in our transactions with our Advisor and others are described below.

Our trustees and officers and the officers and key personnel of our Advisor (herein individually and collectively our "Leadership") may spend a portion of their time on activities unrelated to us, which may significantly reduce the amount of time to be spent by one or more of our Leadership on Sterling activities. Each of our Leadership, including Messrs. Regan and Weiland, is currently expected to spend a significant portion of their time on our behalf, but may not always spend a majority of their time on our behalf.

One or more of our Leadership, including Messrs. Regan and Weiland, may also serve as trustees, directors, governors, members, officers or key personnel of other: (a) affiliated entities, including our Advisor; (b) real estate programs, real estate entities, or REITs; (c) advisors to other real estate programs, real estate entities or REITs; or (d) property managers to real estate programs, real estate entities or REITs (herein collectively "Other Real Estate Related Activities"). In addition, from time to time, members of our Leadership may purchase real estate or interests in real estate for themselves, which may conflict with Sterling's activities or objectives. Leadership's management of Other Real Estate Related Activities may significantly reduce the amount of time our Leadership is able to spend on Sterling related activities. Given Leadership is or may become involved in Other Real Estate Related Activities, there may be times where Sterling's fundraising, acquisition, disposition and liquidation activities overlap with similar activities of Leadership's Other Real Estate Related Activities. This overlap may cause conflicts of interest to arise with respect to, among other things, finding investors, locating and acquiring real estate investments, leasing activities and disposing of investments. The conflicts of interest faced could generally cause our operating results to suffer.

Certain members of Leadership will have fiduciary duties relating to their Other Real Estate Related Activities. These fiduciary duties may conflict with Leadership's duties to Sterling and its shareholders. Leadership's Other Real Estate Related Activities could result in actions or inactions detrimental to Sterling, which could harm the implementation of Sterling's business strategies and Sterling's investments. If Sterling does not successfully implement its business strategy, we may be unable to generate cash needed to pay dividends to shareholders and to maintain or increase the value of our assets.

Conflicts with Sterling's business and interests are most likely to arise from Leadership's involvement in activities related to: (a) allocation of new investments and management time and services between Sterling and Leadership's Other

Real Estate Related Activities, (b) allocation of time and services between Sterling and Leadership's Other Real Estate Related Activities; (c) Sterling's purchase of properties from, or sale of properties to, affiliated entities, (d) the timing and terms of the investment in or sale of an asset, (e) development of our properties by affiliates, (f) investments with or activities of affiliates of our Advisor and (g) compensation to our Advisor.

To the extent Leadership engages in future Other Real Estate Related Activities, Sterling may compete for investors with such activities. Any overlap of capital raising efforts of Other Real Estate Related Activities with Sterling's capital raising efforts or other activities could adversely affect our ability to raise capital in the future and the amount of proceeds we have to spend on real estate investments.

Sterling may, in the future, purchase real estate investments at the same time as Leadership is purchasing real estate investments via Other Real Estate Related Activities. As a result, Leadership may owe duties to both Sterling and the Other Real Estate Related Activities, their members and limited partners and these investors, which duties may from time to time conflict with the duties they owe to Sterling and its shareholders.

Leadership may engage for their own account in business activities of the types conducted or to be conducted by Sterling or our subsidiaries. To the extent Leadership takes actions that are more favorable to other entities than to us, these actions could have a negative impact on Sterling's financial performance and, consequently, on dividends to our shareholders and the value of our stock.

Interests in Other Real Estate Programs

Leadership and entities owned by Leadership may, in the future, acquire real estate investments for their own accounts, and have done so in the past. Furthermore, Leadership and entities owned or managed by Leadership may form additional real estate investment entities in the future, including additional REITs, which can be expected to have the same or similar investment objectives and policies as we do, and which may be involved in the same geographic areas. Leadership is not obligated to present to us any particular investment opportunity that comes to their attention, unless such opportunity is of a character that might be suitable for investment by us. Leadership likely will experience conflicts of interest as they simultaneously perform services for us and Other Real Estate Related Activities.

Any affiliated entity, whether or not currently existing, could compete with us in the purchase, sale or operation of real estate investments. We will seek to achieve any operating efficiency or similar savings that may result from affiliated management of competitive investments. However, to the extent that affiliates own or acquire an investment that is adjacent or its underlying property is adjacent, or in close proximity, to a property we own, our property may compete with the affiliate's property for tenants or purchasers. Every transaction that we enter into with Leadership is subject to an inherent conflict of interest. Leadership may encounter conflicts of interest in enforcing our rights against any affiliate in the event of a default by or disagreement with an affiliate or in invoking powers, rights or options pursuant to any agreement between us and our Advisor or any of its affiliates.

Other Activities of Our Advisor and Its Affiliates

We rely on our Advisor for the day-to-day operation of our business. As a result of the current and/or future interests of Leadership in any other program and the fact that they also are engaged, or may continue to engage, in Other Real Estate Related Activities, Leadership has conflicts of interest in allocating their time between us and any other programs and other activities in which they are involved. Our Advisor presently believes that it and its affiliates have sufficient personnel to discharge fully their responsibilities to all of the sponsored programs and other ventures in which they are or may become involved.

In addition, each of our executive officers also serves or may serve in the future as an officer of one or more affiliated entities, including our Advisor, and/or other affiliated entities. As a result, these individuals owe or will owe fiduciary duties to these other entities, which may conflict with the fiduciary duties that they owe to us and our shareholders.

We may purchase real estate investments from affiliates of our Advisor. The prices we pay to affiliates of our Advisor for these investments will not be the subject of arm's-length negotiations, which could mean that the acquisitions may be on terms less favorable to us than those negotiated with unaffiliated parties.

Competition in Acquiring, Leasing and Operating of Properties

Conflicts of interest will exist to the extent Sterling acquires, or seeks to acquire, properties in the same geographic areas where properties owned by Leadership or Leadership's Other Real Estate Related Activities are located. In such a case, a conflict could arise in the acquisition or leasing of properties if we and one of Leadership's Other Real Estate Related Activities were to compete for the same properties or tenants in negotiating leases, or a conflict could arise in connection with the resale of properties if we were to attempt to sell similar properties at the same time.

Conflicts of interest also may exist at such time as we or our affiliates managing property on our behalf seek to employ developers, contractors or building managers, as well as under other circumstances. Leadership will seek to reduce conflicts relating to the employment of developers, contractors or building managers. Leadership will also seek to reduce conflicts that may arise with respect to properties available for sale or rent. However, these conflicts cannot be fully avoided in that there may be established differing compensation arrangements at different properties or differing terms for resales or leasing of the various properties.

Joint Ventures with Affiliates

We may enter into joint ventures with Leadership's Other Real Estate Related Activities (as well as other parties) for the acquisition of real estate investments. Leadership may have conflicts of interest in determining whether its Other Real Estate Related Activity should enter into any particular joint venture agreement. The co-venturer may have economic or business interests or goals which are or which may become inconsistent with Sterling's business interests or goals. In addition, should any such joint venture be consummated, Leadership may face a conflict in structuring the terms of the relationship between Sterling's interests and the interest of the co-venturer and in managing the joint venture. Since Leadership may control both us and any affiliated co-venturer, agreements and transactions between the co-venturers with respect to any such joint venture may not have the benefit of arm's-length negotiation of the type normally conducted between unrelated co-venturers.

Conflict Resolution

Every transaction that we enter into with Leadership will be subject to an inherent conflict of interest. Our Board of Trustees may encounter conflicts of interest in enforcing our rights or options against a member of Leadership in the event of a disagreement.

Critical Accounting Estimates

Preparation of our financial statements requires estimates and judgments to be made that affect the amounts of assets, liabilities, revenues and expenses reported. Such decisions include the selection of the appropriate accounting principles to be applied and the assumptions on which to base accounting estimates. We evaluate these estimates based on assumptions we believe to be reasonable under the circumstances.

There have been no material changes in our Critical Accounting Policies as disclosed in Note 2 to our financial statements for the six months ended June 30, 2018 included elsewhere in this report.

Specific Achievements

- Increased revenues from rental operations by \$1,975 or 3.5% for the six months ended June 30, 2018, compared to same six month period in 2017.
- Acquired one residential apartment property totaling 57 units for a total of \$4,579 during the six months ended June 30, 2018.
- Disposed of an industrial property located in Redwood Falls, Minnesota and recognized a gain of \$1,084 (see Note 16 to the consolidated financial statements).

- Declared and paid dividends aggregating \$0.508750 per common share for the first six months of 2018.

Results of Operations for the Three Months Ended June 30, 2018 and 2017

	Three months ended June 30, 2018			Three months ended June 30, 2017		
	Residential	Commercial (unaudited) (in thousands)	Total	Residential	Commercial (unaudited) (in thousands)	Total
Real Estate Revenues	\$ 22,644	\$ 6,644	\$ 29,288	\$ 21,667	\$ 6,846	\$ 28,513
Real Estate Expenses						
Real Estate Taxes	2,194	704	2,898	1,890	717	2,607
Property Management	3,688	210	3,898	2,803	188	2,991
Utilities	1,859	351	2,210	1,721	327	2,048
Repairs and Maintenance	5,083	574	5,657	4,488	486	4,974
Insurance	562	24	586	345	23	368
Total Real Estate Expenses	13,386	1,863	15,249	11,247	1,741	12,988
Net Operating Income	\$ 9,258	\$ 4,781	14,039	\$ 10,420	\$ 5,105	15,525
Interest			4,576			4,609
Depreciation and amortization			5,283			5,381
Administration of REIT			1,089			1,820
Loss on lease terminations			—			31
Other (income)/expense			(1,886)			(4,606)
Net Income			\$ 4,977			\$ 8,290
Net Income Attributed to:						
Noncontrolling Interest			\$ 3,302			\$ 5,608
Sterling Real Estate Trust			\$ 1,675			\$ 2,682
Dividends per share ⁽¹⁾			\$ 0.254375			\$ 0.2475
Earnings per share			\$ 0.19			\$ 0.33
Weighted average number of common shares			8,720			8,227

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

Revenues

Property revenues of \$29,288 for the three months ended June 30, 2018 increased \$775 or 2.7% in comparison to the same period in 2017. Residential property revenues increased \$977 and commercial property revenues decreased \$202.

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

	June 30, 2018	June 30, 2017
Residential occupancy	94.0 %	95.7 %
Commercial occupancy	95.1 %	97.0 %

Residential revenues for the three months ended June 30, 2018 increased \$977 in comparison to the same period for 2017. Residential properties acquired since January 1, 2017 contributed approximately \$652 to the increase in total residential revenues in the three months ended June 30, 2018. Rental income from residential properties owned for more than one year increased approximately \$325 in comparison to the three months ended June 30, 2017. Residential revenues comprised 77.3% of total revenues for the three months ended June 30, 2018 compared to 76.0% of total revenues for the three months ended June 30, 2017. The residential occupancy rates for the three months ended June 30, 2018 decreased 1.7% primarily due to considerable multifamily development in the Fargo-Moorhead market, which has caused increased competition.

For the three months ended June 30, 2018 total commercial revenues decreased \$202 in comparison to the same period for 2017. Commercial revenues comprised 22.7% of the total revenues for the three months ended June 30, 2018 compared to 24.0% of total revenues for the three months ended June 30, 2017. The commercial occupancy rates for the three months ended June 30, 2018 decreased 1.9% primarily due to vacancy at an office property in Bismarck, North Dakota.

Sterling's portfolio has experienced increased competition from development of new properties in a mature real estate cycle within both the commercial and residential markets. This has contributed to a year-over-year decrease in residential and commercial occupancy of 1.7% and 1.9% respectively, which is still performing favorably above market averages.

Expenses

Residential expenses from operations of \$13,386 during the three months ended June 30, 2018 increased \$2,139 or 19.0% in comparison to the same period in 2017. This increase was attributed to the increase in number of residential properties owned during the three months ended June 30, 2018 versus the same period in 2017. Included within these increases were real estate taxes, which increased \$304 or 16.1% primarily due to real estate tax law changes in North Dakota and increases in property insurance of \$217 or 62.9% due to increased premiums. In addition, we have seen increases in property management fees of \$885 or 31.6%; Our property management fees remain unchanged; however, other property management related expenses have increased due to increased competition for labor and estimates for allowances on uncollectible receivables.

Commercial expenses from operations of \$1,863 during the three months ended June 30, 2018 increased \$122 or 7.0% in comparison to the same period in 2017. The increase was primarily attributed to increases in repairs and maintenance expenses which increased \$88 or 18.1% due to increased snow removal costs at Bismarck, North Dakota and Minneapolis, Minnesota properties.

Interest expense of \$4,576 during the three months ended June 30, 2018 decreased \$33 in comparison to the same period in 2017 due to decreased levels of debt outstanding (an aggregate decrease of \$5,080). Interest expense was approximately 15.6% and 16.2% of rental income for the three months ended June 30, 2018 and 2017, respectively.

Depreciation and amortization expense decreased 1.8% from \$5,381 for the three months ended June 30, 2017 to \$5,283 for the three months ended June 30, 2018. The decrease was primarily a result of a \$88 decrease in amortization related to lease intangibles that are fully amortized. Amortization expense will continue to decrease as lease intangibles become fully amortized.

REIT administration expenses decreased from \$1,820 for the three months ended June 30, 2017 to \$1,089 for the three months ended June 30, 2018 due to a decrease in acquisition expenses. Effective July 1, 2017, acquisitions are considered asset acquisitions and as such, transaction costs are capitalized upon closing. For acquisitions prior to July 1, 2017, which were accounted for as business combinations, the transaction costs totaled \$619 for the three months ended June 30, 2017 and are included in "Acquisition and disposition expenses" in the accompanying consolidated statement of operations and other comprehensive (loss) income.

Net Operating Income

We measure the performance of our segments based on net operating income ("NOI"), which we define as total revenue from rental operations less expenses from rental operations and real estate taxes (excluding depreciation and amortization related to real estate investments and impairment of real estate investments). We believe that NOI is an important supplemental measure of operating performance for a REIT because it provides a measure of core operations unaffected by depreciation, amortization, financing, and administration expense. NOI does not represent cash generated by operating activities in accordance with GAAP and should not be considered an alternative to net income, net income available for non-controlling interests and shareholders of the Trust or cash flow from operating activities as a measure of financial performance.

Residential NOI decreased \$1,162 or 11.2% for the three months ended June 30, 2018 in comparison to the same three month period in 2017 primarily as a result of an increase in operating expenses. Commercial NOI decreased \$324 or 6.3% for the three months ended June 30, 2018 in comparison to the same three month period in 2017. The decrease was primarily due primarily to the sale of a retail property in Fargo, North Dakota in June 2017.

Net Income

Net income for the three months ended June 30, 2018 was \$4,977 compared to \$8,290 for the three months ended June 30, 2017. The decrease in net income is primarily attributable to a \$2,075 gain on the sale of real estate and non-real estate investments and a \$2,186 gain on the change in control over real estate investments during the three months ended June 30, 2017.

Results of Operations for the Six Months Ended June 30, 2018

	Six months ended June 30, 2018			Six months ended June 30, 2017		
	Residential	Commercial	Total	Residential	Commercial	Total
	(unaudited) (in thousands)			(unaudited) (in thousands)		
Real Estate Revenues	\$ 44,994	\$ 13,524	\$ 58,518	\$ 42,715	\$ 13,828	\$56,543
Real Estate Expenses						
Real Estate Taxes	4,374	1,370	5,744	3,764	1,439	5,203
Property Management	6,723	457	7,180	5,596	430	6,026
Utilities	4,268	736	5,004	3,865	680	4,545
Repairs and Maintenance	9,172	1,022	10,194	8,953	979	9,932
Insurance	1,058	45	1,103	689	47	736
Total Real Estate Expenses	25,595	3,630	29,225	22,867	3,575	26,442
Net Operating Income	\$ 19,399	\$ 9,894	29,293	\$ 19,848	\$ 10,253	30,101
Interest			9,076			9,248
Depreciation and amortization			10,633			10,744
Administration of REIT			2,243			3,323
Loss on lease terminations			—			146
Other (income)/expense			(2,895)			(4,850)
Net Income			\$ 10,236			\$11,490
Net Income Attributed to:						
Noncontrolling Interest			\$ 6,819			\$ 7,752
Sterling Real Estate Trust			\$ 3,417			\$ 3,738
Dividends per share ⁽¹⁾			\$0.508750			\$0.4950
Earnings per share			\$ 0.3900			\$0.4600
Weighted average number of common shares			8,674			8,172

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

Revenues

Property revenues of \$58,518 for the six months ended June 30, 2018 increased \$1,975 or 3.5% in comparison to the same period in 2017. Residential property revenues increased \$2,279 and commercial property revenues decreased \$304.

The following table illustrates changes in occupancy for the six month periods indicated:

	June 30, 2018	June 30, 2017
Residential occupancy	94.1 %	95.7 %
Commercial occupancy	95.3 %	97.1 %

Residential revenues for the six months ended June 30, 2018 increased \$2,279 in comparison to the same period for 2017. Residential properties acquired since January 1, 2017 contributed approximately \$1,556 to the increase in total residential revenues in the six months ended June 30, 2018. Rental income from residential properties owned for more than one year increased approximately \$723 in comparison to the six months ended June 30, 2017. Residential revenues comprised 76.9% of total revenues for the six months ended June 30, 2018 compared to 75.5% of total revenues for the six months ended June 30, 2017.

For the six months ended June 30, 2018, total commercial revenues decreased \$304 in comparison to the same period for 2017. The decrease was primarily attributable to the sale of a retail property in June 2017. Commercial revenues comprised 23.1% of the total revenues for the six months ended June 30, 2018 compared to 24.5% of total revenues for the six months ended June 30, 2017.

Sterling's portfolio has experienced increased competition from development of new properties in a mature real estate cycle within both the commercial and residential markets. This has contributed to a year-over-year decrease in residential and commercial occupancy of 1.6% and 1.8% respectively, which is still performing favorably above market averages.

Expenses

Residential expenses from operations of \$25,595 during the six months ended June 30, 2018 increased \$2,728 or 11.9% in comparison to the same period in 2017. This increase was attributable to the increase in the number of residential properties owned during the six months ended June 30, 2018 versus the same period in 2017. Included within these increases were real estate taxes, which increased \$610 or 16.2% primarily due to real estate tax law changes in North Dakota, increases in utilities of \$403 or 10.4% due to increased prices and increases in property insurance of \$369 or 53.6%. In addition, we have increases in property management fees of \$1,127 or 20.1%. Our property management fees remain unchanged; however, other property management related expenses have increased due to increased competition for labor and estimates for allowances on uncollectible receivables.

Commercial expenses from operations of \$3,630 during the six months ended June 30, 2018 increased \$55 or 1.5% in comparison to the same period in 2017. The increase was not attributed to one specific expense type but reflects an overall increase in operating expenses.

Interest expense of \$9,076 during the six months ended June 30, 2018 decreased \$172 in comparison to the same period in 2017 due to decreased levels of debt outstanding. Interest expense was approximately 15.5% and 16.4% of rental income for the six months ended June 30, 2018 and 2017, respectively.

Depreciation and amortization expense decreased 1.0% from \$10,744 for the six months ended June 30, 2017 to \$10,633 for the six months ended June 30, 2018. The \$111 decrease was primarily a result of a \$162 decrease in amortization related to lease intangibles that are fully amortized. Amortization expense will continue to decrease as lease intangibles become fully amortized. Depreciation and amortization expense as a percentage of rental income for the six months ended June 30, 2018 and 2017 was relatively consistent at 18.2% and 19.0%, respectively.

Other income (expense) decreased 40.3% from \$4,850 for the six months ended June 30, 2017 to \$2,895 for the six months ended June 30, 2018. During the six months ended June 30, 2018, the Company recognized a net gain of \$1,084 on the sale of real estate investments and a gain on involuntary conversion of \$1,367. In comparison, the Company's other income (expense) during the six months ended June 30, 2017 included a net gain of \$2,049 incurred in connection with the sale of a retail property in June 2017 and the sale of vehicles in January 2017. In addition, other income in the prior period included a \$2,186 gain on change in control over a real estate investment.

REIT administration expenses decreased from \$3,323 for the six months ended June 30, 2017 to \$2,243 for the six months ended June 30, 2018 due to a decrease in acquisition expenses. Effective July 1, 2017, acquisitions are considered asset acquisitions and as such, transaction costs are capitalized upon closing. For acquisitions prior to July 1, 2017, which were accounted for as business combinations, the transaction costs totaled \$1,131 for the six months ended

June 30, 2017 and are included in “Acquisition and disposition expenses” in the accompanying consolidated statement of operations and other comprehensive (loss) income.

Net Operating Income

We measure the performance of our segments based on net operating income (“NOI”), which we define as total revenue from rental operations less expenses from rental operations and real estate taxes (excluding depreciation and amortization related to real estate investments and impairment of real estate investments). We believe that NOI is an important supplemental measure of operating performance for a REIT because it provides a measure of core operations unaffected by depreciation, amortization, financing, and administration expense. NOI does not represent cash generated by operating activities in accordance with GAAP and should not be considered an alternative to net income, net income available for non-controlling interests and shareholders of the Trust or cash flow from operating activities as a measure of financial performance.

Residential NOI decreased \$449 or 2.3% for the six months ended June 30, 2018 in comparison to the same six month period in 2017 primarily as a result of an increase in operating expenses. Commercial NOI decreased \$359 or 3.5% for the six months ended June 30, 2018 in comparison to the same six month period in 2017 due primarily attributed to the sale of a retail property located in Fargo, North Dakota in June 2017.

Net Income

Net income for the six months ended June 30, 2018 was \$10,236 compared to \$11,490 for the six months ended June 30, 2017. During the six months ended June 30, 2018, the Company recognized a net gain of \$1,084 on the sale of real estate investments and a gain on involuntary conversion of \$1,367. In comparison, the Company’s other income (expense) during the six months ended June 30, 2017 included a net gain of \$2,049 incurred in connection with the sale of a retail property in June 2017 and the sale of vehicles in January 2017. In addition, the prior year period, other income included a \$2,186 gain on change in control over a real estate investment.

Property Acquisitions and Dispositions

Property Acquisitions and Dispositions during the six months ended June 30, 2018

We acquired one property for a total of \$4,579 during the six months ended June 30, 2018. Total consideration for the acquisition was the issuance of approximately \$1,546 in limited partnership units of the operating partnership, assumed liabilities of \$54 and cash of \$2,979.

During the six months ended June 30, 2018, the operating partnership sold an industrial property in Redwood Falls, Minnesota for approximately \$5,200 and recognized a gain of \$1,084.

Property Acquisitions and Dispositions during the six months ended June 30, 2017

We acquired nine properties for a total of \$13,968 during the six months ended June 30, 2017. Total consideration for the acquisitions was the issuance of approximately \$9,651 in limited partnership units of the operating partnership, new loans of \$2,392, (includes \$872 loan from property acquired through change in control of real estate) and cash of \$1,925. In addition, there was a change in control over a real estate investment, with the operating partnership acquiring the other tenant in common’s 59.74% ownership interest in a 144 unit property (See Note 2 and 17 of the consolidated financial statements). We estimated the property had a fair value of approximately \$10,080. The operating partnership assumed a loan of \$1,295 and issued \$4,727 of limited partnership units for a total purchase price of approximately \$6,022. The Company accounted for this as a business combination and recognized a gain on change in control of real estate investment of \$2,186 in the second quarter of 2017 as a result of remeasuring the carrying value to fair value.

During the six months ended June 30, 2017, the operating partnership sold a retail property in Fargo, North Dakota for approximately \$4,400 and recognized a gain of \$2,075.

See Notes 16 and 17 to the Consolidated Financial Statements included above for more information regarding our acquisitions and dispositions during the six months ended June 30, 2018 and 2017.

Construction in Progress and Development Projects

Construction in progress as of June 30, 2018 consists primarily of development and planning costs associated with phase III of a multifamily apartment community under construction in Bismarck, North Dakota and a project to rebuild a multifamily apartment building destroyed by fire in Omaha, Nebraska. Phase I and II of the Bismarck development are completed and Phase III is still in the planning and review stages to determine if the Company will commence construction. During the six months ended June 30, 2018, Phase I and II contributed \$1,165 in rental revenues and had 93.8% economic occupancy.

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.

The following tables include calculations of FFO, and the reconciliations to net income, for the three and six months ended June 30, 2018 and 2017, 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 June 30, 2018			Three months ended June 30, 2017		
	Amount	Weighted Avg Shares and Units(1)	Per Share and Unit (2)	Amount	Weighted Avg Shares and Units(1)	Per Share and Unit (2)
	(unaudited)					
	(in thousands, except per share data)					
Net Income attributable to Sterling Real Estate Trust	\$ 1,675	8,720	\$ 0.19	\$ 2,682	8,227	\$ 0.33
Add back:						
Noncontrolling Interest - OPU	3,376	17,567		5,654	17,357	
Depreciation & Amortization from continuing operations	5,283			5,381		
Pro rata share of unconsolidated affiliate depreciation & amortization	94			93		
Loss on sale of depreciable real estate investments	—			—		
Loss on impairment of real estate investments	—			—		
Subtract:						
Gain on sales of land, depreciable real estate, investment in equity method investee, and change in control of real estate investments	(1,084)			(4,261)		
Funds from operations applicable to common shares and limited partnership units (FFO)	\$ 9,344	26,287	\$ 0.36	\$ 9,549	25,584	\$ 0.37

- (1) Please see Note 10 and Note 12 to the consolidated financial statements included above for more information.
(2) Net Income is calculated on a per share basis. FFO are calculated on a per share and unit basis.

	Six months ended June 30, 2018			Six months ended June 30, 2017		
	Amount	Weighted Avg Shares and Units(1)	Per Share and Unit (2)	Amount	Weighted Avg Shares and Units(1)	Per Share and Unit (2)
	(unaudited)					
	(in thousands, except per share data)					
Net Income attributable to Sterling Real Estate Trust	\$ 3,417	8,674	\$ 0.39	\$ 3,738	8,172	\$ 0.46
Add back:						
Noncontrolling Interest - OPU	6,912	17,550		7,883	17,231	
Depreciation & Amortization from continuing operations	10,633			10,744		
Pro rata share of unconsolidated affiliate depreciation & amortization	188			195		
Subtract:						
Gain on sale of land, depreciable real estate, investment in equity method investee, and change in control of real estate investments	(1,084)			(4,264)		
Funds from operations applicable to common shares and limited partnership units (FFO)	\$ 20,066	26,224	\$ 0.77	\$ 18,296	25,403	\$ 0.72

- (1) Please see Note 10 and Note 12 to the consolidated financial statements included above for more information.
(2) Net Income is calculated on a per share basis. FFO are calculated on a per share and unit basis.

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, and (v) redemptions of our securities under our redemption plans. 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.

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.

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.

Historically, the geographic location of our properties and credit-worthiness of our tenants have resulted in minimal to no property impairments or write-offs on uncollectible rental revenues. It is possible, however, that tenants may file for bankruptcy or default on their leases in the future and that economic conditions may deteriorate.

To mitigate credit risk on commercial properties, we have historically looked to invest in assets that we believe are critically important to our tenant's 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

No significant leases are scheduled to expire or renew in the next twelve months. 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.

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.

	Six Months Ended June 30,	
	2018	2017
	(in thousands)	
Net cash flows provided by operating activities	\$ 17,018	\$ 15,965
Net cash flows used in investing activities	\$ (1,873)	\$ (802)
Net cash flows used in financing activities	\$ (11,382)	\$ (5,902)

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 and building maintenance cost, 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 \$17,018 and \$15,965 for the six months ended June 30, 2018 and 2017, respectively, which consists primarily of net income from property operations adjusted for non-cash depreciation and amortization. The funds generated for the six months ended June 30, 2018 and 2017 were primarily from property operations of our real estate portfolio.

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 \$1,873 and \$802 for the six months ended June 30, 2018 and 2017, respectively (this does not include the value of UPREIT units issued in connection with investing activities). For the six months ended June 30, 2018 and 2017, cash flows used in investing activities related primarily to the acquisition of properties and capital expenditures was \$7,527 and \$7,424, respectively. In addition, during the six months ended June 30, 2018, proceeds of \$5,200 were generated from the sale of one commercial industrial property and were deposited into a 1031 exchange escrow at June 30, 2018. In addition, during the six months ended June 30, 2018, proceeds of \$330 were received from involuntary conversions. During the six months ended June 30, 2017, proceeds of \$4,442 were generated from the sale of one commercial retail property and the sale of vehicles. In addition, during the six months ended June 30, 2017, proceeds of \$1,914 were received from involuntary conversions. The majority of the proceeds were related to one property that was damaged in 2016.

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 used in financing activities was \$11,382 and \$5,902 for the six months ended June 30, 2018 and 2017, respectively. During the six months ended June 30, 2018, we paid \$10,301 in dividends and distributions, redeemed \$1,663 of shares and units, received proceeds from new mortgage notes payable of \$7,064, and made mortgage principal payments of \$8,223. For the six months ended June 30, 2017, we paid \$9,620 in dividends and distributions, redeemed \$1,109 of shares and units, received proceeds from new mortgage notes payable of \$16,152, and made mortgage principal payments of \$12,252.

Dividends

Common Stock

We declared cash dividends to our shareholders during the period from January 1, 2018 to June 30, 2018 totaling \$4,407 or \$0.508750 per share, including amounts reinvested through the dividend reinvestment plan. During the six months ended June 30, 2018, we paid cash dividends of \$1,524 and dividends of \$2,883 were reinvested under the dividend reinvestment plan. The cash dividends were paid with the \$17,018 from our cash flows from operations and \$124 provided by distributions from unconsolidated affiliates.

We declared cash dividends to our shareholders during the period from January 1, 2017 to June 30, 2017 totaling \$4,044 or \$0.4950 per share, including amounts reinvested through the dividend reinvestment plan. During the six months ended June 30, 2017, we paid cash dividends of \$1,461 and dividends of \$2,583 were reinvested under the dividend

reinvestment plan. The cash dividends were paid with the \$15,965 from our cash flows from operations and \$245 provided by distributions from unconsolidated affiliates.

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 these cash flows 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:

	Six Months Ended June 30,	
	2018	2017
	(in thousands)	
Cash flows provided by operations (includes net income of \$10,236 and \$11,490, respectively)	\$ 17,018	\$ 15,965
Distributions in excess of earnings received from unconsolidated affiliates	124	245
Gain (Loss) on sales of real estate and non-real estate investments	1,084	2,052
Dividends declared	(4,407)	(4,044)
Excess	\$ 13,819	\$ 14,218

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 six months ended June 30, 2018, we declared quarterly distributions totaling \$8,938 to holders of limited partnership units in our operating partnership, which we paid on April 16 and July 16, 2018. Distributions were paid at a rate of \$0.254375 per unit per quarter, which is equal to the per share distribution rate paid to the common shareholders.

For the six months ended June 30, 2017, we declared quarterly distributions totaling \$8,572 to holders of limited partnership units in our operating partnership, which we paid on April 17 and July 17, 2017. Distributions were paid at a rate of \$0.2475 per unit per quarter, which is equal to the per share distribution rate paid to the common shareholders.

Sources of Dividends

For the six months ended June 30, 2018, we paid aggregate dividends of \$4,407, which were paid with cash flows provided by operating activities and distributions from unconsolidated affiliates. Our funds from operations, or FFO, was \$20,066; therefore, our management believes our distribution policy is sustainable over time. For the six months ended June 30, 2017, we paid aggregate dividends of \$4,044 which were paid with cash flows provided by operating activities and distributions from unconsolidated affiliates. Our FFO was \$18,296 as of the six months ended June 30, 2017. For a further discussion of FFO, including a reconciliation of FFO to net income, see “Funds from Operations” above.

Cash Resources

At June 30, 2018, our cash resources consisted of cash and cash equivalents totaling approximately \$13,809. Our cash reserves can be used for working capital needs and other commitments. In addition, we had unencumbered properties with a gross book value of \$35,962, which could potentially be used as collateral to secure additional financing in future periods.

At June 30, 2018, there was no balance outstanding on the lines of credit, leaving \$32,815 available and unused under the agreements. See Note 6 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 six months ended June 30, 2018, we did not sell any common shares in a private placement. During the six months ended June 30, 2018, we issued 159,000 and 117,000 common shares under the dividend reinvestment plan, through dividends reinvested and the optional share purchases, respectively, and raised gross proceeds of \$4,957. During the six months ended June 30, 2017, we did not sell any common shares in a private placement. During the six months ended June 30, 2017, we issued 165,000 and 84,000 common shares under the dividend reinvestment plan, through dividends reinvested and the optional share repurchases, respectively, and raised gross proceeds of \$3,907.

During the six months ended June 30, 2018, we issued limited partnership units valued at approximately \$1,546 in connection with the acquisition of one property.

During the six months ended June 30, 2017, we issued limited partnership units valued at approximately \$14,378 in connection with the acquisitions of properties and one property that had a change in control.

Off-Balance Sheet Arrangements

As of June 30, 2018 and December 31, 2017, we had no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Inflation

Substantially all of our multifamily property leases are for a term of one year or less. In an inflationary environment, this may allow us to realize increased rents upon renewal of existing leases or the beginning of new leases. Short-term leases generally will minimize our risk from the adverse effects of inflation, although these leases generally permit residents to leave at the end of the lease term and therefore will expose us to the effect of a decline in market rents. In a deflationary rent environment, we may be exposed to declining rents more quickly under these shorter term leases.

As of June 30, 2018, most of our commercial leases require tenants to reimburse us for a share of our operating expenses. As a result, we are able to pass on much of any increases to our property operating expenses that might occur due to inflation by correspondingly increasing our expense reimbursement revenues. During the six months ended June 30, 2018, inflation did not have a material impact on our revenues or net income.

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.

As virtually all 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, 2017 filed with the Securities and Exchange Commission on March 15, 2018.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Accounting 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 Accounting Officer have concluded that, as of June 30, 2018, 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 second fiscal quarter of 2018 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 June 30, 2018.

Other Sales

During the three months ended June 30, 2018, 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(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 three months ended June 30, 2018:

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
April 1-30, 2018	4,000	7,000	\$ 17.50	1,150,000	730,000	\$ 9,207
May 1-31, 2018	6,000	6,000	\$ 17.50	1,156,000	736,000	\$ 9,005
June 1-30, 2018	4,000	16,000	\$ 17.50	1,160,000	752,000	\$ 8,654
Total	14,000	29,000				

For the three months ended June 30, 2018, we redeemed all shares or units for which we received redemption requests. In addition, for the three months ended June 30, 2018, 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 \$35,000 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 redemption price for such shares and units redeemed under the plan was fixed at \$15.50 per share or unit, which was increased to \$17.50 effective January 1, 2018. 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 Accounting 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 Accounting 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 June 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets at June 30, 2018 and December 31, 2017; (ii) Consolidated Statements of Operations and Other Comprehensive Income for the three and six months ended June 30, 2018 and 2017; (iii) Consolidated Statement of Shareholders' Equity for six months ended June 30, 2018; (iv) Consolidated Statements of Cash Flows for the six months ended June 30, 2018 and 2017, and; (v) Notes to Consolidated Financial Statements.

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: August 8, 2018

STERLING REAL ESTATE TRUST

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

By: /s/ Angie D. Stock
Angie D. Stock
Chief Accounting 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. I am 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: August 8, 2018

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

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

I, Angie D. Stock, 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. I am 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: August 8, 2018

By: /s/ Angie D. Stock
Chief Accounting 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 June 30, 2018 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: August 8, 2018

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

By: /s/ Angie D. Stock
Chief Accounting 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.
