

**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 March 31, 2022

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: 001-38010

**CLIPPER REALTY INC.**

(Exact name of Registrant as specified in its charter)

**Maryland**

**47-4579660**

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**4611 12<sup>th</sup> Avenue, Suite 1L**

**Brooklyn, New York 11219**

(Address of principal executive offices) (Zip Code)

**(718) 438-2804**

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition 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

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

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

Title of each class  
Common Stock, par value \$0.01 per share

Trading Symbol  
CLPR

Name of each exchange on which registered  
New York Stock Exchange

As of May 10, 2022, there were 16,063,228 shares of the Registrant's Common Stock outstanding.

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## PART I – FINANCIAL INFORMATION

### CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Quarterly Report on Form 10-Q for Clipper Realty Inc. (the “Company”), including, without limitation, statements under “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” regarding the Company’s financial position, business strategy and the plans, objectives, expectations, or assumptions of management for future operations, are forward-looking statements. When used in this Quarterly Report on Form 10-Q, words such as “may,” “will,” “should,” “could,” “expect,” “anticipate,” “believe,” “estimate,” “project,” “predict,” “believe,” “expect,” “intend,” “continue,” “potential,” “plan,” “goal” or other words that convey the uncertainty of future events or outcomes are intended to identify forward-looking statements, which are generally not historical in nature. These statements involve risks and uncertainties that could cause actual results to differ materially from those described in such statements. These risks, contingencies and uncertainties include, but are not limited to, the following:

- the effect of the ongoing novel strain of coronavirus (“COVID-19”) pandemic, and measures intended to curb its spread, including its effect on our tenants’ ability or willingness to pay rents and on demand for housing in the New York metropolitan area;
- the severe economic, market and other disruptions worldwide caused, and likely to continue to be caused, by the COVID-19 pandemic;
- market and economic conditions affecting occupancy levels (including continued declines at one of our properties), rental rates, the overall market value of our properties, our access to capital and the cost of capital and our ability to refinance indebtedness;
- economic or regulatory developments in New York City;
- the single government tenant in our commercial buildings may suffer financial difficulty;
- changes in rent stabilization regulations or claims by tenants in rent-stabilized units that their rents exceed specified maximum amounts under current regulations;
- our ability to control operating costs to the degree anticipated;
- the risk of damage to our properties, including from severe weather, natural disasters, climate change, and terrorist attacks;
- risks related to financing, cost overruns, and fluctuations in occupancy rates and rents resulting from development or redevelopment activities and the risk that we may not be able to pursue or complete development or redevelopment activities or that such development or redevelopment activities may not be profitable;
- concessions or significant capital expenditures that may be required to attract and retain tenants;
- the relative illiquidity of real estate investments;
- competition affecting our ability to engage in investment and development opportunities or attract or retain tenants;
- unknown or contingent liabilities in properties acquired in formative and future transactions;
- the possible effects of departure of key personnel in our management team on our investment opportunities and relationships with lenders and prospective business partners;
- conflicts of interest faced by members of management relating to the acquisition of assets and the development of properties, which may not be resolved in our favor;
- a transfer of a controlling interest in any of our properties that may obligate us to pay transfer tax based on the fair market value of the real property transferred;
- the impact of the restatement of our financial statements and management’s recently identified material weakness in our internal control over financial reporting;
- the need to establish litigation reserves, costs to defend litigation and unfavorable litigation

settlements or judgments; and

- other risks *and* risk factors *or* uncertainties identified from time to time in our filings with the SEC.

## ITEM 1. CONDENSED FINANCIAL STATEMENTS

**Clipper Realty Inc.**  
**Consolidated Balance Sheets**  
(In thousands, except for share and per share data)

	<b>March 31,</b>	<b>December 31,</b>
	<b>2022</b>	<b>2021</b>
	<b>(unaudited)</b>	
<b>ASSETS</b>		
Investment in real estate		
Land and improvements	\$540,859	\$540,859
Building and improvements	651,437	649,686
Tenant improvements	3,406	3,406
Furniture, fixtures and equipment	12,582	12,500
Real estate under development	111,902	97,301
Total investment in real estate	1,320,186	1,303,752
Accumulated depreciation	(164,648)	(158,002)
Investment in real estate, net	1,155,538	1,145,750
Cash and cash equivalents	25,342	34,524
Restricted cash	18,493	17,700
Tenant and other receivables, net of allowance for doubtful accounts of \$179 and \$7,905, respectively	5,076	10,260
Deferred rent	2,599	2,656
Deferred costs and intangible assets, net	6,966	7,126
Prepaid expenses and other assets	12,765	15,641
<b>TOTAL ASSETS</b>	<b>\$1,226,779</b>	<b>\$1,233,657</b>
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Notes payable, net of unamortized loan costs of \$12,077 and \$12,898, respectively	\$1,139,038	\$1,131,154
Accounts payable and accrued liabilities	17,230	19,558
Security deposits	7,199	7,110
Below-market leases, net	44	53
Other liabilities	6,534	5,833
<b>TOTAL LIABILITIES</b>	<b>1,170,045</b>	<b>1,163,708</b>
Equity:		
Preferred stock, \$0.01 par value; 100,000 shares authorized (including 140 shares of 12.5% Series A cumulative non-voting preferred stock), zero shares issued and outstanding	—	—
Common stock, \$0.01 par value; 500,000,000 shares authorized, 16,063,228 shares issued and outstanding	160	160
Additional paid-in-capital	88,215	88,089
Accumulated deficit	(66,871)	(61,736)
Total stockholders' equity	21,504	26,513
Non-controlling interests	35,230	43,436
<b>TOTAL EQUITY</b>	<b>56,734</b>	<b>69,949</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$1,226,779</b>	<b>\$1,233,657</b>

See accompanying notes to these consolidated financial statements.

**Clipper Realty Inc.**  
**Consolidated Statements of Operations**  
(In thousands, except per share data)  
(Unaudited)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2022</b>	<b>2021</b>
<b>REVENUES</b>		
Residential rental income	\$21,462	\$21,604
Commercial rental income	10,588	9,047
<b>TOTAL REVENUES</b>	<b>32,050</b>	<b>30,651</b>
<b>OPERATING EXPENSES</b>		
Property operating expenses	7,539	8,642
Real estate taxes and insurance	7,931	7,312
General and administrative	2,942	2,293
Transaction pursuit costs	424	60
Depreciation and amortization	6,705	6,227
<b>TOTAL OPERATING EXPENSES</b>	<b>25,541</b>	<b>24,534</b>
<b>INCOME FROM OPERATIONS</b>	<b>6,509</b>	<b>6,117</b>
Interest expense, net	(9,985)	(10,217)
Loss on extinguishment of debt	-	(3,034)
<b>Net loss</b>	<b>(3,476)</b>	<b>(7,134)</b>
Net loss attributable to non-controlling interests	2,158	4,430
<b>Net loss attributable to common stockholders</b>	<b>\$(1,318)</b>	<b>\$(2,704)</b>
Basic and diluted net loss per share	\$(0.09)	\$(0.18)

See accompanying notes to these consolidated financial statements.

**Clipper Realty Inc.**  
**Consolidated Statements of Changes in Equity**  
(In thousands, except for share data)  
(Unaudited)

	Number of common shares	Common stock	Additional paid-in- capital	Accumulated deficit	Total stockholders' equity	Non- controlling interests	Total equity
<b>Balance December 31, 2021</b>	16,063,228	\$160	\$88,089	\$(61,736)	\$26,513	\$43,436	\$69,949
Cumulative-effect adjustment	—	—	—	(2,291)	(2,291)	(3,755)	(6,046)
Amortization of LTIP grants	—	—	—	—	—	495	495
Dividends and distributions	—	—	—	(1,526)	(1,526)	(2,662)	(4,188)
Net loss	—	—	—	(1,318)	(1,318)	(2,158)	(3,476)
Reallocation of noncontrolling interests	—	—	126	—	126	(126)	—
<b>Balance March 31, 2022</b>	16,063,228	\$160	\$88,215	\$(66,871)	\$21,504	\$35,230	\$56,734

	Number of common shares	Common stock	Additional paid-in- capital	Accumulated deficit	Total stockholders' equity	Non- controlling interests	Total equity
<b>Balance December 31, 2020</b>	16,063,228	\$160	\$87,347	\$(48,045)	\$39,462	\$64,652	\$104,114
Amortization of LTIP grants	—	—	—	—	—	486	486
Dividends and distributions	—	—	—	(1,526)	(1,526)	(2,665)	(4,191)
Net loss	—	—	—	(2,704)	(2,704)	(4,430)	(7,134)
Reallocation of noncontrolling interests	—	—	122	—	122	(122)	—
<b>Balance March 31, 2021</b>	16,063,228	\$160	\$87,469	\$(52,275)	\$35,354	\$57,921	\$93,275

See accompanying notes to these consolidated financial statements.

**Clipper Realty Inc.**  
**Consolidated Statements of Cash Flows**  
**(In thousands)**  
**(Unaudited)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2022</b>	<b>2021</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$(3,476)	\$(7,134)
<i>Adjustments to reconcile net loss to net cash provided by operating activities:</i>		
Depreciation	6,646	6,171
Amortization of deferred financing costs	313	308
Amortization of deferred costs and intangible assets	179	176
Amortization of above- and below-market leases	(9)	(31)
Loss on extinguishment of debt	—	3,034
Deferred rent	(189)	(1)
Stock-based compensation	495	486
Bad debt (recovery) expense	(379)	1,178
Transaction pursuit costs	—	60
<i>Changes in operating assets and liabilities:</i>		
Tenant and other receivables	(237)	(2,519)
Prepaid expenses, other assets and deferred costs	3,122	2,101
Accounts payable and accrued liabilities	(668)	2,986
Security deposits	89	6
Other liabilities	701	616
<b>Net cash provided by operating activities</b>	<b>6,587</b>	<b>7,437</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to land, buildings, and improvements	(13,885)	(7,745)
Acquisition deposit	(265)	—
Cash paid in connection with acquisition of real estate	(3,701)	—
<b>Net cash used in investing activities</b>	<b>(17,851)</b>	<b>(7,745)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payments of mortgage notes	(554)	(74,776)
Proceeds from mortgage notes	7,617	100,248
Dividends and distributions	(4,188)	(4,191)
Loan issuance and extinguishment costs	—	(3,809)
<b>Net cash provided by financing activities</b>	<b>2,875</b>	<b>17,472</b>
Net increase (decrease) in cash and cash equivalents and restricted cash	(8,389)	17,164
Cash and cash equivalents and restricted cash - beginning of period	52,224	89,032
<b>Cash and cash equivalents and restricted cash - end of period</b>	<b>\$43,835</b>	<b>\$106,196</b>
Cash and cash equivalents and restricted cash – beginning of period:		
Cash and cash equivalents	\$34,524	\$72,058
Restricted cash	17,700	16,974
Total cash and cash equivalents and restricted cash – beginning of period	<u>\$52,224</u>	<u>\$89,032</u>
Cash and cash equivalents and restricted cash – end of period:		
Cash and cash equivalents	\$25,342	\$87,952
Restricted cash	18,493	18,244
Total cash and cash equivalents and restricted cash – end of period	<u>\$43,835</u>	<u>\$106,196</u>
Supplemental cash flow information:		
Cash paid for interest, net of capitalized interest of \$607 and \$393 in 2022 and 2021, respectively	\$10,351	\$9,999
Non-cash interest capitalized to real estate under development	508	16
Additions to investment in real estate included in accounts payable and accrued liabilities	6,906	1,970

See accompanying notes to these consolidated financial statements.



**Clipper Realty Inc.**  
**Notes to Condensed Consolidated Financial Statements**  
**(In thousands, except for share and per share data and as noted)**  
**(Unaudited)**

**INTRODUCTION TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

The unaudited condensed consolidated financial statements of Clipper Realty Inc. (the “Company” or “we”) and subsidiaries have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. We believe that the disclosures are adequate to make the information presented not misleading when read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2021, filed with the SEC on March 15, 2022.

The financial information presented reflects all adjustments (consisting of normal recurring adjustments) which are, in our opinion, necessary for a fair presentation of the results of operations, cash flows and financial position for the interim periods presented. These results are not necessarily indicative of a full year’s results of operations.

**1. Organization**

As of March 31, 2022, the properties owned by the Company consist of the following (collectively, the “Properties”):

- Tribeca House in Manhattan, comprising two buildings, one with 21 stories and one with 12 stories, containing residential and retail space with an aggregate of approximately 483,000 square feet of residential rental Gross Leasable Area (“GLA”) and 77,000 square feet of retail rental and parking GLA;
- Flatbush Gardens in Brooklyn, a 59-building residential housing complex with 2,494 rentable units and approximately 1,749,000 square feet of residential rental GLA;
- 141 Livingston Street in Brooklyn, a 15-story office building with approximately 216,000 square feet of GLA;
- 250 Livingston Street in Brooklyn, a 12-story office and residential building with approximately 370,000 square feet of GLA (fully remeasured);
- Aspen in Manhattan, a 7-story building containing residential and retail space with approximately 166,000 square feet of residential rental GLA and approximately 21,000 square feet of retail rental GLA;
- Clover House in Brooklyn, a 11-story residential building with approximately 102,000 square feet of residential rental GLA;
- 10 West 65<sup>th</sup> Street in Manhattan, a 6-story residential building with approximately 76,000 square feet of residential rental GLA;
- 1010 Pacific Street in Brooklyn, which the Company plans to redevelop as a 9-story residential building with approximately 119,000 square feet of residential rental GLA; and
- the Dean Street property, which the Company plans to redevelop as a 9-story residential building with approximately 160,000 square feet of residential rental GLA and approximately 9,000 square feet of retail rental GLA. In February and April 2022, the Company purchased additional parcels of land for \$3.7 million and \$4.3 million, respectively.

During 2019, we entered into a joint venture in which we own a 50% interest through which we are paying certain legal and advisory expenses in connection with various rent laws and ordinances which govern certain of our properties. During the three months ended March 31, 2022 and 2021, the Company incurred \$0.02 million and \$0.02

million, respectively, of such expenses, which are recorded as part of general and administrative in the Condensed Consolidated Statements of Operations, and the Company has fulfilled its commitment in the joint venture.

The operations of Clipper Realty Inc. and its consolidated subsidiaries are carried on primarily through the Operating Partnership. The Company has elected to be taxed as a Real Estate Investment Trust (“REIT”) under Sections 856 through 860 of the Internal Revenue Code (the “Code”). The Company is the sole general partner of the Operating Partnership and the Operating Partnership is the sole managing member of the LLCs that comprised the Predecessor.

At March 31, 2022, the Company’s interest, through the Operating Partnership, in the LLCs that own the properties generally entitles it to 37.9% of the aggregate cash distributions from, and the profits and losses of, the LLCs.

The Company determined that the Operating Partnership and the LLCs are variable interest entities (“VIEs”) and that the Company was the primary beneficiary. The assets and liabilities of these VIEs represented substantially all of the Company’s assets and liabilities.

## **2. Significant Accounting Policies**

### *Segments*

At March 31, 2022, the Company had two reportable operating segments, Residential Rental Properties and Commercial Rental Properties. The Company’s chief operating decision maker may review operational and financial data on a property basis.

### *Basis of Consolidation*

The accompanying consolidated financial statements of the Company are prepared in accordance with GAAP. The effect of all intercompany balances has been eliminated. The consolidated financial statements include the accounts of all entities in which the Company has a controlling interest. The ownership interests of other investors in these entities are recorded as non-controlling interests.

### *Use of Estimates*

The preparation of 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 commitments and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from these estimates.

### *Investment in Real Estate*

Real estate assets held for investment are carried at historical cost and consist of land, buildings and improvements, furniture, fixtures and equipment. Expenditures for ordinary repair and maintenance costs are charged to expense as incurred. Expenditures for improvements, renovations, and replacements of real estate assets are capitalized and depreciated over their estimated useful lives if the expenditures qualify as betterment or the life of the related asset will be substantially extended beyond the original life expectancy.

In accordance with ASU 2017-01, “Business Combinations – Clarifying the Definition of a Business,” the Company evaluates each acquisition of real estate or in-substance real estate to determine if the integrated set of assets and activities acquired meets the definition of a business and needs to be accounted for as a business combination. Generally, the Company expects that acquisitions of real estate or in-substance real estate will not meet the revised definition of a business because substantially all of the fair value is concentrated in a single identifiable asset or group of similar identifiable assets (i.e., land, buildings and related intangible assets) or because the acquisition does not include a substantive process in the form of an acquired workforce or an acquired contract that cannot be replaced without significant cost, effort or delay.

Upon acquisition of real estate, the Company assesses the fair values of acquired tangible and intangible assets including land, buildings, tenant improvements, above-market and below-market leases, in-place leases and any other identified intangible assets and assumed liabilities. The Company allocates the purchase price to the assets acquired and liabilities assumed based on their fair values. In estimating fair value of tangible and intangible assets acquired, the Company assesses and considers fair value based on estimated cash flow projections that utilize

appropriate discount and capitalization rates, estimates of replacement costs, net of depreciation, and available market information. The fair value of the tangible assets of an acquired property considers the value of the property as if it were vacant.

The Company records acquired above-market and below-market lease values initially based on the present value, using a discount rate which reflects the risks associated with the leases acquired based on the difference between (i) the contractual amounts to be paid pursuant to each in-place lease and (ii) management's estimate of fair market lease rates for each corresponding in-place lease, measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the term of any below-market fixed renewal options for the below-market leases. Other intangible assets acquired include amounts for in-place lease values and tenant relationship values (if any) that are based on management's evaluation of the specific characteristics of each tenant's lease and the Company's overall relationship with the respective tenant. Factors to be considered by management in its analysis of in-place lease values include an estimate of carrying costs to execute similar leases. In estimating carrying costs, management includes real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, management considers leasing commissions, legal and other related expenses.

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. A property's value is impaired if management's estimate of the aggregate future cash flows (undiscounted and without interest charges) to be generated by the property is less than the carrying value of the property. To the extent impairment has occurred, a write-down is recorded and measured by the amount of the difference between the carrying value of the asset and the fair value of the asset. In the event that the Company obtains proceeds through an insurance policy due to impairment, the proceeds are offset against the write-down in calculating gain/loss on disposal of assets. Management of the Company does not believe that any of its properties within the portfolio are impaired as of March 31, 2022.

For long-lived assets to be disposed of, impairment losses are recognized when the fair value of the assets less estimated cost to sell is less than the carrying value of the assets. Properties classified as real estate held-for-sale generally represent properties that are actively marketed or contracted for sale with closing expected to occur within the next twelve months. Real estate held-for-sale is carried at the lower of cost, net of accumulated depreciation, or fair value less cost to sell, determined on an asset-by-asset basis. Expenditures for ordinary repair and maintenance costs on held-for-sale properties are charged to expense as incurred. Expenditures for improvements, renovations and replacements related to held-for-sale properties are capitalized at cost. Depreciation is not recorded on real estate held-for-sale.

If a tenant vacates its space prior to the contractual termination of the lease and no rental payments are being made on the lease, any unamortized balances of the related intangibles are written off. The tenant improvements and origination costs are amortized to expense over the remaining life of the lease (or charged against earnings if the lease is terminated prior to its contractual expiration date).

Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

Building and improvements	10–44 years
Tenant improvements	Shorter of useful life or lease term
Furniture, fixtures and equipment	3–15 years

The capitalized above-market lease values are amortized as a reduction to base rental revenue over the remaining terms of the respective leases, and the capitalized below-market lease values are amortized as an increase to base rental revenue over the remaining initial terms plus the terms of any below-market fixed rate renewal options of the respective leases. The value of in-place leases is amortized to expense over the remaining initial terms of the respective leases.

#### *Cash and Cash Equivalents*

Cash and cash equivalents are defined as cash on hand and in banks, plus all short-term investments with a maturity of three months or less when purchased. The Company maintains some of its cash in bank deposit accounts, which, at times, may exceed the federally insured limit. No losses have been experienced related to such accounts.

### *Restricted Cash*

Restricted cash generally consists of escrows for future real estate taxes and insurance expenditures, repairs, capital improvements, loan reserves and security deposits.

### *Tenant and Other Receivables and Allowance for Doubtful Accounts*

Tenant and other receivables are comprised of amounts due for monthly rents and other charges less allowance for doubtful accounts. As described more fully under *Revenue Recognition* below, in the first quarter of 2022 the Company adopted Accounting Standards Codification (“ASC”) 842 “Leases” which replaced guidance under ASC 840 and provided for transition from balances at December 31, 2021. In accordance with ASC 842, the Company performed a detailed review of amounts due from tenants to determine if accounts receivable balances and future lease payments were probable of collection, wrote off receivables not probable of collection and recorded a general reserve against revenues for receivables probable of collection. If management determines that the tenant receivable is not probable of collection it is written off against revenues. In addition, the Company records a general reserve under ASC 450. For transition, the Company recorded a cumulative-effect adjustment in retained earnings as of January 1, 2022 using the methods of ASC 842 applied to balances as of December 31, 2021.

### *Deferred Costs*

Deferred lease costs consist of fees incurred to initiate and renew operating leases. Lease costs are being amortized using the straight-line method over the terms of the respective leases.

Deferred financing costs represent commitment fees, legal and other third-party costs associated with obtaining financing. These costs are amortized over the term of the financing and are recorded in interest expense in the consolidated statements of operations. Unamortized deferred financing costs are expensed when the associated debt is refinanced or repaid before maturity. Costs incurred in seeking financing transactions which do not close are expensed in the period the financing transaction is terminated.

### *Comprehensive Income (Loss)*

Comprehensive income (loss) is comprised of net income (loss) adjusted for changes in unrealized gains and losses, reported in equity, for financial instruments required to be reported at fair value under GAAP. For the three months ended March 31, 2022 and 2021, the Company did not own any financial instruments for which the change in value was not reported in net income (loss); accordingly, its comprehensive income (loss) was its net income (loss) as presented in the consolidated statements of operations.

### *Revenue Recognition*

As mentioned above under *Tenant and Other Receivables and Allowance for Doubtful Accounts*, effective the first quarter of 2022, the Company has adopted ASC 842, “Leases” which replaces the guidance under ASC 840. ASC 842 applies to the Company principally as lessor; as a lessee, the Company’s leases are immaterial. The Company has determined that all its leases as lessor are operating leases. The Company has elected to not bifurcate lease and non-lease components under a practical expedient provision. With respect to collectability, beginning the first quarter of 2022, the Company has written off all receivables not probable of collection and related deferred rent, and has recorded income for those tenants based on a cash basis. When the probability assessment has changed for these receivables, the Company has recognized lease income to the extent of the difference between the lease income that would have been recognized if collectability had always been assessed as probable and the lease income recognized to date. For remaining receivables probable of collection, the Company has recorded a general reserve under ASC 450. In the first quarter, the Company has charged revenue in the amount of \$0.8 million for receivables not deemed probable of collection and recorded an increase in revenues for \$1.1 million for a reassessment of collectability of one customer at Tribeca House that was determined to be probable of collection. By comparison, in the first quarter of 2021, the Company has charged \$1.1 million to operating expenses for bad debt expense computed under the guidance of ASC 450. In transitioning to ASC 842 in the first quarter of 2022, the Company has elected the modified retrospective approach to existing leases at the beginning of the quarter and has recorded a cumulative-effect adjustment in retained earnings using the above methods applied to balances as of December 31, 2021, of \$6.0 million.

In accordance with the provisions of ASC 842, rental revenue for commercial leases is recognized on a straight-line basis over the terms of the respective leases. Deferred rents receivable represents the amount by which

straight-line rental revenue exceeds rents currently billed in accordance with lease agreements. Rental income attributable to residential leases and parking is recognized as earned, which is not materially different from the straight-line basis. Leases entered by residents for apartment units are generally for one-year terms, renewable upon consent of both parties on an annual or monthly basis.

Reimbursements for operating expenses due from tenants pursuant to their lease agreements are recognized as revenue in the period the applicable expenses are incurred. These costs generally include real estate taxes, utilities, insurance, common area maintenance costs and other recoverable costs and are recorded as part of commercial rental income in the condensed consolidated statements of operations.

#### *Stock-based Compensation*

The Company accounts for stock-based compensation pursuant to Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 718, “Compensation — Stock Compensation.” As such, all equity-based awards are reflected as compensation expense in the Company’s consolidated statements of operations over their vesting period based on the fair value at the date of grant. In the event of a forfeiture, the previously recognized expense would be reversed.

As of March 31, 2022, and December 31, 2021, there were 1,774,823 and 1,704,089 long-term incentive plan (“LTIP”) units outstanding, respectively, with a weighted average grant date fair value of \$9.64 and \$9.66 per unit, respectively. As of March 31, 2022, and December 31, 2021, there was \$2.4 million and \$2.3 million, respectively, of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under share incentive plans. As of March 31, 2022, the weighted-average period over which the unrecognized compensation expense will be recorded is approximately one year.

In April 2022, the Company granted employees and non-employee directors 900,000 and 275,000 LTIP units, respectively, with a grant date value of \$9.07 per unit, substantially all which vest in 10 years. Of these grants, 270,000 and 82,500 are subject to approval of a proposal made to shareholders to be voted on at the 2022 Annual Stockholders’ Meeting on June 15, 2022 to increase the number of shares issuable under the Company’s 2015 Omnibus Incentive Plan and the 2015 Non-Employee Director Plan by 1.3 million and 0.5 million shares, respectively.

#### *Transaction Pursuit Costs*

Transaction pursuit costs primarily reflect costs incurred for abandoned acquisition, disposition or other transaction pursuits.

#### *Income Taxes*

The Company elected to be taxed and to operate in a manner that will allow it to qualify as a REIT under the Code. To qualify as a REIT, the Company is required to distribute dividends equal to at least 90% of the REIT taxable income (computed without regard to the dividends paid deduction and net capital gains) to its stockholders, and meet the various other requirements imposed by the Code relating to matters such as operating results, asset holdings, distribution levels and diversity of stock ownership. Provided the Company qualifies for taxation as a REIT, it is generally not subject to U.S. federal corporate-level income tax on the earnings distributed currently to its stockholders. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to U.S. federal and state income tax on its taxable income at regular corporate tax rates and any applicable alternative minimum tax. In addition, the Company may not be able to re-elect as a REIT for the four subsequent taxable years. The entities comprising the Predecessor are limited liability companies and are treated as pass-through entities for income tax purposes. Accordingly, no provision has been made for federal, state or local income or franchise taxes in the accompanying consolidated financial statements.

In accordance with FASB ASC Topic 740, the Company believes that it has appropriate support for the income tax positions taken and, as such, does not have any uncertain tax positions that, if successfully challenged, could result in a material impact on its financial position or results of operations. The prior three years’ income tax returns are subject to review by the Internal Revenue Service.

#### *Fair Value Measurements*

Refer to Note 7, “Fair Value of Financial Instruments”.

### Derivative Financial Instruments

FASB derivative and hedging guidance establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. As required by FASB guidance, the Company records all derivatives on the consolidated balance sheets at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and the resulting designation.

As of March 31, 2022, the Company has no derivatives for which it applies hedge accounting.

### Loss Per Share

Basic and diluted net loss per share is computed by dividing net loss attributable to common stockholders by the weighted average common shares outstanding. As of March 31, 2022 and 2021, the Company had unvested LTIP units which provide for non-forfeitable rights to dividend-equivalent payments. Accordingly, these unvested LTIP units are considered participating securities and are included in the computation of basic and diluted net loss per share pursuant to the two-class method. The Company did not have dilutive securities as of March 31, 2022 or 2021.

The effect of the conversion of the 26,317 Class B LLC units outstanding is not reflected in the computation of basic and diluted net loss per share, as the effect would be anti-dilutive. The net loss allocable to such units is reflected as non-controlling interests in the accompanying consolidated financial statements.

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated (unaudited):

<b>(in thousands, except per share amounts)</b>	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2022</b>	<b>2021</b>
<u>Numerator</u>		
Net loss attributable to common stockholders	\$(1,318)	\$(2,704)
Less: income attributable to participating securities	(162)	(165)
Subtotal	\$(1,480)	\$(2,869)
<u>Denominator</u>		
Weighted-average common shares outstanding	16,063	16,063
Basic and diluted net loss per share attributable to common stockholders	<u>\$(0.09)</u>	<u>\$(0.18)</u>

### Recently Issued Pronouncements

In April 2020, FASB issued a Staff Q & A to provide interpretive guidance for lease concessions related to the effects of the COVID-19 pandemic. The Company did not provide any material concessions to its tenants as a result of COVID-19 during the three months ended March 31, 2022 and 2021; therefore, this guidance did not have a material impact on its consolidated financial statements. The Company continues to evaluate the effect that this guidance may have on its consolidated financial statements.

In March 2020, FASB issued ASU 2020-04, "Reference Rate Reform: Facilitation of the Effects of Reference Rate Reform on Financial Reporting" (Topic 848). ASU 2020-04 provides temporary optional expedients and exceptions to ease financial reporting burdens related to applying current GAAP to modifications of contracts, hedging relationships and other transactions in connection with the transition from the London Interbank Offered Rate ("LIBOR") and other interbank offered rates to alternative reference rates. ASU 2020-04 is effective beginning on March 12, 2020, and may be applied prospectively to such transactions through December 31, 2022. We will apply ASU 2020-04 prospectively as and when we enter transactions to which this guidance applies.

In January 2021, FASB issued ASU 2021-01, "Reference Rate Reform" (Topic 848). ASU 2021-01 modifies ASC 848 (ASU 2020-04), which was intended to provide relief related to "contracts and transactions that reference LIBOR or a reference rate that is expected to be discontinued as a result of reference rate reform." ASU 2021-01 expands the scope of ASC 848 to include all affected derivatives and give reporting entities the ability to apply certain aspects of the contract modification and hedge accounting expedients to derivative contracts affected by the discounting transition. ASU 2021-01 also adds implementation guidance to clarify which optional expedients in

ASC 848 may be applied to derivative instruments that do not reference LIBOR or a reference rate that is expected to be discontinued, but that are being modified as a result of the discounting transition. The Company does not expect the adoption of ASU 2021-01 to have a material impact on its consolidated financial statements.

### 3. Deferred Costs and Intangible Assets

Deferred costs and intangible assets consist of the following:

	<b>March 31, 2022</b>	<b>December 31, 2021</b>
	<b>(unaudited)</b>	
Deferred costs	\$348	\$348
Lease origination costs	1,210	1,191
In-place leases	428	428
Real estate tax abatements	9,142	9,142
Total deferred costs and intangible assets	11,128	11,109
Less accumulated amortization	(4,162)	(3,983)
Total deferred costs and intangible assets, net	<u>\$6,966</u>	<u>\$7,126</u>

Amortization of deferred costs, lease origination costs and in-place lease intangible assets was \$59 and \$56 for the three months ended March 31, 2022 and 2021, respectively; \$10 of deferred costs were written off during the three months ended March 31, 2021, and are included in transaction pursuit costs in the consolidated statements of operations. Amortization of real estate tax abatements of \$120 and \$120 for the three months ended March 31, 2022 and 2021, respectively, is included in real estate taxes and insurance in the consolidated statements of operations.

Deferred costs and intangible assets as of March 31, 2022, amortize in future years as follows:

2022 (Remainder)	\$505
2023	575
2024	559
2025	548
2026	533
Thereafter	4,246
Total	<u>\$6,966</u>

### 4. Below-Market Leases, Net

The Company's below-market lease intangibles liabilities are as follows:

	<b>March 31, 2022</b>	<b>December 31, 2021</b>
	<b>(unaudited)</b>	
Below-market leases	\$297	\$297
Less accumulated amortization	(253)	(244)
Below-market leases, net	<u>\$44</u>	<u>\$53</u>

Rental income included amortization of below-market leases of \$9 and \$31 for the three months ended March 31, 2022 and 2021, respectively.

Below-market leases as of March 31, 2022, amortize in future years as follows:

2022 Remainder	26
2023	18
Total	<u>\$44</u>

### 5. Notes Payable

The mortgages, loans and mezzanine notes payable collateralized by the properties, or the Company's interest

in the entities that own the properties and assignment of leases, are as follows:

Property	Maturity	Interest Rate	March 31, 2022	December 31, 2021
Flatbush Gardens, Brooklyn, NY (a)	6/1/2032	3.125%	\$329,000	\$329,000
250 Livingston Street, Brooklyn, NY (b)	6/6/2029	3.63%	125,000	125,000
141 Livingston Street, Brooklyn, NY (c)	3/6/2031	3.21%	100,000	100,000
Tribeca House, Manhattan, NY (d)	3/6/2028	4.506%	360,000	360,000
Aspen, Manhattan, NY (e)	7/1/2028	3.68%	63,670	64,047
Clover House, Brooklyn, NY (f)	12/1/2029	3.53%	82,000	82,000
10 West 65 <sup>th</sup> Street, Manhattan, NY (g)	11/1/2027	3.375%	32,743	32,921
1010 Pacific Street, Brooklyn, NY (h)	9/1/2024	LIBOR + 3.60%	28,702	21,084
Dean Street, Brooklyn, NY (i)	12/22/2022	Prime + 1.60%	30,000	30,000
Total debt			\$1,151,115	\$1,144,052
Unamortized debt issuance costs			(12,077)	(12,898)
Total debt, net of unamortized debt issuance costs			<u>\$1,139,038</u>	<u>\$1,131,154</u>

(a) The \$329,000 mortgage note agreement with New York Community Bank (“NYCB”), entered into on May 8, 2020, matures on June 1, 2032, and bears interest at 3.125% through May 2027 and thereafter at the prime rate plus 2.75%, subject to an option to fix the rate. The note requires interest-only payments through May 2027, and monthly principal and interest payments thereafter based on a 30-year amortization schedule. The Company has the option to prepay all (but not less than all) of the unpaid balance of the note prior to the maturity date, subject to certain prepayment premiums, as defined.

(b) The \$125,000 mortgage note agreement with Citi Real Estate Funding Inc., entered into on May 31, 2019, matures on June 6, 2029, bears interest at 3.63% and requires interest-only payments for the entire term. The Company has the option to prepay all (but not less than all) of the unpaid balance of the note within three months of maturity, without a prepayment premium.

(c) On February 18, 2021, the Company refinanced the \$79,500 mortgage note agreement with NYCB, with a \$100,000, ten-year secured first mortgage note with Citi Real Estate Funding Inc. The note matures on March 6, 2031, bears interest at 3.21% and requires interest-only payments for the entire term. The Company has the option to prepay all (but not less than all) of the unpaid balance of the note within three months of maturity, without a prepayment premium.

(d) The \$360,000 loan with Deutsche Bank, entered into on February 21, 2018, matures on March 6, 2028, bears interest at 4.506% and requires interest-only payments for the entire term. The Company has the option to prepay all (but not less than all) of the unpaid balance of the loan prior to the maturity date, subject to a prepayment premium if it occurs prior to December 6, 2027.

(e) The \$70,000 mortgage note agreement with Capital One Multifamily Finance LLC matures on July 1, 2028, and bears interest at 3.68%. The note required interest-only payments through July 2017, and monthly principal and interest payments of \$321 thereafter based on a 30-year amortization schedule. The Company has the option to prepay the note prior to the maturity date, subject to a prepayment premium.

(f) The \$82,000 mortgage note agreement with MetLife Investment Management, entered into on November 8, 2019, matures on December 1, 2029, bears interest at 3.53% and requires interest-only payments for the entire term. The Company has the option, commencing on January 1, 2024, to prepay the note prior to the maturity date, subject to a prepayment premium if it occurs prior to September 2, 2029.

(g) On October 27, 2017, the Company entered into a \$34,350 mortgage note agreement with NYCB, related to the 10 West 65<sup>th</sup> Street acquisition. The note matures on November 1, 2027, and bears interest at 3.375% through October 2022 and thereafter at the prime rate plus 2.75%, subject to an option to fix the rate. The note required interest-only payments through November 2019, and monthly principal and interest payments of \$152 thereafter based on a 30-year amortization schedule. The Company has the option to prepay all (but not less than all) of the unpaid balance of the note prior to the maturity date, subject to certain prepayment premiums, as defined.

(h) On December 24, 2019, the Company entered into a \$18,600 mortgage note agreement with CIT Bank, N.A., related to the 1010 Pacific Street acquisition. The Company also entered into a pre-development bridge loan secured by the property with the same lender to provide up to \$2,987 for eligible pre-development and carrying



costs. The notes were scheduled to mature on June 24, 2021, required interest-only payments and bore interest at one-month LIBOR (with a floor of 1.25%) plus 3.60% (4.85% as of June 30, 2021). The notes were extended in June 2021 with a new maturity date of August 30, 2021. The Company guaranteed this mortgage note and complied with the financial covenants therein.

On August 10, 2021, the Company refinanced the above 1010 Pacific Street loan with a group of loans with AIG Asset Management (U.S.), LLC providing for maximum borrowings of \$52,500 to develop the property. The notes have a 36-month term, bear interest at 30 day LIBOR plus 3.60% (with a floor of 4.1%) (4.1% at March 31, 2022). The notes mature on September 1, 2024 and may be extended until September 1, 2026. The Company may prepay the unpaid balance of the note within five months of maturity. During the quarter ended March 31, 2022, the Company borrowed \$7,617 to fund development costs of the property.

(i) On December 22, 2021, the Company entered into a \$30,000 mortgage note agreement with Bank Leumi, N.A related to the Dean Street acquisition. The note matures on December 22, 2022, is subject to two six month extension options, requires interest-only payments and bears interest at the prime rate (with a floor of 3.25%) plus 1.60% (5.10% as of March 31, 2022). In April 2022, the Company borrowed an additional \$6,985 under the mortgage note in connection with the acquisition of additional parcels of land in February and April 2022.

The Company has provided a limited guaranty for the mortgage notes at several of its properties. The Company's loan agreements contain customary representations, covenants and events of default. Certain loan agreements require the Company to comply with affirmative and negative covenants, including the maintenance of debt service coverage and debt yield ratios. In the event that they are not compliant, certain lenders may require cash sweeps of rent until the conditions are cured. The Company is not in default on any of its loan agreements.

The following table summarizes principal payment requirements under the terms of the mortgage notes as of March 31, 2022:

2022 (Remainder)	\$31,661
2023	2,296
2024	31,076
2025	2,468
2026	4,549
Thereafter	<u>1,079,065</u>
Total	<u><u>\$1,151,115</u></u>

The Company recognized a loss on extinguishment of debt of \$3,034 during the quarter ended March 31, 2021, in connection with the refinancing of debt on the 141 Livingston Street property in February 2021; the loss consisted of the write-off of unamortized debt costs and other fees.

## 6. Rental Income under Operating Leases

The Company's commercial properties are leased to commercial tenants under operating leases with fixed terms of varying lengths. As of March 31, 2022, the minimum future cash rents receivable (excluding tenant reimbursements for operating expenses) under non-cancelable operating leases for the commercial tenants in each of the next five years and thereafter are as follows:

2022 (Remainder)	29,066
2023	28,813
2024	23,139
2025	2,820
2026	2,149
Thereafter	<u>38,505</u>
Total	<u><u>\$124,492</u></u>

The Company has commercial leases with the City of New York that comprised approximately 24% and 25% of total revenues for the three months ended March 31, 2022 and 2021, respectively.

## 7. Fair Value of Financial Instruments

GAAP requires the measurement of certain financial instruments at fair value on a recurring basis. In addition, GAAP requires the measure of other financial instruments and balances at fair value on a non-recurring

basis (e.g., carrying value of impaired real estate and long-lived assets). Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The GAAP fair value framework uses a three-tiered approach. Fair value measurements are classified and disclosed in one of the following three categories:

- Level 1: unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities;
- 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 in which significant inputs and significant value drivers are observable in active markets; and
- Level 3: prices or valuation techniques where little or no market data is available that require inputs that are both significant to the fair value measurement and unobservable.

When available, the Company utilizes quoted market prices from an independent third-party source to determine fair value and classifies such items in Level 1 or Level 2. In instances where the market for a financial instrument is not active, regardless of the availability of a nonbinding quoted market price, observable inputs might not be relevant and could require the Company to make a significant adjustment to derive a fair value measurement. Additionally, in an inactive market, a market price quoted from an independent third party may rely more on models with inputs based on information available only to that independent third party. When the Company determines the market for a financial instrument owned by the Company to be illiquid or when market transactions for similar instruments do not appear orderly, the Company uses several valuation sources (including internal valuations, discounted cash flow analysis and quoted market prices) and establishes a fair value by assigning weights to the various valuation sources.

Changes in assumptions or estimation methodologies can have a material effect on these estimated fair values. In this regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, may not be realized in an immediate settlement of the instrument.

The financial assets and liabilities in the consolidated balance sheets include cash and cash equivalents, restricted cash, receivables, prepaid expenses, accounts payable and accrued liabilities, security deposits and notes payable. The carrying amount of cash and cash equivalents, restricted cash, receivables, prepaid expenses, accounts payable and accrued liabilities, and security deposits reported in the consolidated balance sheets approximates fair value due to the short-term nature of these instruments. The fair value of notes payable, which are classified as Level 2, is estimated by discounting the contractual cash flows of each debt instrument to their present value using adjusted market interest rates.

The carrying amount and estimated fair value of the notes payable are as follows:

	<b>March 31, 2022</b>	<b>December 31, 2021</b>
	<b>(unaudited)</b>	
Carrying amount (excluding unamortized debt issuance costs)	\$1,151,115	\$1,144,052
Estimated fair value	\$1,138,150	\$1,199,409

## **8. Commitments and Contingencies**

### *Legal*

On July 3, 2017, the Supreme Court of the State of New York (the “Court”) ruled in favor of 41 present or former tenants of apartment units at the Company’s buildings located at 50 Murray Street and 53 Park Place in Manhattan, New York (the Tribeca House property), who brought an action (the “*Kuzmich*” case) against the Company alleging that they were subject to applicable rent stabilization laws with the result that rental payments charged by the Company exceeded amounts permitted under these laws because the buildings were receiving certain tax abatements under Real Property Tax Law (“RPTL”) 421-g. The Court also awarded the plaintiffs-tenants their attorney’s fees and costs. The Court declared that the plaintiffs-tenants were subject to rent stabilization requirements and referred the matter to a special referee to determine the amount of rent over-charges, if any. On

July 18, 2017, the Court, pursuant to the parties' agreement, stayed the Court's ruling; the Company subsequently appealed the decision to the Appellate Division, First Department. On January 18, 2018, the Appellate Division unanimously reversed the Court's ruling and ruled in favor of the Company, holding that the Company acted properly in de-regulating the apartments. The plaintiffs-tenants thereafter moved for leave to appeal to the Court of Appeals, which motion was granted on April 24, 2018. On June 25, 2019, the New York Court of Appeals reversed the Appellate Division's order and ruled in favor of the plaintiffs-tenants, holding that apartments in buildings receiving RPTL 421-g tax benefits are not subject to luxury deregulation. The Court of Appeals also remitted the matter for further proceedings consistent with its opinion. As a result of the Court of Appeals' order, Company management believes that payments may be required to be made to the 41 present or former tenants comprising the plaintiff group, that other tenants may attempt to make similar claims, and that the special referee process referred to above will be used to determine the timing and the amount of any claims that must be paid. On July 25, 2019, the Company filed a motion for reargument with the New York Court of Appeals, which was denied on September 12, 2019. On October 24, 2019, the Company filed a Petition for a Writ of Certiorari with the United States Supreme Court, seeking permission to have that Court hear the Company's appeal on Constitutional grounds from the Court of Appeals' order. On January 13, 2020, the United States Supreme Court denied the Company's Petition for a Writ of Certiorari, meaning that the Court of Appeals' order is final. On August 13, 2019, the Court, in effect, reinstated its prior order and referred the calculation of rent overcharges and attorneys' fees for a hearing before a special referee. The special referee's hearing was scheduled for October 23, 2019. On October 17, 2019, the Company made a motion in the Appellate Division for a stay of the special referee's hearing pending the Company's appeal from the August 13 order. On such date, the Appellate Division granted an interim stay of the special referee's hearing, pending the determination of the underlying motion. On January 7, 2020, the Appellate Division granted the Company's motion for a full stay of the special referee's hearing pending appeal. The appeal had been scheduled to be argued during the May 2020 term, but on March 16, 2020, the parties filed a stipulation adjourning the appeal to the September 2020 term. On or about July 13, 2020, the parties filed another stipulation adjourning the appeal to the October 2020 term. The appeal was orally argued on October 8, 2020. On October 29, 2020, the Appellate Division reversed the lower court's ruling to the extent that it directed any rent overcharges to be calculated pursuant to the so-called "default formula." Instead, the Appellate Division held that (1) the "base date" for the determination of rent overcharges is four years prior to the 2016 filing of the complaint, and (2) overcharges, if any, are to be determined by comparing the rents actually charged during the four-year period to the rent increases permitted by the New York City Rent Guidelines Board. Although not eliminating rent overcharge liability altogether, this ruling is expected to limit the Company's financial exposure in this regard. The Appellate Division, however, affirmed the lower court's award of attorneys' fees to the plaintiffs-tenants. The case was thereafter remanded to the lower courts, and on May 20, 2021, an appearance was held concerning the determination of any overcharges to which the plaintiffs-tenants are entitled as well as the amount of plaintiffs-tenants' attorneys' fees. Hearings in connection with determining the amount of rent overcharges if any, due to the plaintiffs, took place on October 27, 2021, December 14, 2021, and January 19, 2022. In connection therewith, the parties submitted supplemental briefings on November 17, 2021 and at various other times thereafter. Additionally, the Company has reason to believe that the plaintiffs' purported engagement letter did not authorize the plaintiffs' attorneys to proceed on their behalf in this action, insofar as the plaintiffs did not individually execute such engagement letter. On this basis, on December 3, 2021 the Company submitted a written motion to the court to dismiss the action. On March 4, 2022 the motion was denied. The court has issued a draft ruling regarding the rent overcharges, which at this time is subject to finalization. On or about April 7, 2022, in lieu of a hearing, the plaintiffs filed a written submission in support of their attorneys' fees application. The Company's papers in opposition to such application are due on May 25, 2022.

On November 18, 2019, the same law firm which filed the *Kuzmich* case filed a second action involving a separate group of 26 tenants (captioned *Crowe et al v 50 Murray Street Acquisition LLC*, Supreme Court, New York County, Index No. 161227/19), which action advances the same claims as in *Kuzmich*. The Company's deadline to answer or otherwise respond to the complaint in *Crowe* had been extended to June 30, 2020; on such date, the Company filed its answer to the complaint. Pursuant to the court's rules, on July 16, 2020, the plaintiffs filed an amended complaint; the sole difference as compared to the initial complaint is that seven new plaintiffs-tenants were added to the caption; there were no substantive changes to the complaint's allegations. On August 5, 2020, the Company filed its answer to the amended complaint.

On March 9, 2021, the same law firm which filed the *Kuzmich* and *Crowe* cases filed a third action involving another tenant (captioned *Horn v 50 Murray Street Acquisition LLC*, Supreme Court, New York County, Index No. 152415/21), which action advances the same claims as in *Kuzmich* and *Crowe*. The Company filed its answer to the

complaint on May 21, 2021.

On March 4, 2022, the Supreme Court, New York County rendered a decision to deny the Company's motion to dismiss the *Kuzmich* case as noted above and a decision that quantified amounts owed to tenants for rent overcharges in the *Kuzmich* case. These decisions established the probability and ability to reasonably compute amounts owed to tenants for all the cases. As a result, the Company recorded a charge for litigation settlement and other of \$2.7 million in the consolidated statements of operations in the quarter ended December 31, 2021 comprising rent overcharges, interest and legal costs of plaintiff's counsel.

In addition to the above, the Company is subject to certain legal proceedings and claims arising in connection with its business. Management believes, based in part upon consultation with legal counsel, that the ultimate resolution of all such claims will not have a material adverse effect on the Company's consolidated results of operations, financial position or cash flows.

The Office of the Attorney General of the State of New York ("OAG") commenced an investigation concerning the conduct of screening of tenant applicants in the building portfolio in which Clipper Equity and its principals have a management and/or ownership interest. Clipper Equity cooperated with the investigation and, in April 2022 entered into an Assurance of Discontinuance with the OAG to resolve the investigation on behalf of itself and its affiliates, the terms of which have no impact to the Company's financial position or results of operations.

#### *Commitments*

The Company is obligated to provide parking availability through August 2025 under a lease with a tenant at the 250 Livingston Street property; the current cost to the Company is approximately \$205 per year.

#### *Contingencies*

The COVID-19 pandemic has adversely impacted global economic activity and contributed to significant volatility in financial markets. The COVID-19 pandemic and associated government actions intended to curb its spread created disruptions in, and adversely impacted, many industries and negatively impacted, and could continue to negatively impact, the Company's business in several ways, including affecting its tenants' ability or willingness to pay rents and reducing demand for housing in the New York metropolitan area. The Tribeca House property and several other properties experienced declines in leased occupancy and residential rental rate as a result of the COVID-19 pandemic. Certain of the Company's commercial tenants requested and received partial rent deferrals during the pandemic (the total deferred amount at March 31, 2022, was \$0.6 million). In some cases, the Company restructured rent and other obligations under its leases with its tenants on terms that were less favorable to it than those currently in place. Additionally, the outbreak could have a continued material adverse impact on economic and market conditions which may ultimately result in a further decrease in occupancy levels across the Company's portfolio as residents reduce their spending and replacement tenants become harder to find. Despite mitigation of the worst effects of the pandemic, we are still unable to make a prediction as to the ultimate material adverse impact of the COVID-19 pandemic. Nevertheless, COVID-19 presents uncertainty and risk with respect to the Company's tenants, which could adversely affect the Company's financial performance.

The Company's properties remained open and operational throughout the pandemic. The Company took the necessary steps to keep employees and tenants safe in compliance with state and local orders and has continued to provide typical services to its residents.

#### *Concentrations*

The Company's properties are located in the Boroughs of Manhattan and Brooklyn in New York City, which exposes the Company to greater economic risks than if it owned a more geographically dispersed portfolio.

The breakdown between commercial and residential revenue is as follows (unaudited):

	<b>Commercial</b>	<b>Residential</b>	<b>Total</b>
Three months ended March 31, 2022	33%	67%	100%
Three months ended March 31, 2021	30%	70%	100%

## 9. Related-Party Transactions

The Company recorded office and overhead expenses pertaining to a related company in general and administrative expense of \$64 and \$66 for the three months ended March 31, 2022 and 2021, respectively. The Company recognized a credit to reimbursable payroll expense pertaining to a related company in general and administrative expense of \$8 and \$41 for the three months ended March 31, 2022 and 2021, respectively.

The Company paid legal and advisory fees to firms in which two of our directors were principals or partners of \$0 and \$404 for the three months ended March 31, 2022 and 2021 respectively.

## 10. Segment Reporting

The Company has classified its reporting segments into commercial and residential rental properties. The commercial reporting segment includes the 141 Livingston Street property and portions of the 250 Livingston Street, Tribeca House and Aspen properties. The residential reporting segment includes the Flatbush Gardens property, the Clover House property, the 10 West 65<sup>th</sup> Street property, the 1010 Pacific Street property and portions of the 250 Livingston Street, Tribeca House and Aspen properties.

The Company's income from operations by segment for the three months ended March 31, 2022 and 2021, is as follows (unaudited):

<b>Three months ended March 31, 2022</b>	<b>Commercial</b>	<b>Residential</b>	<b>Total</b>
Rental income	\$10,588	\$21,462	\$32,050
Total revenues	\$10,588	\$21,462	\$32,050
Property operating expenses	1,143	6,396	7,539
Real estate taxes and insurance	2,020	5,911	7,931
General and administrative	524	2,418	2,942
Transaction pursuit costs	79	345	424
Depreciation and amortization	1,356	5,349	6,705
Total operating expenses	5,122	20,419	25,541
Income from operations	\$5,466	\$1,043	\$6,509

<b>Three months ended March 31, 2021</b>	<b>Commercial</b>	<b>Residential</b>	<b>Total</b>
Rental income	\$9,047	\$21,604	\$30,651
Total revenues	9,047	21,604	30,651
Property operating expenses	1,119	7,523	8,642
Real estate taxes and insurance	1,896	5,416	7,312
General and administrative	299	1,994	2,293
Transaction pursuit costs	60	—	60
Depreciation and amortization	1,243	4,984	6,227
Total operating expenses	4,617	19,917	24,534
Income from operations	\$4,430	\$1,687	\$6,117

The Company's total assets by segment are as follows, as of:

	<b>Commercial</b>	<b>Residential</b>	<b>Total</b>
March 31, 2022 (unaudited)	\$310,782	\$915,997	\$1,226,779
December 31, 2021	310,423	923,324	1,233,657

The Company's interest expense by segment for the three months ended March 31, 2022 and 2021, is as follows (unaudited):

	<u>Commercial</u>	<u>Residential</u>	<u>Total</u>
<u>Three months ended March 31,</u>			
2022	\$2,494	\$7,491	\$9,985
2021	2,076	8,141	10,217

The Company's capital expenditures by segment for the three months ended March 31, 2022 and 2021, are as follows (unaudited):

	<u>Commercial</u>	<u>Residential</u>	<u>Total</u>
<u>Three months ended March 31,</u>			
2022	\$790	\$15,644	\$16,434
2021	\$2,370	\$3,172	\$5,542

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*You should read the following discussion of our financial condition and results of operations in conjunction with the more detailed information set forth under the caption, "Cautionary Note Concerning Forward-Looking Statements," and in our financial statements and the related notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q.*

### Overview of Our Company

Clipper Realty Inc. (the "Company" or "we") is a self-administered and self-managed real estate company that acquires, owns, manages, operates and repositions multifamily residential and commercial properties in the New York metropolitan area, with a current portfolio in Manhattan and Brooklyn. Our primary focus is to own, manage and operate our portfolio and to acquire and reposition additional multifamily residential and commercial properties in the New York metropolitan area. The Company has been organized and operates in conformity with the requirements for qualification and taxation as a real estate investment trust ("REIT") under the U.S. federal income tax law and elected to be treated as a REIT commencing with the taxable year ended December 31, 2015.

The Company was incorporated on July 7, 2015. On August 3, 2015, we closed a private offering of shares of our common stock, in which we raised net proceeds of approximately \$130.2 million. In connection with the private offering, we consummated a series of investment and other formation transactions that were designed, among other things, to enable us to qualify as a REIT for U.S. federal income tax purposes.

In February 2017, the Company sold 6,390,149 primary shares of common stock (including the exercise of the over-allotment option, which closed on March 10, 2017) to investors in an initial public offering ("IPO") at \$13.50 per share. The proceeds, net of offering costs, were approximately \$78.7 million. The Company contributed the IPO proceeds to the Operating Partnership in exchange for units in the Operating Partnership.

On May 9, 2017, the Company completed the purchase of 107 Columbia Heights (since rebranded as "Clover House"), a 158-unit apartment community located in Brooklyn Heights, New York, for \$87.5 million.

On October 27, 2017, the Company completed the acquisition of an 82-unit residential property at 10 West 65<sup>th</sup> Street in Manhattan, New York, for \$79.0 million.

On November 8, 2019, the Company completed the acquisition of property located at 1010 Pacific Street in Prospect Heights, New York, for \$31.0 million.

During the period December 2021 through February 2022, the Company purchased the Dean Street property located in Prospect Heights, Brooklyn, New York, for approximately \$44.0 million including \$3.7 million spent to purchase an additional parcel of land

As of March 31, 2022, the Company owns:

- two neighboring residential/retail rental properties at 50 Murray Street and 53 Park Place in the Tribeca

neighborhood of Manhattan;

- one residential property complex in the East Flatbush neighborhood of Brooklyn consisting of 59 buildings;
- two primarily commercial properties in Downtown Brooklyn (one of which includes 36 residential apartment units);
- one residential/retail rental property at 1955 1<sup>st</sup> Avenue in Manhattan;
- one residential rental property at 107 Columbia Heights in the Brooklyn Heights neighborhood of Brooklyn;
- one residential rental property at 10 West 65<sup>th</sup> Street in the Upper West Side neighborhood of Manhattan; and
- one property at 1010 Pacific Street in the Prospect Heights neighborhood of Brooklyn, to be redeveloped as a residential rental building.
- the Dean Street property, to be redeveloped as a residential/retail rental building.

These properties are located in the most densely populated major city in the United States, each with immediate access to mass transportation.

The Company's ownership interest in its initial portfolio of properties, which includes the Tribeca House, Flatbush Gardens and the two Livingston Street properties, was acquired in the formation transactions in connection with the private offering. These properties are owned by the LLC subsidiaries, which are managed by the Company through the Operating Partnership. The Operating Partnership's interests in the LLC subsidiaries generally entitle the Operating Partnership to all cash distributions from, and the profits and losses of, the LLC subsidiaries other than the preferred distributions to the continuing investors who hold Class B LLC units in these LLC subsidiaries. The continuing investors own an aggregate amount of 26,317,396 Class B LLC units, representing 62.1% of the Company's common stock on a fully diluted basis. Accordingly, the Operating Partnership's interests in the LLC subsidiaries entitle the Operating Partnership to receive 37.9% of the aggregate distributions from the LLC subsidiaries. The Company, through the Operating Partnership, owns all of the ownership interests in the Aspen property, the Clover House property, the 10 West 65<sup>th</sup> Street property, the 1010 Pacific Street property and the Dean Street property.

### **COVID-19 Pandemic**

The COVID-19 pandemic has adversely impacted global economic activity and contributed to significant volatility in financial markets. The COVID-19 pandemic and associated government actions intended to curb its spread created disruptions in, and adversely impacted, many industries and negatively impacted, and could continue to negatively impact, the Company's business in several ways, including affecting its tenants' ability or willingness to pay rents and reducing demand for housing in the New York metropolitan area. The Tribeca House property and several other properties experienced declines in leased occupancy and residential rental rate as a result of the COVID-19 pandemic. Certain of the Company's commercial tenants requested and received partial rent deferrals during the pandemic (the total deferred amount at March 31, 2022, was \$0.6 million). In some cases, the Company restructured rent and other obligations under its leases with its tenants on terms that were less favorable to it than those currently in place. Additionally, the outbreak could have a continued material adverse impact on economic and market conditions which may ultimately result in a further decrease in occupancy levels across the Company's portfolio as residents reduce their spending and replacement tenants become harder to find. Despite mitigation of the worst effects of the pandemic, we are still unable to make a prediction as to the ultimate material adverse impact of the COVID-19 pandemic. Nevertheless, COVID-19 presents uncertainty and risk with respect to the Company's tenants, which could adversely affect the Company's financial performance.

Despite these continuing very challenging circumstances, our business has remained durable. Our properties have remained open and operational throughout the pandemic. We are taking the necessary steps to keep our employees and tenants safe in compliance with state and local orders, and we continue to provide typical services to

our residents. Our rent collection rate during the first quarter of 2022 was 96.5%; for full-year 2021, our rent collection rate was 96.7%. At March 31, 2022, our properties were 96% leased. We expect our properties and the New York City market to remain desirable to a broad range of tenants and our operations to return to a more normal state over time.

## Results of Operations

Our focus throughout 2021 and year-to-date 2022 has been to manage our properties to optimize revenues and control costs, while continuing to renovate and reposition certain properties. The discussion below highlights the specific properties contributing to the changes in the results of operations.

### *Income Statement for the Three Months Ended March 31, 2022 and 2021 (in thousands)*

	2022	2021	Increase (decrease)	%
Revenues				
Residential rental income	\$21,462	\$21,604	\$(142)	(0.7)%
Commercial rental income	10,588	9,047	1,541	17.0%
Total revenues	<u>32,050</u>	<u>30,651</u>	<u>1,399</u>	<u>4.6%</u>
Operating Expenses				
Property operating expenses	7,539	8,642	(1,103)	(12.8)%
Real estate taxes and insurance	7,931	7,312	619	8.5%
General and administrative	2,942	2,293	649	28.3%
Transaction pursuit costs	424	60	364	NM
Depreciation and amortization	6,705	6,227	478	7.7%
Total operating expenses	<u>25,541</u>	<u>24,534</u>	<u>1,007</u>	<u>4.1%</u>
Income from operations	6,509	6,117	392	6.4%
Interest expense, net	(9,985)	(10,217)	232	2.3%
Loss on extinguishment of debt	—	(3,034)	3,034	NM
Net loss	<u><u>\$(3,476)</u></u>	<u><u>\$(7,134)</u></u>	<u><u>\$3,658</u></u>	<u><u>51.3%</u></u>

**Revenue.** Residential rental income decreased to \$21,462 for the three months ended March 31, 2022, from \$21,604 for the three months ended March 31, 2021, primarily due to reserves and writeoffs of receivables recorded in accordance with ASC 842 of \$700 substantially offset by increases in rental rates and leased occupancy at the Tribeca House, Clover House and Aspen properties. For example, base rent per square foot increased at the Tribeca House property to \$64.76 (98.8% leased occupancy) at March 31, 2022, from \$62.43 (96.5% leased occupancy) at March 31, 2021.

Commercial rental income increased to \$10,588 for the three months ended March 31, 2022, from \$9,047 for the three months ended March 31, 2021 due the restoration of revenue as per ASC 842 from a tenant at Tribeca House now probable of collection of \$1,100 and to the commencement of a new leases at the Tribeca House.

**Property operating expenses.** Property operating expenses include property-level costs such as compensation costs for property-level personnel, repairs and maintenance, supplies, utilities and landscaping and, in 2021, bad debt expense. Property operating expenses decreased to \$7,539 for the three months ended March 31, 2022, from \$8,642 for the three months ended March 31, 2021, primarily due to bad debt expense recorded in 2021 under ASC 450 which is now recorded as a reduction of revenues in accordance with the adoption of ASC 842.

**Real estate taxes and insurance.** Real estate taxes and insurance expenses increased to \$7,931 for the three months ended March 31, 2022, from \$7,312 for the three months ended March 31, 2021, due to increased real estate taxes and property insurance across the portfolio.

**General and administrative.** General and administrative expenses increased to \$2,942 for the three months ended March 31, 2022, from \$2,293 for the three months ended March 31, 2021 primarily due to increased executive compensation expense.

**Transaction pursuit costs.** Transaction pursuit costs primarily reflect costs incurred for an abandoned acquisition.

**Depreciation and amortization.** Depreciation and amortization expense increased to \$6,705 for the three



months ended March 31, 2022, from \$6,227 for the three months ended March 31, 2021, due to additions to real estate across the portfolio.

**Interest expense, net.** Interest expense, net, decreased to \$9,985 for the three months ended March 31, 2022, from \$10,217 for the three months ended March 31, 2021 primarily due to interest capitalized related to development of the 1010 Pacific Street and Dean Street property in the first quarter of 2022.

**Loss on extinguishment of debt.** Loss on extinguishment of debt for the three months ended March 31, 2021, was due to write-off of unamortized debt cost in the refinancing of the 141 Livingston Street loan in February 2021

**Net loss.** As a result of the foregoing, net loss decreased to \$3,476 for the three months ended March 31, 2022, from \$7,134 for the three months ended March 31, 2021.

## **Liquidity and Capital Resources**

As of March 31, 2022, we had \$1,139 million of indebtedness, net of unamortized issuance costs, secured by our properties, \$25.3 million of cash and cash equivalents, and \$18.5 million of restricted cash. See Note 5, “Notes Payable” of our consolidated financial statements for a discussion of for a discussion of the Company’s property-level debt.

As a REIT, we are required to distribute at least 90% of our REIT taxable income, computed without regard to the dividends paid deduction and excluding net capital gains, to stockholders on an annual basis. We expect that these needs will be met from cash generated from operations and other sources, including proceeds from secured mortgages and unsecured indebtedness, proceeds from additional equity issuances and cash generated from the sale of property.

### **Short-Term and Long-Term Liquidity Needs**

Our short-term liquidity needs will primarily be to fund operating expenses, recurring capital expenditures, property taxes and insurance, interest and scheduled debt principal payments, general and administrative expenses, and distributions to stockholders and unit holders. We generally expect to meet our short-term liquidity requirements through net cash provided by operations and cash on hand, and we believe we will have sufficient resources to meet our short-term liquidity requirements.

Our principal long-term liquidity needs will primarily be to fund additional property acquisitions, major renovation and upgrading projects, and debt payments and debt payments at maturity. We do not expect that net cash provided by operations will be sufficient to meet all of these long-term liquidity needs. We anticipate meeting our long-term liquidity requirements by using cash as an interim measure and funds from public and private equity offerings and long-term secured and unsecured debt offerings.

We believe that as a publicly traded REIT, we will have access to multiple sources of capital to fund our long-term liquidity requirements. These sources include the incurrence of additional debt and the issuance of additional equity. However, we cannot provide assurance that this will be the case. Our ability to secure additional debt will depend on a number of factors, including our cash flow from operations, our degree of leverage, the value of our unencumbered assets and borrowing restrictions that may be imposed. Our ability to access the equity capital markets will depend on a number of factors as well, including general market conditions, market conditions for REITs and market perceptions about our company.

We believe that our current cash flows from operations and cash on hand, coupled with additional mortgage debt, will be sufficient to allow us to continue operations, satisfy our contractual obligations and make distributions to our stockholders and the members of our LLC subsidiaries for at least the next twelve months. However, no assurance can be given that we will be able to refinance any of our outstanding indebtedness in the future on favorable terms or at all.

### **Distributions**

In order to qualify as a REIT for Federal income tax purposes, we must currently distribute at least 90% of our taxable income to our shareholders. During the three months ended March 31, 2022 and 2021, we paid dividends and distributions on our common shares, Class B LLC units and LTIP units totaling \$4.2 million and \$4.2 million, respectively.

***Cash Flows for the Three Months Ended March 31, 2022 and 2021 (in thousands)***

	<b>Three Months Ended March 31,</b>	
	<b>2022</b>	<b>2021</b>
Operating activities	\$6,587	\$7,437
Investing activities	(17,851)	(7,745)
Financing activities	2,875	17,472

*Cash flows provided by (used in) operating activities, investing activities and financing activities for the three months ended March 31, 2022 and 2021, were as follows:*

Net cash flow provided by operating activities was \$6,587 for the three months ended March 31, 2022, compared to \$7,437 for the three months ended March 31, 2021. The net decrease during the 2022 period primarily reflected a decrease of \$667 of cash flow from operating results.

Net cash used in investing activities was \$17,851 for the three months ended March 31, 2022, compared to \$7,745 for the three months ended March 31, 2021. The increase was primarily due to capital spending on developing 1010 Pacific Street and the Dean Street property including acquisition of a few remaining parcels of land purchased in 2022.

Net cash provided by financing activities was \$2,875 for the three months ended March 31, 2022, compared to \$17,472 for the three months ended March 31, 2021. Cash was provided in the three months ended March 31, 2022, by borrowings under the lending facility for 1010 Pacific Street (\$7,617) partially offset by dividends and distributions (\$4,188) and scheduled debt amortization payments (\$554). Cash was provided in the three months ended March 31, 2021, by proceeds from a new loan on the 141 Livingston Street property (\$100,000) and additional borrowings related to the development at the 1010 Pacific Street property (\$248), partially offset by repayment of the existing loan on the 141 Livingston Street property (\$74,241), regularly scheduled debt amortization (\$535), loan issuance and extinguishment costs (\$3,809) and dividends and distributions (\$4,191).

***Income Taxes***

No provision has been made for income taxes since all of the Company's operations are held in pass-through entities and accordingly the income or loss of the Company is included in the individual income tax returns of the partners or members.

We elected to be treated as a REIT for U.S. federal income tax purposes, beginning with our first taxable three months ended March 31, 2015. As a REIT, we generally will not be subject to federal income tax on income that we distribute to our stockholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax on our taxable income at regular corporate tax rates. We believe that we are organized and operate in a manner that will enable us to qualify and be taxed as a REIT and we intend to continue to operate to satisfy the requirements for qualification as a REIT for federal income tax purposes.

***Inflation***

Inflation did not have a significant impact on the results of operations for the Company's business for the periods reported in the consolidated financial statements. We do not believe that inflation currently poses a material risk to the Company. The leases at our residential rental properties, which comprise approximately 67% of our revenue, are short-term in nature. Our longer-term commercial and retail leases would generally allow us to recover some increased operating costs in the event of significant inflation.

Although the impact of inflation has been relatively insignificant in recent years, it has recently become a factor in the United States economy and could increase the cost of acquiring or replacing properties in the future.

**Non-GAAP Financial Measures**

In this Quarterly Report on Form 10-Q, we disclose and discuss funds from operations ("FFO"), adjusted funds from operations ("AFFO"), adjusted earnings before interest, income taxes, depreciation and amortization ("Adjusted EBITDA") and net operating income ("NOI"), all of which meet the definition of "non-GAAP financial

measures” set forth in Item 10(e) of Regulation S-K promulgated by the SEC.

While management and the investment community in general believe that presentation of these measures provides useful information to investors, neither FFO, AFFO, Adjusted EBITDA, nor NOI should be considered as an alternative to net income (loss) or income from operations as an indication of our performance. We believe that to understand our performance further, FFO, AFFO, Adjusted EBITDA, and NOI should be compared with our reported net income (loss) or income from operations and considered in addition to cash flows computed in accordance with GAAP, as presented in our consolidated financial statements.

#### ***Funds From Operations and Adjusted Funds From Operations***

FFO is defined by the National Association of Real Estate Investment Trusts (“NAREIT”) as net income (computed in accordance with GAAP), excluding gains (or losses) from sales of property and impairment adjustments, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. Our calculation of FFO is consistent with FFO as defined by NAREIT.

AFFO is defined by us as FFO excluding amortization of identifiable intangibles incurred in property acquisitions, straight-line rent adjustments to revenue from long-term leases, amortization costs incurred in originating debt, interest rate cap mark-to-market adjustments, amortization of non-cash equity compensation, acquisition and other costs, transaction pursuit costs, loss on modification/extinguishment of debt, gain on involuntary conversion, gain on termination of lease and certain litigation-related expenses, less recurring capital spending.

Historical cost accounting for real estate assets implicitly assumes that the value of real estate assets diminishes predictably over time. In fact, real estate values have historically risen or fallen with market conditions. FFO is intended to be a standard supplemental measure of operating performance that excludes historical cost depreciation and valuation adjustments from net income. We consider FFO useful in evaluating potential property acquisitions and measuring operating performance. We further consider AFFO useful in determining funds available for payment of distributions. Neither FFO nor AFFO represent net income (loss) or cash flows from operations computed in accordance with GAAP. You should not consider FFO and AFFO to be alternatives to net income (loss) as reliable measures of our operating performance; nor should you consider FFO and AFFO to be alternatives to cash flows from operating, investing or financing activities (computed in accordance with GAAP) as measures of liquidity.

Neither FFO nor AFFO measure whether cash flow is sufficient to fund all of our cash needs, including principal amortization, capital improvements and distributions to stockholders. FFO and AFFO do not represent cash flows from operating, investing or financing activities computed in accordance with GAAP. Further, FFO and AFFO as disclosed by other REITs might not be comparable to our calculations of FFO and AFFO.

The following table sets forth a reconciliation of FFO and AFFO for the periods presented to net loss, computed in accordance with GAAP (amounts in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2022</b>	<b>2021</b>
<b>FFO</b>		
Net loss	\$(3,476)	\$(7,134)
Real estate depreciation and amortization	6,705	6,227
<b>FFO</b>	<b>\$3,229</b>	<b>\$(907)</b>
<b>AFFO</b>		
FFO	\$3,229	\$(907)
Amortization of real estate tax intangible	120	120
Amortization of above- and below-market leases	(9)	(31)
Straight-line rent adjustments	(189)	(1)
Amortization of debt origination costs	313	308
Amortization of LTIP awards	495	486
Transaction pursuit costs	424	60
Loss on extinguishment of debt	-	3,034
Certain litigation-related expenses	86	59
Recurring capital spending	(49)	(50)
<b>AFFO</b>	<b>\$4,420</b>	<b>\$3,078</b>

***Adjusted Earnings Before Interest, Income Taxes, Depreciation and Amortization***

We believe that Adjusted EBITDA is a useful measure of our operating performance. We define Adjusted EBITDA as net income (loss) before allocation to non-controlling interests, plus real estate depreciation and amortization, amortization of identifiable intangibles, straight-line rent adjustments to revenue from long-term leases, amortization of non-cash equity compensation, interest expense (net), acquisition and other costs, transaction pursuit costs, loss on modification/extinguishment of debt and certain litigation-related expenses, less gain on involuntary conversion and gain on termination of lease.

We believe that this measure provides an operating perspective not immediately apparent from GAAP income from operations or net income (loss). We consider Adjusted EBITDA to be a meaningful financial measure of our core operating performance.

However, Adjusted EBITDA should only be used as an alternative measure of our financial performance. Further, other REITs may use different methodologies for calculating Adjusted EBITDA, and accordingly, our Adjusted EBITDA may not be comparable to that of other REITs.

The following table sets forth a reconciliation of Adjusted EBITDA for the periods presented to net loss, computed in accordance with GAAP (amounts in thousands):

	<b>Three Months Ended March 31,</b>	
	<b>2022</b>	<b>2021</b>
<b>Adjusted EBITDA</b>		
Net loss	\$(3,476)	\$(7,134)
Real estate depreciation and amortization	6,705	6,227
Amortization of real estate tax intangible	120	120
Amortization of above- and below-market leases	(9)	(31)
Straight-line rent adjustments	(189)	(1)
Amortization of LTIP awards	495	486
Interest expense, net	9,985	10,217
Transaction pursuit costs	424	60
Loss on extinguishment of debt	-	3,034
Certain litigation-related expenses	86	59
<b>Adjusted EBITDA</b>	<b>\$14,141</b>	<b>\$13,037</b>

### ***Net Operating Income***

We believe that NOI is a useful measure of our operating performance. We define NOI as income from operations plus real estate depreciation and amortization, general and administrative expenses, acquisition and other costs, transaction pursuit costs, amortization of identifiable intangibles and straight-line rent adjustments to revenue from long-term leases, less gain on termination of lease. We believe that this measure is widely recognized and provides an operating perspective not immediately apparent from GAAP income from operations or net income (loss). We use NOI to evaluate our performance because NOI allows us to evaluate the operating performance of our company by measuring the core operations of property performance and capturing trends in rental housing and property operating expenses. NOI is also a widely used metric in valuation of properties.

However, NOI should only be used as an alternative measure of our financial performance. Further, other REITs may use different methodologies for calculating NOI, and accordingly, our NOI may not be comparable to that of other REITs.

The following table sets forth a reconciliation of NOI for the periods presented to income from operations, computed in accordance with GAAP (amounts in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2022</b>	<b>2021</b>
<b>NOI</b>		
Income from operations	\$6,509	\$6,117
Real estate depreciation and amortization	6,705	6,227
General and administrative expenses	2,942	2,293
Transaction pursuit costs	424	60
Amortization of real estate tax intangible	120	120
Amortization of above- and below-market leases	(9)	(31)
Straight-line rent adjustments	(189)	(1)
<b>NOI</b>	<b>\$16,502</b>	<b>\$14,785</b>

### **Critical Accounting Policies**

Management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Management bases its estimates on historical experience and assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Except for the effects of adoption of ASC 842 in the first quarter of 2022 as more fully described in Note 2 Significant Accounting Policies, we believe that there have been no material changes to the items that we disclosed as our critical accounting policies under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in our Form 10-K for the year ended December 31, 2021.

### **Recent Accounting Pronouncements**

See Note 2, "Significant Accounting Policies" of our consolidated financial statements for a discussion of recent accounting pronouncements.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our future income, cash flows and fair value relevant to our financial instruments depends upon prevailing market interest rates. Market risk refers to the risk of loss from adverse changes in market prices and interest rates. Based upon the nature of our operations, the principal market risk to which we are exposed is the risk related to interest rate fluctuations. Many factors, including governmental monetary and tax policies, domestic and international economic and political considerations, and other factors that are beyond our control, contribute to interest rate risk.

A one percent change in interest rates on our \$58.7 million of variable rate debt as of March 31, 2022, would

impact annual net loss by approximately \$0.6 million.

At March 31, 2022, there were no interest rate caps for the Company's outstanding debt.

The fair value of the Company's notes payable was approximately \$1,138.2 million and \$1,199.4 million as of March 31, 2022 and December 31, 2021, respectively

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the period covered by this Annual Report on Form 10-K. Based on the evaluation of our disclosure controls and procedures as of March 31, 2022, our CEO and CFO concluded that, as of such date, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

### **Changes in Internal Control**

There were no changes in our internal control over financial reporting identified in management's evaluation pursuant to Rules 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Management's Annual Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of March 31, 2022, based on the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of March 31, 2022.

## **PART II – OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

See Note 8, "Commitments and Contingencies" of our consolidated financial statements for a discussion of legal proceedings.

### **ITEM 1A. RISK FACTORS**

The risk factors disclosed in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2021, set forth information relating to various risks and uncertainties that could materially adversely affect our business, financial condition, liquidity and operating results. Such risk factors continue to be relevant to an understanding of our business, financial condition, liquidity and operating results as of March 31, 2022, and there have been no material changes to those risk factors for the three months ended March 31, 2022. Moreover, many of the risks described in the risk factors set forth in our Annual Report on Form 10-K may be more likely to impact us as a result of the COVID-19 pandemic.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURE**

Not applicable.

**ITEM 6. EXHIBITS**

<b>Exhibit Number</b>	<b>Description</b>
*31.1	Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer
*31.2	Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer
*32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
*32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
**101.INS	Inline XBRL Instance Document (the Instance Document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document)
**101.SCH	Inline XBRL Taxonomy Extension Schema Document
**101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
**101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
**101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
**101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
**104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

\*Filed herewith

\*\*Submitted electronically with the report

## SIGNATURES

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

### CLIPPER REALTY INC.

May 10, 2022

By: /s/ David Bistricher

David Bistricher

*Co-Chairman and Chief Executive Officer*