# LEGEND OAKS II, LLC
# (A NEBRASKA LIMITED LIABILITY COMPANY)

## dba LEGEND OAKS II

## FINANCIAL STATEMENTS
## WITH INDEPENDENT AUDITOR'S REPORT

## YEARS ENDED DECEMBER 31, 2022 AND 2021

**LEGEND OAKS II, LLC**
**(A NEBRASKA LIMITED LIABILITY COMPANY)**

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DAUBY O'CONNOR & ZALESKI, LLC

# INDEPENDENT AUDITOR'S REPORT

To the Members of
Legend Oaks II, LLC
(A Nebraska Limited Liability Company)

## Opinion

We have audited the accompanying financial statements of Legend Oaks II, LLC, which comprise the balance sheets as of December 31, 2022 and 2021, and the related statements of operations, changes in members' equity (deficit), and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Legend Oaks II, LLC as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Legend Oaks II, LLC and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Legend Oaks II, LLC's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

**Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Legend Oaks II, LLC's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Legend Oaks II, LLC's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Dauby O'Connor & Zaleski, LLC

January 31, 2023 — Dauby O'Connor & Zaleski, LLC
Carmel, Indiana — Certified Public Accountants

**LEGEND OAKS II, LLC**
**(A NEBRASKA LIMITED LIABILITY COMPANY)**

**BALANCE SHEETS**
**DECEMBER 31, 2022 AND 2021**

**ASSETS**

| | 2022 | 2021 |
|---|---|---|
| **Cash and cash equivalents** | | |
| Cash | $ 25,270 | $ 45,977 |
| Operating reserve | 41,942 | 41,853 |
| Reserve for replacements | 55,891 | 51,704 |
| **Total cash and cash equivalents** | **123,103** | **139,534** |
| Other assets | 2,782 | 2,045 |
| Property and equipment, net | 1,591,678 | 1,645,432 |
| Unamortized costs, net | 6,056 | 7,986 |
| | **$ 1,723,619** | **$ 1,794,997** |

**LIABILITIES AND MEMBERS' EQUITY (DEFICIT)**

| | 2022 | 2021 |
|---|---|---|
| Accounts payable | $ 27,586 | $ 15,346 |
| Accrued interest | 2,538 | 2,789 |
| Accrued real estate taxes | 5,172 | 9,428 |
| Resident security deposits | 8,954 | 8,208 |
| Mortgage notes and loans payable | 235,011 | 249,183 |
| **Total liabilities** | **279,261** | **284,954** |
| **Members' equity (deficit)** | **1,444,358** | **1,510,043** |
| | **$ 1,723,619** | **$ 1,794,997** |

See notes to financial statements

## STATEMENTS OF OPERATIONS
### YEARS ENDED DECEMBER 31, 2022 AND 2021

| | 2022 | 2021 |
|---|---|---|
| **Revenues** | | |
| Rental income | $ 103,056 | $ 102,064 |
| Interest | 114 | 75 |
| Other | 20 | 53 |
| **Total revenues** | **103,190** | **102,192** |
| **Expenses** | | |
| Depreciation and amortization | 88,361 | 87,263 |
| Administrative | 26,660 | 25,593 |
| Operating and maintenance | 17,752 | 17,670 |
| Taxes and insurance | 28,146 | 27,851 |
| Interest expense | 7,956 | 8,157 |
| **Total expenses** | **168,875** | **166,534** |
| **Net income (loss)** | **$ (65,685)** | **$ (64,342)** |

**LEGEND OAKS II, LLC**
**(A NEBRASKA LIMITED LIABILITY COMPANY)**

## STATEMENTS OF CHANGES IN MEMBERS' EQUITY (DEFICIT)
## YEARS ENDED DECEMBER 31, 2022 AND 2021

| | Investor Member | Special Member | Managing Member | Total |
|---|---|---|---|---|
| **Balance, January 1, 2021** | **$ 1,574,434** | **$ 10** | **$ (59)** | **$ 1,574,385** |
| Net income (loss) | (64,336) | - | (6) | (64,342) |
| **Balance, December 31, 2021** | **1,510,098** | **10** | **(65)** | **1,510,043** |
| Net income (loss) | (65,678) | - | (7) | (65,685) |
| **Balance, December 31, 2022** | **$ 1,444,420** | **$ 10** | **$ (72)** | **$ 1,444,358** |
| Ownership Percentage | 99.99% | 0.00% | 0.01% | 100.00% |

See notes to financial statements

**STATEMENTS OF CASH FLOWS**
**YEARS ENDED DECEMBER 31, 2022 AND 2021**

| | 2022 | 2021 |
|---|---|---|
| **Reconciliation of net income (loss) to net cash provided by (used in) operating activities** | | |
| Net income (loss) | **$ (65,685)** | **$ (64,342)** |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 88,361 | 87,263 |
| Capitalization of interest into mortgage notes and loans payable | 2,454 | 3,347 |
| Changes in: | | |
| Other assets | (737) | 114 |
| Accounts payable | (5,299) | (1,557) |
| Accrued interest | (251) | (903) |
| Accrued real estate taxes | (4,256) | (56) |
| Resident security deposits liability | 746 | (26) |
| **Total adjustments** | **81,018** | **88,182** |
| **Net cash provided by (used in) operating activities** | **15,333** | **23,840** |
| **Cash flow from investing activities** | | |
| Purchase of property and equipment | (15,138) | (4,153) |
| **Net cash provided by (used in) investing activities** | **(15,138)** | **(4,153)** |
| **Cash flow from financing activities** | | |
| Repayment of mortgage notes and loans payable | (16,626) | (44,493) |
| **Net cash provided by (used in) financing activities** | **(16,626)** | **(44,493)** |
| **Change in cash and cash equivalents** | **(16,431)** | **(24,806)** |
| **Cash and cash equivalents at beginning of year** | **139,534** | **164,340** |
| **Cash and cash equivalents at end of year** | **$ 123,103** | **$ 139,534** |
| **Supplemental disclosure** | | |
| Interest paid | **$ 5,753** | **$ 5,713** |

Cash flow from investing activities related to the purchase of property and equipment for the year ended December 31, 2022 excludes $17,539, which is included in accounts payable at December 31, 2022.

## NOTE 1-ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### ORGANIZATION

Legend Oaks II, LLC (the "Company") is a Nebraska Limited Liability Company formed to acquire, develop, and construct an 18 unit multifamily residential rental community known as Legend Oaks II (the "Property") located in Lexington, Nebraska. The Company has qualified 100% of the units in the Property for low-income housing credits in accordance with Section 42 of the Internal Revenue Code as enacted by the Tax Reform Act of 1986. Generally, the low-income housing credit is computed as a percentage of the qualified basis of the property and is allowed annually during a period of ten years commencing with the year the building is placed in service. The applicable units must meet the provisions of these regulations during each of fifteen consecutive years in order to remain qualified to receive the credits. The Company has received an annual maximum allocation of credits of $266,018. The final year of tax credits is 2024.

The ownership of the Company is as follows:

| | |
|---|---|
| Housing Authority of the City of Lexington, Nebraska (the "Managing Member") | 00.010% |
| MHEG Fund 40, LP (the "Investor Member") | 99.990% |
| Midwest Housing Assistance Corporation (the "Special Member") | 00.000% |
| | **100.000%** |

The term of the Company shall extend in perpetuity, unless sooner terminated as provided in the Operating Agreement.

### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of preparation of the financial statements

The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

#### New accounting pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued *Accounting Standards Update* ("ASU") 2016-02, Leases, which requires the lessee to recognize leased assets and corresponding lease liabilities on the Balance Sheets. This standard was effective for the Company on January 1, 2022. The adoption of the lease standard did not have a material impact on the financial statements.

#### Cash

For the Statements of Cash Flows, all unrestricted investments with original maturities of three months or less are cash. At December 31, 2022 and 2021, cash consists of operating checking and savings accounts.

**Resident receivable and bad debt policy**

Resident rent charges for the current month are due on the first of the month. Residents who are evicted or move-out are charged with damages or cleaning fees, if applicable. Resident receivables consist of amounts due for rental income, security deposit or the charges for damages and cleaning fees. The Company does not accrue interest on the resident receivable balances.

The Company reviews its outstanding resident receivables on a regular basis and records an allowance for the outstanding resident receivables over 60 days. Bad debts expensed for the years ended December 31, 2022 and 2021 totaled $0 and $0.

**Property and equipment**

Property and equipment is recorded at cost. Depreciation is provided principally on the straight line method over the remaining estimated useful lives of the assets, which range from 5 to 27.5 years. Expenditures for repairs and betterments, which do not materially extend the life of the asset, are charged to expense.

The Company is subject to the provisions of the Impairment or Disposal of Long-Lived Assets topic of the FASB *Accounting Standards Codification* ("ASC") 360-10. Impairment or Disposal of Long-Lived Assets has no retroactive impact on the Company's financial statements. The standard requires impairment losses to be recorded on long-lived assets when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets (excluding interest) are less than the carrying amount of the assets. In such cases, the carrying value of assets to be held and used are adjusted to their estimated fair value and assets held for sale are adjusted to their estimated fair value less selling expenses. No impairment losses were recognized for the years ended December 31, 2022 and 2021.

**Unamortized costs**

Unamortized costs consist of costs to obtain the tax credits. These costs are being amortized over the compliance period or credit period, as applicable, on a straight line basis.

**Revenue recognition**

Rental revenue attributable to residential operating leases is recorded when due from residents, generally upon the first day of each month for periods of up to one year, and are considered operating leases under FASB ASU 842 and are not within the scope of FASB ASU 2014-09. Advance receipts of rental income will be deferred until earned. Other income results from fees for late payments, cleaning, damages and laundry facilities and is recorded when earned.

**Syndication costs**

Costs incurred in connection with the Investor Member's investment in the Company of $6,000 have been netted against the Investor Member's capital contributions for reporting purposes.

**Advertising costs**

Advertising costs are expensed as incurred and are included in administrative expenses in the Statements of Operations.

**Property taxes**

Property taxes are expensed in the year of the lien such that twelve months of expense are recorded.

**Concentration of credit risk**

The Company places its temporary cash investments with high credit quality financial institutions that are insured by the Federal Deposit Insurance Corporation ("FDIC") up to $250,000. At times, the account balances may exceed the FDIC insurance limits.

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

**Use of estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Fair value**

The Company is subject to the provisions of the Fair Value Measurement topic of the FASB *Accounting Standards Codification* (ASC) 820-10 which provides guidance for assets and liabilities which are required to be measured at fair value and requires expanded disclosure for fair value measurement. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value and does not require any new fair value measurements. The Fair Value Measurement did not have a material impact on the Company's financial statements for the years ended December 31, 2022 and 2021.

**Accounting for uncertainty in income taxes**

The Company is treated as a pass-through entity for income tax purposes and, as such, is not subject to income taxes. Rather, all items of taxable income, deductions and tax credits are passed through to and are reported by its owners on their respective income tax returns. The Company's federal tax status as a pass-through entity is based on its legal status as a limited liability company. Accordingly, the Company is not required to take any tax positions in order to qualify as a pass-through entity. The Company is required to file and does file tax returns with the Internal Revenue Service and other taxing authorities. Accordingly, these financial statements do not reflect a provision for income taxes and the Company has no other tax positions which it must consider for disclosure. There has been no interest or penalties recognized in the Statements of Operations or Balance Sheets for the years ended December 31, 2022 and 2021. Generally, the federal and state returns are subject to examination for three years after the later of the original or extended due date or the date filed with the applicable tax authorities.

**Subsequent events**

Management performed an evaluation of the Company's activity through January 31, 2023, the audit report date, and has concluded that there are no significant subsequent events requiring disclosure through the date these financial statements were available to be issued.

## NOTE 2-PROPERTY AND EQUIPMENT

Property and equipment have been recorded at cost and consist of the following:

| | 2022 | 2021 |
|---|---|---|
| Land | $ 40,000 | $ 40,000 |
| Buildings | 2,229,159 | 2,229,159 |
| Furniture and equipment | 286,037 | 253,360 |
| Subtotal | 2,555,196 | 2,522,519 |
| Accumulated depreciation | ( 963,518) | ( 877,087) |
| Property and equipment, net | **$ 1,591,678** | **$ 1,645,432** |

For the years ended December 31, 2022 and 2021, depreciation expense totaled $86,431 and $85,333, respectively.

## NOTE 3-MORTGAGE NOTES AND LOANS PAYABLE

Mortgage notes and loans payable consist of the following at December 31:

| Description of debt | Interest Rate | Payments | Maturity | Principal Balance 2022 | Principal Balance 2021 |
|---|---|---|---|---|---|
| Managing Member loan, in the original principal amount of $151,851, collateralized by a security interest in Legend Oaks II, LLC | 2.37% | From available cash flow | November 5, 2029 | $ 93,318 | $ 103,524 |
| Managing Member perm loan, in the original principal amount of $169,620, collateralized by a security interest in Legend Oaks II, LLC | 4% | Monthly principal and interest payments of $810 | November 10, 2030 | 141,693 | 145,659 |
| | | | | $ 235,011 | $ 249,183 |

For the years ended December 31, 2022 and 2021, interest expense totaled $7,956 and $8,157, respectively. At December 31, 2022 and 2021, accrued interest totaled $2,538 and $2,789, respectively.

Principal payments related to the mortgage notes and loans payable for the next five years and thereafter are as follows:

| | |
|---|---|
| 2023 | $ 4,128 |
| 2024 | 4,280 |
| 2025 | 4,470 |
| 2026 | 4,652 |
| 2027 | 4,842 |
| Thereafter | 212,639 |
| | $ 235,011 |

The property and equipment and other assets are pledged as collateral on the mortgage notes and loans payable.

## NOTE 4-RELATED PARTIES

### Management fee

The Company has entered into an agreement with the Managing Member for management of the rental operations of the Property. For the years ended December 31, 2022 and 2021, management fees totaled $10,308 and $10,212, respectively. These expenses are included in administrative expenses on the Statements of Operations.

### Compliance monitoring fee

Midwest Housing Equity Group, Inc., an affiliate of the Investor Member, earned a compliance monitoring and consulting service fee of $2,109 and $2,068 for the years ended December 31, 2022 and 2021, respectively. These fees are included in administrative expenses on the Statements of Operations. At December 31, 2022 and 2021, $2,070 and $2,029 remained payable, respectively. These fees are included in accounts payable on the Balance Sheets.

### Incentive management fee

In consideration for the efficient management of the Company and business, the Company shall pay to the Managing Member an annual non-cumulative incentive management fee of 100% of cash flow remaining after certain payments, as defined, to the extent that the Company has net cash flow available for payment of such fee. In no year will the incentive management fee exceed 12% of gross rental receipts. For the years ended December 31, 2022 and 2021, no incentive management fees were earned.

### Related party notes payable – See Note 3

## NOTE 5-MEMBERS' EQUITY (DEFICIT)

Except as otherwise provided in the Operating Agreement, all net profits, net losses and each item of income, gain, loss, deduction and/or low income housing tax credit shall be allocated 99.99% to the Investor Member and .01% to the Managing Member.

As of December 31, 2022 and 2021, the Investor Member has contributed $2,281,374, per the Operating Agreement.

In accordance with the Operating Agreement, the Special Member has made a capital contribution of $10, and the Managing Member has made a capital contribution of $10.

## NOTE 6-COMMITMENTS AND CONTINGENCIES

The Company expects to generate an aggregate of $2,660,180 of low-income housing tax credits ("Tax Credits") issued by Nebraska Investment Finance Authority. Generally, such low-income housing credits become available for use by its Partners pro-rata over a ten-year period that began in 2014. Because the Tax Credits are subject to complying with certain requirements, there can be no assurance that the aggregate amount of Tax Credits will be realized and failure to meet all such requirements may result in generating a lesser amount of Tax Credits than the expected amount. Also, low-income housing tax credits are contingent on the Company's ability to maintain compliance with Section 42 of the Internal Revenue Code. Failure to maintain compliance with occupant eligibility, and/or unit gross rent, or to correct non-compliance within a specified time period, could result in recapture of previously taken tax credits plus interest. In addition, such potential non-compliance may require an adjustment to the capital contributed by the Investor Member, which could reduce the fair value of the property.

### Extended Use Agreement and Declaration of Restrictive Covenants

The Company has entered into an Extended Use Agreement and Declaration of Restrictive Covenants with the Nebraska Investment Finance Authority, which restricts the use of the Property to low-income and very low-income families, as defined, for twenty years after the close of the compliance period, as defined.