

**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, 2021

**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, 2021, 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, rental rates (including continued declines at one of our properties), 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 may obligate us to pay transfer tax based on the fair market value of the real property transferred;
- the impact of the recent restatement of our financial statements for the first three quarters of 2020 and management’s recently identified material weakness in our internal control over financial reporting;  
and

- other risks and risk factors or uncertainties identified from time to time in our filings with the Securities and Exchange Commission (“SEC”).

Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Reference is made to a more complete discussion of forward-looking statements and applicable risks contained under the captions “Cautionary Note Concerning Forward-Looking Statements” and “Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2020, filed with the SEC on March 16, 2021, and other reports filed from time to time with the SEC. Clipper Realty Inc. undertakes no obligation to update or revise any of its forward-looking statements, whether as a result of new information, future events or otherwise.

## 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>2021</b>	<b>2020</b>
	<b>(unaudited)</b>	
<b>ASSETS</b>		
Investment in real estate		
Land and improvements	\$540,859	\$540,859
Building and improvements	634,502	630,662
Tenant improvements	3,243	3,121
Furniture, fixtures and equipment	12,278	12,217
Real estate under development	37,637	36,118
Total investment in real estate	1,228,519	1,222,977
Accumulated depreciation	(138,650)	(132,479)
Investment in real estate, net	1,089,869	1,090,498
Cash and cash equivalents	87,952	72,058
Restricted cash	18,244	16,974
Tenant and other receivables, net of allowance for doubtful accounts of \$7,199 and \$5,993, respectively	8,343	7,002
Deferred rent	2,455	2,454
Deferred costs and intangible assets, net	7,568	7,720
Prepaid expenses and other assets	8,975	11,160
<b>TOTAL ASSETS</b>	<b>\$1,223,406</b>	<b>\$1,207,866</b>
<b>LIABILITIES AND EQUITY</b>		
Liabilities:		
Notes payable, net of unamortized loan costs of \$10,713 and \$10,262, respectively	\$1,104,479	\$1,079,458
Accounts payable and accrued liabilities	12,492	11,725
Security deposits	6,989	6,983
Below-market leases, net	126	157
Other liabilities	6,045	5,429
<b>TOTAL LIABILITIES</b>	<b>1,130,131</b>	<b>1,103,752</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	87,469	87,347
Accumulated deficit	(52,275)	(48,045)
Total stockholders' equity	35,354	39,462
Non-controlling interests	57,921	64,652
<b>TOTAL EQUITY</b>	<b>93,275</b>	<b>104,114</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$1,223,406</b>	<b>\$1,207,866</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 March 31,</b>	
	<b>2021</b>	<b>2020</b>
<b>REVENUES</b>		
Residential rental income	\$21,604	\$23,718
Commercial rental income	9,047	7,597
<b>TOTAL REVENUES</b>	<b>30,651</b>	<b>31,315</b>
<b>OPERATING EXPENSES</b>		
Property operating expenses	8,642	7,159
Real estate taxes and insurance	7,312	6,864
General and administrative	2,293	2,323
Transaction pursuit costs	60	—
Depreciation and amortization	6,227	5,558
<b>TOTAL OPERATING EXPENSES</b>	<b>24,534</b>	<b>21,904</b>
<b>INCOME FROM OPERATIONS</b>	<b>6,117</b>	<b>9,411</b>
Interest expense, net	(10,217)	(9,788)
Loss on extinguishment of debt	(3,034)	—
<b>Net loss</b>	<b>(7,134)</b>	<b>(377)</b>
Net loss attributable to non-controlling interests	4,430	225
<b>Net loss attributable to common stockholders</b>	<b>\$(2,704)</b>	<b>\$(152)</b>
Basic and diluted net loss per share	\$(0.18)	\$(0.01)

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, 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>	<b>16,063,228</b>	<b>\$160</b>	<b>\$87,469</b>	<b>\$(52,275)</b>	<b>\$35,354</b>	<b>\$57,921</b>	<b>\$93,275</b>

	Number of common shares	Common stock	Additional paid-in- capital	Accumulated deficit	Total stockholders' equity	Non- controlling interests	Total equity
<b>Balance December 31, 2019</b>	17,814,672	\$178	\$93,431	\$(36,375)	\$57,234	\$84,549	\$141,783
Amortization of LTIP grants	—	—	—	—	—	158	158
Dividends and distributions	—	—	—	(1,692)	(1,692)	(2,584)	(4,276)
Net loss	—	—	—	(152)	(152)	(225)	(377)
Reallocation of noncontrolling interests	—	—	30	—	30	(30)	—
<b>Balance March 31, 2020</b>	<b>17,814,672</b>	<b>\$178</b>	<b>\$93,461</b>	<b>\$(38,219)</b>	<b>\$55,420</b>	<b>\$81,868</b>	<b>\$137,288</b>

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>2021</b>	<b>2020</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$(7,134)	\$(377)
<i>Adjustments to reconcile net loss to net cash provided by operating activities:</i>		
Depreciation	6,171	5,485
Amortization of deferred financing costs	308	304
Amortization of deferred costs and intangible assets	176	192
Amortization of above- and below-market leases	(31)	(99)
Loss on extinguishment of debt	3,034	—
Deferred rent	(1)	(228)
Stock-based compensation	486	158
Bad debt expense	1,178	—
Transaction pursuit costs	60	—
<i>Changes in operating assets and liabilities:</i>		
Tenant and other receivables	(2,519)	(563)
Prepaid expenses, other assets and deferred costs	2,101	5,918
Accounts payable and accrued liabilities	2,986	(1,926)
Security deposits	6	67
Other liabilities	616	119
<b>Net cash provided by operating activities</b>	<b>7,437</b>	<b>9,050</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to land, buildings, and improvements	(7,745)	(7,101)
Purchase of interest rate cap	—	(14)
<b>Net cash used in investing activities</b>	<b>(7,745)</b>	<b>(7,115)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payments of mortgage notes	(74,776)	(897)
Proceeds from mortgage notes	100,248	176
Dividends and distributions	(4,191)	(4,276)
Loan issuance and extinguishment costs	(3,809)	—
<b>Net cash provided by (used in) financing activities</b>	<b>17,472</b>	<b>(4,997)</b>
Net increase (decrease) in cash and cash equivalents and restricted cash	17,164	(3,062)
Cash and cash equivalents and restricted cash - beginning of period	89,032	56,932
<b>Cash and cash equivalents and restricted cash - end of period</b>	<b>\$106,196</b>	<b>\$53,870</b>
Cash and cash equivalents and restricted cash – beginning of period:		
Cash and cash equivalents	\$72,058	\$42,500
Restricted cash	16,974	14,432
Total cash and cash equivalents and restricted cash – beginning of period	\$89,032	\$56,932
Cash and cash equivalents and restricted cash – end of period:		
Cash and cash equivalents	\$87,952	\$36,298
Restricted cash	18,244	17,572
Total cash and cash equivalents and restricted cash – end of period	\$106,196	\$53,870
Supplemental cash flow information:		
Cash paid for interest, net of capitalized interest of \$393 and \$300 in 2021 and 2020, respectively	\$9,999	\$9,532
Non-cash interest capitalized to real estate under development	16	280
Additions to investment in real estate included in accounts payable and accrued liabilities	1,970	2,581

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, 2020, filed with the SEC on March 16, 2021.

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**

The Company was organized in the state of Maryland on July 7, 2015. On August 3, 2015, we completed certain formation transactions and the sale of shares of common stock in a private offering. We contributed the net proceeds of the private offering to Clipper Realty L.P., our operating partnership subsidiary (the “Operating Partnership”), in exchange for units in the Operating Partnership. The Operating Partnership in turn contributed such net proceeds to the limited liability companies (“LLCs”) that comprised the predecessor of the Company (the “Predecessor”) in exchange for Class A LLC units in such LLCs and became the managing member of such LLCs. The owners of the LLCs exchanged their interests for Class B LLC units and an equal number of special, non-economic, voting stock in the Company. The Class B LLC units, together with the special voting shares, are convertible into common shares of the Company on a one-for-one basis and are entitled to distributions.

On June 27, 2016, the Operating Partnership acquired the Aspen property at 1955 First Avenue in Manhattan, New York.

On February 9, 2017, the Company priced an initial public offering of 6,390,149 primary shares of its common stock (including the exercise of the over-allotment option, which closed on March 10, 2017) at a price of \$13.50 per share (the “IPO”). The net proceeds of the IPO were approximately \$78.7 million. We contributed the proceeds of the IPO 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 (subsequently renovated and rebranded “Clover House”), a 158-unit apartment community located in Brooklyn Heights, New York.

On October 27, 2017, the Company completed the acquisition of an 82-unit residential property at 10 West 65th Street in the Upper West Side neighborhood of Manhattan, New York.

On November 8, 2019, the Company completed the acquisition of 1010 Pacific Street located in the Prospect Heights neighborhood of Brooklyn, New York; the Company plans to redevelop the property as a 175-unit residential building.

As of March 31, 2021, 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 2,493 rentable units;
- 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; and
- 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.

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, 2021 and 2020, the Company incurred \$0.02 million and \$0.2 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, 2021, 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. Repurchase of Common Stock**

In August 2020, the Company’s board of directors (the “Board”) adopted a stock repurchase program to permit the repurchase of up to an aggregate of \$10.0 million in outstanding shares of the Company’s common stock. Under the repurchase program, the Company was permitted to repurchase its common stock at any time, or from time to time. The Company anticipated funding for the program to come from available sources of liquidity, including cash on hand and future cash flow. The repurchase program permitted shares to be repurchased in open market or private transactions, through block trades or otherwise. The number of shares repurchased and the timing, manner, price and amount of any repurchases was to be determined at the Company’s discretion, subject to the availability of stock, general market conditions, the trading price of the stock, alternative uses of capital and the Company’s financial performance. The repurchase program was permitted to be suspended, terminated or modified at any time for any reason, including market conditions, the cost of repurchasing shares, the availability of alternative investment opportunities, liquidity and other factors deemed appropriate by the Company. These factors could also affect the timing and amount of share repurchases. The repurchase program did not obligate the Company to repurchase any particular number of shares. On November 24, 2020, the Company completed the stock repurchase program. During the year ended December 31, 2020, the Company repurchased and retired 1,751,444 shares of common stock under the repurchase program for a total purchase price of approximately \$10.0 million.

### 3. Significant Accounting Policies

#### *Segments*

At March 31, 2021, 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. If either of the following criteria is met, the integrated set of assets and activities acquired would not qualify as a business:

- Substantially all of the fair value of the gross assets acquired is concentrated in either a single identifiable asset or a group of similar identifiable assets; or
- The integrated set of assets and activities is lacking, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs (i.e., revenue generated before and after the transaction).

An acquired process is considered substantive if:

- The process includes an organized workforce (or includes an acquired contract that provides access to an organized workforce) that is skilled, knowledgeable and experienced in performing the process;
- The process cannot be replaced without significant cost, effort or delay; or
- The process is considered unique or scarce.

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, 2021.

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. The Company periodically performs a detailed review of amounts due from tenants to determine if accounts receivable balances are impaired based on factors affecting the collectability of those balances. If a tenant fails to make contractual payments beyond any allowance, the Company may recognize additional bad debt expense in future periods.

#### *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, 2021 and 2020, 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*

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 into 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, 2021 and December 31, 2020, there were 1,735,563 and 1,410,371 long-term incentive plan (“LTIP”) units outstanding, respectively, with a weighted average grant date fair value of \$9.61 and \$9.90 per unit, respectively. As of March 31, 2021, and December 31, 2020, there was \$4.6 million and \$2.4 million, respectively,

of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under share incentive plans. As of March 31, 2021, the weighted-average period over which the unrecognized compensation expense will be recorded is approximately one year.

In March 2021, the Company granted employees and non-employee directors 222,298 and 102,894 LTIP units, respectively, with a weighted-average grant date fair value of \$8.34 per unit.

#### *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.

On March 27, 2020, the President signed into law the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). The CARES Act was enacted to provide economic relief to companies and individuals in response to the COVID-19 pandemic. Included in the CARES Act are tax provisions which increase allowable interest expense deductions for 2019 and 2020 and increase the ability for taxpayers to use net operating losses. While we do not expect these provisions to have a material impact on the Company's taxable income or tax liabilities, we continue to analyze the provisions of the CARES Act and related guidance as it is published.

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 8, "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.

Derivatives used to hedge the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected future cash flows, or other types of forecast transactions, are considered cash flow hedges. For derivatives designated as fair value hedges, changes in the fair value of the derivative and the hedged item related to the hedged risk are recognized in earnings. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is initially reported in other comprehensive income (loss) (outside of earnings) and subsequently reclassified to earnings when the hedged transaction affects earnings, and the ineffective portion of changes in the fair value of the derivative is recognized directly in earnings. The Company assesses the effectiveness of each hedging relationship by comparing the changes in the fair value or cash

flows of the derivative hedging instrument with the changes in the fair value or cash flows of the designated hedged item or transaction. For derivatives not designated as hedges, changes in fair value would be recognized in earnings. As of March 31, 2021, 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, 2021 and 2020, 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, 2021 or 2020.

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>2021</b>	<b>2020</b>
<u>Numerator</u>		
Net loss attributable to common stockholders	\$(2,704)	\$(152)
Less: income attributable to participating securities	(165)	(84)
Subtotal	\$(2,869)	\$(236)
<u>Denominator</u>		
Weighted-average common shares outstanding	16,063	17,815
Basic and diluted net loss per share attributable to common stockholders	<u>\$(0.18)</u>	<u>\$(0.01)</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, 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 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.

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 into transactions to which this guidance applies.

In March 2019, FASB issued ASU 2019-01, “Leases (Topic 842), Codification Improvements.” There are three codification updates to Topic 842 covered by this ASU: Issue 1 provides guidance on how to compute fair value of leased items for lessors who are non-dealers or manufacturers; Issue 2 relates to cash flow presentation for lessors of sales-type and direct financing leases; and Issue 3 clarifies that certain transition disclosures will only be required in annual disclosures. The Company does not expect the adoption of ASU 2019-01 to have a material impact on its consolidated financial statements.

In December 2018, FASB issued ASU 2018-20, “Leases (Topic 842), Narrow-Scope Improvements for Lessors.” This ASU modifies ASU 2016-02 to permit lessors, as an accounting policy election, not to evaluate whether certain sales taxes and other similar taxes are lessor costs or lessee costs. Instead, those lessors will account for those costs as if they are lessee costs. Consequently, a lessor making this election will exclude from the consideration in the contract and from variable payments not included in the consideration in the contract all collections from lessees of taxes within the scope of the election and will provide certain disclosures (includes sales, use, value-added, and some excise taxes and excludes real estate taxes). The Company has elected not to evaluate whether the aforementioned costs are lessor or lessee costs. This ASU also provides that certain lessor costs require lessors to exclude from variable payments, and therefore revenue, specifically lessor costs paid by lessees directly to third parties. The amendments also require lessors to account for costs excluded from the consideration of a contract that are paid by the lessor and reimbursed by the lessee as variable payments. A lessor will record those reimbursed costs as revenue. The Company does not expect the adoption of ASU 2018-20 to have a material impact on its consolidated financial statements.

In February 2016, FASB issued ASU 2016-02, “Leases.” ASU 2016-02 supersedes the current accounting for leases and while retaining two distinct types of leases, finance and operating, requires lessees to recognize most leases on their balance sheets and makes targeted changes to lessor accounting. In July 2018, FASB issued ASU 2018-10, “Codification Improvements to Topic 842, Leases,” which provides minor clarifications and corrections to ASU 2016-02, “Leases (Topic 842).” Further, in July 2018, the FASB issued ASU 2018-11, “Leases (Topic 842): Targeted Improvements.” This amendment provides a new practical expedient that allows lessors, by class of underlying asset, to avoid separating lease and associated non-lease components within a contract if certain criteria are met: (i) the timing and pattern of transfer for the non-lease component and the associated lease component are the same and (ii) the stand-alone lease component would be classified as an operating lease if accounted for separately. These pronouncements are effective for fiscal years beginning after December 15, 2021, and early adoption is permitted. The Company will adopt this standard effective January 1, 2022 and is currently evaluating the impact of adoption on its consolidated financial statements. As lessor, the Company expects that the adoption of ASU 2016-02 (as amended by subsequent ASUs) will not change the timing of revenue recognition of the Company’s rental revenues. For lease payments deemed uncollectible, the Company will record bad debt expense as a reduction of revenue. As lessee, the Company is party to certain office equipment leases with future payment obligations for which the Company expects to record right-of-use assets and lease liabilities at the present value of the remaining minimum rental payments upon adoption of this standard.

#### 4. Deferred Costs and Intangible Assets

Deferred costs and intangible assets consist of the following:

	<b>March 31, 2021</b>	<b>December 31, 2020</b>
	<b>(unaudited)</b>	
Deferred costs	\$348	\$348
Above-market leases	—	—
Lease origination costs	1,102	1,078
In-place leases	428	428
Real estate tax abatements	9,142	9,142
Total deferred costs and intangible assets	11,020	10,996
Less accumulated amortization	(3,452)	(3,276)
Total deferred costs and intangible assets, net	<u>\$7,568</u>	<u>\$7,720</u>

Amortization of deferred costs, lease origination costs and in-place lease intangible assets was \$56 and \$73 for the three months ended March 31, 2021 and 2020, 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 \$119 for the three months ended March 31, 2021 and 2020, respectively, is included in real estate taxes and insurance in the consolidated statements of operations. Amortization of above-market leases of \$0 and \$30 for the three months ended March 31, 2021 and 2020, respectively, is included in commercial rental income in the consolidated statements of operations. \$444 of fully amortized above-market leases was written off during the three months ended March 31, 2020.

Deferred costs and intangible assets as of March 31, 2021, amortize in future years as follows:

2021 (Remainder)	\$528
2022	676
2023	567
2024	551
2025	540
Thereafter	4,706
Total	<u>\$7,568</u>

## 5. Below-Market Leases, Net

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

	<b>March 31, 2021 (unaudited)</b>	<b>December 31, 2020</b>
Below-market leases	\$785	\$785
Less accumulated amortization	(659)	(628)
Below-market leases, net	<u>\$126</u>	<u>\$157</u>

Rental income included amortization of below-market leases of \$31 and \$129 for the three months ended March 31, 2021 and 2020, respectively.

Below-market leases as of March 31, 2021, amortize in future years as follows:

2021 (Remainder)	\$73
2022	35
2023	18
Total	<u>\$126</u>

## 6. 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, 2021	December 31, 2020
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)	6/1/2028	3.875%	—	74,241
141 Livingston Street, Brooklyn, NY (c)	3/6/2031	3.21%	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%	65,122	65,485
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%	33,447	33,619
1010 Pacific Street, Brooklyn, NY (h)	6/24/2021	LIBOR + 3.60%	20,623	20,375
Total debt			<u>\$1,115,192</u>	<u>\$1,089,720</u>
Unamortized debt issuance costs			(10,713)	(10,262)
Total debt, net of unamortized debt issuance costs			<u>\$1,104,479</u>	<u>\$1,079,458</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 that will provide up to \$2,987 for eligible pre-development and carrying costs, of which \$2,023 was drawn as of March 31, 2021. The notes mature on June 24, 2021, require interest-only payments and bear interest at one-month LIBOR (with a floor of 1.25%) plus 3.60% (4.85% as of March 31, 2021). The Company has guaranteed this mortgage note and has complied with the financial covenants therein. The Company is in negotiations with third parties to refinance the notes with a construction loan prior to maturity, although there are no assurances that the Company will be able to do so.

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, 2021:

2021 (Remainder)	\$22,225
2022	2,215
2023	2,296
2024	2,374
2025	2,468
Thereafter	1,083,614
Total	<u><u>\$1,115,192</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.

## 7. 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, 2021, 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:

2021 (Remainder)	\$22,313
2022	30,279
2023	29,042
2024	28,663
2025	22,976
Thereafter	11,639
Total	<u><u>\$144,912</u></u>

The Company has commercial leases with the City of New York that comprised approximately 25% and 18% of total revenues for the three months ended March 31, 2021 and 2020, respectively.

## 8. 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, 2021</b>	<b>December 31, 2020</b>
	<b>(unaudited)</b>	
Carrying amount (excluding unamortized debt issuance costs)	\$1,115,192	\$1,089,720
Estimated fair value	\$1,159,344	\$1,204,201

The Company purchased interest rate caps in connection with the loans obtained for the Clover House acquisition, the 250 Livingston Street loan obtained on December 6, 2018, and the 1010 Pacific Street loans obtained on December 24, 2019. During December 2020, the interest rate caps at the 250 Livingston Street property and the 1010 Pacific Street property matured with no residual value. The fair value of the interest rate caps, which are classified as Level 2, is estimated using market inputs and credit valuation inputs.

These interest rate caps were not designated as hedges. Accordingly, changes in fair value of the 250 Livingston Street instrument were recognized in earnings. Changes in fair value of the Clover House instrument which matured and was written off in May 2020, were recognized in real estate under development during construction and were recognized in earnings following completion of development. Changes in fair value of the 1010 Pacific Street instrument were recognized in real estate under development. Fair value of the 250 Livingston Street instrument did not change during the three months ended March 31, 2020. Fair value of the Clover House instrument did not change during the three months ended March 31, 2020. Decrease in fair value of the 1010 Pacific Street instrument of \$14 for the three months ended March 31, 2020, was capitalized to real estate under development.

The above disclosures regarding fair value of financial instruments are based on pertinent information available as of March 31, 2021, and December 31, 2020, respectively. Although the Company is not aware of any factors that

would significantly affect the reasonableness of the estimated fair value amounts, current estimates of fair value may differ from the amounts presented herein.

## 9. 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 will eventually be remanded back to the lower court, which will determine the exact amount of the Company’s liability for rent overcharges and attorneys’ fees; no future court dates have been scheduled as of yet.

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's deadline to answer or otherwise respond to the complaint in *Horn* has been extended to May 21, 2021.

The Company cannot predict what the timing or ultimate resolution of these matters will be, and accordingly, at this time, the Company has not recorded any liability for the potential settlement of these matters.

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.

#### *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 are creating disruptions in, and adversely impacting, many industries and have negatively impacted, and could continue to negatively impact, the Company's business in a number of 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 has experienced declines in leased occupancy and residential rental rate as a result of the COVID-19 pandemic; several of our other properties experienced declines in leased occupancy as well. Certain of the Company's commercial tenants have requested and received partial rent deferrals during the pandemic (the total deferred amount at March 31, 2021, was \$0.9 million); such deferrals are recorded in line with the leasing standard under ASC 840. In some cases, the Company may restructure rent and other obligations under its leases with its tenants on terms that are 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. The rapid development and fluidity with which the situation continues to develop, including the rollout of vaccines, precludes any 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 have remained open and operational throughout the pandemic. The Company is taking the necessary steps to keep employees and tenants safe in compliance with state and local orders, and continues 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, 2021	30%	70%	100%
Three months ended March 31, 2020	24%	76%	100%

## 10. Related-Party Transactions

The Company recorded office and overhead expenses pertaining to a related company in general and administrative expense of \$66 and \$88 for the three months ended March 31, 2021 and 2020, respectively. The Company recognized reimbursable payroll expense pertaining to a related company in general and administrative expense of \$41 and \$2 for the three months ended March 31, 2021 and 2020, respectively.

The Company paid legal and advisory fees to firms in which two of our directors were principals or partners of \$404 and \$5 for the three months ended March 31, 2021 and 2020, respectively.

## 11. 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, 2021 and 2020, is as follows (unaudited):

<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

<b>Three months ended March 31, 2020</b>	<b>Commercial</b>	<b>Residential</b>	<b>Total</b>
Rental income	\$7,597	\$23,718	\$31,315
Total revenues	7,597	23,718	31,315
Property operating expenses	1,137	6,022	7,159
Real estate taxes and insurance	1,491	5,373	6,864
General and administrative	337	1,986	2,323
Depreciation and amortization	1,019	4,539	5,558
Total operating expenses	3,984	17,920	21,904
Income from operations	\$3,613	\$5,798	\$9,411

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

	<b>Commercial</b>	<b>Residential</b>	<b>Total</b>
March 31, 2021 (unaudited)	\$304,842	\$918,564	\$1,223,406
December 31, 2020	282,789	925,077	1,207,866

The Company's interest expense by segment for the three months ended March 31, 2021 and 2020, is as follows (unaudited):

	<u>Commercial</u>	<u>Residential</u>	<u>Total</u>
<u>Three months ended March 31,</u>			
2021	\$2,076	\$8,141	\$10,217
2020	1,987	7,801	9,788

The Company's capital expenditures by segment for the three months ended March 31, 2021 and 2020, are as follows (unaudited):

	<u>Commercial</u>	<u>Residential</u>	<u>Total</u>
<u>Three months ended March 31,</u>			
2021	\$2,370	\$3,172	\$5,542
2020	1,783	4,288	6,071

## 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.

As of March 31, 2021, 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.

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

On February 18, 2021, the Company refinanced the existing 141 Livingston Street loan with a \$100 million, 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.

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 and the 1010 Pacific 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 are creating disruptions in, and adversely impacting, many industries and have negatively impacted, and could continue to negatively impact, our business in a number of ways, including affecting our tenants' ability or willingness to pay rents and reducing demand for housing in the New York metropolitan area. The Tribeca House property has experienced declines in leased occupancy and residential rental rate as a result of the COVID-19 pandemic; several of our other properties experienced declines in leased occupancy as well. Certain of our commercial tenants have requested and received partial rent deferrals during the pandemic. In some cases, we may restructure rent and other obligations under our leases with tenants on terms that are less favorable to us 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 our portfolio as residents reduce their spending and replacement tenants become harder to find. The rapid development and fluidity with which the situation continues to develop, including the rollout of vaccines, precludes any prediction as to the ultimate adverse impact of the COVID-19 pandemic on our business. Nevertheless, COVID-19 presents uncertainty and risk with respect to our tenants, which could adversely affect the Company's business, financial condition, liquidity and results of operations.

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 2021 was 96.2%. At March 31, 2021, our properties were 95% 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 2020 and year-to-date 2021 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, 2021 and 2020 (in thousands)*

	2021	2020	Increase (decrease)	%
Revenues				
Residential rental income	\$21,604	\$23,718	\$(2,114)	(8.9)%
Commercial rental income	9,047	7,597	1,450	19.1%
Total revenues	30,651	31,315	(664)	(2.1)%
Operating Expenses				
Property operating expenses	8,642	7,159	1,483	20.7%
Real estate taxes and insurance	7,312	6,864	448	6.5%
General and administrative	2,293	2,323	(30)	(1.3)%
Transaction pursuit costs	60	—	60	NM
Depreciation and amortization	6,227	5,558	669	12.0%
Total operating expenses	24,534	21,904	2,630	12.0%
Income from operations	6,117	9,411	(3,294)	(35.0)%
Interest expense, net	(10,217)	(9,788)	429	4.4%
Loss on extinguishment of debt	(3,034)	—	3,034	NM
Net loss	\$(7,134)	\$(377)	\$(6,757)	1,792.3%

**Revenue.** Residential rental income decreased from \$23,718 for the three months ended March 31, 2020, to \$21,604 for the three months ended March 31, 2021, primarily due to decreases in rental rates and leased occupancy at the Tribeca House property as a result of the COVID-19 pandemic. Base rent per square foot decreased at the Tribeca House property from \$70.75 (99.6% leased occupancy) at March 31, 2020, to \$62.43 (96.5% leased occupancy) at March 31, 2021.

Commercial rental income increased from \$7,597 for the three months ended March 31, 2020, to \$9,047 for the three months ended March 31, 2021, primarily due to the commencement of a new lease at the 250 Livingston Street property in August 2020, partially offset by the termination of certain leases at the Tribeca House property.

**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. Property operating expenses increased from \$7,159 for the three months ended March 31, 2020, to \$8,642 for the three months ended March 31, 2021, primarily due to increases in the provision for bad debt across the portfolio due to the impact of COVID-19 and increases utility costs across the portfolio, partially offset by decreases in payroll costs.

**Real estate taxes and insurance.** Real estate taxes and insurance expenses increased from \$6,864 for the three months ended March 31, 2020, to \$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 were essentially flat for the three months ended March 31, 2021, compared to the three months ended March 31, 2020.

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

**Depreciation and amortization.** Depreciation and amortization expense increased from \$5,558 for the three

months ended March 31, 2020, to \$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, increased from \$9,788 for the three months ended March 31, 2020, to \$10,217 for the three months ended March 31, 2021. The increase primarily resulted from the refinancing of the Flatbush Gardens property in May 2020 and the 141 Livingston Street property in February 2021. Interest expense included amortization of loan costs of \$308 and \$304 for the three months ended March 31, 2021 and 2020, respectively.

**Loss on extinguishment of debt.** Loss on extinguishment of debt for the three months ended March 31, 2021, related to the refinancing of the 141 Livingston Street loan in February 2021; the amount included the write-off of unamortized debt costs of \$3,034.

**Net loss.** As a result of the foregoing, net loss increased from \$377 for the three months ended March 31, 2020, to \$7,134 for the three months ended March 31, 2021.

### **Liquidity and Capital Resources**

As of March 31, 2021, we had \$1,104.5 million of indebtedness (net of unamortized issuance costs) secured by our properties, \$88.0 million of cash and cash equivalents, and \$18.2 million of restricted cash. See Note 6 of the accompanying “Notes to Condensed Consolidated Financial Statements” 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 retirements 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 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, 2021 and 2020, we paid dividends and distributions on our common shares, Class B LLC units and LTIP units totaling \$4.2 million and \$4.3 million, respectively.

### ***Cash Flows for the Three Months Ended March 31, 2021 and 2020 (in thousands)***

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2021</b>	<b>2020</b>
Operating activities	\$7,437	\$9,050
Investing activities	(7,745)	(7,115)
Financing activities	17,472	(4,997)

*Cash flows provided by (used in) operating activities, investing activities and financing activities for the three months ended March 31, 2021 and 2020, were as follows:*

Net cash flow provided by operating activities was \$7,437 for the three months ended March 31, 2021, compared to \$9,050 for the three months ended March 31, 2020. The net decrease during the 2021 period reflected a decrease of \$1,188 of cash flow from operating results and a decrease of \$425 of cash generated by operating assets and liabilities.

Net cash used in investing activities was \$7,745 for the three months ended March 31, 2021, compared to \$7,115 for the three months ended March 31, 2020. The cash in the respective periods was spent on capital projects (with \$14 spent on the purchase of an interest rate cap in the 2020 period).

Net cash provided by financing activities was \$17,472 for the three months ended March 31, 2021, compared to \$4,997 of net cash used in financing activities for the three months ended March 31, 2020. 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), scheduled debt amortization (\$535) and loan issuance and extinguishment costs (\$3,809); cash was used in the three months ended March 31, 2020, for scheduled debt amortization (\$897), partially offset by additional borrowings related to the development at the 1010 Pacific Street property (\$176). The Company paid distributions of \$4,191 and \$4,276 in the three months ended March 31, 2021 and 2020, respectively.

### ***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 so as to satisfy the requirements for qualification as a REIT for federal income tax purposes.

### ***Inflation***

Inflation in the United States has been relatively low in recent years and 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 70% of our revenue, are short-term in nature. Our

longer-term commercial and retail leases would generally allow us to recover some increased costs in the event of significant inflation.

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

### **Off-Balance Sheet Arrangements**

As of March 31, 2021, we do not have any off-balance sheet arrangements that have had or are reasonably likely to have a material effect on our financial condition, revenues or expenses, results of operations, liquidity, capital resources or capital expenditures.

### **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 non-recurring 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</b>	
	<b>March 31,</b>	
	<b>2021</b>	<b>2020</b>
<b>FFO</b>		
Net loss	\$(7,134)	\$(377)
Real estate depreciation and amortization	6,227	5,558
<b>FFO</b>	<b>\$(907)</b>	<b>\$5,181</b>
<b>AFFO</b>		
FFO	\$(907)	\$5,181
Amortization of real estate tax intangible	120	119
Amortization of above- and below-market leases	(31)	(99)
Straight-line rent adjustments	(1)	(228)
Amortization of debt origination costs	308	304
Amortization of LTIP awards	486	158
Transaction pursuit costs	60	—
Loss on extinguishment of debt	3,034	—
Non-recurring litigation-related expenses	59	264
Recurring capital spending	(50)	(145)
<b>AFFO</b>	<b>\$3,078</b>	<b>\$5,554</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 non-recurring 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</b>	
	<b>March 31,</b>	
	<b>2021</b>	<b>2020</b>
<b>Adjusted EBITDA</b>		
Net loss	\$(7,134)	\$(377)
Real estate depreciation and amortization	6,227	5,558
Amortization of real estate tax intangible	120	119
Amortization of above- and below-market leases	(31)	(99)
Straight-line rent adjustments	(1)	(228)
Amortization of LTIP awards	486	158
Interest expense, net	10,217	9,788
Transaction pursuit costs	60	—
Loss on extinguishment of debt	3,034	—
Non-recurring litigation-related expenses	59	264
<b>Adjusted EBITDA</b>	<b>\$13,037</b>	<b>\$15,183</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>2021</b>	<b>2020</b>
<b>NOI</b>		
Income from operations	\$6,117	\$9,411
Real estate depreciation and amortization	6,227	5,558
General and administrative expenses	2,293	2,323
Transaction pursuit costs	60	—
Amortization of real estate tax intangible	120	119
Amortization of above- and below-market leases	(31)	(99)
Straight-line rent adjustments	(1)	(228)
NOI	<u>\$14,785</u>	<u>\$17,084</u>

### **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. 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, 2020.

### **Recent Accounting Pronouncements**

See Note 3, "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. To manage this risk, we purchased interest rate caps on the \$64.7 million of Clover House debt outstanding (prior to the Clover House debt refinancing on November 8, 2019), the \$75.0 million of 250 Livingston

Street debt outstanding (prior to the 250 Livingston Street debt refinancing on May 31, 2019) and the \$20.6 million of 1010 Pacific Street debt outstanding as of March 31, 2021 (the 1010 Pacific Street interest rate cap matured in December 2020), that would provide interest rate protection if one-month LIBOR exceeds 3.0% for the Clover House loans, 4.0% for the 250 Livingston Street loan and 3.6% for the 1010 Pacific Street loans.

A one percent change in interest rates on our \$20.6 million of variable rate debt as of March 31, 2021, would impact annual net income by approximately \$0.2 million.

The fair value of the Company's notes payable was approximately \$1,159.3 million and \$1,204.2 million as of March 31, 2021, and December 31, 2020, 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 Quarterly Report on Form 10-Q. Based on such evaluation, our CEO and CFO have concluded that as of March 31, 2021, our disclosure controls and procedures were not effective at the reasonable assurance level as a result of the material weakness in our internal control over financial reporting discussed below.

### **Changes in Internal Control**

Other than the material weakness described below, 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.

### **Material Weakness in Internal Control over Financial Reporting**

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. In connection with the preparation of our consolidated financial statements as of and for the year ended December 31, 2020, our management identified a material weakness in our internal control over financial reporting related to an error identified in connection with the understatement of revenue for straight-line rent associated with the reassessment of a lease term. Management identified the following deficiency in our processes and procedures that constitute a material weakness in our internal control over financial reporting: the misapplication of guidance in connection with accounting for a modification of an existing commercial lease. Our management communicated the results of its assessment to the Audit Committee of the Board of Directors of the Company.

Management is in the process of implementing remediation procedures to address the control deficiency that led to the material weakness. The remediation plan includes, but is not limited to, the implementation of additional review procedures regarding the method for accounting for straight-line rent associated with the reassessment of the lease term. We believe these measures will remediate the material weakness noted. While we have completed some of these measures as of the date of this report, we have not completed all measures. The material weakness has not been fully remediated as of the date of the filing of this Form 10-Q. As we continue to evaluate and work to remediate the control deficiencies that gave rise to the material weakness, we may determine that additional measures or time are required to address the control deficiencies or that we need to modify or otherwise adjust the remediation measures described above. We will continue to assess the effectiveness of our remediation efforts in connection with our evaluation of our internal control over financial reporting.

### **Limitations on Effectiveness of Controls and Procedures**

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of

possible controls and procedures relative to their costs.

## **PART II – OTHER INFORMATION**

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

See Note 9, “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, 2020, 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, 2021, and there have been no material changes to those risk factors for the three months ended March 31, 2021. 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 5. OTHER INFORMATION**

On May 4, 2021, Michael Frenz informed the Company of his resignation as Chief Financial Officer of the Company effective May 11, 2021. Lawrence Kreider, Jr., the Company’s previous Chief Financial Officer, will become Chief Financial Officer effective upon Mr. Frenz’s resignation. Mr. Frenz will continue with the Company for a short period of time to assist with the transition.

Mr. Kreider and the Company have entered into an employment agreement pursuant to which Mr. Kreider is entitled to (i) a base salary of \$340,000 per year, (ii) an annual cash incentive bonus with a target bonus opportunity of 44% of annual base salary, (iii) eligibility for long-term incentive compensation with a target annual amount of \$150,000, and (iv) participation in the Company’s employee benefit and welfare plans.

Mr. Kreider, age 73, previously served as Chief Financial Officer of the Company from August 2015 until his retirement in June 2019, following which he served as a consultant to the Company through June 2020 to assist the Company’s executive management, finance and accounting teams with the transition of the responsibilities of the Chief Financial Officer to Mr. Frenz. Previously, Mr. Kreider was Chief Financial Officer of Cedar Realty Trust from 2007 to 2011, where he had direct responsibility for all aspects of the company’s financial operations. From 2001 to 2007, Mr. Kreider was Senior Vice President, Chief Financial Officer, Chief Information Officer and Chief Accounting Officer for Affordable Residential Communities. From 1999 to 2001, Mr. Kreider was Senior Vice President of Finance for Warnaco Group Inc. and, in 2000 and 2001, President of Warnaco Europe. From 1986 to 1999, Mr. Kreider held several senior finance positions with Revlon, Inc., as Senior Vice President, Controller and Chief Accounting Officer, and with MacAndrews & Forbes Holdings. Prior to 1986, he held senior finance positions with Zale Corporation, Johnson Matthew Jewelry Corporation and Refinement International Company. Mr. Kreider began his career with Coopers & Lybrand, now PricewaterhouseCoopers. Mr. Kreider holds a Bachelor of Arts from Yale University and a Master’s of Business Administration from the Stanford Graduate School of Business.

In connection with Mr. Kreider’s retirement from the Company and his provision of consulting services, he received a prorated bonus (through the date of his retirement) for 2019 in the form of a long-term incentive plan award of 5,800 long-term incentive plan units vesting on June 30, 2019. Additionally, the Company accelerated the vesting of Mr. Kreider’s restricted long-term incentive plan units so that they vested in full on June 30, 2019.

There are no family relationships between Mr. Kreider and any of the directors and executive officers of the Company, nor are there any transactions in which Mr. Kreider has an interest requiring disclosure under Item 404(a) of Regulation S-K other than as set forth above.

## 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, 2021

By: /s/ David Bistricher  
David Bistricher  
*Co-Chairman and Chief Executive Officer*