

**STERLING** | OFFICE AND INDUSTRIAL TRUST



# Annual Report 2020

# OUR VISION

TO BE THE MOST RELIABLE,  
WELL-MANAGED AND  
TRANSPARENT REIT  
IN THE UNITED STATES.

# OUR MISSION

TO PROVIDE LOW-RISK AND  
INCOME-PRODUCING REAL  
ESTATE INVESTMENT  
OPPORTUNITIES TO INVESTORS.

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# BOARD OF TRUSTEES



**WILBUR WRIGHT**  
**CHAIRMAN OF THE BOARD**



**KENNETH REGAN**



**TIMOTHY HAUGEN**



**RUP NAGALA**



**JAMES WIELAND**



**DANIEL WILSON**



**LANCE WOLF**

Sterling Office and Industrial Trust operates under the direction of our Board of Trustees. The Board is responsible for the overall management and control of our affairs. Our Trustees have decades of business, real estate, property management, banking and finance experience. Each board member is also a shareholder. The Board is deeply involved in the Trust's risk management. As part of this process, the Board receives regular reports from Management, which include consideration of operational, financial, legal, regulatory and strategic risks facing the Trust and Partnership.

## AUDIT COMMITTEE

**TIMOTHY HAUGEN\***

**DANIEL WILSON**

**WILBUR WRIGHT**

## EXECUTIVE COMMITTEE

**JAMES WIELAND**

**DANIEL WILSON**

**WILBUR WRIGHT\***

## NOMINATION AND GOVERNANCE COMMITTEE

**RUP NAGALA**

**JAMES WIELAND**

**LANCE WOLF\***

\*INDICATES COMMITTEE CHAIR

## EXECUTIVE OFFICERS



**KENNETH REGAN**  
**CHIEF EXECUTIVE  
OFFICER**



**JOEL THOMSEN**  
**PRESIDENT & CHIEF  
INVESTMENT OFFICER**



**ERICA CHAFFEE**  
**CHIEF FINANCIAL  
OFFICER & TREASURER**



**WAYNE CARLSON**  
**GENERAL COUNSEL  
& SECRETARY**



# FINANCIAL HIGHLIGHTS

## YEAR-ENDED DECEMBER 31 (IN THOUSANDS)

	2020	2019	2018
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### INCOME STATEMENT

RENTAL REVENUES	\$20,970	\$19,332	\$18,213
TOTAL EXPENSES	\$19,785	\$20,324	\$20,961
NET INCOME (LOSS)	\$1,249	(\$891)	(\$2,630)
FUNDS FROM OPERATIONS	\$8,498	\$6,738	\$7,124

### BALANCE SHEET

TOTAL REAL ESTATE INVESTMENTS <sup>1</sup>	\$135,532	\$133,969	\$109,041
TOTAL ASSETS	\$145,714	\$149,970	\$138,462
TOTAL LIABILITIES	\$96,938	\$98,046	\$84,212
SHAREHOLDER EQUITY	\$48,776	\$51,924	\$54,250

### SHAREHOLDER DATA

COMMON SHARES/UPREIT UNITS OUTSTANDING	8,026	7,639	7,047
UPREIT UNITS OUTSTANDING	2,937	2,769	2,626
COMMON SHARES OUTSTANDING	5,089	4,870	4,421

(1) TOTAL REAL ESTATE INVESTMENTS INCLUDE REAL ESTATE AND RELATED ASSETS PURCHASED AT THE TIME OF ACQUISITION.

# OUR VALUES

## RESPECT

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WE DEVELOP AND MAINTAIN RELATIONSHIPS BASED ON TRUST, COOPERATION, COLLABORATION AND OPEN COMMUNICATION WITH INVESTORS, STATE AND FEDERAL AGENCIES, BROKERS AND OUR MANY SERVICE PROVIDERS.

## EXCELLENCE

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WE ACHIEVE EXCELLENCE BY FOSTERING A WORK ENVIRONMENT THAT SUPPORTS LEARNING, INNOVATION AND CHANGE. WE STRIVE FOR CONTINUOUS IMPROVEMENT, RECOGNIZING THESE COMPONENTS AS ESSENTIAL TO ACHIEVING EXCELLENCE.

## INTEGRITY

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INTEGRITY IS THE FOUNDATION OF OUR CREDIBILITY. WE SET HIGH STANDARDS FOR OUR WORK AND FOLLOW THE HIGHEST ETHICAL AND PROFESSIONAL STANDARDS.

## TRANSPARENCY

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TO BEST SERVE OUR INVESTORS, WE PROVIDE ACCURATE, COMPLETE AND CONSERVATIVE INFORMATION. WE PRODUCE REPORTS THAT ARE OBJECTIVE, USEFUL, CLEAR AND CANDID. THE RESULTS OF OUR WORK ARE INTENDED TO ADD VALUE TO OUR INVESTORS.

## STEWARDSHIP

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WE DARE TO LEAD WITH A FOCUS BEYOND TODAY. WE ARE COMMITTED TO OUR INVESTORS LONG-TERM, WORKING TO BUILD A STRONGER TRUST FOR FUTURE GENERATIONS AND ACTING AT ALL TIMES WITH AN OWNER'S MENTALITY.

# DEAR VALUED INVESTORS,

On behalf of your Board of Trustees, Officers, and the entire Sterling Team, thank you for your continued trust and support. We greatly value the opportunity to serve you, our loyal investor. 2020 was a year unlike any other. Covid-19, the widespread novel coronavirus, impacted our world in unprecedented ways as its effects permeated every facet of the global economy. While seemingly impossible to predict Covid-19's unpredictable nature, the manufacturing and distribution of vaccines should bring us closer to normalcy as each month passes. Despite the pandemic, 2020 proved to be another strong year for Sterling Office and Industrial Trust. Our collective commitment to our values coupled with our focus on excellence produced robust results, adding to the growing history of success we have established over the past five years. In fact, the pandemic created opportunities in the market with regard to interest rates and leasing, which we were able to turn into long-term value for the Trust. Sterling remains committed to our core values of Respect, Excellence, Integrity, Transparency, and Stewardship. We remain steadfast in our mission to preserve and protect our shareholders' investments with us.

## 2020 HIGHLIGHTS

Sterling Office and Industrial Trust marked its 5th year of existence in 2020. Over the past five years, the Trust has sought to build a portfolio that provides consistent, sustainable growth over the long term. Additionally, we surpassed \$20 million in revenue, an important achievement and milestone. This growth has been accomplished through diligent vetting of acquisitions and tenants, as well as intentional investment in existing assets, adhering to our strict methodology of ensuring a balanced portfolio of office and industrial properties, and multi-tenant and single tenant net leased properties. Revenue grew by over \$1.6 million, with \$882,000 from our office sector and \$756,000 from our industrial portfolio.

Despite many companies embracing remote work, the Trust experienced positive absorption within our office portfolio with net income increasing by \$2.1 million. This growth was achieved by executing new leases on 18,500 square feet while renewing leases on over 200,000 square feet. Together these efforts resulted in total future lease value of \$9.2 million for the Trust. As a result, our occupancy reached an all-time high of 94%.

The U.S. economy presented several challenges during 2020; however, the Trust was able to withstand the ever-present turmoil within the market. We also capitalized on the attractive interest rate environment by renegotiating or refinancing over 25% of our existing debt loans. In doing so, we reduced our weighted average interest rate by 37 basis points to 3.86%. This results in an annual ongoing savings of \$300,000 on our debt portfolio.

## SHARE PRICE

2017	\$10.00
2018	\$10.25
2019	\$10.25
2020	\$10.50

## DIVIDEND YIELD

2017	5.50%
2018	5.50%
2019	5.75%
2020	5.75%

## DIVIDENDS PER SHARE

2017	\$0.55
2018	\$0.56
2019	\$0.59
2020	\$0.60

## SHARES AND UNITS OUTSTANDING

2017	5,454,753
2018	7,478,159
2019	7,893,438
2020	8,109,970



One of our most significant achievements during 2020 was the 26% increase in Funds from Operations (FFO) over the prior year. This notable accomplishment creates value for our investors in the form of an increased dividend – up 14 cents from 2019. This strong FFO equated to a 175.4% dividend/distribution coverage ratio. Since the Trust's inception, our average return to investors has remained strong and steady, averaging 10.18% per year as compared to the MSCI US REIT Index at 5.59% and the S&P 500 at 12.37% over the same time period.

Dividend payout to our investors totaled \$4.8 million. Our share and unit holders reinvested \$2.2 million or 47% of this payout total. Total shares outstanding climbed 221,000 to 5,173,000 on December 31, 2020, while units outstanding fell slightly from 2019 to 2,937,000. The market capitalization of the Trust grew 1.45% to \$182,093,000.

Despite several opportunities presented throughout the year, no new properties were added to our portfolio. We were unwilling to stray from our investment principles or otherwise lower our underwriting standards for the sake of making one or more acquisitions. Given the risky, overpriced market, we chose to focus our attention on maximizing the performance of our existing portfolio. The ultra-competitive investment climate fueled by historically low interest rates and a surplus of cash stimulus in the market pushed real estate pricing to all-time highs. We remain committed to finding ways to create portfolio value through acquisitions, asset management, leasing, and financing activities. We understand a larger portfolio does not necessarily correlate to a high-performing portfolio and therefore remain steadfast in our strategy.

The Trust's strong 2020 operating and financial performance resulted in your Board of Trustees electing to increase our share and unit prices from \$10.50 to \$11.00, a 4.76% increase effective January 1, 2021. Additionally, the Board voted to increase the monthly dividend/distribution from \$0.600 to \$0.605 per share/unit. This resulted in the dividend/distribution rate of 5.50% of the share/unit price.

## THE FUTURE

Looking ahead, we will continue to be diligent in our proven strategy of owning and acquiring well-located investment real estate leased to quality tenants on desirable rates and terms. Our success here ultimately drives our shareholder returns. In addition, we will continue to focus on capturing savings for the Trust. We are currently negotiating another \$15 million in debt refinancing with a weighted average interest of 3.83%. We maintain a well-balanced debt to market capitalization of 53.24%.



In 2021, the Trust will experience lease expirations equaling only 3.4% of our entire portfolio, or only 60,000 square feet. For perspective, the weighted average lease to maturity as of year-end 2020 is 7.35 years. Our proactive strategy with current tenants is to renew their leases at or above market rates when possible. Over the coming three years, 33.6% of our portfolio will experience renewal opportunities. Our focus on renewals and leasing activity will be a key driver in the Trust's ongoing success.

Our vision remains unchanged. We value our role as financial stewards for our investors in this uncertain market. The 2021 real estate investment landscape looks to be softening slightly, potentially giving us the opportunity to make some quality acquisitions. Accordingly, we continue to actively search for assets meeting our disciplined investment principles while practicing patience and commitment to our high standards. Additionally, we continue to invest in our existing portfolio to help maintain strong market performance and ensure our level of cash returns to our investors.

A sincere thank you to the Board of Trustees and the dedicated team at Sterling Management for their ongoing insight, ingenuity, and dedication to our values. On behalf of the entire Sterling team, we thank you, our loyal investor, for your confidence in us and your continued support.

Sincerely,

*Wilbur D. Wright*      *Kenneth P. Regan*

Wilbur D. Wright  
Chairman of the Board

Kenneth P. Regan  
Chief Executive Officer

# OUR BUSINESS

## THE REIT STRUCTURE

A Real Estate Investment Trust ("REIT") is an investment vehicle created by the United States Congress through the Real Estate Investment Act, enacted in 1960. This Act authorized real estate ownership structures to be treated similar to mutual funds, providing for a tax-exempt pass-through entity with broad-based ownership distributing most of its earnings and capital gains to investors. Investment in a REIT offers diversification benefits since REITs often render differing investment strategies in terms of property type and geographic focus.

## STERLING OFFICE AND INDUSTRIAL TRUST

Sterling Office and Industrial Trust is an unincorporated North Dakota trust formed on March 2, 2016, to invest primarily in a diversified portfolio of freestanding, single or multi-tenant office and industrial properties leased to creditworthy tenants. The Trust has elected to be taxed as a Real Estate Investment Trust ("REIT") under Sections 856-860 of the Internal Revenue Code. The Trust's mission is to provide investors the opportunity of long-term ownership in lower risk and well-managed income-producing real estate.

## STERLING OFFICE AND INDUSTRIAL PROPERTIES, LLLP

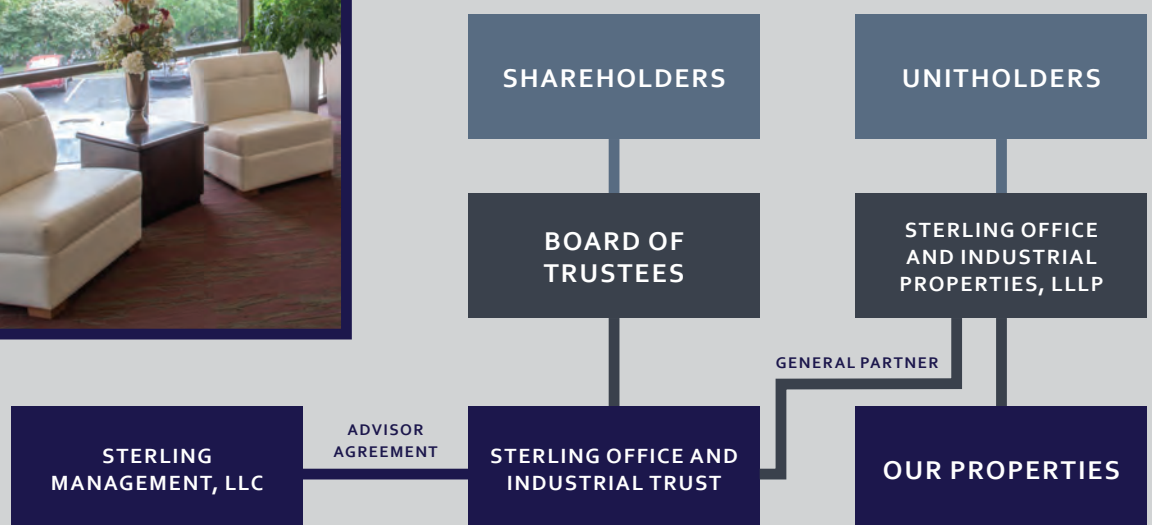
Sterling Office and Industrial Trust is an Umbrella Partnership Real Estate Investment Trust that holds all of its properties in a separate partnership, Sterling Office and Industrial Properties, LLLP ("Sterling Office and Industrial Properties"). The Trust controls Sterling Office and Industrial Properties and acts as its general partner. The Trust uses Sterling Office and Industrial Properties to acquire properties, including through the exchange of limited partnership units for properties. These "UPREIT" exchanges can be advantageous, as the seller may be able to defer taxation of gain until the seller later resells the limited partnership units received in the exchange. By offering sellers the ability to defer taxation, the Trust gains an advantage in acquiring quality properties.

## STERLING MANAGEMENT, LLC

Sterling Office and Industrial Trust operates under the direction of the Board of Trustees. Sterling Office and Industrial Trust has no employees and therefore retains Sterling Management, LLC to manage its owned real estate and business operations. Sterling Management's CEO, President, CIO, and CFO serve as executive officers of the Trust.



## ORGANIZATIONAL STRUCTURE





# KEY LEASES

## COLLEGE OAKS A

LOCATION: **OVERLAND PARK, KANSAS**

TENANT: **CSC GOLD, INC.**

TERM: **8 YEARS**

SQUARE FEET: **10,253**

AGGREGATE  
CONSIDERATION: **1,050,000**



## SHOREMASTER

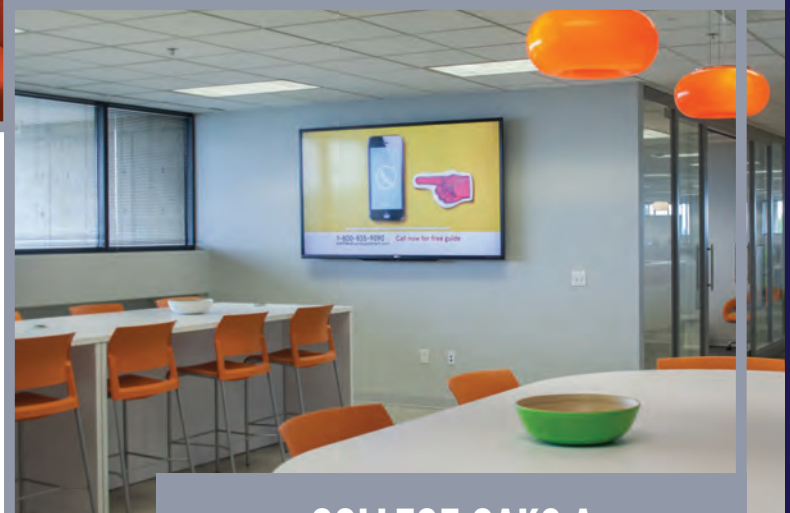
LOCATION: **FERGUS FALLS, MINNESOTA**

TENANT: **SHOREMASTER**

TERM: **4 ½ YEARS**

SQUARE FEET: **116,605**

AGGREGATE  
CONSIDERATION: **2,690,000**



## PACIFIC HILLS 5

LOCATION: **OMAHA, NEBRASKA**

TENANT: **MOYLAN KROPP**

TERM: **10 YEARS**

SQUARE FEET: **5,114**

AGGREGATE  
CONSIDERATION: **1,190,000**



## COLLEGE OAKS A

LOCATION: **OVERLAND PARK, KANSAS**

TENANT: **SEDGWICK CLAIMS  
MANAGEMENT SERVICES, INC.**

TERM: **7 YEARS**

SQUARE FEET: **9,339**

AGGREGATE  
CONSIDERATION: **1,471,000**

# OUR PORTFOLIO

# 311

INVESTORS

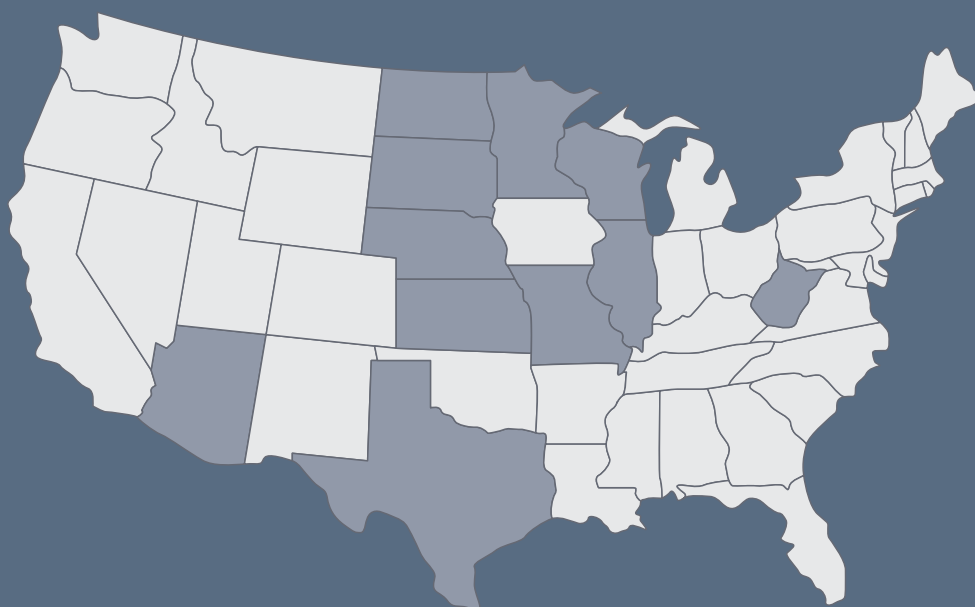
# 1.8M

SQUARE FEET

# 11

STATES

## NET OPERATING INCOME BY STATE



NORTH DAKOTA ○ \$1,004,050

SOUTH DAKOTA ○ \$711,425

MINNESOTA ○ \$2,464,067

WISCONSIN ○ \$1,920,319

NEBRASKA ○ \$4,267,947

KANSAS ○ \$2,178,228

MISSOURI ○ \$217,197

ILLINOIS ○ \$219,760

ARIZONA ○ \$288,781

TEXAS ○ \$298,572

WEST VIRGINIA ○ \$210,171

**TOTAL \$13,780,517**

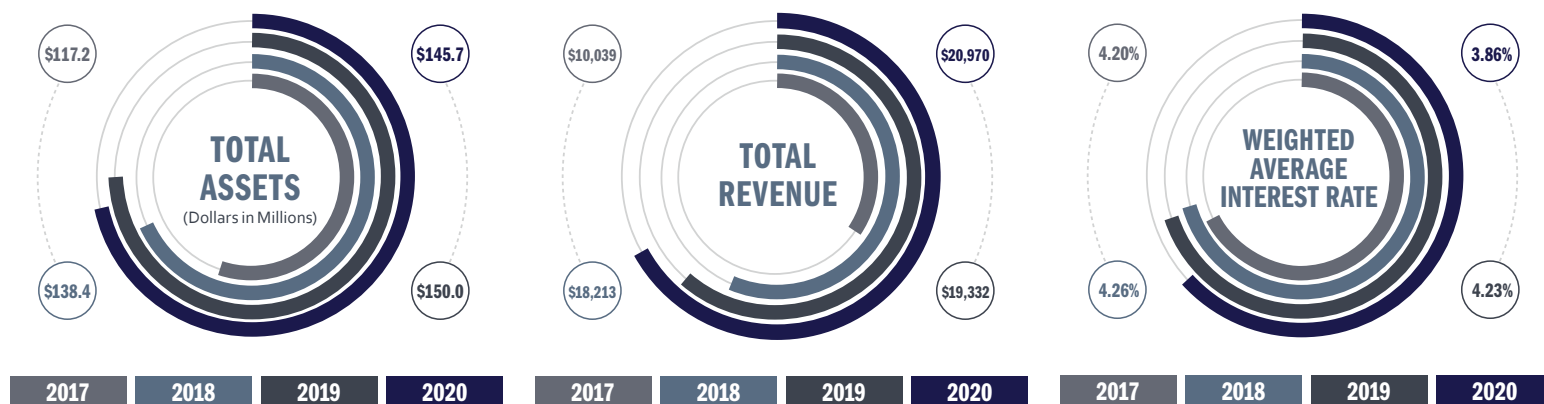
## DIVERSIFIED ASSETS BY INDUSTRY

We consider many factors as we build our portfolio of diversified office and industrial investment real estate. These factors include tenant strength, lease duration, financing terms, geography and industry. Our properties are geographically diverse with locations in 11 states. We intend to maintain a long-term, buy-and-hold strategy while expanding our footprint throughout the Midwest corridor.

## INVESTMENT OBJECTIVES

- Provide our investors a high-quality, long-term real estate investment through acquisition of stabilized office and industrial properties in the Midwest region of the United States.
- Offer an investment option where our common share value is correlated to real estate as an asset class rather than traditional asset classes such as stocks and bonds.
- Provide a hedge against inflation through the use of short-term and long-term lease arrangements with our tenants.

# PORTFOLIO SUMMARY



## INVESTOR RETURN

### TOTAL EQUITY

Total equity is the residual interest in the assets of an entity that remains after deducting its liabilities. Sterling Office and Industrial Trust's year-end 2020 Equity was \$48,776,000, which includes accumulated depreciation and amortization of \$27,116,392 from real estate property value. Adding back the accumulated depreciation and amortization for 2020 shows an Adjusted Equity position of \$75,892,392.

2018	\$54,250,000
2019	\$51,924,000
2020	\$48,776,000

### ACCUMULATED DEPRECIATION AND AMORTIZATION

2018	\$13,595,231
2019	\$20,347,000
2020	\$27,116,392

### ADJUSTED EQUITY POSITION

2018	\$67,845,231
2019	\$72,271,000
2020	\$75,892,392

### DIVIDENDS AND DISTRIBUTIONS DECLARED

Sterling Office and Industrial Trust and Sterling Office and Industrial Properties, LLLP has a consistent history of dividend and distribution payments to share and unit holders. In 2020, the annual yield remained 5.75% (\$0.60375 per share) and declared its 19th consecutive quarterly dividend/distribution payment.

2018	\$4,075,426
2019	\$4,512,793
2020	\$4,845,375

### TOTAL ANNUAL SHAREHOLDER RETURN

Annualized return is the amount earned by an investment each year over a given time period. These figures show the compounded return throughout the given time frames. The total annualized return calculation includes dividend payments and share price appreciation.

1 year	8.78%
3 years	7.84%
5 years	9.41%

### FUNDS FROM OPERATION

2018	\$7,124,000
2019	\$6,738,000
2020	\$8,498,000



# INVESTOR RELATIONS

Sterling Office and Industrial Trust was formed to invest primarily in a diversified portfolio of freestanding, single and multi-tenant office and industrial properties leased to creditworthy tenants. Our work for investors starts with our Mission: to provide investors the opportunity of long-term ownership in lower risk and well-managed income-producing real estate. It declares our purpose and serves as the gold standard against which we weigh our decisions. It is enduring and drives us to consistently look forward.

Communications concerning shareholder address changes, stock transfers, changes of ownership, payment of dividends or other account services can be directed to

**INVESTOR RELATIONS**  
**1711 GOLD DRIVE SOUTH, SUITE 100**  
**FARGO, ND 58103**  
**(877) 269-1031**  
**SOITIR@SRETRUST.COM**

## ANNUAL MEETING

We are looking forward to this year's annual meeting on June 23, 2021, at 6:00 p.m. The meeting will be hosted both in person at the Holiday Inn and virtually. Communication with more details regarding this year's hybrid format will be provided to shareholders as promptly as practicable.

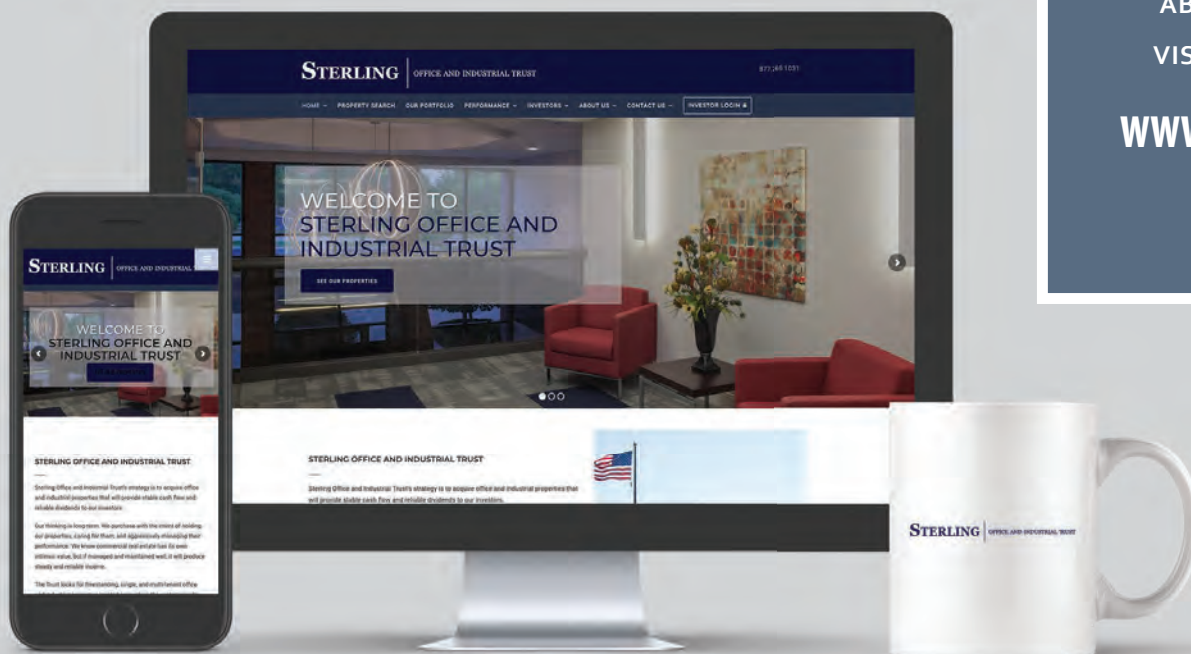
If you have any questions regarding the annual meeting, please contact our office by calling (877) 269-1031.

We sincerely hope you can join us in June, in whichever format you prefer.

**VISIT US ONLINE!**

FOR MORE INFORMATION  
ABOUT THE TRUST,  
VISIT US ONLINE AT:

**WWW.SOITRUST.COM**



# AUDITED FINANCIALS

DECEMBER 31, 2020

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4.....CONSOLIDATED STATEMENTS OF CASH FLOWS

6.....NOTES TO CONSOLIDATED FINANCIAL STATEMENTS



**STERLING OFFICE AND INDUSTRIAL TRUST AND SUBSIDIARIES**

CONSOLIDATED BALANCE SHEETS AS OF *DECEMBER 31, 2020* AND *2019*,  
AND THE RELATED CONSOLIDATED STATEMENTS OF OPERATIONS,  
SHAREHOLDERS' EQUITY AND CASH FLOWS FOR THE YEARS ENDED  
*DECEMBER 31, 2020* AND *2019*  
INCLUDING NOTES

and

INDEPENDENT AUDITORS' REPORT



## **STERLING OFFICE AND INDUSTRIAL TRUST AND SUBSIDIARIES**

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### **CONSOLIDATED FINANCIAL STATEMENTS**

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## INDEPENDENT AUDITORS' REPORT

To the Shareholders, Audit Committee and Board of Directors  
Sterling Office and Industrial Trust and Subsidiaries  
Fargo, North Dakota

We have audited the accompanying consolidated financial statements of Sterling Office and Industrial Trust and its subsidiaries ("the Company") which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of operations and other comprehensive loss, shareholders' equity, and cash flows for the years ended December 31, 2020 and 2019 and the related notes to the consolidated financial statements.

### *Management's Responsibility for the Consolidated Financial Statements*

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

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years ended December 31, 2020 and 2019 in accordance with accounting principles generally accepted in the United States of America.

*Baker Tilly US, LLP*

Chicago, Illinois  
April 23, 2021



**STERLING OFFICE AND INDUSTRIAL TRUST AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**AS OF DECEMBER 31, 2020 AND 2019**

	December 31, 2020	December 31, 2019
	(in thousands)	
<b>ASSETS</b>		
Real estate investments, net	\$ 121,520	\$ 124,195
Cash and cash equivalents	7,915	7,099
Restricted deposits	475	475
Receivables	3,144	2,486
Prepaid expenses	148	176
Financing and lease costs, less accumulated amortization of \$297 in 2020 and \$143 in 2019	729	706
Intangible assets, less accumulated amortization of \$12,808 in 2020 and \$10,431 in 2019	11,691	14,717
Other assets	92	116
Total Assets	\$ 145,714	\$ 149,970
<b>LIABILITIES</b>		
Mortgage notes payable, net	\$ 86,483	\$ 88,905
Special assessments payable	440	437
Dividends and distributions payable	1,224	1,163
Due to related party	127	236
Tenant security deposits payable	384	366
Lease intangible liabilities, less accumulated amortization of \$2,495 in 2020 and \$1,890 in 2019	2,970	3,748
Accounts payable - trade	215	476
Fair value of interest rate swaps	2,791	1,073
Accrued expenses and other liabilities	2,304	1,642
Total Liabilities	96,938	98,046
<b>SHAREHOLDERS' EQUITY</b>		
Beneficial interest	34,330	34,401
Noncontrolling interest		
Special limited partner in the Operating Partnership	5	5
Common unitholders in the Operating Partnership	17,232	18,591
Total Noncontrolling Interest	17,237	18,596
Accumulated other comprehensive loss	(2,791)	(1,073)
Total Shareholders' Equity	48,776	51,924
Total Liabilities and Shareholders' Equity	\$ 145,714	\$ 149,970

**STERLING OFFICE AND INDUSTRIAL TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE LOSS**  
**FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019**

	Year Ended December 31,	
	2020	2019
	(in thousands, except per share data)	
Income from rental operations		
Real estate rental income	\$ 20,970	\$ 19,332
Expenses		
Expenses from rental operations		
Interest	3,682	3,798
Depreciation and amortization	7,249	7,629
Real estate taxes	2,342	2,218
Property management fees	714	561
Utilities	1,273	1,349
Repairs and maintenance	2,721	3,119
Insurance	140	95
	18,121	18,769
Administration of REIT		
Administrative expenses	127	129
Advisory fees	1,375	1,303
Trustee fees	24	22
Legal and accounting	137	101
	1,663	1,555
Total expenses	19,784	20,324
Income (loss) from operations	\$ 1,186	\$ (992)
Other income	63	101
Net income (loss)	\$ 1,249	\$ (891)
Net income (loss) attributable to noncontrolling interest	457	(323)
Net income (loss) attributable to Sterling Office and Industrial Trust	\$ 792	\$ (568)
Net income (loss) per common share, basic and diluted	\$ 0.16	\$ (0.12)
Comprehensive income (loss):		
Net income (loss)	\$ 1,249	\$ (891)
Other comprehensive loss - change in fair value of interest rate swaps	(1,718)	(1,073)
Comprehensive loss:	(469)	(1,964)
Comprehensive loss attributable to noncontrolling interest	(172)	(712)
Comprehensive loss attributable to Sterling Office and Industrial Trust	\$ (297)	\$ (1,252)
Weighted average Common Shares outstanding	5,089	4,870

**STERLING OFFICE AND INDUSTRIAL TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019**

	Common Shares	Paid-in Capital	Accumulated Distributions in Excess of Earnings	Total Beneficial Interest	Noncontrolling Interest	Accumulated Comprehensive Income (Loss)	Total
				(in thousands)			
BALANCE AT DECEMBER 31, 2018	4,743	\$ 46,295	\$ (10,489)	\$ 35,806	\$ 18,444	\$ -	\$ 54,250
Shares issued under trustee compensation plan	2	23	-	23	-	-	23
Contribution of assets in exchange for the issuance of noncontrolling interest shares	-	-	-	-	2,118	-	2,118
Dividends and distributions declared	-	-	(2,870)	(2,870)	(1,643)	-	(4,513)
Dividends reinvested - stock dividend	206	2,010	-	2,010	-	-	2,010
Change in fair value of interest rate swaps	-	-	-	-	-	(1,073)	(1,073)
Net loss	-	-	(568)	(568)	(323)	-	(891)
BALANCE AT DECEMBER 31, 2019	4,951	\$ 48,328	\$ (13,927)	\$ 34,401	\$ 18,596	\$ (1,073)	\$ 51,924
Shares issued under trustee compensation plan	2	23	-	23	-	-	23
Shares/units redeemed	(7)	(69)	-	(69)	(43)	-	(112)
Dividends and distributions declared	-	-	(3,072)	(3,072)	(1,773)	-	(4,845)
Dividends reinvested - stock dividend	226	2,256	-	2,256	-	-	2,256
Syndication costs	-	-	(1)	(1)	-	-	(1)
Change in fair value of interest rate swaps	-	-	-	-	-	(1,718)	(1,718)
Net income	-	-	792	792	457	-	1,249
BALANCE AT DECEMBER 31, 2020	5,172	\$ 50,538	\$ (16,208)	\$ 34,330	\$ 17,237	\$ (2,791)	\$ 48,776

See notes to consolidated financial statements



**STERLING OFFICE AND INDUSTRIAL TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019**

	Year Ended December 31,	
	2020	2019
	(in thousands)	
OPERATING ACTIVITIES		
Net income (loss)	\$ 1,249	\$ (891)
Adjustments to reconcile net income (loss) to net cash from operating activities		
Depreciation	4,319	4,102
Amortization	2,426	3,172
Amortization of debt issuance costs	136	152
Effects on operating cash flows due to changes in		
Receivables	(638)	(1,129)
Prepaid expenses	28	(42)
Other assets	24	5
Due to related party	(86)	138
Tenant security deposits payable	18	2
Accounts payable - trade	62	(1,189)
Accrued expenses and other liabilities	655	(145)
NET CASH PROVIDED BY OPERATING ACTIVITIES	8,193	4,175
INVESTING ACTIVITIES		
Purchase of real estate investment properties	-	(11,144)
Capital expenditures and tenant improvements	(1,963)	(2,281)
NET CASH USED IN INVESTING ACTIVITIES	(1,963)	(13,425)
FINANCING ACTIVITIES		
Payments for financing and lease costs	(297)	(361)
Principal payments on special assessments payable	(27)	(23)
Proceeds from issuance of mortgage notes payable	-	3,750
Principal payments on mortgage notes payable	(2,449)	(2,237)
Shares/units redeemed	(112)	-
Dividends/distributions paid	(2,528)	(2,393)
Payment of syndication costs	(1)	-
NET CASH PROVIDED BY FINANCING ACTIVITIES	(5,414)	(1,264)
NET CHANGE IN CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS	816	(10,514)
CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS AT BEGINNING OF YEAR	7,574	18,088
CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS AT END OF YEAR	\$ 8,390	\$ 7,574
CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS AT END OF YEAR		
Cash and cash equivalents	\$ 7,915	\$ 7,099
Restricted deposits	475	475
TOTAL CASH AND CASH EQUIVALENTS AND RESTRICTED DEPOSITS, END OF YEAR	\$ 8,390	\$ 7,574

**STERLING OFFICE AND INDUSTRIAL TRUST AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019 (continued)**

	Year Ended December 31,	
	2020	2019
	(in thousands)	
SCHEDULE OF CASH FLOW INFORMATION		
Cash paid during the year for interest net of capitalized interest	\$ 3,568	\$ 3,616
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Dividends reinvested	\$ 2,256	\$ 2,010
Dividends declared and not paid	781	730
UPREIT distributions declared and not paid	443	433
Shares issued pursuant to trustee compensation plan	23	23
Acquisitions of assets in exchange for the issuance of noncontrolling interest units in UPREIT	-	2,118
Increase in land improvements due to increase in special assessments payable	30	46
Acquisition of assets with new financing	-	12,475
Acquisition of assets through assumption of debt and liabilities	-	3
Disposal of liabilities from acquisition activity in prior years	-	(54)
Unrealized loss on interest rate swap	(1,718)	(1,073)
Capitalized interest and real estate taxes related to construction in progress	7	-

**STERLING OFFICE AND INDUSTRIAL TRUST AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2020 AND 2019**

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

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**NOTE 1 - ORGANIZATION**

Sterling Office and Industrial Trust (“Sterling”, “the Trust” or “the Company”) is a registered, but unincorporated business trust organized in North Dakota in March 2016. Sterling has elected to be taxed as a Real Estate Investment Trust (“REIT”) under Sections 856-860 of the Internal Revenue Code, which requires that 75% of the assets of a REIT must consist of real estate assets and that 75% of its gross income must be derived from real estate. The net income of the REIT is allocated in accordance with the stock ownership in the same fashion as a regular corporation.

Sterling plans to hold all, or substantially all, of the assets through an operating partnership (“Sterling Office and Industrial Properties, LLLP”), a limited liability limited partnership (“LLLP”) organized in North Dakota in March 2016. The Operating Partnership will own real estate investments and other real estate related assets, directly or indirectly. As the general partner, Sterling has management responsibility for all activities of the operating partnership. As of December 31, 2020 and 2019, Sterling owned approximately 63.8% and 62.7% of the operating partnership, respectively.

**NOTE 2 – PRINCIPAL ACTIVITY AND SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation and Use of Estimates*

The accompanying consolidated financial statements include the accounts of Sterling and all subsidiaries for which we maintain a controlling interest.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Actual results could differ from those estimates.

*Principles of Consolidation*

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

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

*Principal Business Activity*

Sterling expects to acquire primarily freestanding, single or multi-tenant office and industrial properties net leased to creditworthy tenants.

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Sterling owns 29 commercial industrial and office properties located in Arizona, Illinois, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota, Texas, West Virginia and Wisconsin as of December 31, 2020.

Commercial Property	Location	No. of Properties	Sq. Ft
	Arizona	1	64,000
	Illinois	1	49,000
	Kansas	3	230,000
	Minnesota	6	418,000
	Missouri	1	18,000
	Nebraska	7	401,000
	North Dakota	2	117,000
	South Dakota	3	179,000
	Texas	1	73,000
	West Virginia	1	19,000
	Wisconsin	3	219,000
		29	1,787,000

*Concentration of Credit Risk*

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

*Use of Estimates*

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Real Estate Investments*

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

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

For tangible assets acquired, including land, building and other improvements, the Company considers available comparable market and industry information in estimating acquisition date fair value. Key factors considered in the calculation of fair value of both real property and intangible assets include the current market rent values, "dark" periods (building in vacant status), direct costs estimated with obtaining a new tenant, discount rates, escalation factors, standard lease terms, and tenant improvement costs. The Company allocates a portion of the purchase price to the estimated acquired in-place lease value intangibles based on factors available in third party appraisals or cash flow estimates of the property prepared by our internal analysis. These estimates are based upon cash flow projections for the property, existing leases, lease origination costs for similar leases as well as lost rental payments during an assumed lease-up period. The Company also evaluates each acquired lease as compared to current market rates. If an acquired lease is determined to be above or below market, the Company allocates a portion of the purchase price to such above or below market leases based upon the present value of the difference between the contractual lease payments and estimated market rent payments over the remaining lease term. Renewal periods are included within the



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lease term in the calculation of above and below market lease values if, based upon factors known at the acquisition date, market participants would consider it reasonably assured that the lessee would exercise such options. Fair value estimates used in acquisition accounting, including the discount rate used, require the Company to consider various factors, including, but not limited to, market knowledge, demographics, age and physical condition of the property, geographic location, and size and location of tenant spaces within the acquired investment property.

The portion of the purchase price allocated to acquired in-place lease value intangibles is amortized on a straight-line basis over the life of the related lease as amortization expense. The Company incurred amortization expense pertaining to acquired in-place lease value intangibles of \$2,784 and \$3,405 for the years ended December 31, 2020 and 2019, respectively.

The portion of the purchase price allocated to acquired above and below market lease intangibles is amortized on a straight-line basis over the life of the related lease as an adjustment to rental income. Amortization pertaining to above market lease intangibles of \$242 and \$415 for the years ended December 31, 2020 and 2019, respectively, was recorded as a reduction to income from rental operations. Amortization pertaining to below market lease intangibles of \$778 and \$769 for the years ended December 31, 2020 and 2019, respectively, was recorded as an increase to income from rental operations.

Furniture and fixtures are stated at cost less accumulated depreciation. All costs associated with the development and construction of real estate investments, including acquisition fees and interest, are capitalized as a cost of the property. Expenditures for renewals and improvements that significantly add to the productive capacity or extend the useful life of an asset are capitalized. Expenditures for routine maintenance and repairs, which do not add to the value or extend useful lives, are charged to expense as incurred.

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

Building and improvements	40 years
Furniture, fixtures and equipment	5-10 years
Tenant improvements	1-20 years

Depreciation expense for the years ended December 31, 2020 and 2019 totaled \$4,319 and \$4,102 respectively.

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

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

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

If the presence of one or more impairment indicators as described above is identified at the end of the reporting period or throughout the year with respect to an investment property, the asset is tested for recoverability by comparing its carrying value to the estimated future undiscounted cash flows. An investment property is considered to be impaired when the estimated future undiscounted cash flows from the use and eventual disposition of the property are less than its current carrying value. When performing a test for recoverability or estimating the fair value of an impaired investment property, the Company makes complex or subjective assumptions which include, but are not limited to:

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

To the extent impairment has occurred, the Company will record an impairment charge calculated as the excess of the carrying value of the asset over its fair value for impairment of investment properties. There were no impairment losses on real estate properties during the years ended December 31, 2020 and 2019.

*Construction in Progress*

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

Construction in progress as of December 31, 2020 consists primarily of elevator modernization costs at College Oaks A in Overland Park, Kansas. The contract includes services to modernize three elevator cabs and decommission one elevator cab. Current expectations are that the project will be completed second quarter of 2021. The project is expected to cost approximately \$894 of which \$548 has been incurred and included in construction in progress as of December 31, 2020.

*Cash and Cash Equivalents and Restricted Deposits*

We classify highly liquid investments with a maturity of three months or less when purchased as cash equivalents. Restricted cash includes funds escrowed for tenant security deposits, real estate tax, insurance and mortgage escrows and escrow deposits required by lenders on certain properties to be used for future building renovations or tenant improvements and potential Internal Revenue Code Section 1031 tax deferred exchanges (1031 Exchange).

*Receivables*

Receivables consist primarily of amounts due for rent and tenant charges. Accounts receivable are carried at original amounts billed. The operating partnership reviews collectability of charges under its tenant operating leases on a quarterly basis. In the event that collectability is deemed not probable for any tenant charges, beginning with the adoption of ASC 842 as of January 1, 2019, the operating partnership recognizes an adjustment to rental income.

*Financing and Lease Costs*

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

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

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*Debt Issuance Costs*

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

*Intangible Assets*

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

The carrying amount of intangible assets is regularly reviewed for indicators of impairments in value. Impairment is recognized only if the carrying amount of the intangible asset is considered to be unrecoverable from its undiscounted cash flows and is measured as the difference between the carrying amount and the estimated fair value of the asset. Based on the review, management determined no impairment charges were necessary at December 31, 2020 and 2019.

*Noncontrolling Interest*

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

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

*Syndication Costs*

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

*Special Limited Partner*

Pursuant to the LLLP Agreement, the Founders (as defined in the Trust's Private Placement Memorandum dated April 1, 2016) own, jointly, one (1) special limited partnership interest in the operating partnership. As a special limited partner, the Founders have no voting rights but have rights to certain redemption payments upon liquidation in exchange for the special limited partnership interest.

*Federal Income Taxes*

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

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A summary of the tax characterization of the dividends paid to shareholders of the Company's common stock for the years ended December 31, 2020 and 2019 as follows:

	Tax Year Ended December 31,			
	Dividend 2020	% 2020	Dividend 2019	% 2019
Tax status				
Ordinary income	\$ 0.6038	100.00 %	\$ 0.3550	60.23 %
Capital gain	-	- %	-	- %
Return of capital	-	- %	0.2344	39.77 %
	<u>\$ 0.6038</u>	<u>100.00 %</u>	<u>\$ 0.5894</u>	<u>100.00 %</u>

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

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

We follow ASC Topic 740, *Income Taxes*, to recognize, measure, present and disclose in our consolidated financial statements uncertain tax positions that we have taken or expect to take on a tax return. As of December 31, 2020 and 2019, we did not have any liabilities for uncertain tax positions that we believe should be recognized in our consolidated financial statements.

We have elected to record related interest and penalties, if any, as income tax expense on the consolidated statements of operations and other comprehensive income.

#### *Revenue Recognition*

We are the lessor for our commercial leases. Leases are analyzed on an individual basis to determine lease classification. As of December 31, 2020, all leases analyzed under the lease classification process were determined to be operating leases.

For the year ended December 31, 2020, we derived 99% of our revenues from commercial leases primarily under long-term lease agreements. Substantially all commercial leases contain fixed escalations or, in some instances, changes based on the Consumer Price Index, which occur at specified times during the term of the lease. In certain commercial leases, variable lease income is recognized when rents are earned. We recognize rental income and rental abatements from our commercial leases when earned on a straight-line basis over the lease term. Recognition of rental income commences when control of the leased space has been transferred to the tenant.

We recognize variable income from pass-through expenses on an accrual basis over the periods in which the expenses were incurred. Pass-through expenses are comprised of real estate taxes, operating expenses and common area maintenance costs which are reimbursed by tenants in accordance with specific allowable costs per tenant lease agreements. When we pay pass-through expenses, subject to reimbursement by the tenant, they are included within operating expenses, excluding real estate taxes, and reimbursements are included within real estate rental income along with the associated base rent in the accompanying consolidated financial statements.



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We record base rents on a straight-line basis. The monthly base rent income according to the terms of our leases is adjusted so that an average monthly rent is recorded for each tenant over the term of its lease. The straight-line rent adjustment increased revenue by \$615 and \$1,090 for the years ended December 31, 2020 and 2019, respectively. The straight-line receivable balance included in receivables on the consolidated balance sheets as of December 31, 2020 and 2019 was \$2,937 and \$2,343, respectively. We receive payments for expense reimbursements from substantially all our multi-tenant commercial tenants throughout the year based on estimates. Differences between estimated recoveries and the final billed amounts, which generally are immaterial, are recognized in the subsequent year.

Upon adoption of ASU 2016-02 on January 1, 2019, we elected not to bifurcate lease contracts into lease and non-lease components, since the timing and pattern of revenue is not materially different, and the non-lease component is not the primary component of the lease. Accordingly, both lease and non-lease components are presented in real estate rental income beginning January 1, 2019 in our consolidated financial statements. The adoption of ASU 2016-02 did not result in a material change to our recognition of real estate rental income.

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

	<b>Year ended December 31, 2020</b>
	<b>(in thousands)</b>
Lease income related to fixed lease payments	\$ 16,506
Lease income related to variable lease payments	3,532
Other (a)	677
Lease Income (b)	<u>\$ 20,715</u>

- (a) For the year ended December 31, 2020, "Other" is comprised of revenue adjustments related to changes in collectability and amortization of above and below market lease intangibles and lease inducements.
- (b) Excludes other rental income for the year ended December 31, 2020 of \$255, which is accounted for under the revenue recognition standard.

	<b>Year ended December 31, 2019</b>
	<b>(in thousands)</b>
Lease income related to fixed lease payments	\$ 14,771
Lease income related to variable lease payments	2,811
Other (c)	1,396
Lease Income (d)	<u>\$ 18,978</u>

- (c) For the year ended December 31, 2019, "Other" is comprised of revenue adjustments related to changes in collectability and amortization of above and below market lease intangibles and lease inducements.
- (d) Excludes other rental income for the year ended December 31, 2019 of \$354, which is accounted for under the revenue recognition standard.

*Earnings per Common Share*

Basic earnings per common share is computed by dividing net income available to common shareholders (the "numerator") by the weighted average number of common shares outstanding (the "denominator") during the period. Sterling had no dilutive potential common shares as of December 31, 2020 and 2019, and therefore, basic earnings per common share was equal to diluted earnings per common share for the period.

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For the years ended December 31, 2020 and 2019, Sterling's denominators for the basic and diluted earnings per common share were approximately 5,089,000 and 4,870,000 respectively.

*Recent Accounting Pronouncements*

In March 2020, the FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848)*. The standard provides for optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform. On July 27, 2017, the Financial Conduct Authority (FCA), tasked with overseeing the London Interbank Offered Rate (LIBOR) announced the benchmark interest rate will be phased out by the end of 2021. As a result, existing and future contracts indexed to LIBOR will need to be renegotiated to reference another rate.

We adopted the standard effective as of January 1, 2020, using the optional transition method to apply the standard as of the effective date. The Trust elected to apply the optional expedients for all of the Trust's hedging relationships. The Trust will disregard the potential change in the designated hedged risk that may occur due to reference rate reform when the Trust assesses whether the hedged forecasted transaction is probable in accordance with the requirements of Topic 815. The Trust will continue current hedge accounting for our existing cash flow hedges when the hedged risk changes by assuming the reference rate will not be replaced for the remainder of the hedging relationships for our assessment of hedge effectiveness and all subsequent hedge effectiveness assessments.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which superseded FASB ASC Topic 840. The standard for operating leases as lessor is largely unchanged under ASU 2016-02. However, the standard requires lessees to recognize lease assets and lease liabilities for leases classified as operating and finance leases on the balance sheet. Lessees will recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it will recognize lease expense for such leases generally on a straight-line basis over the lease term.

We adopted this standard effective January 1, 2019 and used the optional transition method to apply the standard as of the effective date. The Company elected to apply the package of practical expedients for the leases as lessor for its commercial leases and these leases will continue to be accounted for as operating leases as of the effective date. Further, the Company elected the practical expedient to combine lease and non-lease components for leases as lessor. Finally, the Company evaluated taxes collected from lessees, lessor costs paid directly by lessees, and initial direct costs and determined that the guidance was consistent with existing practice. Based on these evaluations, the Company determined that for leases as lessor, as of January 1, 2019, there was no impact on retained earnings.

In April 2020, the FASB met to discuss lease modifications guidance in Topic 842 as it relates to lease concessions amidst the COVID-19 pandemic. The FASB determined that requiring the analysis of all leases in which concessions are made would be costly and complex for both the lessees and lessors. As such, the FASB has made the decision to allow companies to avoid lease modification accounting when lease concessions do not result in a significant change in cash flow. The Trust has elected to apply the lease modification guidance in Topic 842 for concessions and deferrals made during the COVID-19 pandemic as it relates to the Trust's leases, as the cash flows related to these concessions and deferrals do not cause a significant change in the cash received from the leases.

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

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**NOTE 3 – REAL ESTATE INVESTMENTS**

**As of December 31, 2020**

	(in thousands)
Land and land improvements	\$ 31,617
Building and improvements	103,131
Furniture, fixtures and equipment	214
Construction in progress	569
	135,531
Less accumulated depreciation	(14,011)
	<u>\$ 121,520</u>

**As of December 31, 2019**

	(in thousands)
Land and land improvements	\$ 31,587
Building and improvements	101,825
Furniture, fixtures and equipment	214
Construction in progress	343
	133,969
Less accumulated depreciation	(9,774)
	<u>\$ 124,195</u>

**NOTE 4 – RESTRICTED DEPOSITS AND FUNDED RESERVES**

*Tenant Security Deposits*

We have set aside funds to repay tenant security deposits upon tenant move-out.

*Replacement Reserves*

Pursuant to the terms of certain mortgages, we have established and maintain replacement reserve accounts.

**NOTE 5 – LEASE INTANGIBLES**

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

As of December 31, 2020	Lease Intangibles	Accumulated Amortization	Lease Intangibles, net
Intangible Assets		(in thousands)	
In-place leases	\$ 23,109	\$ (11,824)	\$ 11,285
Above-market leases	1,390	(984)	406
	<u>\$ 24,499</u>	<u>\$ (12,808)</u>	<u>\$ 11,691</u>
Intangible Liabilities			
Below-market leases	\$ (5,465)	\$ 2,495	\$ (2,970)

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<b>As of December 31, 2019</b>	<b>Lease Intangibles</b>	<b>Accumulated Amortization</b>	<b>Lease Intangibles, net</b>
		(in thousands)	
Intangible Assets			
In-place leases	\$ 23,754	\$ (9,686)	\$ 14,068
Above-market leases	1,393	(744)	649
	<u>\$ 25,147</u>	<u>\$ (10,430)</u>	<u>\$ 14,717</u>
Intangible Liabilities			
Below-market leases	<u>\$ (5,638)</u>	<u>\$ 1,890</u>	<u>\$ (3,748)</u>

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

<b>Years ending December 31,</b>	<b>Intangible Assets</b>	<b>Intangible Liabilities</b>
	(in thousands)	
2021	\$ 2,356	\$ 660
2022	1,596	416
2023	1,026	292
2024	891	226
2025	770	204
Thereafter	5,052	1,172
	<u>\$ 11,691</u>	<u>\$ 2,970</u>

The weighted average amortization period for the intangible assets (in-place leases, above-market leases) and intangible liabilities (below-market leases) acquired as of December 31, 2020 was 4.96 years.

**NOTE 6 – LINE OF CREDIT**

We have a \$3,000 variable rate (WSJ prime minus 1.00% not to be less than 2.90%) line of credit agreement with Bell Bank, which expires in July 2021. The line of credit is secured by property in Kansas City, Missouri and Scott Depot, West Virginia. At December 31, 2020 and 2019, there was no balance outstanding on the line of credit, leaving \$3,000 available and unused under the agreement.

The line of credit agreement includes covenants that, in part, impose maintenance of certain debt service coverage ratios. As of December 31, 2020, we were in compliance with all covenants.



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**NOTE 7 – MORTGAGE NOTES PAYABLE**

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

	<b>Principal Balance At</b>	
	<b>December 31,</b>	<b>December 31,</b>
	<b>2020</b>	<b>2019</b>
	<b>(in thousands)</b>	
Fixed rate mortgage notes payable (a)	\$ 86,927	\$ 89,376
Less unamortized debt issuance costs	(444)	(471)
	<u>\$ 86,483</u>	<u>\$ 88,905</u>

(a) Includes \$32,763 and \$16,013 of variable rate mortgage debt that was swapped to a fixed rate as of December 31, 2020 and 2019, respectively.

As of December 31, 2020, we had 16 fixed rate and no variable rate mortgage loans with effective interest rates ranging from 3.29% to 4.60% per annum and a weighted average effective interest rate of 3.86% per annum.

As of December 31, 2019, we had 16 fixed rate and no variable rate mortgage loans with effective interest rates ranging from 3.53% to 4.79% per annum and a weighted average effective interest rate of 4.23% per annum.

The majority of the Company's mortgages payable require monthly payments of principal and interest. Mortgages are secured by the respective properties, assignment of rents, business assets, deeds to secure debt, deeds of trust and/or cash deposits with the lender.

Certain mortgage note agreements include covenants that, in part, impose maintenance of certain debt service coverage and debt to worth ratios. As of December 31, 2020, no loans were out of compliance with their covenants. As of December 31, 2019, two loans were out of compliance due to vacancy and repairs and maintenance on the properties. An annual waiver was received from the lender.

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

<b>Years ending December 31,</b>	<b>Amount</b>
	<b>(in thousands)</b>
2021	\$ 17,346
2022	2,359
2023	5,792
2024	2,330
2025	13,580
Thereafter	45,520
Total payments	<u>\$ 86,927</u>

**NOTE 8 – DERIVATIVES AND HEDGING ACTIVITIES**

As part of our interest rate risk management strategy, we have used interest rate derivatives to manage our exposure to interest rate movements and add stability to interest expense. Interest rate swaps designated as cash flow hedges

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involve the receipt of variable rate amounts from a counterparty in exchange for the Trust making fixed rate payments over the life of the agreement without exchange of the underlying notional amount.

As of December 31, 2020, the Trust used four interest rate swaps to hedge the variable cash flows associated with variable rate debt. Changes in fair value of the derivatives that are designated and that qualify as cash flow hedges are recorded in accumulated other comprehensive (loss) income and are reclassified into interest expense as interest payments are made on the Company's variable rate debt. Over the next 12 months, the Company estimates that an additional \$543 will be reclassified as an increase to interest expense.

The following table summarizes the Trust's interest rate swaps as of December 31, 2020, which effectively convert one-month floating rate LIBOR to a fixed rate:

<b>Effective Date</b>	<b>Notional</b>	<b>Fixed Interest Rate</b>	<b>Maturity Date</b>
March 15, 2019	\$ 11,970	4.24 %	March 15, 2029
December 12, 2019	\$ 3,659	3.66 %	December 12, 2029
March 31, 2020	\$ 9,504	3.29 %	May 15, 2030
April 14, 2020	\$ 7,630	3.50 %	May 20, 2028

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

<b>Interest Rate Derivatives</b>	<b>Number of Instruments</b>		<b>Notional</b>	
	<b>December 31, 2020</b>	<b>December 31, 2019</b>	<b>December 31, 2020</b>	<b>December 31, 2019</b>
Interest rate swaps	4	2	\$ 32,763	\$ 16,013

The table below presents the estimated fair value of the Company's derivative financial instruments as well as their classification in the accompanying consolidated balance sheets. The valuation techniques are described in Note 9 to the consolidated financial statements.

<b>Derivatives designated as cash flow hedges:</b>	<b>Derivatives</b>			
	<b>December 31, 2020</b>		<b>December 31, 2019</b>	
	<b>Balance Sheet Location</b>	<b>Fair Value</b>	<b>Balance Sheet Location</b>	<b>Fair Value</b>
Interest rate swaps	Accrued expenses and other liabilities	\$ 2,791	Accrued expenses and other liabilities	\$ 1,073

The carrying amount of the swaps have been adjusted to their fair value at the end of the quarter, which because of changes in forecasted levels of LIBOR, resulted in reporting a liability for the fair value of the future net payments forecasted under the swap. The interest rate swap is accounted for as an effective hedge in accordance with ASC 815-20 whereby it is recorded at fair value and changes in fair value are recorded to comprehensive income. The following

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table presents the effect of the Company's derivative financial instruments on the accompanying consolidated statements of operations and other comprehensive (loss) income for the years ended December 31, 2020 and 2019:

Derivatives in Cash Flow Hedging Relationship	Amount of Loss Recognized in Other Comprehensive Income on Derivatives	Location of Gain Reclassified from Accumulated other Comprehensive Income (AOCI) into Income	Amount of Loss Reclassified from AOCI into income
	2020		2020
Interest rate swaps	\$ 1,718	Interest expense	\$ 408
	2019		2019
Interest rate swaps	\$ 1,073	Interest expense	\$ 46

*Credit-risk-related Contingent Features*

The Trust has agreements with each of its derivative counterparties that contain a provision whereby if the Trust defaults on the related indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Trust could also be declared in default on its corresponding derivative obligation. As of December 31, 2020, the termination value of derivatives in a liability position was \$2,791. As of December 31, 2020, the Trust has pledged the properties related to the loans which are hedged as collateral.

**NOTE 9 – FAIR VALUE MEASUREMENT**

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

	December 31, 2020		December 31, 2019	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(in thousands)		(in thousands)	
<b>Financial liabilities:</b>				
Mortgages notes payable, net	\$ 86,927	\$ 89,379	\$ 89,376	\$ 92,563
Fair value of interest rate swaps	\$ 2,791	\$ 2,791	\$ 1,073	\$ 1,073

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

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

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

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*Recurring Fair Value Measurements*

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

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	(in thousands)			
<u>December 31, 2020</u>				
Fair value of interest rate swaps	\$ —	\$ 2,791	\$ —	\$ 2,791
<u>December 31, 2019</u>				
Fair value of interest rate swaps	\$ —	\$ 1,073	\$ —	\$ 1,073

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

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of December 31, 2020 and 2019, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation. As a result, the Company has determined that its derivative valuations in their entirety are classified within Level 2 of the fair value hierarchy. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered any applicable credit enhancements. The Company's derivative instrument is further described in Note 8.

*Fair value Disclosures*

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

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	(in thousands)			
<b><u>December 31, 2020</u></b>				
Mortgage notes payable, net	\$ —	\$ —	\$ 89,379	\$ 89,379
<b><u>December 31, 2019</u></b>				
Mortgage notes payable, net	\$ —	\$ —	\$ 92,563	\$ 92,563

*Mortgage notes payable:* The Company estimates the fair value of its mortgage notes payable by discounting the future cash flows of each instrument at rates currently offered to the Company for similar debt instruments of comparable maturities by the Company's lenders. Judgment is used in determining the appropriate rate for each of the Company's individual mortgages and notes payable based upon the specific terms of the agreement, including the



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term to maturity, the quality and nature of the underlying property and its leverage ratio. The rates used were 3.4% and 3.6% for December 31, 2020 and 2019, respectively. The fair value of the Company's matured mortgage notes payable were determined to be equal to the carrying value of the properties because there is no market for similar debt instruments and the properties' carrying value was determined to be the best estimate of fair value. The Company's mortgage notes payable are further described in Note 7.

**NOTE 10 – NONCONTROLLING INTEREST OF UNITHOLDERS IN OPERATING PARTNERSHIP**

*Non-controlling Interests*

As of December 31, 2020 and 2019, outstanding common limited partnership units totaled 2,937,000 and 2,942,000, respectively. The operating partnership declared fourth quarter distributions of \$443 and \$433, respectively, to limited partners paid in January 2021 and 2020, respectively. Distributions per unit were \$0.6038 and \$0.5894 during the years ended December 31, 2020 and 2019, respectively.

Limited Partners may request the operating partnership to exchange their limited partnership units. The operating partnership may choose to offer the Limited Partner: (i) cash for the exchange or, at the request of the Limited Partner, (2) shares in lieu of cash for the exchange on a basis of one limited partnership unit for one Sterling common share (the "Exchange Request"). The Exchange Request shall be exercised pursuant to a Notice of Exchange. If the issuance of Sterling common shares pursuant to an Exchange Request will cause the shareholder to exceed the ownership limitations, as defined in the Declaration of Trust and/or the Limited Liability Partnership Agreement, among other reasons, payment will be made to the Limited Partner in cash. No Limited Partner may exercise an Exchange Request more than twice during any calendar year, and Exchange Requests may not be made for less than 1,000 limited partnership units. If a Limited Partner owns less than 1,000 limited partnership units, all of the limited partnership units held by the Limited Partner must be exchanged pursuant to the Exchange Request.

*Special Limited Partner*

As of December 31, 2020 and 2019, outstanding special limited partnership units totaled 1.

Pursuant to the LLLP Agreement, the Founders (as defined in the Trust's Private Placement Memorandum dated April 1, 2016) own, jointly, one (1) special limited partnership interest in the operating partnership. As a special limited partner, the Founders have no voting rights but have rights to certain redemption payments in exchange for the special limited partnership interest, as described below:

In connection with a merger or sale of assets or other transaction, or our shares of beneficial interest become listed on a national securities exchange, the operating partnership will redeem the Founders' special limited partnership interest for \$5,000 plus an amount equal to 15% of the net proceeds remaining, as if all assets of the Trust and the operating partnership had been sold for such value and all liabilities had been satisfied in full according to their terms. The proceeds shall be determined utilizing the then current established share/unit price, or if greater, the value of the partners or shareholders original contribution.

Redemption of the Founders' special limited partnership interest for the amounts stated above shall be in cash or, at the option of the Founders, units of limited partner interests in our operating partnership or common shares of beneficial interest in the Trust.

**NOTE 11 – REDEMPTION PLANS**

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

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Our redemption plans currently provide that the maximum amount that can be redeemed under the plan is \$5,000 worth of securities. As of December 31, 2020, there were \$4,888 worth of securities left to be redeemed under the redemption plan. Currently, the fixed redemption price is \$10.00 per share or unit under the plans which price became effective January 1, 2021. Prior to January 1, 2021 the redemption price was \$9.50 per share or unit under the plan. Prior to January 1, 2020 the redemption price was \$9.25 per share or unit under the plan.

We may redeem securities under the plans provided the aggregate total has not been exceeded if we have sufficient funds to do so. The plans will terminate in the event the shares become listed on any national securities exchange, the subject of bona fide quotes on any inter-dealer quotation system or electronic communications network or are the subject of bona fide quotes in the pink sheets. Additionally, the Board, in its sole discretion, may terminate, amend or suspend the redemption plans, either or both of them, if it determines to do so in its sole discretion.

During the year ended December 31, 2020, the Company redeemed 7,000 common shares valued at \$69 and 5,000 units valued at \$43. During the year ended December 31, 2019, the Company redeemed no common shares or units.

**NOTE 12 – BENEFICIAL INTEREST**

We are authorized to issue 100,000,000 voting common shares of beneficial interest with \$0.01 par value and 50,000,000 voting preferred shares with \$0.01 par value, which collectively represent the beneficial interest of Sterling. As of December 31, 2020 and 2019, there were 5,172,000 and 4,951,000 common shares outstanding. We had no preferred shares outstanding as of either date.

The Trust declared fourth quarter dividends of \$781 and \$730 to shareholders paid in January 2021 and 2020, respectively. Dividends paid to holders of common shares were \$0.6038 and \$0.5894 per share for the years ended December 31, 2020 and 2019, respectively.

**NOTE 13 – DIVIDEND REINVESTMENT PLAN**

Our Board of Trustees approved a dividend reinvestment plan to provide existing holders of our common shares with a convenient method to purchase additional common shares without payment of brokerage commissions, fees or service charges.

Under this plan, eligible shareholders may elect to have all or a portion (but not less than 25%) of the cash dividends they receive automatically reinvested in our common shares. The purchase price per common share under the plan equals 95% of the estimated value per common share for dividend reinvestments, as determined by our Board of Trustees.

The purchase price per common share for dividend reinvestments was \$9.98 and \$9.74 at December 31, 2020 and 2019, respectively. The Board, in its sole discretion, may amend, suspend or terminate the plan at any time, without the consent of shareholders, upon a ten day notice to participants.

During the year ended December 31, 2020, 226,000 shares were issued pursuant to dividend reinvestments under the plan. During the year ended December 31, 2019, 206,000 shares were issued pursuant to dividend reinvestments under the plan.

**NOTE 14 – RELATED PARTY TRANSACTIONS**

*Property Management Fee*

During the years ended December 31, 2020 and 2019, we paid property management fees to GOLDMARK Property Management in an amount equal to approximately 5% of rents of the properties managed. GOLDMARK Property Management is owned in part by Kenneth Regan and James Wieland, two of our trustees. For the years ended December 31, 2020 and 2019, we paid management fees of \$14 and \$13, respectively to GOLDMARK Property

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Management. In addition, during the years ended December 31, 2020 and 2019, we paid repair and maintenance related payroll and payroll related expenses to GOLDMARK Property Management of \$4 and \$3, respectively.

*Board of Trustee Fees*

During the years ended December 31, 2020 and 2019, we incurred independent Trustee fees of \$24 and \$22, respectively. As of December 31, 2020 and 2019 we owed our Trustees \$12 and \$11 for unpaid board of trustee fees, respectively. There is no cash retainer paid to Trustees. Instead, we pay Trustees specific amounts of shares for meetings attended. Our Trustee Compensation Plan provides:

The plan provides:

Board Chairman – Board Meeting	118 shares/meeting
Trustee – Board Meeting	79 shares/meeting
Committee Chair – Committee Meeting	30 shares/meeting
Trustee – Committee Meeting	30 shares/meeting

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

*Advisory Agreement*

We are an externally managed trust and as such, although we have a Board of Trustees and executive officers responsible for our management, we have no paid employees. The following is a brief description of the current fees and compensation that may be received by the Advisor under the Advisory Agreement, which must be renewed on an annual basis and approved by a majority of the independent trustees. The Advisory Agreement was approved by the Board of Trustees (including all the independent Trustees) on March 25, 2020, effective until March 31, 2021.

**Management Fee:** For its services during the year, our Advisor receives 0.8% of our total assets (before depreciation and amortization), annually. Total assets are our gross assets (before depreciation and amortization) as reflected on our consolidated financial statements. The management fee will be payable monthly in cash or our common shares, at the option of the Advisor, not to exceed one-twelfth of 0.8% of the total assets as of the last day of the immediately preceding month. The management fee calculation is subject to quarterly and annual reconciliations. The management fee may be deferred at the option of the Advisor, without interest.

During the years ended December 31, 2020 and 2019, we incurred advisory management fees of \$1,374 and \$1,303 with Sterling Management, LLC, our Advisor. As of December 31, 2020 and 2019, we owed our Advisor \$115 and \$225, respectively, for unpaid advisory management fees. These fees cover the office facilities, equipment, supplies, and staff required to manage our day-to-day operations. In addition, during the years ended December 31, 2020 and 2019, we reimbursed the Advisor for insurance premiums and operating expenses such as travel and meals, legal and office supplies totaling \$101 and \$13, respectively.

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

During the year ended December 31, 2020, we incurred no acquisition fees. During the year ended December 31, 2019 we incurred acquisition fees of \$519 with our Advisor. As of December 31, 2020 and 2019, we had no unpaid acquisition fees.

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

During the years ended December 31, 2020 and 2019, we incurred no disposition fees.

**Financing Fee:** For its services in the effort to place financing for us, the Advisor receives a financing fee of 0.25% of all amounts made available to us pursuant to any loan, refinance (excluding rate and/or term modifications of an existing loan with the same lender), line of credit or other credit facility. The financing fee shall be capped at \$38 per loan, refinance, line of credit or other credit facility.

During the year ended December 31, 2020, we incurred no financing fees with our Advisor. During the year ended December 31, 2019, we incurred financing fees of \$41, with our Advisor for loan financing and refinancing activities. As of December 31, 2020 and 2019 we had no unpaid financing fees.

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

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

TC = Total Project Cost

During the years ended December 31, 2020 and 2019, we incurred no development fees.

*Operating Partnership Units Issued in Connection with Acquisitions*

During the years ended December 31, 2020 and 2019, we did not issue directly or indirectly, any operating partnership units to entities affiliated with any related parties.

*Commissions*

During the year ended December 31, 2020, we did not incur any real estate commissions. During the year ended December 31, 2019, we incurred real estate commissions of \$229 owed to GOLDMARK SCHLOSSMAN Commercial Real Estate Services, Inc., which is controlled by Messrs. Regan, Wieland, and Thomsen. There were no outstanding commissions owed as of December 31, 2020 or 2019.

**NOTE 15 – RENTALS UNDER OPERATING LEASES / RENTAL INCOME**

Commercial properties are leased to tenants under terms expiring at various dates through 2036. Lease terms often include renewal options. For the years ended December 31, 2020 and 2019, gross revenues from commercial property rentals, including CAM income (common area maintenance) of \$3,532 and \$2,811 respectively, totaled \$20,970 and \$19,332, respectively.

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Commercial space is rented under long-term agreements. Minimum future rentals on non-cancelable operating leases as of December 31, 2020 are as follows:

<b>Years ending December 31,</b>	<b>Amount</b>
	<b>(in thousands)</b>
2021	\$ 16,678
2022	13,964
2023	10,815
2024	8,562
2025	7,376
Thereafter	49,139
	<u>\$ 106,534</u>

**NOTE 16 - COMMITMENTS AND CONTINGENCIES**

*Environmental Matters*

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

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

*Risk of Uninsured Property Losses*

We maintain property damage, fire loss, and liability insurance. However, there are certain types of losses (generally of a catastrophic nature) which may be either uninsurable or not economically insurable. Such excluded risks may include war, earthquakes, tornados, certain environmental hazards, and floods. Should such events occur, (i) we might suffer a loss of capital invested, (ii) tenants may suffer losses and may be unable to pay rent for the spaces, and (iii) we may suffer a loss of profits which might be anticipated from one or more properties.

*Litigation*

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

*Significant Risks and Uncertainties*

The Trust continues to closely monitor the impact of the COVID-19 pandemic on all aspects of its business and geographies, including how it will impact its tenants and business partners. Several uncertainties continue to exist at this time, including but not limited to the uncertainty of additional state and/or federal stimulus and the effect of the recent surge in COVID-19 cases in many states. The Trust did not incur significant disruptions for the year ended December 31, 2020 from the COVID-19 pandemic.

During the year ended December 31, 2020, the Trust received certain rent relief requests because of COVID-19. These requests were received most often in the form of rent deferral requests. Few rental defaults have occurred to



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date and the Trust is pursuing legal remedies as to these amounts which are not material in the aggregate. The Trust will continue to evaluate any further tenant rent relief requests on an individual basis, considering several factors. Not all tenant requests will ultimately result in modification agreements, nor will the Trust forgo its contractual rights under its lease agreements.

**NOTE 17 – BUSINESS COMBINATIONS AND ACQUISITIONS**

The Company did not acquire any properties during the year ended December 31, 2020.

The Company closed on the following property acquisitions during the year ended December 31, 2019:

Date	Property Name	Location	Property Type	Units/ Square	Acquisition	
				Footage/		Price
				Acres		
(in thousands)						
03/11/19	Dakota Supply Group	Aberdeen, SD	Industrial	61,945 sq. ft.	\$ 2,563	
03/11/19	Dakota Supply Group	Pierre, SD	Industrial	18,342 sq. ft.	1,202	
03/11/19	Dakota Supply Group	Fargo, ND	Industrial	14,544 sq. ft.	3,310	
03/11/19	Dakota Supply Group	Rochester, MN	Industrial	69,276 sq. ft.	5,733	
03/11/19	Dakota Supply Group	La Crosse, WI	Industrial	70,000 sq. ft.	5,069	
03/11/19	Dakota Supply Group	Plover, WI	Industrial	16,800 sq. ft.	1,313	
11/01/19	Woodbury Technology Center	Woodbury, MN	Industrial	69,600 sq. ft.	5,765	
					\$ 24,955 (a)	

(a) Acquisition price does not include capitalized closing costs and adjustments of \$785.

Total consideration given for acquisitions for the year ended December 31, 2019 was completed through issuing approximately 207,000 limited partnership units of the operating partnership valued at \$10.25 per unit, for an aggregate consideration of approximately \$2,118, new loans of \$12,475 and assumed liabilities of \$3 and cash of \$11,144. The value of units issued in exchange for property is determined through a value established annually by our Board of Trustees, and reflects the estimated fair value at the time of issuance.

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

	2020	2019
	(in thousands)	
Land, building, tenant improvements and FF&E	\$ -	\$ 22,695
Acquired lease intangible assets	-	3,436
Acquired lease intangible liabilities	-	(391)
Other liabilities	-	(3)
Net assets acquired	-	25,737
Equity/limited partnership unit consideration	-	(2,118)
New loans	-	(12,475)
Net cash consideration	<u>\$ -</u>	<u>\$ 11,144</u>

***Estimated Value of Units/Shares***

The Board of Trustees determined an estimate of fair value for the trust shares in 2020 and 2019. In addition, the Board of Trustees, acting as general partner for the operating partnership, determined an estimate of fair value for the limited partnership units in 2020 and 2019. In determining this value, the Board relied upon their experience with, and knowledge about, the Trust's real estate portfolio and debt obligations. The Board typically determines the share price

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

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on an annual basis. The trustees determine the price in their discretion and use data points to guide their determination which is typically based on a consensus of opinion. In addition, the Board considers how the price chosen will affect existing share and unit values, redemption prices, dividend coverage ratios, yield percentages, dividend reinvestment factors, and future UPREIT transactions, among other considerations and information. The fair value was not determined based on, nor intended to comply with, fair value standards under US GAAP and the value may not be indicative of the price we would get for selling our assets in their condition.

Based on the results of the methodologies, the Board determined the fair value of the shares and limited partnership units to be \$10.50 per share/unit effective January 1, 2020. The Board determined the fair value of the shares and limited partnership units to be \$11.00 per share/unit effective January 1, 2021.

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

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

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

**NOTE 18 - SUBSEQUENT EVENTS**

On January 15, 2021, we paid a dividend or distribution of \$0.150938 per share on our common shares of beneficial interest or limited partnership units, to common shareholders and limited unit holders of record on December 31, 2020.

On March 24, 2021, the Board of Trustees approved a dividend or distribution of \$0.15125 per share on our common shares of beneficial interest or limited partnership units, to common shareholders and limited unit holders of record on March 31, 2021, which was paid on April 15, 2021.

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

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

**STERLING**

OFFICE AND INDUSTRIAL TRUST

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