# FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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## FILER

**KRUPP GOVERNMENT INCOME TRUST-II**

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SIC: **6798** Real estate investment trusts

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

# FORM 10-Q

**(Mark One)**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2002**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**

**Commission file number 0-20164**

**Krupp Government Income Trust II**

**Massachusetts**

**(State or other jurisdiction of incorporation or organization)**

**04-3073045**

**(IRS employer identification no.)**

**One Beacon Street, Boston, Massachusetts**

**(Address of principal executive offices)**

**02108**

**(Zip Code)**

**(617) 523-0066**

**(Registrant's telephone number, including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

## Part I. FINANCIAL INFORMATION

### Item 1. FINANCIAL STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this Form 10-Q, the words "believes," "anticipates," "expects," "plans," "intends," "estimates," "continue," "may" or "will" (or the negative of such words) and similar expressions are intended to identify forward-looking statements. Such statements are subject to a number of risks and uncertainties, including but not limited to the following: federal, state or local regulations; adverse changes in general economic or local conditions; prepayments of mortgages; failure of borrowers to pay participation interests due to poor operating results of properties underlying the mortgages; uninsured losses and potential conflicts of interest between the Trust and its Affiliates, including the Trustees. The Company's filings with the Securities and Exchange Commission, including its Annual Report on Form 10-K for the year ended December 31, 2001, contain additional information concerning such risk factors. Actual results in the future could differ materially from those described in any forward-looking statements as a result of the risk factors set forth above, and the risk factors described in the Annual Report.

KRUPP GOVERNMENT INCOME TRUST II

BALANCE SHEETS

ASSETS

| | March 31, 2002 | December 31, 2001 |
|---|---|---|
| Participating Insured Mortgage Investments ("PIMIs")(Note 2) | | |
| Insured mortgages | $ 70,203,824 | $ 85,625,185 |
| Additional Loans, net of impairment provision of $0 of $500,000 respectively | 13,654,000 | 17,654,500 |
| Participating Insured Mortgages ("PIMs")(Note 2) | 37,137,389 | 37,239,922 |
| Mortgage-Backed Securities ("MBS")(Note 3) | 13,850,687 | 15,600,964 |
| Total mortgage investments | 134,845,900 | 156,120,571 |
| Cash and cash equivalents | 8,602,274 | 6,453,663 |
| Interest receivable and other assets | 963,064 | 1,174,106 |
| Prepaid acquisition fees and expenses, net of accumulated amortization of $6,615,183 and $7,964,938, respectively | 1,999,727 | 2,913,250 |
| Prepaid participation servicing fees, net of accumulated amortization of $2,038,156 and $2,420,697, respectively | 730,588 | 1,102,473 |
| Total assets | $ 147,141,553 | $ 167,764,063 |

LIABILITIES AND SHAREHOLDERS' EQUITY

| | March 31, 2002 | December 31, 2001 |
|---|---|---|
| Deferred income on Additional Loans (Note 2) | $ - | $ 1,242,282 |
| Other liabilities | 52,481 | 25,985 |
| Total liabilities | 52,481 | 1,268,267 |
| Shareholders' equity (Note 4) | | |
| Common stock, no par value; 25,000,000 Shares authorized; 18,371,477 Shares issued and outstanding | 146,806,524 | 166,214,677 |
| Accumulated comprehensive income | 282,548 | 281,119 |
| Total Shareholders' equity | 147,089,072 | 166,495,796 |

| | | |
|---|---|---|
| Total liabilities and Shareholders' equity | $ 147,141,553 | $ 167,764,063 |

The accompanying notes are an integral part of the financial statements.

KRUPP GOVERNMENT INCOME TRUST II

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

| | For the Three Months Ended March 31, | |
|---|---|---|
| | 2002 | 2001 |
| Revenues: | | |
| Interest income - PIMs and PIMIs: | | |
| Basic interest | $ 1,974,637 | $ 2,725,053 |
| Additional Loan interest | 2,206,227 | 667,426 |
| Participation interest | 2,673,573 | 2,511,079 |
| Interest income - MBS | 226,007 | 331,823 |
| Interest income - cash and cash equivalents | 45,822 | 124,756 |
| Total revenues | 7,126,266 | 6,360,137 |
| Expenses: | | |
| Asset management fee to an affiliate | 263,587 | 362,932 |
| Expense reimbursements to affiliates | 31,975 | 41,983 |
| Amortization of prepaid fees and expenses | 1,285,408 | 921,288 |
| General and administrative | 100,810 | 107,919 |
| Reduction of provision for impaired additional loan (Note 2) | (500,000) | - |
| Total expenses | 1,181,780 | 1,434,122 |
| Net income | 5,944,486 | 4,926,015 |
| Other comprehensive income: | | |
| Net change in unrealized gain on MBS | 1,429 | 56,684 |
| Total comprehensive income | $ 5,945,915 | $ 4,982,699 |
| Basic earnings per Share | $ .32 | $ .27 |
| Weighted average Shares outstanding | 18,371,477 | 18,371,477 |

The accompanying notes are an integral part of the financial statements.

KRUPP GOVERNMENT INCOME TRUST II

STATEMENTS OF CASH FLOWS

| | For The Three Months Ended March 31, 2002 | 2001 |
|---|---|---|
| Operating activities: | | |
| Net income | $ 5,944,486 | $ 4,926,015 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of net premium | 30,997 | 13,257 |
| Amortization of prepaid fees and expenses | 1,285,408 | 921,288 |
| Reduction of provision for impaired additional loan | (500,000) | - |
| Changes in assets and liabilities: | | |
| Decrease in interest receivable and other assets | 211,042 | 392,891 |
| Decrease in deferred income on Additional Loans | (1,242,282) | (527,608) |
| Increase (decrease) in other liabilities | 26,496 | (144,490) |
| Net cash provided by operating activities | 5,756,147 | 5,581,353 |
| Investing activities: | | |
| Principal collections on MBS | 1,720,642 | 639,515 |
| Principal collections on Additional Loans | 4,500,500 | 650,000 |
| Principal collections on PIMs and Insured Mortgages | 15,523,961 | 12,794,514 |
| Net cash provided by investing activities | 21,745,103 | 14,084,029 |
| Financing activity: | | |
| Dividends | (25,352,639) | (19,657,481) |
| Net increase in cash and cash equivalents | 2,148,611 | 7,901 |
| Cash and cash equivalents, beginning of period | 6,453,663 | 7,089,453 |
| Cash and cash equivalents, end of period | $ 8,602,274 | $ 7,097,354 |
| Non cash activities: | | |
| Increase in Fair Value of MBS | $ 1,429 | $ 56,684 |

The accompanying notes are an integral part of the financial statements.

KRUPP GOVERNMENT INCOME TRUST II

NOTES TO FINANCIAL STATEMENTS

1. Accounting Policies

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted in this report on Form 10-Q pursuant to the Rules and Regulations of the Securities and Exchange Commission. However, in the opinion of Berkshire Mortgage Advisors Limited Partnership (the "Advisor"), which is the advisor to Krupp Government Income Trust II (the "Trust"), the disclosures contained in this report are adequate to make the information presented not misleading. See Notes to Financial

Statements in the Trust's Form 10-K for the year ended December 31, 2001 for additional information relevant to significant accounting policies followed by the Trust.

In the opinion of the Advisor of the Trust, the accompanying unaudited financial statements reflect all adjustments (consisting primarily of normal recurring accruals) necessary to present fairly the Trust's financial position as of March 31, 2002 and the results of its operations and its cash flows for the three months ended March 31, 2002 and 2001.
The results of operations for the three months ended March 31, 2002 are not necessarily indicative of the results which may be expected for the full year. See Management's Discussion and Analysis of Financial Condition and Results of Operations included in this report.

2. PIMs and PIMIs

At March 31, 2002, the Trust's PIMs and PIMIs, including Additional Loans, had a fair value of $122,261,981 and gross unrealized gains of $1,266,768. The PIMs and PIMIs had maturities ranging from 2008 to 2036. At March 31, 2002 there are no insured mortgage loans within the Trust's portfolio that were delinquent of principal or interest.

On March 28, 2002, the Trust received a prepayment of the Windmill Lakes Subordinated Promissory Note and the Windmill Lakes Additional Loan. The Trust received $2,000,000 of Additional Loan principal and $162,500 of Additional Loan interest. The Trust recognized $562,500 of the Additional Loan principal as Additional Loan interest. Due to the payoff, the remaining impairment provision of $500,000 was reversed (see Note 6 also).

On February 13, 2002, the Trust received a prepayment of the Norumbega Pointe Subordinated Promissory Note and the Norumbega Pointe Additional Loan. The Trust received $3,063,000 of Additional Loan principal, $302,877 of Shared Appreciation Interest and $2,280,362 of Preferred Interest. On February 25, 2002, the Trust received $15,123,167 representing the principal proceeds on the first mortgage note. In addition, the Trust recognized $1,242,282 of Additional Loan interest that had been previously received and recorded as deferred income on the additional loan. The Trust paid a special dividend of $1.14 per share from the proceeds of the Norumbega Pointe prepayment on March 12, 2002.

3. MBS

At March 31, 2002, the Trust's MBS portfolio had an amortized cost of approximately $13,568,139 and gross unrealized gains of approximately $282,548. The MBS portfolio had maturities ranging from 2008 to 2031.

Continued



4. Changes in Shareholder's Equity

A summary of changes in Shareholders' equity for the three months ended March 31, 2002 is as follows:

| | Common Stock | Retained Earnings | Accumulated Comprehensive Income | Total Shareholders' Equity |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Balance at December 31, 2001 | $ 166,214,677 | $ - | $ 281,119 | $ 166,495,796 |
| Net income | - | 5,944,486 | - | 5,944,486 |
| Dividends | (19,408,153) | (5,944,486) | - | (25,352,639) |
| Change in unrealized gain on MBS | - | - | 1,429 | 1,429 |
| Balance at March 31, 2002 | $ 146,806,524 | $ - | $ 282,548 | $ 147,089,072 |

5. Related Party Transactions

The Trust received $221,641 of Additional Loan interest during the first quarter of 2001 from an affiliate of the Advisor. The Trust also received participation interest of $129,872 from an affiliate of the Advisor during the first quarter of 2001.

6. Subsequent Event

On April 25, 2002, the Trust received $10,727,382 representing the principal proceeds on the first mortgage note from Windmill Lakes. The Trust intends to pay a special dividend of $.71 per share from the proceeds of the Windmill Lakes prepayment in the second quarter of 2002.

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

Certain statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report on Form 10-Q constitute "forward-looking statements" within the meaning of the Federal Private Securities Litigation Reform Act of 1995. These forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the Trust's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. These factors include, among other things, federal, state or local regulations; adverse changes in general economic or local conditions; the inability of the borrower to meet financial obligations on additional loans; pre-payments of mortgages; failure of borrowers to pay participation interests due to poor operating results at properties underlying the mortgages; uninsured losses and potential conflicts of interest between the Trust and its Affiliates, including the Advisor.

Liquidity and Capital Resources

At March 31, 2002, the Trust had liquidity consisting of cash and cash equivalents of approximately $8.6 million, as well as the cash inflows provided by PIMs, PIMIs, MBS and cash and cash equivalents. The Trust may also receive additional cash flow from the participation features of its PIMs and PIMIs. The Trust anticipates that these sources will be adequate to provide the Trust with sufficient liquidity to meet its obligations, including providing dividends to its investors.

The most significant demands on the Trust's liquidity are quarterly dividends paid to investors of approximately $4.4 million and special dividends. Funds for dividends come from interest income received on PIMs, PIMIs, MBS and cash and cash equivalents net of operating expenses, and the principal collections received on PIMs, PIMIs and MBS. The portion of dividends funded from principal collections reduces the capital resources of the Trust. As the capital resources of the Trust decrease, the total cash flows to the Trust will also decrease which may result in periodic adjustments to the dividends paid to the investors.

The Advisor periodically reviews the dividend rate to determine whether an adjustment is necessary based on projected future cash flows. The current dividend rate is $.24 per Share per quarter. The Trustees, based on the Advisor's recommendations, generally set a dividend rate that provides for level quarterly distributions. To the extent quarterly dividends do not fully utilize the cash available for distribution and cash balances increase, the Trustees may adjust the dividend rate or distribute such funds through a special dividend. The Advisor expects to make a recommendation to the Trustees at the May Board Meeting regarding a reduction in the dividend rate effective for the August dividend.

In addition to providing guaranteed or insured monthly principal and interest payments, the Trust's investments in the PIMs and PIMIs also may provide additional income through the interest on the Additional Loan portion of the PIMIs as well as participation interest based on operating cash flow and increase in the value realized upon the sale or refinance of the underlying properties. However, these payments are neither guaranteed nor insured and depend on the successful operations of the underlying properties.

The Trust received the Additional Loan interest payments from three of the remaining five PIMI investments during the three months ended March 31, 2002. Both outstanding payments were received in April 2002.

During the first quarter of 2002, the Trust received $90,334 of participation interest from the operations of Mequon Trails. In addition, the Trust received and recognized participation interest related to the Norumbega Pointe payoff (see below).

On March 28, 2002, the Trust received a prepayment of the Windmill Lakes Subordinated Promissory Note and the Windmill Lakes Additional Loan. The Trust received $2,000,000 of Additional Loan principal and $162,500 of Additional Loan interest. The Trust recognized $562,500 of the Additional Loan principal as Additional Loan interest. Due to the payoff, the remaining impairment provision of $500,000 was reversed. On April 25, 2002, the Trust received $10,727,382 representing the principal proceeds on the first mortgage note from Windmill Lakes. The Trust intends to pay a special dividend of $.71 per share from the proceeds of the Windmill Lakes prepayment in the second quarter of 2002.

On February 13, 2002, the Trust received a prepayment of the Norumbega Pointe Subordinated Promissory Note and the Norumbega Pointe Additional Loan. The Trust received $3,063,000 of Additional Loan principal, $302,877 of Shared Appreciation Interest and $2,280,362 of Preferred Interest. On February 25, 2002, the Trust received $15,123,167 representing the principal proceeds on the first mortgage note. In addition, the Trust recognized $1,242,282 of Additional Loan interest that had been previously received and recorded as deferred income on the additional loan. The Trust paid a special dividend of $1.14 per share from the proceeds of the Norumbega Pointe prepayment on March 12, 2002.

There are contractual restrictions on the prepayment of the PIMs and PIMIs. During the first five years of the investment, borrowers are generally prohibited from repayment. During the second five years, the PIM borrowers can prepay the insured mortgage by paying the greater of a prepayment premium or the participation interest due at the time of the prepayment. Similarly, the PIMI borrowers can prepay the insured mortgage and the Additional Loan by satisfying the Preferred Return obligation. The participation features and the Additional Loans are neither insured nor guaranteed. If the prepayment of the PIM or PIMI results from the foreclosure on the underlying property or an insurance claim, the Trust generally would not receive any participation interest or any amounts due under the Additional Loan.

The Trust has the option to call certain PIMs and all the PIMIs by accelerating their maturity if the loans are not prepaid by the tenth year after permanent funding. The Advisor will determine the merits of exercising the call option for each PIM and PIMI as economic conditions warrant. Such factors as the condition of the asset, local market conditions, the interest rate environment and available financing will have an impact on these decisions.

Critical Accounting Policies

The Trust's critical accounting policies relate primarily to revenue recognition related to the participation features of the Trust's PIM and PIMI investments as well as the recognition of deferred interest income on the Additional Loans. The Trust's policies are as follows:

Basic interest is recognized based on the stated rate of the Department of Housing and Urban Development ("HUD") Insured Mortgage loan (less the servicer's fee) or the coupon rate of the Fannie Mae MBS. The Trust recognizes interest related to the participation features when the amount becomes fixed and the transaction that gives rise to such amount is consummated. The Trust defers the recognition of Additional Loan interest payments as income to the extent these interest payments are from escrows established with the proceeds of the Additional Loan. When the properties underlying the PIMIs generate sufficient cash flow to make the required Additional Loan interest payments and the Additional Loan value is deemed collectible, the Trust recognizes income as earned and commences amortizing deferred interest amounts into income over the remaining estimated term of the Additional Loan. During periods where mortgage loans are impaired the Trust suspends amortizing deferred interest.

The Trust also fully reserves the portion of any Additional Loan interest payment satisfied through the issuance of an operating loan and any associated interest due on such operating loan. The Trust will recognize the income related to the operating loan when the borrower repays amounts due under the operating loan.

Results of Operations

The Trust's net income increased in the first quarter of 2002 as compared to the first quarter of 2001 primarily due to an increase in Additional Loan interest and decreases in asset management fees and the provision for impaired mortgage loan. This was partially offset by an increase in amortization expense and a decrease in basic interest from PIMs and PIMIs. Additional Loan interest increased primarily due to the recognition of deferred income from the Norumbega Pointe payoff and base interest recognized from the Windmill Lakes payoff. The decrease in asset management fees is a result of the Trust's asset base declining from PIM and PIMI prepayments in 2001 and the first quarter of 2002. These prepayments also caused basic interest on PIMs and PIMIs to decrease. Amortization expense increased primarily due to the full amortization of the remaining prepaid fees and expenses related to the Norumbega Pointe and Windmill Lakes payoffs. The provision for impaired mortgage decreased due to the reversal of the impairment provision for the Windmill Lakes PIMI as a result of the Additional Loan payoff received in the first quarter of 2002.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Assessment of Credit Risk

The Trust's investments in insured mortgages and MBS are guaranteed or insured by Fannie Mae, the Federal Home Loan Mortgage Corporation ("FHLMC"), the Government National Mortgage Association ("GNMA") or the Department of Housing and Urban Development ("HUD"), and therefore, the certainty of their cash flows and the risk of a material loss of the amounts invested depends upon the creditworthiness of these entities.

Fannie Mae is a federally chartered private corporation that guarantees obligations originated under its programs. However, obligations of Fannie Mae are not backed by the U.S. Government. Fannie Mae is one of the largest corporations in the United States and the Secretary of the Treasury of the United States has discretionary authority to lend up to $2.25 billion to Fannie Mae at any time. FHLMC is a federally chartered corporation that guarantees obligations originated under its programs and is wholly-owned by the twelve Federal Home Loan Banks. These obligations are not guaranteed by the U.S. Government or the Federal Home Loan Bank Board. GNMA guarantees the full and timely payment of principal and basic interest on the securities it issues, which represent interests in pooled mortgages insured by HUD. Obligations insured by HUD, an agency of the U.S. Government, are backed by the full faith and credit of the U.S. Government.

The Trust's Additional Loans have similar risks as those associated with higher risk debt instruments, including: reliance on the owner's operating skills, ability to maintain occupancy levels, control operating expenses, ability to maintain the properties and obtain adequate insurance coverage. Operations also may be affected by adverse changes in general economic conditions, local conditions and changes in governmental regulations, real estate zoning laws, or tax laws; and other circumstances over which the Trust may have little or no control.

The Trust includes in cash and cash equivalents approximately $6.2 million of Agency paper, which is issued by Government Sponsored Enterprises with a credit rating equal to the top rating category of a nationally recognized statistical rating organization.

Interest Rate Risk

The Trust's primary market risk exposure is to interest rate risk, which can be defined as the exposure of the Trust's net income, comprehensive income or financial condition to adverse movements in interest rates. At March 31, 2002, the Trust's PIMs, PIMIs and MBS comprise the majority of the Trust's assets. Decreases in interest rates may accelerate the prepayment of the Trust's investments. The Trust does not utilize any derivatives or other instruments to manage this risk as the Trust plans to hold all of its investments to expected maturity.

The Trust monitors prepayments and considers prepayment trends, as well as dividend requirements of the Trust, when setting regular dividend policy. For MBS, the fund forecasts prepayments based on trends in similar securities as reported by statistical reporting entities such as Bloomberg. For PIMs and PIMIs, the Trust incorporates prepayment assumptions into planning as individual properties notify the Trust of the intent to prepay or as they mature.

KRUPP GOVERNMENT INCOME TRUST II

## PART II - OTHER INFORMATION

Item 1. Legal Proceedings
None

Item 2. Changes in Securities
None

Item 3. Defaults upon Senior Securities
None

Item 4. Submission of Matters to a Vote of Security Holders
None

Item 5. Other Information
None

Item 6. Exhibits and Reports on Form 8-K
None

SIGNATURE

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

Krupp Government Income Trust II

(Registrant)

BY: /s/ Robert A. Barrows

Robert A. Barrows
Treasurer and Chief Accounting Officer
of Krupp Government Income Trust II.

Date: May 1, 2002

(Unaudited)
(Amounts in thousands, except per Share amounts)

| | Period Ended 03/31/02 | Inception Through 03/31/02 |
|---|---|---|
| Distributable Cash Flow (a): | | |
| Net income | 5,944 | 153,535 |
| Items providing or not requiring (not providing) the use of operating funds: | | |
| Additional Loan Base interest collected and reflected as Reduction of provision for impaired mortgage loan | (562) | - |
| Provision for impaired mortgage loans | (500) | - |
| Loss on sale of MBS | - | 1,379 |
| Amortization of prepaid fees and expenses and organization costs | 1,285 | 19,297 |
| Additional Loan interest received and deferred, net | (1,242) | - |
| Total Distributable Cash Flow ("DCF") | $ 4,925 | $ 174,211 |
| DCF per Share based on Shares outstanding at March 31, 2002 (18,371,477) | $ .27 | $ 9.48(d) |
| Dividends: | | |
| Total dividends to Shareholders | $ 38,396(b) | $ 365,987(c) |
| Average dividend per Share based on Shares outstanding at March 31, 2002 | $ 2.09(b) | $ 19.92(c)(d) |

======== ==========

(a) Distributable Cash Flow consists of income before provision for impaired mortgage loans, amortization of prepaid fees and expenses and organization costs and includes interest collections on Additional Loans which have not been recognized as income for book purposes. The Trust believes Distributable Cash Flow is an appropriate supplemental measure of operating performance, however, it should not be considered as a substitute for net income as an indication of operating performance or cash flows as a measure of liquidity.

(b) Represents all dividends paid in 2002 except the February 2002 quarterly dividend and includes an estimate of the quarterly dividend to be paid in May 2002. Also includes an estimate of the Windmill Lakes special distribution of $.71 per share to be paid in the second quarter of 2002.

(c) Includes an estimate of the quarterly dividend to be paid in May 2002. Also includes an estimate of the Windmill Lakes special distribution of $.71 per share to be paid in the second quarter of 2002.

(d) Shareholders average per Share return of capital on a cash basis as of March 2002 is $10.44 [$19.92-$9.48]. Return of capital represents that portion of dividends which is not funded from DCF, such as proceeds from the sale of assets and substantially all of the principal collections received from MBS, PIMs and PIMIs.