

**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 September 30, 2015**

**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 000-54957

**OWENS REALTY MORTGAGE, INC.**

(Exact Name of Registrant as Specified in Its Charter)

Maryland _____ (State or Other Jurisdiction of Incorporation or Organization)	46-0778087 _____ (I.R.S. Employer Identification No.)
2221 Olympic Boulevard Walnut Creek, California _____ (Address of Principal Executive Offices)	94595 _____ (Zip Code)

(925) 935-3840  
Registrant's Telephone Number, Including Area Code

**NOT APPLICABLE**  
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).  
Yes  No

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

<u>Class</u>	<u>Outstanding as of November 6, 2015</u>
Common Stock, \$.01 par value	10,326,205 shares

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**Part I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**OWENS REALTY MORTGAGE, INC.**  
Consolidated Balance Sheets  
(UNAUDITED)

	<u>September 30,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>
<b><u>ASSETS</u></b>		
Cash and cash equivalents	\$ 6,707,686	\$ 1,413,545
Restricted cash	7,495,337	6,248,746
Loans, net of allowance for loan losses of \$3,341,714 in 2015 and \$2,869,355 in 2014	73,492,372	65,164,156
Interest and other receivables	1,688,948	1,482,380
Other assets, net of accumulated depreciation and amortization of \$259,597 in 2015 and \$1,065,172 in 2014	681,715	1,138,123
Deferred financing costs, net of accumulated amortization of \$676,047 in 2015 and \$253,675 in 2014	936,948	1,317,585
Investment in limited liability company	2,188,064	2,142,581
Real estate held for sale	104,681,106	59,494,339
Real estate held for investment, net of accumulated depreciation of \$2,591,431 in 2015 and \$6,075,287 in 2014	53,905,407	103,522,466
Total assets	<u>\$ 251,777,583</u>	<u>\$ 241,923,921</u>
<b><u>LIABILITIES AND EQUITY</u></b>		
<b>LIABILITIES:</b>		
Dividends payable	\$ 835,533	\$ 1,292,160
Due to Manager	234,588	283,644
Accounts payable and accrued liabilities	4,654,230	2,219,674
Deferred gains on sales of real estate	209,662	362,283
Lines of credit payable	8,954,000	11,450,000
Notes and loans payable on real estate	41,197,782	37,569,549
Total liabilities	<u>56,085,795</u>	<u>53,177,310</u>
Commitments and Contingencies (Note 13)		
<b>EQUITY:</b>		
Stockholders' equity:		
Preferred stock, \$.01 par value per share, 5,000,000 shares authorized, no shares issued and outstanding at September 30, 2015 and December 31, 2014	—	—
Common stock, \$.01 par value per share, 50,000,000 shares authorized, 11,198,119 shares issued, 10,407,738 and 10,768,001 shares outstanding at September 30, 2015 and December 31, 2014	111,981	111,981
Additional paid-in capital	182,437,522	182,437,522
Treasury stock, at cost – 790,381 and 430,118 shares at September 30, 2015 and December 31, 2014	(10,602,004)	(5,349,156)
Retained earnings	19,143,709	7,371,511
Total stockholders' equity	191,091,208	184,571,858
Non-controlling interests	4,600,580	4,174,753
Total equity	<u>195,691,788</u>	<u>188,746,611</u>
Total liabilities and equity	<u>\$ 251,777,583</u>	<u>\$ 241,923,921</u>

The accompanying notes are an integral part of these consolidated financial statements.

**OWENS REALTY MORTGAGE, INC.**  
Consolidated Statements of Income  
(UNAUDITED)

	<u>For the Three Months Ended</u>		<u>For the Nine Months Ended</u>	
	<u>September 30, 2015</u>	<u>September 30, 2014</u>	<u>September 30, 2015</u>	<u>September 30, 2014</u>
<b>Revenues:</b>				
Interest income on loans	\$ 1,372,739	\$ 1,399,122	\$ 6,697,476	\$ 3,564,842
Rental and other income from real estate properties	2,996,873	3,262,549	9,983,138	8,936,923
Income from investment in limited liability company	44,605	43,686	130,483	126,357
Other income	—	—	—	19
Total revenues	<u>4,414,217</u>	<u>4,705,357</u>	<u>16,811,097</u>	<u>12,628,141</u>
<b>Expenses:</b>				
Management fees to Manager	513,292	435,652	1,410,293	1,275,901
Servicing fees to Manager	46,663	39,605	128,208	115,991
General and administrative expense	292,531	285,669	951,579	1,090,876
Rental and other expenses on real estate properties	2,070,680	2,060,670	6,420,490	5,952,479
Depreciation and amortization	526,178	549,189	1,712,136	1,642,922
Interest expense	354,163	338,225	1,413,109	718,707
Bad debt expense	150,402	660	150,537	1,296
Provision for loan losses	44,316	117,680	472,359	141,032
Impairment losses on real estate properties	—	123,500	1,256,434	179,040
Total expenses	<u>3,998,225</u>	<u>3,950,850</u>	<u>13,915,145</u>	<u>11,118,244</u>
<b>Operating income</b>	415,992	754,507	2,895,952	1,509,897
Gain on sales of real estate, net	—	113,113	15,031,299	2,740,105
Gain on foreclosure of loan	—	—	—	257,020
<b>Net income</b>	415,992	867,620	17,927,251	4,507,022
Less: Net income attributable to non-controlling interests	(31,671)	(83,797)	(2,630,434)	(151,752)
<b>Net income attributable to common stockholders</b>	<u>\$ 384,321</u>	<u>\$ 783,823</u>	<u>\$ 15,296,817</u>	<u>\$ 4,355,270</u>
 <b>Per common share data:</b>				
Basic and diluted earnings per common share	<u>\$ 0.04</u>	<u>\$ 0.07</u>	<u>\$ 1.43</u>	<u>\$ 0.40</u>
Basic and diluted weighted average number of common shares outstanding	<u>10,538,735</u>	<u>10,768,001</u>	<u>10,690,736</u>	<u>10,768,495</u>
Dividends declared per share of common stock	<u>\$ 0.08</u>	<u>\$ 0.05</u>	<u>\$ 0.33</u>	<u>\$ 0.15</u>

The accompanying notes are an integral part of these consolidated financial statements.

**OWENS REALTY MORTGAGE, INC.**  
Consolidated Statements of Stockholders' Equity  
Nine Months Ended September 30, 2015 and 2014  
(UNAUDITED)

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Treasury Stock</u>		<u>Retained Earnings</u>	<u>Total Stockholders' Equity</u>	<u>Non- controlling Interests</u>	<u>Total Equity</u>
	<u>Shares</u>	<u>Amount</u>		<u>Shares</u>	<u>Amount</u>				
Balances, December 31, 2013	11,198,119	\$ 111,981	\$ 182,437,522	(403,910)	\$ (5,023,668)	\$ 2,348,575	\$ 179,874,410	\$ 6,351,896	\$ 186,226,306
Net income	—	—	—	—	—	4,355,270	4,355,270	151,752	4,507,022
Dividends declared	—	—	—	—	—	(1,614,533)	(1,614,533)	—	(1,614,533)
Purchase of treasury stock	—	—	—	(26,208)	(325,488)	—	(325,488)	—	(325,488)
Contribution from non- controlling interest	—	—	—	—	—	—	—	112,533	112,533
Distributions to non- controlling interests	—	—	—	—	—	—	—	(6,108)	(6,108)
Balances, September 30, 2014	<u>11,198,119</u>	<u>\$ 111,981</u>	<u>\$ 182,437,522</u>	<u>(430,118)</u>	<u>\$ (5,349,156)</u>	<u>\$ 5,089,312</u>	<u>\$ 182,289,659</u>	<u>\$ 6,610,073</u>	<u>\$ 188,899,732</u>
Balances, December 31, 2014	11,198,119	\$ 111,981	\$ 182,437,522	(430,118)	(5,349,156)	\$ 7,371,511	\$ 184,571,858	\$ 4,174,753	\$ 188,746,611
Net income	—	—	—	—	—	15,296,817	15,296,817	2,630,434	17,927,251
Dividends declared	—	—	—	—	—	(3,524,619)	(3,524,619)	—	(3,524,619)
Purchase of treasury stock	—	—	—	(360,263)	(5,252,848)	—	(5,252,848)	—	(5,252,848)
Contribution from non- controlling interest	—	—	—	—	—	—	—	279,184	279,184
Distributions to non- controlling interests	—	—	—	—	—	—	—	(2,483,791)	(2,483,791)
Balances, September 30, 2015	<u>11,198,119</u>	<u>\$ 111,981</u>	<u>\$ 182,437,522</u>	<u>(790,381)</u>	<u>\$ (10,602,004)</u>	<u>\$ 19,143,709</u>	<u>\$ 191,091,208</u>	<u>\$ 4,600,580</u>	<u>\$ 195,691,788</u>

The accompanying notes are an integral part of these consolidated financial statements.

**OWENS REALTY MORTGAGE, INC.**  
Consolidated Statements of Cash Flows  
(UNAUDITED)

	<b>Nine Months Ended September 30,</b>	
	<b>2015</b>	<b>2014</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 17,927,251	\$ 4,507,022
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of real estate and other assets, net	(15,031,299)	(2,740,105)
Gain on foreclosure of loan	—	(257,020)
Income from investment in limited liability company	(130,483)	(126,357)
Provision for loan losses	472,359	141,032
Impairment losses on real estate properties	1,256,434	179,040
Depreciation and amortization of real estate and related assets	1,712,136	1,642,922
Amortization of deferred financing costs to interest expense	266,862	78,261
Accretion of discount on loan to interest income	(536,816)	(85,403)
Changes in operating assets and liabilities:		
Interest and other receivables	(206,568)	(561,304)
Other assets	(46,149)	(74,934)
Accounts payable and accrued liabilities	91,447	(198,465)
Due to Manager	(49,056)	(98,161)
Net cash provided by operating activities	<u>5,726,118</u>	<u>2,406,528</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Principal collected on loans	31,698,649	20,857,860
Investments in loans	(39,962,408)	(27,168,876)
Investment in real estate properties	(15,475,195)	(18,024,721)
Net proceeds from disposition of real estate properties and other assets	34,865,173	174,890
Purchases of furniture, fixtures and equipment	(48,402)	(7,212)
Transfer to restricted cash, net	(1,246,591)	(1,485,050)
Distribution received from investment in limited liability company	85,000	84,000
Net cash provided by (used in) investing activities	<u>9,916,226</u>	<u>(25,569,109)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Advances on notes payable	23,538,846	372,472
Repayments on notes payable	(19,910,613)	(330,905)
Advances on lines of credit	30,161,000	41,144,507
Repayments on lines of credit	(32,657,000)	(20,291,807)
Payment of deferred financing costs	(41,735)	(354,549)
Distributions to non-controlling interests	(2,483,791)	(6,108)
Contributions from non-controlling interest	279,184	112,533
Purchase of treasury stock	(5,252,848)	(325,488)
Dividends paid	(3,981,246)	(1,256,133)
Net cash (used in) provided by financing activities	<u>(10,348,203)</u>	<u>19,064,522</u>
Net increase (decrease) in cash and cash equivalents	5,294,141	(4,098,059)
Cash and cash equivalents at beginning of period	<u>1,413,545</u>	<u>8,158,734</u>
Cash and cash equivalents at end of period	<u>\$ 6,707,686</u>	<u>\$ 4,060,675</u>
<b>Supplemental Disclosures of Cash Flow Information</b>		
Cash paid during the period for interest (excluding amounts capitalized)	\$ 1,207,669	\$ 705,238
Cash paid during the period for interest that was capitalized	187,784	—

Supplemental Disclosures of Non-Cash Activity

Increase in real estate from loan foreclosures	\$	—	\$	3,241,220
Decrease in loans, net of allowance for loan losses, from loan foreclosures		—		(2,959,500)
Decrease in interest and other receivables from loan foreclosures		—		(281,720)
Transfers from real estate held for investment to real estate held for sale		64,627,930		11,651,439
Transfers from real estate held for sale to real estate held for investment		1,953,677		1,958,400
Capital expenditures financed through accounts payable		(2,343,109)		(838,419)
Deferred financing costs paid from construction loan		—		620,391
Amortization of deferred financing costs capitalized to construction project		(155,510)		(69,116)

The accompanying notes are an integral part of these consolidated financial statements.

## **OWENS REALTY MORTGAGE, INC.**

### Notes to Consolidated Financial Statements (Unaudited)

#### **NOTE 1 – ORGANIZATION**

Owens Realty Mortgage, Inc. (the “Company”) was incorporated on August 9, 2012, under the laws of the State of Maryland. The Company is authorized to issue 50,000,000 shares of its \$0.01 par value common stock. In addition, the Company is authorized to issue 5,000,000 shares of preferred stock at \$0.01 par value per share. The Company was created to effect the merger (the “Merger”) of Owens Mortgage Investment Fund, a California Limited Partnership (“OMIF”) with and into the Company as described in the Registration Statement on Form S-4, as amended, of the Company, declared effective on February 12, 2013 (File No. 333-184392). The Merger was part of a plan to reorganize the business operations of OMIF so that it could elect to qualify as a real estate investment trust for Federal income tax purposes. The Merger was approved by OMIF limited partners on April 16, 2013 and was completed on May 20, 2013.

The Company has elected to be taxed as a real estate investment trust (“REIT”) under the Internal Revenue Code of 1986, as amended (the “Code”), commencing with the Company’s taxable year ended December 31, 2012. As a REIT, the Company is permitted to deduct distributions made to its stockholders, allowing its operating income represented by such distributions to avoid taxation at the entity level and to be taxed generally only at the stockholder level. The Company intends to distribute substantially all of its operating income. As a REIT, however, the Company is subject to separate, corporate-level tax, including potential 100% penalty taxes under various circumstances, as well as certain state and local taxes. In addition, the Company’s taxable REIT subsidiaries are subject to full corporate income tax. Furthermore, the Company’s ability to continue to qualify as a REIT will depend upon its continuing satisfaction of various requirements, such as those related to the diversity of its stock ownership, the nature of its assets, the sources of its income and the distributions to its stockholders, including a requirement that the Company distribute to its stockholders at least 90% of its REIT taxable income on an annual basis (determined without regard to the dividends paid deduction and by excluding net capital gain).

#### **NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

In the opinion of the management of the Company, the accompanying unaudited financial statements contain all adjustments, consisting of normal, recurring adjustments, necessary to present fairly the financial information included therein. Certain information and footnote disclosures presented in the annual consolidated financial statements are not included in these interim financial statements. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Form 10-K of ORM for the year ended December 31, 2014 filed with the Securities and Exchange Commission (“SEC”). The results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the operating results to be expected for the full year ending December 31, 2015. The Company evaluates subsequent events up to the date it files its Form 10-Q with the SEC.

#### ***Basis of Presentation***

#### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned taxable REIT subsidiary (TRS) and its majority- and wholly-owned limited liability companies (see notes 5 and 6). The Company is in the business of providing mortgage lending services and manages its business as one operating segment. Due to foreclosure activity, the Company also owns and manages real estate assets.

Certain reclassifications, not affecting previously reported net income or total stockholders’ equity, have been made to the previously issued consolidated financial statements to conform to the current period presentation.

#### **Management Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements (Unaudited)

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 periods. Such estimates are inherently imprecise and actual results could differ significantly from such estimates.

#### **Recently Issued Accounting Standards**

In April 2015, the FASB issued Accounting Standards Update 2015-03, “Interest - Imputation of Interest (Subtopic 835-30) – Simplifying the Presentation of Debt Issuance Costs,” or ASU 2015-03. ASU 2015-03 simplifies the presentation of debt issuance costs by requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct reduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. The amendments in this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The adoption of this ASU by the Company will change the presentation of debt issuance costs of its notes and loans payable, which will be reported as a direct offset to the applicable debt on the balance sheet. Pursuant to Accounting Standards Update 2015-15 that was issued by the FASB in August 2015, this treatment will not be required for the Company’s line of credit arrangements.

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606),” or ASU 2014-09. ASU 2014-09 broadly amends the accounting guidance for revenue recognition. ASU 2014-09 is effective for the first interim or annual period beginning after December 15, 2016 (deferred by one year to December 15, 2017 with ASU 2015-14 issued in August 2015), and is to be applied prospectively. Early adoption is not permitted. The Company is currently evaluating the impact that ASU 2014-09 will have on its financial statements.

In April 2014, the FASB issued Accounting Standards Update 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity”. ASU 2014-08 updated guidance that changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity’s operations and financial results. As a result of this new guidance, future dispositions of real estate owned assets may no longer meet the criteria to be considered as discontinued operations. The guidance was effective as of the first quarter of 2015 and did not have a material effect on the Company’s consolidated financial statements.

#### ***Significant Accounting Policies***

The significant accounting policies used in the preparation of these interim consolidated financial statements are disclosed in the Company’s consolidated financial statements for the year ended December 31, 2014 included in its 2014 annual report on Form 10-K. There have been no significant changes to those significant accounting policies.

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

**NOTE 3 – LOANS AND ALLOWANCE FOR LOAN LOSSES**

The following tables show the changes in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2015 and 2014 and the allocation of the allowance for loan losses and loans as of September 30, 2015 and December 31, 2014 by portfolio segment and by impairment methodology:

<u>2015</u>	<u>Commercial</u>	<u>Residential</u>	<u>Land</u>	<u>Total</u>
<b>Allowance for loan losses:</b>				
<b><u>Three Months Ended September 30, 2015</u></b>				
Beginning balance	\$ 940,215	\$ 2,074,617	\$ 282,566	\$ 3,297,398
Charge-offs	—	—	—	—
Provision	<u>(40,858)</u>	<u>85,174</u>	<u>—</u>	<u>44,316</u>
Ending Balance	<u>\$ 899,357</u>	<u>\$ 2,159,791</u>	<u>\$ 282,566</u>	<u>\$ 3,341,714</u>
<b><u>Nine Months Ended September 30, 2015</u></b>				
Beginning balance	\$ 888,260	\$ 1,975,112	\$ 5,983	\$ 2,869,355
Charge-offs	—	—	—	—
Provision	<u>11,097</u>	<u>184,679</u>	<u>276,583</u>	<u>472,359</u>
Ending balance	<u>\$ 899,357</u>	<u>\$ 2,159,791</u>	<u>\$ 282,566</u>	<u>\$ 3,341,714</u>
<b><u>As of September 30, 2015</u></b>				
Ending balance: individually evaluated for impairment	<u>\$ 480,005</u>	<u>\$ 1,839,345</u>	<u>\$ —</u>	<u>\$ 2,319,350</u>
Ending balance: collectively evaluated for impairment	<u>\$ 419,352</u>	<u>\$ 320,446</u>	<u>\$ 282,566</u>	<u>\$ 1,022,364</u>
Ending balance	<u>\$ 899,357</u>	<u>\$ 2,159,791</u>	<u>\$ 282,566</u>	<u>\$ 3,341,714</u>
<b>Loans:</b>				
Ending balance	<u>\$ 51,011,804</u>	<u>\$ 19,779,734</u>	<u>\$ 6,042,548</u>	<u>\$ 76,834,086</u>
Ending balance: individually evaluated for impairment	<u>\$ 2,510,752</u>	<u>\$ 7,779,694</u>	<u>\$ —</u>	<u>\$ 10,290,446</u>
Ending balance: collectively evaluated for impairment	<u>\$ 48,501,052</u>	<u>\$ 12,000,040</u>	<u>\$ 6,042,548</u>	<u>\$ 66,543,640</u>

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

<b>2014</b>	<b><u>Commercial</u></b>	<b><u>Residential</u></b>	<b><u>Land</u></b>	<b><u>Total</u></b>
<b>Allowance for loan losses:</b>				
	<b><u>Three Months Ended September 30, 2014</u></b>			
Beginning balance	\$ 1,507,196	\$ 3,249,975	\$ 5,269	\$ 4,762,440
Charge-offs	—	—	—	—
Provision	<u>46,937</u>	<u>70,742</u>	<u>1</u>	<u>117,680</u>
Ending Balance	\$ <u>1,554,133</u>	\$ <u>3,320,717</u>	\$ <u>5,270</u>	\$ <u>4,880,120</u>
	<b><u>Nine Months Ended September 30, 2014</u></b>			
Beginning balance	\$ 932,651	\$ 3,798,203	\$ 8,234	\$ 4,739,088
Charge-offs	—	—	—	—
Provision (reversal)	<u>621,482</u>	<u>(477,486)</u>	<u>(2,964)</u>	<u>141,032</u>
Ending balance	\$ <u>1,554,133</u>	\$ <u>3,320,717</u>	\$ <u>5,270</u>	\$ <u>4,880,120</u>
	<b><u>As of December 31, 2014</u></b>			
Ending balance: individually evaluated for impairment	\$ <u>550,010</u>	\$ <u>1,839,345</u>	\$ <u>—</u>	\$ <u>2,389,355</u>
Ending balance: collectively evaluated for impairment	\$ <u>338,250</u>	\$ <u>135,767</u>	\$ <u>5,983</u>	\$ <u>480,000</u>
Ending balance	\$ <u>888,260</u>	\$ <u>1,975,112</u>	\$ <u>5,983</u>	\$ <u>2,869,355</u>
<b>Loans:</b>				
Ending balance	\$ <u>52,531,537</u>	\$ <u>13,491,906</u>	\$ <u>2,010,068</u>	\$ <u>68,033,511</u>
Ending balance: individually evaluated for impairment	\$ <u>12,666,935</u>	\$ <u>7,788,747</u>	\$ <u>1,860,068</u>	\$ <u>22,315,750</u>
Ending balance: collectively evaluated for impairment	\$ <u>39,864,602</u>	\$ <u>5,703,159</u>	\$ <u>150,000</u>	\$ <u>45,717,761</u>

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

The following tables show an aging analysis of the loan portfolio by the time monthly payments are past due as of September 30, 2015 and December 31, 2014:

<u>September 30, 2015</u>	<u>Loans 30-59 Days Past Due</u>	<u>Loans 60-89 Days Past Due</u>	<u>Loans 90 or More Days Past Due</u>	<u>Total Past Due Loans</u>	<u>Current Loans</u>	<u>Total Loans</u>
Commercial	\$ —	\$ 1,432,000	\$ 1,078,752	\$ 2,510,752	\$ 48,501,052	\$ 51,011,804
Residential	—	—	7,779,694	7,779,694	12,000,040	19,779,734
Land	—	—	—	—	6,042,548	6,042,548
	<u>\$ —</u>	<u>\$ 1,432,000</u>	<u>\$ 8,858,446</u>	<u>\$ 10,290,446</u>	<u>\$ 66,543,640</u>	<u>\$ 76,834,086</u>

  

<u>December 31, 2014</u>	<u>Loans 30-59 Days Past Due</u>	<u>Loans 60-89 Days Past Due</u>	<u>Loans 90 or More Days Past Due</u>	<u>Total Past Due Loans</u>	<u>Current Loans</u>	<u>Total Loans</u>
Commercial	\$ —	\$ —	\$ 1,078,752	\$ 1,078,752	\$ 51,452,785	\$ 52,531,537
Residential	—	—	7,788,747	7,788,747	5,703,159	13,491,906
Land	—	—	1,860,068	1,860,068	150,000	2,010,068
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 10,727,567</u>	<u>\$ 10,727,567</u>	<u>\$ 57,305,944</u>	<u>\$ 68,033,511</u>

All of the loans that are 90 or more days past due as listed above are on non-accrual status as of September 30, 2015 and December 31, 2014. In addition, two commercial loans totaling \$11,588,000 as of December 31, 2014 were considered impaired but were restored to accrual status during 2014 because the Company had received consistent payments from the borrower over a six month period and management expected that the borrower would continue to keep the loans current with respect to principal and interest payments. These two loans were paid off in full during the first quarter of 2015.

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

The following tables show information related to impaired loans as of and for the three and nine months ended September 30, 2015:

	<u>As of September 30, 2015</u>		
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>
<i>With no related allowance recorded:</i>			
Commercial	\$ 1,463,453	\$ 1,432,000	\$ —
Residential	244,694	244,694	—
Land	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$ 1,708,147</u>	<u>\$ 1,676,694</u>	<u>\$ —</u>
<i>With an allowance recorded:</i>			
Commercial	\$ 1,144,864	\$ 1,078,752	\$ 480,005
Residential	7,983,345	7,535,000	1,839,345
Land	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$ 9,128,209</u>	<u>\$ 8,613,752</u>	<u>\$ 2,319,350</u>
<i>Totals:</i>			
Commercial	\$ 2,608,317	\$ 2,510,752	\$ 480,005
Residential	8,228,039	7,779,694	1,839,345
Land	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$ 10,836,356</u>	<u>\$ 10,290,446</u>	<u>\$ 2,319,350</u>

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

	<u>Three Months Ended September 30, 2015</u>		<u>Nine Months Ended September 30, 2015</u>	
	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
<i>With no related allowance recorded:</i>				
Commercial	\$ 487,818	\$ 9,547	\$ 2,741,825	\$ 611,206
Residential	245,725	5,654	248,762	16,581
Land	<u>—</u>	<u>—</u>	<u>413,348</u>	<u>216,904</u>
	<u>\$ 733,543</u>	<u>\$ 15,201</u>	<u>\$ 3,403,935</u>	<u>\$ 844,691</u>
<i>With an allowance recorded:</i>				
Commercial	\$ 1,148,627	\$ 17,979	\$ 1,111,170	\$ 40,452
Residential	7,983,345	35,000	7,983,345	157,600
Land	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$ 9,131,972</u>	<u>\$ 52,979</u>	<u>\$ 9,094,515</u>	<u>\$ 198,052</u>
<i>Totals:</i>				
Commercial	\$ 1,636,445	\$ 27,526	\$ 3,852,995	\$ 651,658
Residential	8,229,070	40,654	8,232,107	174,181
Land	<u>—</u>	<u>—</u>	<u>413,348</u>	<u>216,904</u>
	<u>\$ 9,865,515</u>	<u>\$ 68,180</u>	<u>\$ 12,498,450</u>	<u>\$ 1,042,743</u>

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

The following tables show information related to impaired loans as of December 31, 2014 and for the three and nine months ended September 30, 2014:

	<u>As of December 31, 2014</u>		
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>
<i>With no related allowance recorded:</i>			
Commercial	\$ 11,588,183	\$ 11,588,183	\$ —
Residential	253,747	253,747	—
Land	<u>1,860,068</u>	<u>1,860,068</u>	<u>—</u>
	<u>\$ 13,701,998</u>	<u>\$ 13,701,998</u>	<u>\$ —</u>
<i>With an allowance recorded:</i>			
Commercial	\$ 1,079,699	\$ 1,078,752	\$ 550,010
Residential	7,983,345	7,535,000	1,839,345
Land	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$ 9,063,044</u>	<u>\$ 8,613,752</u>	<u>\$ 2,389,355</u>
<i>Totals:</i>			
Commercial	\$ 12,667,882	\$ 12,666,935	\$ 550,010
Residential	8,237,092	7,788,747	1,839,345
Land	<u>1,860,068</u>	<u>1,860,068</u>	<u>—</u>
	<u>\$ 22,765,042</u>	<u>\$ 22,315,750</u>	<u>\$ 2,389,355</u>

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

	<u>Three Months Ended September 30, 2014</u>		<u>Nine Months Ended September 30, 2014</u>	
	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
<i>With no related allowance recorded:</i>				
Commercial	\$ 16,410,099	\$ 617,507	\$ 16,306,543	\$ 1,405,623
Residential	2,233,235	—	2,374,941	67,733
Land	<u>1,860,216</u>	<u>38,276</u>	<u>2,633,298</u>	<u>132,916</u>
	<u>\$ 20,503,550</u>	<u>\$ 655,783</u>	<u>\$ 21,314,782</u>	<u>\$ 1,606,272</u>
<i>With an allowance recorded:</i>				
Commercial	\$ 1,910,269	\$ 13,484	\$ 1,867,315	\$ 39,956
Residential	7,983,345	22,000	7,983,373	96,000
Land	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
	<u>\$ 9,893,614</u>	<u>\$ 35,484</u>	<u>\$ 9,850,688</u>	<u>\$ 135,956</u>
<i>Totals:</i>				
Commercial	\$ 18,320,368	\$ 630,991	\$ 18,173,858	\$ 1,445,579
Residential	10,216,580	22,000	10,358,314	163,733
Land	<u>1,860,216</u>	<u>38,276</u>	<u>2,633,298</u>	<u>132,916</u>
	<u>\$ 30,397,164</u>	<u>\$ 691,267</u>	<u>\$ 31,165,470</u>	<u>\$ 1,742,228</u>

The recorded investment balances presented in the above tables include amounts advanced in addition to principal on impaired loans (such as property taxes, insurance and legal charges) that are reimbursable by borrowers and are included in interest and other receivables in the accompanying consolidated balance sheets. Interest income recognized on a cash basis for impaired loans approximates the interest income recognized as reflected in the tables above.

***Troubled Debt Restructurings***

The Company has allocated approximately \$2,319,000 and \$2,389,000 of specific reserves on loans totaling approximately \$9,373,000 and \$20,265,000 (recorded investments before reserves) to borrowers whose loan terms had been modified in troubled debt restructurings as of September 30, 2015 and December 31, 2014, respectively. The Company has not committed to lend additional amounts to any of these borrowers.

No loans were modified as troubled debt restructurings during the three and nine months ended September 30, 2015 and 2014.

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

**NOTE 4 – INVESTMENT IN LIMITED LIABILITY COMPANY**

During 2008, the Company entered into an operating agreement (the “Operating Agreement”) of 1850 De La Cruz LLC, a California limited liability company (“1850”), with Nanook Ventures LLC (“Nanook”), an unrelated party. The purpose of the joint venture is to acquire, own and operate certain industrial land and buildings located in Santa Clara, California that were owned by the Company. The property was subject to a Purchase and Sale Agreement dated July 24, 2007 (the “Sale Agreement”), as amended, between the Company, as seller, and Nanook, as buyer. During the course of due diligence under the Sale Agreement, it was discovered that the property was contaminated and that remediation and monitoring may be required. The parties agreed to enter into the Operating Agreement to restructure the arrangement as a joint venture. At the time of closing in July 2008, the two properties were separately contributed to two new limited liability companies, Nanook Ventures One LLC and Nanook Ventures Two LLC that are wholly owned by 1850. The Company and Nanook are the Members of 1850 and NV Manager, LLC is the manager. (See Note 13 for further discussion of the Company’s environmental remediation obligation with respect to the properties owned by 1850.)

The Company received distributions from 1850 of \$0 and \$85,000 during the three and nine months ended September 30, 2015, respectively, and \$0 and \$84,000 during the three and nine months ended September 30, 2014, respectively. The net income to the Company from its investment in 1850 De La Cruz was approximately \$45,000 and \$44,000 during the three months ended September 30, 2015 and 2014, respectively, and \$130,000 and \$126,000 during the nine months ended September 30, 2015 and 2014, respectively.

**NOTE 5 - REAL ESTATE HELD FOR SALE**

Real estate properties held for sale as of September 30, 2015 and December 31, 2014 consists of properties acquired through foreclosure classified by property type as follows:

	<u>September 30,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>
Land (including land under development)	\$ 40,300,887	\$ 36,263,330
Retail	—	16,494,440
Residential	54,222,726	—
Office	4,716,159	4,716,159
Industrial	1,422,308	—
Storage	3,782,526	—
Marina	236,500	—
Golf course	—	2,020,410
	<u>\$ 104,681,106</u>	<u>\$ 59,494,339</u>

During the three months ended September 30, 2015, the Company transferred four properties (one residential, one industrial, one marina and one storage) from “Held for Investment” to “Held for Sale” as the properties are now listed for sale and sales are expected within the next year. During the nine months ended September 30, 2015, the Company transferred one golf course property from “Held for Sale” to “Held for Investment” as the property was no longer listed for sale and a sale was not expected within the next year. As a result of this transfer, the Company recorded approximately \$79,000 of depreciation expense that would have previously been recorded had the property been continuously classified as “Held for Investment”.

During the quarter ended September 30, 2014, the Company transferred one retail property and one residential property from “Held for investment” to “Held for sale” because the properties were listed for sale and sales were expected within the next year. During the nine months ended September 30, 2014, the Company transferred one parcel of land from “Held for sale” to “Held for investment” because the property was no longer listed for sale and a sale was not likely within the next year.

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

During the nine months ended September 30, 2015, the Company recorded impairment losses of approximately \$1,256,000 on the unimproved residential and commercial land located in Gypsum, Colorado due to a decrease in the listing price of the property and a reduction in the net fair market value estimated by management.

During the three and nine months ended September 30, 2014, the Company recorded impairment losses of \$124,000 and \$179,000, respectively, on the marina property located in Oakley, California due to a decrease in the listing price of the property and a reduction in the fair market value recently estimated by management.

There were no sales during the three months ended September 30, 2015. During the nine months ended September 30, 2015, the Company sold four real estate properties for net sales proceeds aggregating approximately \$34,865,000, resulting in gains on sale of real estate totaling approximately \$14,879,000. In addition, the Company recognized gain of approximately \$152,000 during the nine months ended September 30, 2015 that had previously been deferred related to the sale of a real estate property in 2012. The gain on the sale of this property was being accounted for under the installment method.

There were no sales during the three and nine months ended September 30, 2014; however, gains totaling approximately \$2,626,000 were recognized during the nine months ended September 30, 2014 that had previously been deferred related to the sales of real estate properties in 2012 and 2013. The gains on the sales of the properties were being recognized under the installment method.

**NOTE 6 - REAL ESTATE HELD FOR INVESTMENT**

Real estate held for investment as of September 30, 2015 and December 31, 2014 consists of properties acquired through foreclosure classified by property type as follows:

	<u>September 30, 2015</u>	<u>December 31, 2014</u>
Land	\$ 8,839,255	\$ 10,797,656
Residential	6,721,923	48,154,258
Retail	23,278,649	23,211,896
Assisted care	5,073,316	5,005,000
Office	4,300,543	4,416,108
Industrial	—	4,486,797
Storage	—	3,847,884
Marina	3,740,468	3,602,867
Golf course	1,951,253	—
	<u>\$ 53,905,407</u>	<u>\$ 103,522,466</u>

The balances of land and the major classes of depreciable property for real estate held for investment as of September 30, 2015 and December 31, 2014 are as follows:

	<u>September 30, 2015</u>	<u>December 31, 2014</u>
Land and land improvements	\$ 24,047,216	\$ 39,003,422
Buildings and improvements	32,449,622	70,594,331
	56,496,838	109,597,753
Less: Accumulated depreciation	<u>(2,591,431)</u>	<u>(6,075,287)</u>
	<u>\$ 53,905,407</u>	<u>\$ 103,522,466</u>

It is the Company's intent to sell its real estate properties held for investment, but expected sales of these properties are not probable to occur within the next year.

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

Depreciation expense was approximately \$505,000 and \$523,000 for the three months ended September 30, 2015 and 2014, respectively, and \$1,647,000 and \$1,563,000 for the nine months ended September 30, 2015 and 2014, respectively.

During the quarter ended September 30, 2014, the Company sold one of the improved, residential lots located in West Sacramento, California for \$175,000, resulting in a gain to the Company of approximately \$105,000. The remaining lot was then transferred to “Held for sale” as it is now listed for sale and a sale is expected within the next year.

**2015 Foreclosure Activity**

The Company foreclosed on no loans during the three and nine months ended September 30, 2015.

**2014 Foreclosure Activity**

During the nine months ended September 30, 2014, Sandmound Marina, LLC (“Sandmound”) (wholly owned by the Company) foreclosed on a first mortgage loan secured by unimproved land and a marina and campground located in Bethel Island, California with a principal balance of approximately \$2,960,000 and obtained the properties via the trustee’s sale. In addition, advances made on the loan or incurred as part of the foreclosure (such as legal fees and delinquent property taxes) in the total amount of approximately \$282,000 were capitalized to the basis of the properties. The fair market values of the properties acquired were estimated to be higher than Sandmound’s recorded investment in the subject loan, and, thus, a gain on foreclosure in the amount of approximately \$257,000 was recorded. The properties have been classified as held for investment as sales are not expected within one year.

Certain of the Company’s real estate properties held for sale and investment are leased to tenants under noncancellable leases with remaining terms ranging from one to nine years. Certain of the leases require the tenant to pay all or some operating expenses of the properties. The future minimum rental income from noncancellable operating leases due within the five years subsequent to September 30, 2015 and thereafter is as follows:

Twelve months ending September 30:	
2016	\$ 5,501,140
2017	2,081,943
2018	1,711,319
2019	1,382,710
2020	480,682
Thereafter (through 2024)	<u>1,345,092</u>
	<u>\$ 12,502,886</u>

**NOTE 7 – LINES OF CREDIT PAYABLE**

The Company borrows funds under the revolving California Bank & Trust (“CB&T”) line of credit and the revolving Opus Bank (“Opus”) line of credit (collectively, the “Funding Agreements”). As of September 30, 2015 and December 31, 2014, the outstanding balances and total commitments under the Funding Agreements consisted of the following:

	<u>As of September 30, 2015</u>		<u>As of December 31, 2014</u>	
	<u>Outstanding Balance</u>	<u>Total Commitment</u>	<u>Outstanding Balance</u>	<u>Total Commitment</u>
CB&T Line of Credit	\$ 8,954,000	\$ 17,992,910	\$ 11,450,000	\$ 17,355,000
Opus Bank Line of Credit	—	12,626,000	—	16,721,000
Total	<u>\$ 8,954,000</u>	<u>\$ 30,618,910</u>	<u>\$ 11,450,000</u>	<u>\$ 34,076,000</u>

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements (Unaudited)

The Funding Agreements are generally collateralized by assignments of specific loans and real estate properties owned by the Company.

#### ***CB&T Line of Credit***

In February 2014, the Company entered into a Credit Agreement and Advance Formula Agreement and related agreements with CB&T as the lender (the “CB&T Credit Facility”), which agreements were amended and restated in April 2015 to increase the maximum potential borrowings and to add First Bank as an additional lender. The maximum borrowings available (total commitment) under the amended facility is the lesser of \$30,000,000 or the amount determined pursuant to a borrowing base calculation described in the Advance Formula Agreement.

Borrowings mature on February 5, 2016. Such borrowings bear interest payable monthly at the prime rate of interest established by CB&T from time-to-time plus one quarter percent (.25%) per annum (3.5% at September 30, 2015). Upon a default such interest rate increases by 2.00%. The CB&T Credit Facility required the payment of an origination fee of \$100,000 and other issuance costs totaling \$177,000 that were capitalized to deferred financing costs and are being amortized to interest expense using the straight-line method through the maturity date of the CB&T Credit Facility. The Company is also subject to certain ongoing administrative fees and expenses. Interest expense on the CB&T Credit Facility was approximately \$70,000 and \$171,000 during the three months ended September 30, 2015 and 2014, respectively (including \$36,000 and \$23,000, respectively, in amortization of deferred financing costs) and \$297,000 and \$287,000 during the nine months ended September 30, 2015 and 2014, respectively (including \$90,000 and \$46,000, respectively, in amortization of deferred financing costs).

Borrowings are secured by certain assets of the Company. These collateral assets will include the grant to the lenders of first-priority deeds of trust on certain real property assets and trust deeds of the Company to be identified by the parties from time-to-time and all personal property of the Company, which collateral includes the assets described in the Security Agreement and in other customary collateral agreements that will be entered into by the parties from time-to-time. As of September 30, 2015, the carrying amount and classification of loans and real estate properties securing the CB&T Credit Facility were as follows:

	<b>September 30,</b>
	<b>2015</b>
<b>Loans:</b>	
Commercial	\$ <u>15,996,624</u>
<b>Real Estate:</b>	
Residential	6,852,989
Storage	<u>3,782,526</u>
Total	\$ <u>10,635,515</u>

The CB&T Credit Facility agreements contain financial covenants which are customary for a loan of this type. Management is not aware of any breach of these covenants as of September 30, 2015.

#### ***Opus Bank Line of Credit***

In April 2014, the Company entered into a Secured Revolving Credit Loan Agreement (the “Opus Credit Agreement”) and related agreements with Opus as the lender (the “Opus Credit Facility”). The maximum borrowings available (total commitment) under the facility is the lesser of \$20,000,000 or the Maximum Allowed Advance amount determined pursuant to a borrowing base calculation described in the Opus Credit Agreement.

Advances under the Opus Credit Facility may be made by Opus until April 1, 2016. All borrowings under the Opus Credit Facility bear interest payable monthly as follows: (i) commencing October 1, 2014, and on each successive six month anniversary during the term (the “Rate Change Date”), the rate of interest will be reset to the Six Month LIBOR rate of interest as reported on such Rate Change Date plus four percent (4.0%) per annum but in no event will the interest rate be lower than 4.5% per annum. The interest rate as of September 30, 2015 was 4.5%.

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements (Unaudited)

Upon a default under the Opus Credit Facility such interest rate increases by an additional 5.00%. Commencing on May 1, 2016, in addition to the required interest payments, the Company is also required to make mandatory monthly principal payments and all amounts under the Opus Credit Facility are to be repaid not later than April 1, 2017.

The Opus Credit Facility required the payment of an origination fee of \$100,000 and other issuance costs totaling \$231,000 that were capitalized as deferred financing costs and are being amortized to interest expense using the straight-line method through the maturity date of the Opus Credit Facility. The Company is also subject to certain ongoing administrative fees and expenses. Interest expense on the Opus Credit Facility was approximately \$19,000 and \$40,000 during the three months ended September 30, 2015 and 2014, respectively (including \$19,000 and \$19,000, respectively, in amortization of deferred financing costs) and \$58,000 and \$53,000 during the nine months ended September 30, 2015 and 2014, respectively (including \$58,000 and \$32,000, respectively, in amortization of deferred financing costs).

Borrowings under the Opus Credit Facility will be secured by certain of the Company's assets. These collateral assets will include the following types of assets to be identified by the parties and described in Borrowing Base Collateral Certificates to be entered into by the parties from time-to-time: (i) the grant to Opus of first-priority deeds of trust on certain of the Company's real property assets that meet related eligibility requirements set forth in the Opus Credit Agreement (as further defined in the Opus Credit Agreement, the "REO Collateral"); and (ii) the grant to Opus of a collateral interest in mortgage loan promissory notes issued by the Company in the ordinary course of business that meet related eligibility requirements set forth in the Opus Credit Agreement (as further defined in the Opus Credit Agreement, the "Note Collateral"). As of September 30, 2015, the carrying amount and classification of loans and real estate properties securing the Opus Credit Facility were as follows:

	<b>September 30,</b>
	<b>2015</b>
<b>Loans:</b>	
Commercial	\$ <u>8,425,924</u>
<b>Real Estate:</b>	
Office	9,016,702
Industrial	<u>1,422,308</u>
Total	\$ <u>10,439,010</u>

The Opus Credit Facility contains financial covenants which are customary for loans of this type. Management is not aware of any breach of these covenants as of September 30, 2015.

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

**NOTE 8 - NOTES AND LOANS PAYABLE ON REAL ESTATE**

The Company had the following notes and loans payable outstanding as of September 30, 2015 and December 31, 2014:

	<u>September 30,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>	<u>Interest</u> <u>Rate</u>	<u>Payment</u> <u>Terms/Frequency</u>	<u>Maturity Date</u>
720 University, LLC Note Payable	\$ —	\$ 9,741,463	6.00%	Interest Only Monthly	Paid off
Tahoe Stateline Venture, LLC Note #1	2,900,000	2,900,000	5.00%	Interest Only Semi-annual	December 2016
Tahoe Stateline Venture, LLC Note #2	500,000	500,000	5.00%	Interest Only Quarterly	August 2017
TOTB North, LLC Construction Loan Payable	10,945,502	1,007,919	4.50%	Amortizing Monthly	June 2017
TOTB Miami, LLC Loan Payable	12,754,415	12,975,167	4.33%	Amortizing Monthly	November 2017
Tahoe Stateline Venture, LLC Loan Payable	<u>14,097,865</u>	<u>10,445,000</u>	3.47%	Amortizing Monthly	January 2021
	<u>\$ 41,197,782</u>	<u>\$ 37,569,549</u>			

The following table shows maturities by year on these notes and loans payable as of September 30, 2015:

Twelve months ending September 30:	
2016	\$ 652,322
2017	15,032,576
2018	12,573,703
2019	416,904
2020	431,603
Thereafter	<u>12,090,674</u>
	<u>\$ 41,197,782</u>

***720 University, LLC Note Payable***

The Company had a note payable with a bank through its investment in 720 University, LLC (“720 University”), which was secured by the retail development located in Greeley, Colorado. In November 2014, 720 University entered into an agreement to sell the property that secured this note payable, and the buyer extended a new loan to 720 University to repay the existing note payable. The refinancing closed in January 2015. The principal amount of the new loan was \$9,771,263 and accrued interest at 6.0% per annum until paid off with the closing of the sale of the property to the buyer which occurred on June 15, 2015. 720 University incurred interest expense of approximately \$0 and \$127,000 during the three months ended September 30, 2015 and 2014, respectively, and \$265,000 and \$378,000 during the nine months ended September 30, 2015 and 2014, respectively.

***Tahoe Stateline Venture, LLC Notes Payable***

The Company obtained these obligations as a result of the foreclosure or purchase of nine parcels by Tahoe Stateline Venture, LLC (“TSV”) in 2013 and 2012. The Company paid approximately \$91,000 and \$107,000 of interest on the notes during the nine months ended September 30, 2015 and 2014, respectively. As of September 30, 2015 and December 31, 2014, there was approximately \$55,000 and \$19,000, respectively, in accrued but unpaid interest on these notes. The interest incurred has been capitalized to the basis of the land under development.

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### Notes to Consolidated Financial Statements (Unaudited)

#### ***TOTB North, LLC Construction Loan Payable***

In June 2014, TOTB North, LLC (“TOTB North”) entered into a Construction Loan Agreement (the “Loan Agreement”) and related documents with Bank of the Ozarks (“Ozarks”) as the lender providing TOTB North with a loan (the “North Loan”) of up to \$21,304,000 to renovate and improve the vacant and unimproved “North” apartment building held in TOTB North (the “Project”). The North Loan is secured by a first mortgage lien on the North building and all improvements and certain other assets, and is cross-defaulted and cross-collateralized with the TOTB Miami, LLC Loan Payable described below.

The initial maturity date (the “Maturity Date”) of the North Loan is June 12, 2017, which may be extended at the option of TOTB North for two additional one year periods, subject to certain conditions. The balance of the loan was approximately \$10,946,000 and \$1,008,000 as of September 30, 2015 and December 31, 2014, respectively.

All outstanding borrowings under the North Loan bear interest equal to the floating daily Three Month LIBOR rate of interest plus four percent (4.0%) per annum (the “Note Rate”), but the Note Rate will not be lower than four and one-half percent (4.5%) per annum. The Note Rate as of September 30, 2015 was 4.5% per annum. Upon a default under the North Loan documents the Note Rate increases by an additional eight percent (8.00%) per annum. Interest only payments are payable monthly until the “Amortization Commencement Date” which is the earlier to occur of (i) December 12, 2015 or (ii) the first monthly interest payment date occurring after the Project is completed and the North property achieves a DSCR of greater than 1.25:1. Commencing on the Amortization Commencement Date, monthly principal payments are also required with principal amortizing over 300 months and the balance of the North Loan is due on the Maturity Date.

TOTB North made a required deposit with Ozarks of \$1.0 million (the “Bridge Equity”) in 2014 using a capital contribution by TOTB (excess funds held and capital contributions of \$453,000 from the Company and \$108,000 from OFG). The Bridge Equity was provided to fund project costs pending satisfaction of additional post-closing conditions under the loan documents, and Ozarks reimbursed the Bridge Equity as part of the loan in February 2015. All post-closing conditions were met in February 2015, and TOTB North was given access to the remaining balance of the North Loan once the Company and OFG contributed an additional \$1,170,000 and \$279,000, respectively, during the first quarter of 2015 due to increased construction costs for the Project.

During 2014, TOTB North paid customary closing fees, disbursements and expenses, including an origination fee to Ozarks, which totaled \$622,000. The majority of these costs were paid out of proceeds from the North Loan and capitalized to deferred financing costs and are being amortized to the Project using the straight-line method through the Maturity Date. During the three and nine months ended September 30, 2015, approximately \$52,000 and \$156,000, respectively, of deferred financing costs were amortized to the Project. During the three and nine months ended September 30, 2014, approximately \$52,000 and \$69,000, respectively, of deferred financing costs were amortized to the Project. During the three and nine months ended September 30, 2015, approximately \$91,000 and \$133,000, respectively, of interest was incurred which was capitalized to the Project. During the three and nine months ended September 30, 2014, approximately \$9,000 and \$10,000, respectively, of interest was incurred which was capitalized to the Project.

The North Loan documents contain financial covenants of TOTB North and the Guarantors which are customary for loans of this type. Management is not aware of any breach of these covenants as of September 30, 2015.

#### ***TOTB Miami, LLC Loan Payable***

In November 2014, TOTB Miami, LLC (“TOTB”) entered into another loan agreement (the “TOTB Loan Agreement”) and related documents with Ozarks providing TOTB a loan (the “TOTB Miami Loan”) of \$13,000,000 secured by a first mortgage lien on the 154 leased condominium units owned in the Pointe building and the related parcel and all improvements as well as certain other assets. As a condition of providing the TOTB Miami Loan, Ozarks required that the TOTB Miami Loan and the North Loan be cross-collateralized and cross-defaulted, that

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excess proceeds from any sale of the North property be used to reduce or pay off the TOTB Miami Loan and that excess proceeds from any sale of the TOTB property be used to pay off the North Loan.

The net cash proceeds from the TOTB Miami Loan were distributed to the members of TOTB in 2014. The initial maturity date (the “Maturity Date”) of the TOTB Miami Loan is November 16, 2017, and the Maturity Date may be extended at the option of TOTB for two additional one year periods if a number of conditions are met.

All outstanding borrowings under the TOTB Miami Loan will bear interest equal to the floating daily Three Month LIBOR rate of interest plus four percent (4.0%) per annum (the “Note Rate”), but in no event will the Note Rate be lower than four and one-quarter percent (4.25%) per annum. The Note Rate as of September 30, 2015 was 4.33% per annum. Upon a default under the TOTB Miami Loan documents, including any cross-default, the Note Rate increases by an additional eight percent (8.00%) per annum. Principal and interest is payable monthly with principal amortizing over 300 months, and the balance of the loan is due on the Maturity Date.

TOTB was obligated to pay customary closing fees, disbursements and expenses, including an origination fee to the Lender, which totaled approximately \$323,000. The majority of these costs were paid out of proceeds from the loan and capitalized to deferred financing costs and are being amortized to interest expense using the effective interest method through the Maturity Date. During the three and nine months ended September 30, 2015, approximately \$166,000 and \$497,000, respectively, of interest expense was incurred (including approximately \$33,000 and \$92,000, respectively, of deferred financing costs amortized to interest expense).

The TOTB Miami Loan documents contain financial covenants of TOTB and the Guarantors which are customary for loans of this type. Management is not aware of any breach of these covenants as of September 30, 2015.

#### ***Tahoe Stateline Venture, LLC Loan Payable***

In December 2014, Tahoe Stateline Ventures, LLC (“TSV”) entered into a Credit Agreement (the “Credit Agreement”) and related documents with RaboBank, N.A. as the lender (“Lender”) providing TSV with a loan (the “TSV Loan”) of up to \$14,500,000. TSV borrowed \$10,445,000 at the first closing under the TSV Loan and an additional \$3,830,000 was borrowed in September 2015.

The maturity date of the TSV Loan is January 1, 2021 (the “Maturity Date”). All outstanding borrowings under the TSV Loan documents bear interest initially at a rate of 3.47% per annum (the “Long Term Adjustable Rate”), provided that on January 1, 2018 the Long Term Adjustable Rate will be reset to Lender’s then current market rate for three year fixed rate loans from comparable commercial real estate secured transactions, as determined by Lender in its sole discretion. Upon a default under the TSV Loan documents, the interest rate on the outstanding principal balance increases by an additional five percent (5.00%) per annum and the rate on any other outstanding obligations thereunder increases to ten percent (10.00%) per annum. Prepayments under the TSV Loan documents are subject to certain prepayment fees; provided that during the 90 day period immediately prior to January 1, 2018, and the 90 day period immediately prior to the Maturity Date, TSV may prepay the entire unpaid balance of the Loan in full, without any Prepayment Fee or penalty.

During the term of the TSV Loan, TSV will make equal combined payments of principal and accrued interest on the first day of each month in an amount calculated to fully amortize the original principal amount over a period of 300 months, subject to certain adjustments and the balance of the TSV Loan is due on the Maturity Date.

The Credit Agreement required the payment of a closing fee of \$108,750 and certain administrative fees totaling approximately \$218,000. The majority of these costs were paid out of proceeds from the loan and capitalized to deferred financing costs and are being amortized to interest expense using the effective interest method through the Maturity Date. During the three and nine months ended September 30, 2015, approximately \$99,000 and \$296,000, respectively, of interest expense was incurred (including approximately \$9,000 and \$27,000, respectively, of deferred financing costs amortized to interest expense).

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The TSV Loan documents contain financial covenants which are customary for loans of this type. Management is not aware of any breach of these covenants as of September 30, 2015.

#### **NOTE 9 - TRANSACTIONS WITH AFFILIATES**

In consideration of the management services rendered to the Company, OFG is entitled to receive from the Company a management fee payable monthly, subject to a maximum of 2.75% per annum of the average unpaid balance of the Company's loans.

All of the Company's loans are serviced by OFG, in consideration for which OFG receives a monthly fee, which, when added to all other fees paid in connection with the servicing of a particular loan, does not exceed the lesser of the customary, competitive fee paid in the community where the loan is placed for the provision of such mortgage services on that type of loan, or up to 0.25% per annum of the unpaid principal balance of the loans.

OFG, at its sole discretion may, on a monthly basis, adjust the management and servicing fees as long as they do not exceed the allowable limits calculated on an annual basis. Even though the fees for a month may exceed  $\frac{1}{12}$  of the maximum limits, at the end of the calendar year the sum of the fees collected for each of the 12 months must be equal to or less than the stated limits. Management fees amounted to approximately \$513,000 and \$436,000 for the three months ended September 30, 2015 and 2014, respectively, and \$1,410,000 and \$1,276,000 for the nine months ended September 30, 2015 and 2014, respectively, and are included in the accompanying consolidated statements of income. Servicing fees amounted to approximately \$47,000 and \$40,000 for the three months ended September 30, 2015 and 2014, respectively, and \$128,000 and \$116,000 for the nine months ended September 30, 2015 and 2014, respectively, and are included in the accompanying consolidated statements of income. As of September 30, 2015 and December 31, 2014, the Company owed management and servicing fees to OFG in the amount of approximately \$192,000 and \$171,000, respectively.

The maximum management and servicing fees were paid to OFG during the three and nine months ended September 30, 2015 and 2014.

In determining the management fees to pay to OFG, OFG may consider a number of factors, including current market yields, delinquency experience, un-invested cash and real estate activities. During the three and nine months ended September 30, 2015 and 2014, OFG elected to take the maximum compensation that it is able to take pursuant to the Management Agreement and will likely continue to take the maximum compensation for the foreseeable future.

Pursuant to the charter, OFG receives all late payment charges from borrowers on loans owned by the Company. The amounts paid to or collected by OFG for such charges totaled approximately \$0 and \$2,000 for the three months ended September 30, 2015 and 2014, respectively, and \$17,000 and \$4,000 for the nine months ended September 30, 2015 and 2014, respectively. In addition, the Company remits other miscellaneous fees to OFG, which are collected from loan payments, loan payoffs or advances from loan principal (i.e. funding, demand and partial release fees). The amounts paid to or collected by OFG for such fees totaled approximately \$2,000 and \$1,000, respectively, during the three months ended September 30, 2015 and 2014 and \$6,000 and \$2,000, respectively, during the nine months ended September 30, 2015 and 2014, respectively.

OFG originates all loans the Company invests in and receives loan origination and extension fees from borrowers. During the three and nine months ended September 30, 2015, OFG earned approximately \$289,000 and \$1,001,000, respectively, on loans originated or extended of approximately \$11,982,000 and \$42,034,000, respectively. During the three and nine months ended September 30, 2014, OFG earned approximately \$186,000 and \$726,000, respectively, on loans originated or extended of approximately \$8,025,000 and \$30,226,000, respectively.

OFG is reimbursed by the Company for the actual cost of goods, services and materials used for or by the Company and paid by OFG and the salary and related salary expense of OFG's non-management and non-supervisory personnel performing services for the Company which could be performed by independent parties (subject to certain limitations in the Management Agreement and the Company's charter). The total OFG

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### Notes to Consolidated Financial Statements (Unaudited)

reimbursements expensed by the Company for such services were \$130,000 and \$167,000 during the three months ended September 30, 2015 and 2014, respectively, and \$394,000 and \$507,000 during the nine months ended September 30, 2015 and 2014, respectively. As of September 30, 2015 and December 31, 2014, there was \$43,000 and \$113,000 payable to OFG for such services. The Company also reimbursed certain of OFG's officers for allowed expenses in the total amount of \$1,000 and \$1,000 during the nine months ended September 30, 2015 and 2014, respectively.

The Company paid Investor's Yield, Inc. (a wholly owned subsidiary of OFG) approximately \$7,000 and \$30,000 during the nine months ended September 30, 2015 and 2014, respectively, in fees primarily related to certain foreclosure proceedings on Company loans.

During the nine months ended September 30, 2015, the Company purchased OFG's full interest in a loan secured by an industrial property located in San Ramon, California with a principal balance of \$1,499,000 at face value.

### **NOTE 10 – STOCKHOLDERS' EQUITY**

#### ***Dividends***

On March 18, 2015, the board of directors declared a \$0.07 dividend on our shares of common stock to holders of record as of March 31, 2015. The dividend was paid on April 14, 2015 and totaled \$753,760.

On June 19, 2015, the board of directors declared a \$0.18 dividend on our shares of common stock to holders of record as of June 30, 2015. The dividend was paid on July 14, 2015 and totaled \$1,938,240.

On September 18, 2015, the board of directors declared a \$0.08 dividend on our shares of common stock to holders of record as of September 30, 2015. The dividend was paid on October 14, 2015 and totaled \$835,533.

As of September 30, 2015, the Company has net capital gains from the sales of real estate properties totaling approximately \$12,710,000. It is the intention of management to retain all net capital gains within the Company and not distribute them as is permitted for a REIT. However, the retained net capital gains will be taxable to shareholders and will require the Company to make a tax payment to the U.S Treasury Department on behalf of shareholders at the highest corporate tax rate (currently 35%), which are to be reflected as tax payments on shareholders' tax returns. Such payments will be recorded as dividends in the Company's financial statements.

#### ***Stock Repurchase Programs***

On August 9, 2013, the Board of Directors authorized a Rule 10b5-1 stock repurchase plan (the "2013 Repurchase Plan") which permitted the Company to purchase up to the lesser of \$7 million of its common stock or five percent of the shares of common stock outstanding as of that date. A Rule 10b5-1 plan permits the Company to repurchase shares at times when it might otherwise be prevented from doing so. During the nine months ended September 30, 2014, the Company repurchased 26,208 shares of its common stock for a total cost of approximately \$325,000 (including commissions) and an average cost of \$12.42 per share. The 2013 Repurchase Plan expired on May 19, 2014, and as of that date, the Company had repurchased 430,118 shares of its common stock, for a total cost of approximately \$5,349,000 (including commissions) and an average cost of \$12.44 per share.

On May 27, 2015, the Board of Directors authorized a new Rule 10b5-1 stock repurchase plan (the "2015 Repurchase Plan") under which the Company may purchase up to \$7.5 million of its common stock. Under the 2015 Repurchase Plan, repurchases will be funded from available working capital, and the repurchased shares will return to the status of authorized but unissued shares of common stock. Repurchases under the 2015 Repurchase Plan are subject to certain price, volume and timing constraints specified in the brokerage agreement. There is no guarantee as to the exact number of shares that will be repurchased by the Company. The 2015 Repurchase Plan permits repurchases commencing on June 27, 2015 and expires by its terms on May 12, 2016, although the Company may terminate the 2015 Repurchase Plan at any time. During the quarter ended September 30, 2015, the Company

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repurchased 360,263 shares of its common stock under this new plan for a total cost of approximately \$5,253,000 (including commissions) and an average cost of \$14.58 per share and repurchased another 66,528 shares in October 2015 (subsequent to quarter end) for a total cost of approximately \$938,000 (including commissions) and an average cost of \$14.10 per share.

#### **NOTE 11 – RESTRICTED CASH**

##### **Contingency Reserves**

In accordance with the charter, the Company is required to maintain cash, cash equivalents and marketable securities as contingency reserves in an aggregate amount of 1-1/2% of Capital as defined in the charter. Although the Manager believes the contingency reserves are adequate, it could become necessary for the Company to sell or otherwise liquidate certain of its investments or other assets to cover such contingencies on terms which might not be favorable to the Company, which could lead to unanticipated losses upon sale of such assets.

The contingency reserves required per the charter as of September 30, 2015 and December 31, 2014 were approximately \$4,009,000 and \$3,876,000, respectively, and are reported as part of restricted cash in the accompanying consolidated balance sheets. \$7,000,000 is required to be held in non-interest bearing accounts pursuant to the Company's two lines of credit agreements, which also satisfies the contingency reserve requirement in the charter.

##### **Escrow Deposits**

Restricted cash includes deposits held in third party escrow accounts to fund construction costs and replacement reserves and to pay property taxes and insurance on Company real estate in the amounts of approximately \$495,000 and \$249,000 as of September 30, 2015 and December 31, 2014, respectively.

#### **NOTE 12 – FAIR VALUE**

The Company accounts for its financial and nonfinancial assets and liabilities pursuant to ASC 820 – *Fair Value Measurements and Disclosures*. ASC 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

Fair value is defined in ASC 820 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity, such as the Company's own data or assumptions.

Level 3 inputs include unobservable inputs that are used when there is little, if any, market activity for the asset or liability measured at fair value. In certain cases, the inputs used to measure fair value fall into different levels of the fair value hierarchy. In such cases, the level in which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement. Management's assessment of the significance of a particular input requires judgment and considers factors specific to the asset or liability being measured.

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### Notes to Consolidated Financial Statements (Unaudited)

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

The following is a description of the Company's valuation methodologies used to measure and disclose the fair values of its financial and nonfinancial assets and liabilities on a nonrecurring basis. There were no assets or liabilities measured at fair value on a recurring basis.

#### **Impaired Loans**

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and a specific allowance for loan losses is established. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement or when monthly payments are delinquent greater than ninety days. Once a loan is identified as impaired, management measures impairment in accordance with ASC 310-10-35. The fair value of impaired loans is estimated by either an observable market price (if available) or the fair value of the underlying collateral, if collateral dependent. The fair value of the loan's collateral is determined by third party appraisals (by licensed appraisers), broker price opinions, comparable properties or other indications of value. Those impaired loans not requiring an allowance represent loans for which the fair value of the collateral exceed the recorded investments in such loans. At September 30, 2015 and December 31, 2014, the majority of the total impaired loans were evaluated based on the fair value of the collateral by obtaining third party appraisals that valued the collateral primarily by utilizing an income or market approach or some combination of the two. In accordance with ASC 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. Because appraisals used by management generally include significant unobservable inputs and market data, the Company records the impaired loan as nonrecurring Level 3. Unobservable market data included in appraisals often includes adjustments to comparable property sales for such items as location, size and quality to estimate fair values using a sales comparison approach. Unobservable market data also includes cash flow assumptions and capitalization rates used to estimate fair values under an income approach.

#### **Real Estate Held for Sale and Investment**

Real estate held for sale and investment includes properties acquired through foreclosure of the related loans. When property is acquired, any excess of the Company's recorded investment in the loan and accrued interest income over the estimated fair market value of the property, net of estimated selling costs, is charged against the allowance for loan losses. Subsequently, real estate held for sale properties are carried at the lower of carrying value or fair value less costs to sell. The Company periodically compares the carrying value of real estate held for investment to expected future cash flows as determined by internally or third party generated valuations (including third party appraisals that primarily utilize an income or market approach or some combination of the two) for the purpose of assessing the recoverability of the recorded amounts. If the carrying value exceeds future undiscounted cash flows, the assets are reduced to fair value. The fair value of real estate held for sale and investment is estimated using appraisals in a manner similar to that of collateral dependent impaired loans described above which generally results in a Level 3 classification in the fair value hierarchy.

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The following table presents information about the Company's assets and liabilities measured at fair value on a nonrecurring basis as of September 30, 2015 and December 31, 2014:

	Fair Value Measurements Using			
	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b><u>September 30, 2015</u></b>				
<u>Nonrecurring:</u>				
Impaired loans:				
Commercial	\$ 664,859	\$ —	\$ —	\$ 664,859
Residential	6,144,000	—	—	6,144,000
Total	<u>\$ 6,808,859</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 6,808,859</u>
Real estate properties:				
Land	\$ 4,557,000	\$ —	\$ —	\$ 4,557,000
Total	<u>\$ 4,557,000</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,557,000</u>
<b><u>December 31, 2014</u></b>				
<u>Nonrecurring:</u>				
Impaired loans:				
Commercial	\$ 529,689	\$ —	\$ —	\$ 529,689
Residential	6,144,000	—	—	6,144,000
Total	<u>\$ 6,673,689</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 6,673,689</u>
Real estate properties:				
Commercial	\$ 1,292,500	\$ —	\$ —	\$ 1,292,500
Land	2,334,773	—	—	2,334,773
Total	<u>\$ 3,627,273</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,627,273</u>

The (reversal of) provision for loan losses based on the fair value of loan collateral less estimated selling costs for the impaired loans above totaled approximately \$(64,000) and \$8,000 during the three months ended September 30, 2015 and 2014, respectively, and \$(70,000) and \$81,000 during the nine months ended September 30, 2015 and 2014, respectively. Impairment losses were recorded on real estate properties in the amounts of approximately \$0 and \$124,000 during the three months ended September 30, 2015 and 2014, respectively, and \$1,256,000 and \$179,000 during the nine months ended September 30, 2015 and 2014, respectively.

There were no liabilities measured at fair value on a non-recurring basis at September 30, 2015 and December 31, 2014.

**OWENS REALTY MORTGAGE, INC.**

Notes to Consolidated Financial Statements (Unaudited)

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at September 30, 2015 and December 31, 2014:

**At September 30, 2015:**

<u>Description</u>	<u>Fair Value</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Inputs</u>	<u>Input/Range</u>	<u>Weighted Average</u>
<b>Impaired Loans:</b>					
Commercial	\$ 664,859	Appraisal	Estimated Cost of Improvements	31.9%	N/A
			Capitalization Rate	7%	N/A
			Comparable Sales Adjustment	(20)% to 30%	N/A
Residential	\$ 6,144,000	Appraisal	Estimated Cost of Improvements	1.8%	N/A
			Discount Rate	12%	N/A
			Comparable Sales Adjustment	(10)% to 20%	N/A
<b>Real Estate Properties:</b>					
Land	\$ 4,557,000	Appraisal	Comparable Sales Adjustment	(19)%	N/A

**At December 31, 2014:**

<u>Description</u>	<u>Fair Value</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Inputs</u>	<u>Input/Range</u>	<u>Weighted Average</u>
<b>Impaired Loans:</b>					
Commercial	\$ 529,689	Appraisal	Estimate Cost of Improvements	13.6%	N/A
			Capitalization Rate	6.5%	N/A
			Comparable Sales Adjustment	(59)% to (2.3)%	N/A
Residential	\$ 6,144,000	Appraisal	Estimate Cost of Improvements	1.8%	N/A
			Discount Rate	12%	N/A
			Comparable Sales Adjustment	(10)% to 20%	N/A
<b>Real Estate Properties:</b>					
Commercial	\$ 1,292,500	Appraisal	Comparable Purchase Offers	(42)% to 13.4%	N/A
Land	\$ 2,334,773	Appraisal	Comparable Sales Adjustment	5% to 62.8%	N/A
			Discount Rate	8%	N/A

Where only one percentage is presented in the above table there was only one unobservable input of that type for one loan or property. Adjustments to comparable sales included items such as market conditions, location, size, condition, access/frontage and intended use. A weighted average of an unobservable input is presented in the table above only to the extent there was multiple impaired loans or real estate properties within that class measured at fair value on a nonrecurring basis.

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The approximate carrying amounts and estimated fair values of financial instruments at September 30, 2015 and December 31, 2014 are as follows:

	Carrying Value	Fair Value Measurements at September 30, 2015			
		Level 1	Level 2	Level 3	Total
<b>Financial assets</b>					
Cash and cash equivalents	\$ 6,708,000	\$ 6,708,000	\$ —	\$ —	\$ 6,708,000
Restricted cash	7,495,000	7,495,000	—	—	7,495,000
Loans, net	73,492,000	—	—	73,469,000	73,469,000
Investment in limited liability company	2,188,000	—	—	2,352,000	2,352,000
Accrued interest and advances receivable	1,026,000	—	—	1,026,000	1,026,000
<b>Financial liabilities</b>					
Due to Manager	\$ 235,000	\$ —	\$ 235,000	\$ —	\$ 235,000
Accrued interest payable	186,000	—	132,000	54,000	186,000
Lines of credit payable	8,954,000	—	8,954,000	—	8,954,000
Notes and loans payable	41,198,000	—	37,798,000	3,400,000	41,198,000
<b>Fair Value Measurements at December 31, 2014</b>					
	Carrying Value	Level 1	Level 2	Level 3	Total
<b>Financial assets</b>					
Cash and cash equivalents	\$ 1,414,000	\$ 1,414,000	\$ —	\$ —	\$ 1,414,000
Restricted cash	6,249,000	6,249,000	—	—	6,249,000
Loans, net	65,164,000	—	—	66,009,000	66,009,000
Investment in limited liability company	2,143,000	—	—	2,352,000	2,352,000
Accrued interest and advances receivable	838,000	—	—	838,000	838,000
<b>Financial liabilities</b>					
Due to Manager	\$ 284,000	\$ —	\$ 284,000	\$ —	\$ 284,000
Accrued interest payable	175,000	—	113,000	62,000	175,000
Lines of credit payable	11,450,000	—	11,450,000	—	11,450,000
Notes and loans payable	37,570,000	—	24,428,000	13,155,000	37,583,000

The following methods and assumptions were used by the Company in estimating the fair value of each class of financial instruments:

**Cash, cash equivalents and restricted cash:** The carrying value of cash and cash equivalents and restricted cash approximates the fair value because of the liquidity and/or relatively short maturity of these instruments and are classified as Level 1.

**Loans, net:** The fair value of loans that are not impaired are estimated using discounted cash flow methodology, using discount rates, which, in the opinion of management, best reflect current market interest rates that would be offered for loans with similar characteristics and credit quality but are often unobservable resulting in a Level 3

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements (Unaudited)

classification. The fair values of loans that are impaired are estimated by the Company primarily through the use of third party appraisals of the underlying collateral. Such appraisals often include unobservable market data including adjustments to comparable property sales for such items as location, size and quality to estimate fair values using a sales comparison approach and include cash flow assumptions and capitalization rates used to estimate fair values under an income approach resulting in a Level 3 classification. Accrued interest and advances receivable relate to loans and are thus classified as Level 3.

***Investment in limited liability company:*** The fair value of the Company's investment in limited liability company is estimated based on an appraisal obtained which used unobservable inputs and is classified as Level 3.

***Lines of credit payable:*** The fair value of the Company's lines of credit payable is estimated based upon comparable market indicators of current pricing for the same or similar issue or on the current rate offered to the Company for debt of the same remaining maturity and which are generally observable resulting in a Level 2 classification. Accrued interest payable associated with the lines of credit is also classified as Level 2.

***Notes and loans payable:*** The fair values of the Company's notes and loans payable and related accrued interest payable are estimated based upon comparable market indicators of current pricing for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities resulting in either a Level 2 or Level 3 classification. Generally, Level 2 inputs are used for variable rate notes payable and Level 3 inputs are used for fixed rate notes payable. Accrued interest payable associated with the notes and loans payable is also classified as either Level 2 or Level 3.

***Due to Manager:*** The carrying value of Due to Manager is estimated to approximate fair value due to the short term nature of this instrument and is classified as Level 2.

### **NOTE 13 - COMMITMENTS AND CONTINGENCIES**

#### **Environmental Remediation Obligations**

The Company has an obligation to pay all required costs to remediate and monitor contamination of the real properties owned by 1850. As part of the Operating Agreement executed by the Company and its joint venture partner in 1850, Nanook, the Company has indemnified Nanook against all obligations related to the expected costs to monitor and remediate the contamination. In 2008, the Company had accrued an amount that a third party consultant had estimated will need to be paid to monitor and remediate the site. The majority of clean-up activities were completed during 2012 as part of the tenant's construction of a new building on the site. Thus, approximately \$460,000 was paid by the Company from the previously established liability, and an additional \$100,000 was accrued during the year ended December 31, 2012 as a result of an updated estimate of future costs to be incurred. If additional amounts are required, it will be an obligation of the Company. As of September 30, 2015 and December 31, 2014, approximately \$39,000 and \$60,000 of this obligation remains accrued on the Company's books. All costs for this remediation will be paid from cash reserves.

During the course of due diligence performed by a potential buyer of TOTB Miami in 2012, a low level of arsenic was found in the ground water of a monitoring well located on the property owned by TOTB Miami. While the level of arsenic exceeds the minimum level acceptable for drinking water standards, the water under this property is subject to tidal influence and is not used for domestic consumption. TOTB Miami has retained an environmental consultant to perform additional testing and analysis with the goal of petitioning the appropriate governmental agency to issue a no further action letter for this property due to the low level of contamination and the low quality of the ground water under the property. At this time, the costs of any potential remediation and/or monitoring are unknown and cannot be estimated. As of September 30, 2015 and December 31, 2014, approximately \$104,000 and \$79,000 has been accrued and/or paid for testing and analysis.

## **OWENS REALTY MORTGAGE, INC.**

### Notes to Consolidated Financial Statements (Unaudited)

#### **Contractual Obligations**

The Company has entered into various contracts for design, architectural, engineering and foundation work for the phase II development of the land previously owned by TSV and now owned by Zalanta Resort at the Village, LLC (“Zalanta”). The aggregate amount of these contracts as of the date of this filing is approximately \$4,333,000 of which approximately \$2,244,000 has been incurred as of September 30, 2015. Management expects that all costs for this project will be paid from cash reserves, advances from the lines of credit and/or construction financing to be obtained in the future.

The Company has also entered into contracts for the construction, demolition and concrete remediation, design, architectural and engineering services related to the renovation of the vacant apartment building owned by TOTB North (see Note 8) in the aggregate amount of approximately \$21,042,000 of which approximately \$13,963,000 has been incurred to September 30, 2015 in addition to other capitalized costs related to the construction project of \$1,638,000 (total of \$15,601,000). Management expects that all costs for this project will be paid from cash reserves or the existing construction loan. It is possible that additional change orders will be submitted and construction costs may be higher than expected.

The Company has entered into contracts for new bathrooms and modular offices and improvements to the bridge that accesses the marina held within Brannan Island, LLC in the aggregate amount of approximately \$791,000 of which approximately \$633,000 has been incurred to September 30, 2015. Management expects that all costs from the project will be paid from cash reserves or advances from the lines of credit. It is possible that additional change orders will be submitted and construction costs may be higher than expected.

As of September 30, 2015, the Company has commitments to advance additional funds to borrowers of construction, rehabilitation and other loans in the total amount of approximately \$6,719,000 (including approximately \$922,000 in interest reserves).

#### **Legal Proceedings**

The Company is involved in various legal actions arising in the normal course of business. In the opinion of management, such matters will not have a material effect upon the financial position of the Company.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Forward Looking Statements**

The following discussion provides information to assist you in understanding our financial condition and results of operations. This discussion and analysis contains forward-looking statements. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words "may," "believe," "expect," "anticipate," "estimate," "plan," "continue," "intend," "should," "project" or similar expressions, it intends to identify forward-looking statements. These forward-looking statements are subject to risks and uncertainties, as more particularly set forth in our filings with the Securities and Exchange Commission, including those described in the "Forward Looking Statements" and "Risk Factors" sections of our Annual Report on Form 10-K for the year ended December 31, 2014, that could cause actual results to differ materially from those projected in the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. New risks and uncertainties arise over time and it is not possible to predict those events or how they may affect us. Except as required by law, we are not obligated to, and do not intend to, update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

### ***Overview and Background***

We are a specialty finance company that focuses on the origination, investment and management of commercial real estate mortgage loans. We provide customized, short-term capital to small and middle-market investors and developers who require speed and flexibility. We are organized and conduct our operations to qualify as a real estate investment trust, or REIT, for U.S. federal income tax purposes. We are externally managed and advised by Owens Financial Group, Inc. ("OFG" or the "Manager"), a specialized commercial real estate management company that has originated, serviced and managed alternative commercial real estate investments since 1951.

The Company is a Maryland corporation formed to reorganize the business of its predecessor, OMIF, into a publicly traded REIT. OMIF was a California Limited Partnership registered with the Securities and Exchange Commission that was formed in 1983 for the purposes of funding and servicing short-term commercial real estate loans. Beginning in 2009, OMIF experienced liquidity issues as its borrowers were unable to access credit sources to pay off its loans. OMIF eventually foreclosed on a substantial portion of its loan portfolio, repositioning many of the properties for investment or eventual sale. OMIF also experienced a significant increase in capital withdrawal requests that it was unable to honor due to insufficient cash, net of reserves and restrictions under the terms of its bank line of credit. In addition, OMIF was restricted by provisions within the partnership agreement from making additional investments in mortgage loans while qualified redemption requests remained pending and unpaid. In addition to increasing investor liquidity through public listing of its stock, the Company was created to provide the opportunity for resuming mortgage lending activities, with the goal of increasing income to stockholders.

On May 20, 2013, OMIF merged with and into the Company with the Company as the surviving entity, succeeding to and continuing the operations of OMIF. The Company now, by virtue of the Merger, directly or indirectly owns all of the assets and business formerly owned by OMIF. The Company is a deemed successor issuer to OMIF pursuant to Rule 12g-3(a) under the Exchange Act, and on July 1, 2013, the Company's common stock was listed on the NYSE MKT exchange. For accounting purposes, the merger was treated as a transfer of assets and exchange of shares between entities under common control. The accounting basis used to initially record the assets and liabilities in the Company was the carryover basis of OMIF.

Our primary sources of revenue are interest income earned on our loan portfolio and revenues we generate from our operating real estate assets. We have resumed originating loans and believe the Company is well positioned to capitalize on lending opportunities as the economy continues to recover. However, there can be no assurances that we will be able to identify and make loans to suitable commercial real estate borrowers or have adequate capital and liquidity to fund such loans.

Our operating results are affected primarily by:

- the level of foreclosures and related loan and real estate losses experienced;

- the income or losses from foreclosed properties prior to the time of disposal;
- the amount of cash available to invest in loans;
- the amount of borrowing to finance loan investments and our cost of funds on such borrowing;
- the level of real estate lending activity in the markets serviced;
- the ability to identify and lend to suitable borrowers;
- the interest rates we are able to charge on loans; and
- the level of delinquencies on loans.

Between 2008 and 2013, we experienced increased delinquent loans and foreclosures which created substantial losses. As a result, we now own significantly more real estate than in the past, which has reduced cash flow and net income. As of September 30, 2015, approximately 13% of our loans are impaired and/or past maturity. As of September 30, 2015, we own approximately \$159 million of real estate held for sale or investment, which is approximately 63% of total assets. During the nine month period ended September 30, 2015, we sold four real estate properties for aggregate net sales proceeds of \$34,865,000 and gains totaling \$14,879,000. We also recognized an additional \$152,000 in deferred gain under the installment method due to the final repayment received on a carryback loan from the sale of a real estate property in late 2012. We will continue to attempt to sell certain of our properties but may need to sell them for losses or wait until market values recover. In addition, under the REIT tax rules, we may be subject to a “prohibited transaction” penalty tax on tax gains from the sale of our properties in certain circumstances. In addition, we are also limited in the number and dollar amount of properties we can sell in a given year under the REIT tax rules.

Although management believes that only two of our delinquent loans will result in credit losses to the Company (and has caused the Company to record specific allowances for loan losses on such loans), real estate values could decrease further. Management continues to perform frequent evaluations of such collateral values using internal and external sources, including the use of updated independent appraisals. As a result of these evaluations, the allowance for loan losses and our investments in real estate could change in the near term, and such changes could be material.

Our website can be found at [www.owensmortgage.com](http://www.owensmortgage.com). We make available through the website, access to our annual and quarterly financial statements, current reports on Form 8-K, and amendments to those reports, as well as proxy statements and other periodic reports and filings submitted to the SEC. We also provide access to certain Company presentations, fact sheets, press releases and corporate governance information.

### ***Business Strategy***

Our primary business objective is to provide our stockholders with attractive risk-adjusted returns by producing consistent and predictable dividends while maintaining a strong balance sheet. We believe we have positioned the Company for future growth and seek to increase distributions to stockholders and funds from operations, or FFO, through active portfolio management and execution of our business plan which is outlined below:

- Capitalize on market lending opportunity by leveraging our existing origination network to expand our commercial real estate loan portfolio.
- Enhance and reposition our commercial real estate assets through the investment of capital and strategic management.
- Increase liquidity available for lending activities by focusing on opportunities to remove real estate assets from our balance sheet.
- Manage leverage to marginally expand sources of liquidity while maintaining a conservative balance sheet.

### ***Current Market Conditions, Risks and Recent Trends***

During 2013 and 2014, the global capital, credit and real estate markets continued to slowly recover from the economic downturn which began in 2007. Real estate markets also continued to recover, slowly on a national basis and more significantly in major metropolitan areas, and we expect this trend to continue through 2015 and beyond. Accordingly, as our real estate assets are carried at the lower of carrying value or fair value less costs to sell, it is possible that we have substantial imbedded gains in certain of our real estate properties held for sale and investment

that are not reflected in our financial statements or in the value of our stock. However, despite these improvements, the overall market recovery remains uncertain. Should the economy regress, the commercial real estate sector may experience additional losses and operating challenges.

### **Critical Accounting Policies**

Please refer to the section of ORM's Annual Report on Form 10-K for the year ended December 31, 2014 entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations —Critical Accounting Policies" for a discussion of our critical accounting policies. During the nine months ended September 30, 2015, there were no material changes to these policies.

In preparing the consolidated financial statements, management is required to make estimates based on the information available that affect the reported amounts of assets and liabilities as of the balance sheet dates and revenues and expenses for the reporting periods. Such estimates relate principally to the determination of (1) the allowance for loan losses including the accrued interest and advances that are estimated to be unrecoverable based on estimates of amounts to be collected plus estimates of the value of the property as collateral; (2) the valuation of real estate held for sale and investment (at acquisition and subsequently); and (3) the estimate of environmental remediation liabilities. While we believe that these accounting policies and estimates are based on sound measurement criteria, actual future events can and often do result in outcomes that can be materially different from these estimates and forecasts.

### **Results of Operations**

Net income attributable to our common stockholders decreased approximately \$400,000 and increased approximately \$10,942,000 during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014.

The decrease in net income during the three months ended September 30, 2015 was primarily a result of (i) a decrease in net income from real estate properties of approximately \$129,000 as a result of the sales of two operating properties during the second quarter of 2015, (ii) the write-off of rent receivable as bad debt expense in the amount of \$150,000 related to one real estate property during the quarter and (iii) a decrease in gain on sale of real estate of \$113,000, as there were no sales during the quarter ended September 30, 2015.

The increase in net income during the nine months ended September 30, 2015 was primarily a result of the sales of four real estate properties offset by a decrease in the recognition of deferred gain under the installment method. The total gain on sales of real estate was approximately \$15,031,000 for the nine months ended September 30, 2015. The gain on sales of real estate was reduced by a portion of the gain in the amount of approximately \$2,479,000 that was attributable to our joint venture partner in 720 University, LLC (as the shopping center owned by this entity was sold in June 2015). During the nine months ended September 30, 2014, we sold an improved, residential lot for \$175,000, resulting in a gain of \$105,000 and recognized \$2,626,000 in deferred gains under the installment method related to the sales of certain properties in 2012 and 2013 due to full or partial principal repayments received on the carry back loans in 2014.

### Summary of Financial Results

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Total revenues	\$ 4,414,217	\$ 4,705,357	\$ 16,811,097	\$ 12,628,141
Total expenses	3,998,225	3,950,850	13,915,145	11,118,244
Operating income	415,992	754,507	2,895,952	1,509,897
Gain on sales of real estate	—	113,113	15,031,299	2,740,105
Gain on foreclosure of loan	—	—	—	257,020
Net income	415,992	867,620	17,927,251	4,507,022
Less: Net income attributable to noncontrolling interests	(31,671)	(83,797)	(2,630,434)	(151,752)
Net income attributable to common stockholders	\$ 384,321	\$ 783,823	\$ 15,296,817	\$ 4,355,270
Net income per common share (basic and diluted)	\$ 0.04	\$ 0.07	\$ 1.43	\$ 0.40
Weighted average number of common shares outstanding	10,538,735	10,768,001	10,690,736	10,768,495
Dividends declared per share of common stock	\$ 0.08	\$ 0.05	\$ 0.33	\$ 0.15

### Three and Nine Months Ended September 30, 2015 Compared to Three and Nine Months Ended September 30, 2014

#### Total Revenues

Interest income on loans decreased \$26,000 (1.9% decrease) and increased \$3,133,000 (87.9% increase) during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014. The increase during the nine month period was primarily due to the accretion of the remaining \$512,000 discount on an impaired loan as the loan was repaid prior to maturity in the first quarter of 2015, the collection of past due interest related to an impaired loan that we foreclosed on during 2014 of approximately \$1,723,000 (as compared to \$517,000 that was collected during the same period in 2014) and an increase in the average balance of performing loans between the nine months ended September 30, 2014 and the nine months ended September 30, 2015 of approximately \$24,682,000 (78)%.

Rental and other income from real estate properties decreased \$266,000 (8.1% decrease) and increased \$1,046,000 (11.7% increase) during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014. The decrease during the quarter ended September 30, 2015 was primarily the result of reduced rental income following the sale of two operating properties during the second quarter of 2015. The increase during the nine months ended September 30, 2015 was primarily due to rental income from a real estate property obtained via foreclosure in December 2014, increased rental rates and/or occupancy on certain of our properties during 2014 and 2015 and increased income from the Tahoe Stateline Venture retail property that was completed and partially occupied during the fourth quarter of 2014, net of the reduction in rental income following the sale of two operating properties during the second quarter of 2015.

#### Total Expenses

Management fees amounted to approximately \$513,000 and \$436,000 for the three months ended September 30, 2015 and 2014, respectively, and \$1,410,000 and \$1,276,000 for the nine months ended September 30, 2015 and 2014, respectively. Servicing fees amounted to approximately \$47,000 and \$40,000 for the three months ended September 30, 2015 and 2014, respectively, and \$128,000 and \$116,000 for the nine months ended September 30,

2015 and 2014, respectively.

The maximum management and servicing fees were paid to the Manager during the three and nine months ended September 30, 2015 and 2014.

The maximum management fee permitted under the Management Agreement is 2.75% per year of the average unpaid balance of mortgage loans. For the nine months ended September 30, 2015 (annualized) and the calendar years 2014, 2013 and 2012, the management fees were 2.75%, 2.75%, 2.74% and 2.67% of the average unpaid balance of mortgage loans, respectively.

In determining the management fees, the Manager may consider a number of factors, including current market yields, delinquency experience, un-invested cash and real estate activities. The Manager expects that the management fees it receives from us will vary in amount and percentage from period to period. During the three and nine months ended September 30, 2015 and 2014, the Manager chose to take the maximum compensation that it is able to take pursuant to the charter and will likely continue to take the maximum compensation for the foreseeable future.

General and administrative expense increased \$7,000 (2.4%) and decreased \$139,000 (12.8% decrease) during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014. The decrease during the nine month period was due primarily to lower legal, appraisal, consulting and insurance expenses during 2015 as compared to 2014.

Rental and other expenses on real estate properties increased \$10,000 (0.5% increase) and \$468,000 (7.9% increase) during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014. The increases were primarily due to expenses incurred on the assisted living facility located in Bensalem, Pennsylvania that was obtained via foreclosure in December 2014 and the completion of the retail complex owned by TSV during the fourth quarter of 2014, and, thus, there was a full nine months of operating expenses for these properties during 2015. A significant portion of the TSV expenses were charged to tenants as common area maintenance (“CAM”) reimbursements and reflected in the increase in revenue for the property during the period. These increased expenses were partially offset by a decrease in expenses as a result of the sale of four properties during the first half of 2015.

Depreciation and amortization expense decreased \$23,000 (4.2% decrease) and increased \$69,000 (4.2% increase) during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014. The decrease during the quarter ended September 30, 2015 was primarily a result of the sale of two operating properties during the second quarter of 2015. The increase during the nine months ended September 30, 2015 was primarily a result of depreciation recorded on the assisted living facility obtained via foreclosure in December 2014 and the completion of the retail complex owned by TSV during the fourth quarter of 2014 (and, thus, the commencement of depreciation on that property in late 2014), net of a reduction in depreciation for certain properties that were moved from held for investment to held for sale and the sale of two operating properties during the second quarter of 2015.

Interest expense increased \$16,000 (4.7% increase) and \$694,000 (96.6% increase) during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014, due to interest incurred on our lines of credit, the loans payable within TOTB and TSV and the amortization of deferred financing costs to interest expense from these debt instruments during the three and nine months ended September 30, 2015. All of these debt facilities (other than the CB&T and Opus Credit Facilities) began to incur interest expense subsequent to the third quarter of 2014.

Bad debt expense increased \$150,000 and \$149,000 during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014, due to the write-off of rent receivable in the amount of \$150,000 related to the assisted living facility located in Bensalem, Pennsylvania during the quarter ended September 30, 2015.

The provision for loan losses of \$44,000 and \$472,000 during the three and nine months ended September 30, 2015, respectively, was the result of an analysis performed on the loan portfolio. The general loan loss allowance

increased \$108,000 and \$542,000 during the three and nine months ended September 30, 2015, respectively, due to an increase in the balance of performing loans during the three and nine month periods (net of payoffs). There was also an increase in the balance of both land and residential loans which have a higher historical loss factor for purposes of the general allowance calculation. The specific loan loss allowance decreased \$64,000 and 70,000 during the three and nine months ended September 30, 2015, respectively, due to adjustments to the reserve on one impaired loan.

The provision for loan losses of \$118,000 and \$141,000 during the three and nine months ended September 30, 2014, respectively, was the result of an analysis performed on the loan portfolio. The general loan loss allowance increased \$110,000 and \$60,000 during the three and nine months ended September 30, 2014, respectively, primarily due to an increase in the balance of performing loans as a result of new loan originations during 2014 (net of payoffs). There was also an adjustment to the historical loss factor at the beginning of 2014. The specific loan loss allowance increased \$81,000 during the nine months ended September 30, 2014, primarily because a reserve was established during 2014 on a newly impaired loan with a principal balance of \$690,000.

Impairment losses on real estate properties decreased \$124,000 and increased \$1,077,000 during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014. The impairment losses on real estate properties of \$1,256,000 during the nine months ended September 30, 2015 was the result of a decrease in the listing price of the unimproved residential and commercial land located in Gypsum, Colorado and a reduction in the fair market value estimated by management.

#### Gain on Sales of Real Estate

Gain on sales of real estate decreased \$113,000 and increased \$12,291,000 during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014. The decrease during the quarter ended September 30, 2015 was due to the fact that no properties were sold during the third quarter of 2015, whereas we sold one residential lot during the third quarter of 2014. The increase during the nine months ended September 30, 2015 was a result of the sale of four real estate properties during the nine month period, resulting in gains totaling \$14,879,000 (see further detail under “*Real Estate Properties Held for Sale and Investment*” below). We also recognized \$152,000 of deferred gain under the installment method related to the sale of the condominiums located in Santa Barbara, California in 2012 due to the remaining repayment of the carry back loan during the first quarter of 2015.

During the nine months ended September 30, 2014, we recorded deferred gains under the installment method totaling \$2,626,000 related to the sale of the condominiums located in Santa Barbara, California in 2012 (and held within Anacapa Villas, LLC), the condominiums located in Oakland, California in 2013 (and held within 1401 on Jackson, LLC) and the parcel of land located in Lake Charles, Louisiana in 2013 (and held within Dation, LLC) due to full or partial principal repayments received on the carry back loans during the periods.

#### Net Income Attributable to Non-Controlling Interests

Net income attributable to non-controlling interests decreased \$52,000 and increased \$2,479,000 during the three and nine months ended September 30, 2015, respectively, as compared to the same periods in 2014. The decrease during the quarter ended September 30, 2015 was primarily a result of the sale of the property owned by 720 University during the second quarter of 2015, and, thus, there was a much smaller amount of net income attributable to non-controlling interests for this property. The increase during the nine months ended September 30, 2015 was because a portion of the gain on sale of real estate in the amount of approximately \$2,479,000 was attributable to our joint venture partner in 720 University, LLC (as the shopping center owned by this entity was sold in June 2015).

## Financial Condition

*September 30, 2015 and December 31, 2014*

### Loan Portfolio

During the quarter ended September 30, 2015, we originated nine new loans with aggregate principal balances totaling \$9,474,000 (\$10,837,000 if fully funded). Five of these loans are incrementally funded for construction, renovation and/or interest and have \$1,190,000 available to be funded in the future. We also received full or partial payoffs on five loans totaling \$3,944,000 during the quarter.

The number of loans in our portfolio increased from 34 to 45 and the average loan balance decreased from \$2,001,000 to \$1,707,000, between December 31, 2014 and September 30, 2015.

As of September 30, 2015 and December 31, 2014, we had four and six loans that were impaired totaling approximately \$10,290,000 (13%) and \$22,316,000 (33%), respectively, including two past maturity loans totaling \$8,614,000 (11%) and \$8,614,000 (13%), respectively. In addition, one loan of approximately \$862,000 (1%) was past maturity but current with respect to monthly payments as of December 31, 2014, (combined total of impaired and past maturity loans of \$10,290,000 (13%) and \$23,178,000 (34%), respectively). Of the impaired and past maturity loans, one loan with a principal balance of \$1,432,000 was in the process of foreclosure as of September 30, 2015. No loans were in the process of foreclosure as of December 31, 2014, and no loans involved borrowers who were in bankruptcy as of September 30, 2015 and December 31, 2014.

As of September 30, 2015 and December 31, 2014, approximately \$76,589,000 (99.7%) and \$67,780,000 (99.6%) of our loans are interest-only and/or require the borrower to make a “balloon payment” on the principal amount upon maturity of the loan. To the extent that a borrower has an obligation to pay mortgage loan principal in a large lump sum payment, its ability to satisfy this obligation may be dependent upon its ability to sell the property, obtain suitable refinancing or otherwise raise a substantial cash amount. As a result, these loans involve a higher risk of default than fully amortizing loans. Borrowers occasionally are not able to pay the full amount due at the maturity date. We may allow these borrowers to continue making the regularly scheduled monthly interest payments for certain periods of time to assist the borrower in meeting the balloon payment obligation without formally filing a notice of default. These loans for which the principal is due and payable, but the borrower has failed to make such payment of principal, are referred to as “past maturity loans”. As of September 30, 2015 and December 31, 2014, we had two and three past maturity loans totaling approximately \$8,614,000 and \$9,476,000, respectively.

As of September 30, 2015 and December 31, 2014, we held the following types of loans:

	<u>September 30,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>
<u>By Property Type:</u>		
Commercial	\$ 51,011,804	\$ 52,531,537
Residential	19,779,734	13,491,906
Land	6,042,548	2,010,068
	<u>\$ 76,834,086</u>	<u>\$ 68,033,511</u>
<u>By Position:</u>		
Senior loans	\$ 73,805,384	\$ 65,533,511
Junior loans*	3,028,702	2,500,000
	<u>\$ 76,834,086</u>	<u>\$ 68,033,511</u>

\* The junior loan in our portfolio at December 31, 2014 was junior to an existing senior loan held by us and was secured by the same collateral. This loan was paid off during 2015.

The types of property securing our commercial real estate loans are as follows as of September 30, 2015 and December 31, 2014:

	<u>September 30, 2015</u>	<u>December 31, 2014</u>
<u>Commercial Real Estate Loans:</u>		
Retail	\$ 9,195,944	\$ 7,591,592
Office	13,748,033	25,742,246
Apartment	14,460,827	9,622,580
Industrial	3,065,130	3,080,000
Marina	3,500,000	3,200,000
Church	1,175,000	1,175,000
Restaurant	400,000	1,058,567
Storage	2,673,021	—
Hotel	1,650,000	—
Golf course	1,143,849	1,061,552
	<u>\$ 51,011,804</u>	<u>\$ 52,531,537</u>

Scheduled maturities of loan investments as of September 30, 2015 and the interest rate sensitivity of such loans are as follows:

	<u>Fixed Interest Rate</u>	<u>Variable Interest Rate</u>	<u>Total</u>
Year ending September 30:			
2015 (past maturity)	\$ 8,613,752	\$ —	\$ 8,613,752
2016	23,918,144	1,450,000	25,368,144
2017	30,423,957	5,683,539	36,107,496
2018	3,000,000	3,500,000	6,500,000
2019	—	—	—
2020	—	—	—
Thereafter (through Mar. 2028)	244,694	—	244,694
	<u>\$ 66,200,547</u>	<u>\$ 10,633,539</u>	<u>\$ 76,834,086</u>

Our variable rate loans currently use as an index the 6 Month LIBOR rate (0.53% as of September 30, 2015), or include terms whereby the interest rate is adjusted at a specific later date. Premiums over the index vary for each loan and all such loans have specified floor rates.

The following is a schedule by geographic location of loan investments as of September 30, 2015 and December 31, 2014:

	<u>September 30, 2015</u>	<u>Portfolio</u>	<u>December 31, 2014</u>	<u>Portfolio</u>
	<u>Balance</u>	<u>Percentage</u>	<u>Balance</u>	<u>Percentage</u>
Arizona	\$ 10,208,021	13.29%	\$ 8,788,098	12.92%
California	61,433,517	79.96%	54,685,345	80.38%
Hawaii	1,450,000	1.89%	1,450,000	2.13%
Nevada	2,200,000	2.86%	—	—%
Oregon	150,000	0.19%	1,250,000	1.84%
Washington	1,392,548	1.81%	1,860,068	2.73%
	<u>\$ 76,834,086</u>	<u>100.00%</u>	<u>\$ 68,033,511</u>	<u>100.00%</u>

As of September 30, 2015 and December 31, 2014, our loans secured by real property collateral located in Northern California totaled approximately 76% (\$58,450,000) and 78% (\$53,073,000), respectively, of the loan portfolio. The Northern California region (which includes Monterey, Fresno, Kings, Tulare and Inyo counties and all counties north) is a large geographic area which has a diversified economic base. The ability of borrowers to repay loans is influenced by the economic strength of the region and the impact of prevailing market conditions on the value of real estate.

The allowance for loan losses increased by \$472,000 and \$141,000 during the nine months ended September 30, 2015 and 2014, respectively. The Manager believes that the allowance is appropriate given the estimated underlying collateral values of impaired loans and estimates of probable incurred credit losses on loans not considered to be impaired. There is no precise method used by the Manager to predict delinquency rates or losses on specific loans. The Manager has considered the number and amount of delinquent loans, loans subject to workout agreements and loans in bankruptcy in determining the allowance for loan losses, but there can be no absolute assurance that the allowance is sufficient. Because any decision regarding allowance for loan losses reflects judgment about the probability of losses yet to be realized, there is an inherent risk that such judgments will prove incorrect. Upon realization, actual losses may exceed (or be less than) the amount of any reserve. To the extent that we experience losses greater than the amount of our reserves, we may incur a charge to earnings that will adversely affect operating results and the amount of any dividends paid.

Changes in the allowance for loan losses for the nine months ended September 30, 2015 and 2014 were as follows:

	September 30, 2015	September 30, 2014
Balance, beginning of period	\$ 2,869,355	\$ 4,739,088
Provision for loan losses	472,359	141,032
Charge-offs	—	—
Balance, end of period	<u>\$ 3,341,714</u>	<u>\$ 4,880,120</u>

As of September 30, 2015 and December 31, 2014, there was a general allowance for loan losses of \$1,022,364 and \$480,000, respectively, and a specific allowance for loan losses on two loans in the total amount of \$2,319,350 and \$2,389,355, respectively. The increase in the general allowance during the nine months ended September 30, 2015 was because the balances of land and residential loans in our portfolio, which loan types have higher historical loss factors, increased at a proportionately greater rate than the balance of commercial loans.

### **Real Estate Properties Held for Sale and Investment**

As of September 30, 2015, the Company held title to twenty-eight properties that were acquired through foreclosure with a total carrying amount of approximately \$158,586,000 (including properties held in one corporation and eleven limited liability companies), net of accumulated depreciation on real estate held for investment of \$2,591,000. As of September 30, 2015, properties held for sale total \$104,681,000 and properties held for investment total \$53,905,000. When we acquire property by foreclosure, we typically earn less income on those properties than could be earned on loans and may not be able to sell the properties in a timely manner.

Real estate properties held for sale as of September 30, 2015 and December 31, 2014 consists of the following properties acquired through foreclosure:

	<u>September 30, 2015</u>	<u>December 31, 2014</u>
Retail complex, Greeley, Colorado (held within 720 University, LLC) – sold in 2015	\$ —	\$ 11,547,472
Undeveloped, industrial land, San Jose, California – transferred from held for investment in 2015	1,958,400	—
Light industrial building, Paso Robles, California – transferred from held for investment in 2015	1,422,308	—
Storage facility/business, Stockton, California – transferred from held for investment in 2015	3,782,526	—
Marina with 30 boat slips and 11 RV spaces, Oakley, California (held within The Last Resort and Marina, LLC) – transferred from held for investment in 2015	236,500	—
Golf course, Auburn, California (held within Lone Star Golf, Inc.) – transferred to held for investment in 2015	—	2,020,410
Industrial building, Sunnyvale, California (held within Wolfe Central, LLC) – transferred from held for investment in 2015 – sold in 2015	—	—
133 condominium units, Phoenix, Arizona (held within 54 <sup>th</sup> Street Condos, LLC) – transferred from held for investment in 2015	6,852,989	—
Medical office condominium complex, Gilbert, Arizona (held within AMFU, LLC)	4,716,159	4,716,159
Commercial buildings, Sacramento, California – sold in 2015	—	3,890,968
169 condominium units and 160 unit unoccupied apartment building under renovation, Miami, Florida (held within TOTB Miami, LLC) – transferred from held for investment in 2015	47,369,737	—
Unimproved, residential and commercial land, Gypsum, Colorado	4,557,000	5,813,434
Commercial and residential land under development, South Lake Tahoe, California (held within Tahoe Stateline Venture, LLC) *	23,033,645	30,449,896
Commercial and residential land under development, South Lake Tahoe, California (held within Zalanta Resort at the Village, LLC) *	10,751,842	—
Retail buildings, San Jose, California – sold in 2015	—	1,056,000
	<u>\$ 104,681,106</u>	<u>\$ 59,494,339</u>

\* These two real estate assets had previously been reported as one asset. In the second quarter of 2015, certain parcels owned by Tahoe Stateline Venture, LLC were transferred into Zalanta Resort at the Village, LLC, a new entity that is wholly owned by the Company, to prepare for the proposed second phase retail/condominium project.

Real estate held for investment is comprised of the following properties as of September 30, 2015 and December 31, 2014:

	<u>September 30, 2015</u>	<u>December 31, 2014</u>
Light industrial building, Paso Robles, California – transferred to held for sale in 2015	\$ —	\$ 1,459,063
Commercial buildings, Roseville, California	710,703	731,906
Undeveloped, residential land, Madera County, California	726,580	726,580
Undeveloped, residential land, Marysville, California	403,200	403,200
Undeveloped land, Auburn, California (formerly part of golf course owned by DarkHorse Golf Club, LLC)	103,198	103,198
75 improved, residential lots, Auburn, California (held within Baldwin Ranch Subdivision, LLC)	3,878,544	3,878,544
Undeveloped, industrial land, San Jose, California – transferred to held for sale in 2015	—	1,958,400
Storage facility/business, Stockton, California – transferred to held for sale in 2015	—	3,847,884
One and two improved residential lots, West Sacramento, California	58,560	58,560
Undeveloped, residential land, Coolidge, Arizona	1,017,600	1,017,600
Marina with 30 boat slips and 11 RV spaces, Oakley, California (held within The Last Resort and Marina, LLC) – transferred to held for sale in 2015	—	236,500
Golf course, Auburn, California (held within Lone Star Golf, Inc.) – transferred from held for sale in 2015	1,951,252	—
Office condominium complex (15 units), Roseville, California	3,589,840	3,684,203
Industrial building, Sunnyvale, California (held within Wolfe Central, LLC) – transferred to held for sale in 2015	—	3,027,734
133 condominium units, Phoenix, Arizona (held within 54 <sup>th</sup> Street Condos, LLC) – transferred to held for sale in 2015	—	6,933,229
61 condominium units, Lakewood, Washington (held within Phillips Road, LLC)	4,255,929	4,364,743
169 condominium units and 160 unit unoccupied apartment building under renovation, Miami, Florida (held within TOTB Miami, LLC) – transferred to held for sale in 2015	—	34,353,958
1/7 <sup>th</sup> interest in single family home, Lincoln City, Oregon	93,647	93,647
12 condominium and 3 commercial units, Tacoma, Washington (held within Broadway & Commerce, LLC)	2,372,348	2,408,681
6 improved residential lots, Coeur D’Alene, Idaho	316,800	316,800
Retail Complex, South Lake Tahoe, California (held within Tahoe Stateline Venture, LLC)	23,278,649	23,211,896
Marina and yacht club with 179 boat slips, Isleton, California (held within Brannan Island, LLC)	2,612,585	2,220,448
Unimproved, residential and commercial land, Bethel Island, California (held within Sandmound Marina, LLC)	2,334,773	2,334,773
Marina with 52 boat slips and campground, Bethel Island, California (held within Sandmound Marina, LLC)	1,127,883	1,145,919
Assisted living facility, Bensalem, Pennsylvania	5,073,316	5,005,000
	<u>\$ 53,905,407</u>	<u>\$ 103,522,466</u>

Changes in real estate held for sale and investment during the nine months ended September 30, 2015 and 2014 were as follows:

	<u>September 30, 2015</u>	<u>September 30, 2014</u>
Balance, beginning of period	\$ 163,016,805	\$ 135,315,964
Real estate acquired through foreclosure, net of specific loan loss allowance	—	3,498,240
Investments in real estate properties	17,818,304	18,863,140
Amortization of deferred finance costs capitalized into construction project	155,510	69,116
Sales of real estate properties	(19,500,491)	(60,427)
Impairment losses on real estate properties	(1,256,434)	(179,040)
Depreciation of properties held for investment	<u>(1,647,181)</u>	<u>(1,563,210)</u>
Balance, end of period	<u>\$ 158,586,513</u>	<u>\$ 155,943,783</u>

Thirteen of the Company's twenty-eight properties do not currently generate revenue. For the nine months ended September 30, 2014 and 2015, expenses from real estate properties (not including depreciation, bad debt expense and impairment losses) have increased from approximately \$5,952,000 to \$6,420,000 (7.9% increase), respectively, and revenues associated with these properties have increased from approximately \$8,937,000 to \$9,983,000 (11.7% increase), respectively, thus generating net income (not including depreciation, bad debt expense and impairment losses) from real estate properties of \$3,563,000 during the nine months ended September 30, 2015 (compared to \$2,984,000 for the same period in 2014).

During the nine months ended September 30, 2015, we recorded an impairment loss of approximately \$1,256,000 on the unimproved residential and commercial land located in Gypsum, Colorado due to a decrease in the listing price of the property and a reduction in the fair market value estimated by management.

During the three and nine months ended September 30, 2014, we recorded an impairment loss of \$124,000 and \$179,000, respectively, on the marina property located in Oakley, California due to a recent decrease in the listing price of the property and a reduction in the fair market value recently estimated by management.

### **Sales Activity**

During the nine months ended September 30, 2015, we sold four real estate properties with details as follows:

	<u>Net Sales Proceeds</u>	<u>Gain</u>
Retail complex, Greeley, Colorado (held within 720 University, LLC)*	\$ 20,318,559	\$ 8,642,156
Industrial building, Sunnyvale, California (held within Wolfe Central, LLC)	8,284,081	4,920,957
Commercial buildings, Sacramento, California	5,153,713	1,262,745
Retail buildings, San Jose, California	<u>1,108,820</u>	<u>52,820</u>
	<u>\$ 34,865,173</u>	<u>\$ 14,878,678</u>

\* \$9,771,000 of proceeds were used to pay off debt securing the property and \$2,479,000 was distributed to the non-controlling interest.

In addition to the above table, we recognized gain of approximately \$152,000 during the nine months ended September 30, 2015 that had previously been deferred related to the sale of a real estate property in 2012. The gain on the sale of this property was being accounted for under the installment method.

During the quarter ended September 30, 2014, we sold one of the improved, residential lots located in West Sacramento, California for \$175,000, resulting in a gain of approximately \$105,000.

We recognized gains of approximately \$2,626,000 during the nine months ended September 30, 2014 that had previously been deferred related to the sales of real estate properties in 2012 and 2013. The gains on the sales of those properties were being accounted for under the installment method.

### ***Foreclosure Activity***

We foreclosed on no loans during the nine months ended September 30, 2015.

During the nine months ended September 30, 2014, Sandmound, a wholly owned limited liability company of the Company, foreclosed on a first mortgage loan secured by unimproved land and a marina and campground located in Bethel Island, California with a principal balance of \$2,960,000 and obtained the properties via the trustee's sale. In addition, advances made on the loan or incurred as part of the foreclosure (such as legal fees and delinquent property taxes) in the total amount of approximately \$282,000 were capitalized to the basis of the properties. The fair market values of the properties acquired were estimated to be higher than Sandmound's recorded investment in the subject loan, and, thus, a gain on foreclosure in the amount of approximately \$257,000 was recorded.

### ***Majority and Wholly-Owned Limited Liability Companies***

#### **720 University, LLC**

We have an investment in a limited liability company, 720 University, LLC (720 University), which owned a commercial retail property located in Greeley, Colorado. We receive 65% of the profits and losses in 720 University after priority return on partner contributions is allocated at the rate of 10% per annum. The assets, liabilities, income and expenses of 720 University have been consolidated into the accompanying consolidated balance sheets and statements of operations of the Company.

In November 2014, 720 University entered into a Real Estate Sale Agreement pursuant to which 720 University agreed to sell the property for \$20,750,000. On January 30, 2015, an initial closing was held for the purpose of refinancing the existing 720 University note payable, and the buyer extended a new loan to 720 University to repay the existing note payable to the bank. The principal amount of the new loan was \$9,771,263 and accrued interest at 6.0% per annum until paid off upon the closing of the sale of the property to the buyer. The sale closed on June 15, 2015 resulting in gain on sale of approximately \$8,642,000 (\$6,163,000 to the Company after the gain attributable to the non-controlling interest or approximately \$2,479,000).

The net income to the Company from 720 University was approximately \$27,000 and \$107,000 during the three months ended September 30, 2015 and 2014, respectively, and \$6,439,000 and \$145,000 during the nine months ended September 30, 2015 and 2014, respectively. The non-controlling interest of the joint venture partner was approximately \$115,000 and \$5,000 as of September 30, 2015 and December 31, 2014, respectively.

#### **TOTB Miami, LLC**

During the year ended December 31, 2011, the Company and two co-lenders (which included OFG and PRC Treasures, LLC, or PRC) foreclosed on a participated, first mortgage loan secured by a condominium complex located in Miami, Florida with a principal balance to the Company of approximately \$26,257,000 and obtained an undivided interest in the properties via the trustee's sale. The Company and the other lenders formed a Florida limited liability company, TOTB Miami, LLC ("TOTB"), to own and operate the complex. The complex consists of three buildings, two of which have been renovated and are being leased, and in which 169 units remain unsold and one which has been contributed to a wholly-owned subsidiary of TOTB, TOTB North, and contains 160 vacant units that are currently being renovated. Based on an appraisal, it was determined that the fair value of the property was lower than our total investment in the loan (including a previously established loan loss allowance of \$10,188,000) and an additional charge to provision for loan losses of approximately \$450,000 was recorded at the time of foreclosure during the first quarter of 2011 (total charge-off of \$10,638,000).

In March 2012, we made a priority capital contribution to TOTB in the amount of \$7,200,000. TOTB then purchased PRC's member interest in TOTB for \$7,200,000. Thus, the remaining members in TOTB are now the

Company and OFG. On the same date, the Company and OFG executed an amendment to the TOTB operating agreement to set the percentage of capital held by each at 80.74% for the Company and 19.26% for OFG based on the dollar amount of capital invested in TOTB (excluding any Preferred Class A Units). Income and loss allocations are made based on these percentages. The change in capital as a result of the PRC buyout and the amended agreement resulted in an increase to our capital of approximately \$2,760,000.

During the year ended December 31, 2014, TOTB contributed the vacant and unimproved 160 unit apartment building to a new wholly-owned entity, TOTB North. TOTB North then entered into a construction loan agreement which will provide up to \$21,304,000 for the purpose of renovating and improving the apartment building. As of September 30, 2015 and December 31, 2014, approximately \$10,946,000 and \$1,008,000, respectively, had been drawn from the construction loan. In addition, TOTB North has entered into various contracts for the design, engineering, first phase demolition and concrete remediation and second phase construction for the renovation project in the aggregate amount of approximately \$21,042,000 of which approximately \$13,963,000 had been incurred as of September 30, 2015. In addition, another \$1,638,000 in renovation-related costs, interest, property taxes, and amortization of deferred financing costs have been capitalized (total of \$15,601,000) as of September 30, 2015. During the year ended December 31, 2014, the Company and OFG contributed approximately \$453,000 and \$108,000, respectively, to TOTB to fund the initial \$1,000,000 deposit required pursuant to the construction loan agreement. In addition, during the nine months ended September 30, 2015, the Company and OFG contributed an additional \$1,170,000 and \$279,000, respectively, due to increased construction costs on the project.

During 2014, TOTB entered into a new loan agreement whereby it borrowed \$13,000,000 secured by 154 of the 169 renovated and leased condominium units located in the Pointe building. The outstanding balance as of September 30, 2015 and December 31, 2014 was approximately \$12,754,000 and \$12,975,000, respectively. The loan bears interest at the floating daily three month LIBOR rate of interest plus 4.0% per annum, but in no event will the rate be lower than 4.25%. The interest rate as of September 30, 2015 was 4.33%. Principal and interest are payable monthly with principal amortizing over 300 months. The initial maturity date is November 16, 2017 which may be extended for two additional one year periods if all conditions in the loan agreement are met. The net cash proceeds from the new loan were distributed to the members of TOTB during 2014 (\$10,256,000 to ORM and \$2,446,000 to OFG).

During the quarter ended September 30, 2015, the Company moved the TOTB property from held for investment to held for sale as it is now being actively marketed and a sale is expected within the next year.

The net income to the Company from TOTB was approximately \$72,000 and \$336,000 during the three months ended September 30, 2015 and 2014, respectively, and \$152,000 and \$545,000 during the nine months ended September 30, 2015 and 2014, respectively. The noncontrolling interest of OFG totaled approximately \$4,486,000 and \$4,170,000 as of September 30, 2015 and December 31, 2014, respectively.

The decrease in net income between 2014 and 2015 is primarily related to the new debt obtained on the Pointe building units at the end of 2014 which resulted in interest expense being incurred during 2015.

The approximate net income (loss) from our real estate properties held within wholly-owned limited liability companies and a wholly owned corporation and other investment properties with significant operating results (including gains/losses from sales and impairment losses), for the nine months ended September 30, 2015 and 2014 not already discussed above are included in the table below. The information presented includes only the revenues and expenses directly related to the properties and no allocations have been made for overhead and other expenses the Company incurs that are not directly related to an individual property.

	<u>2015</u>	<u>2014</u>
Lone Star Golf, Inc.	\$ (133,000)	\$ 11,000
Baldwin Ranch Subdivision, LLC	(73,000)	(81,000)
The Last Resort and Marina, LLC	(18,000)	(195,000)
54 <sup>th</sup> Street Condos, LLC	335,000	24,000
Wolfe Central, LLC (including gain on sale)	5,122,000	298,000
AMFU, LLC	102,000	(8,000)
Phillips Road, LLC	68,000	85,000
Broadway & Commerce, LLC	40,000	36,000
Brannan Island, LLC	(50,000)	(2,000)
Piper Point Marina- held in Sandmound Marina, LLC	(53,000)	(36,000)
Tahoe Stateline Venture, LLC	(78,000)	(27,000)
Zalanta Resort at the Village, LLC	(76,000)	—
Light industrial building, Paso Robles, California	231,000	138,000
Undeveloped industrial land, San Jose, California	(94,000)	(92,000)
Office buildings, Roseville, California	5,000	4,000
Office condominium complex, Roseville, California	29,000	(23,000)
Storage facility/business, Stockton, California	297,000	231,000
Undeveloped land, Gypsum, Colorado*	(1,401,000)	(159,000)
Assisted living facility, Bensalem, Pennsylvania	(299,000)	—

\* Includes impairment losses totaling \$1,256,000 in 2015.

### **Cash, Cash Equivalents and Restricted Cash**

Cash, cash equivalents and restricted cash increased from approximately \$7,662,000 as of December 31, 2014 to \$14,203,000 as of September 30, 2015 (\$6,541,000 or 85.4% increase) due primarily to the sale of four real estate properties during the nine months ended September 30, 2015 for net sales proceeds to the Company of approximately \$22,615,000 (after distribution to non-controlling interest of \$2,479,000 and repayment of debt of \$9,771,000 on the 720 University property sale) and an additional advance on the TSV loan payable in the amount of \$3,830,000 during the quarter ended September 30, 2015. The increase in cash from the sales and advance from the TSV loan were partially used to repay the lines of credit and to fund new loan originations during the nine month period.

### **Interest and Other Receivables**

Interest and other receivables increased from approximately \$1,482,000 as of December 31, 2014 to \$1,689,000 as of September 30, 2015 (\$207,000 or 13.9% increase) due primarily to increased interest income receivable on loans due to an increase in performing loans in the portfolio since December 31, 2014.

### **Other Assets**

Other assets decreased from approximately \$1,138,000 as of December 31, 2014 to \$682,000 as of September 30, 2015 (\$456,000 or 40.1% decrease) due primarily to the sales of the shopping center in Greeley, Colorado (720 University) and the industrial building in Sunnyvale, California (Wolfe Central) and the resulting de-recognition of

net lease commissions and deferred rent related to those properties.

### **Deferred Financing Costs**

Deferred financing costs decreased from approximately \$1,318,000 as of December 31, 2014 to \$937,000 as of September 30, 2015 (\$381,000 or 28.9% decrease) due to amortization of deferred financing costs during the nine month period. In addition, we paid approximately \$42,000 in deferred financing costs during the second quarter of 2015 related to the additional \$10,000,000 credit added to the CB&T Credit Facility during the quarter.

### **Dividends Payable**

Dividends payable decreased from approximately \$1,292,000 as of December 31, 2014 to \$836,000 as of September 30, 2015 (\$457,000 or 35.3% increase) because the dividend declared and accrued as of September 30, 2015 included only a regular dividend of \$0.08 per share, whereas the December 31, 2014 dividend included a regular dividend of \$0.05 per share and a special dividend of \$0.07 per share (total of \$0.12 per share).

### **Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities increased from approximately \$2,220,000 as of December 31, 2014 to approximately \$4,654,000 as of September 30, 2015 (\$2,434,000 or 109.7% increase) due primarily to increased payables related to the construction activities on the property owned by TOTB North as the main construction project commenced in the beginning of 2015 and the property owned by Zalanta Resort at the Village, LLC as foundation work on the project commenced during the third quarter.

### **Deferred Gains**

Deferred gains decreased from approximately \$362,000 as of December 31, 2014 to approximately \$210,000 as of September 30, 2015 (\$152,000 or 42.1% decrease) due to the receipt of the remaining principal repayment on one carryback loan during the nine months ended September 30, 2015, resulting in the recognition of additional gain under the installment method of \$152,000.

### **Lines of Credit Payable**

Lines of credit payable decreased from \$11,450,000 as of December 31, 2014 to \$8,954,000 as of September 30, 2015 (\$2,496,000 or 21.8% decrease) due to the receipt of proceeds from the sales of four real estate properties during the nine months ended September 30, 2015, which allowed us to partially repay the balances on the lines of credit.

### **Notes and Loans Payable on Real Estate**

Notes and loans payable increased from \$37,570,000 as of December 31, 2014 to \$41,198,000 as of September 30, 2015 (\$3,628,000 or 9.7% increase) due primarily to additional advances on the TOTB North construction loan of \$9,938,000 and an additional advance taken on the TSV loan of \$3,830,000, net of the full repayment of the note payable securing the 720 University shopping center in the amount of \$9,771,000 at the time of sale in June 2015 and principal payments totaling \$398,000 on the loans securing the TOTB Miami condominium units and the TSV retail property.

### **Noncontrolling Interests**

Noncontrolling interests increased from approximately \$4,175,000 as of December 31, 2014 to approximately \$4,601,000 as of September 30, 2015 (\$426,000 or 10.2% increase), due primarily to a cash contribution made by OFG of \$279,000 during 2015 as a result of additional deposits needed from the members for the TOTB North construction project prior to being able to borrow additional funds from the construction loan.

## Non-GAAP Financial Measures

### *Funds from Operations*

We utilize supplemental non-GAAP measures of operating performance, including funds from operations (“FFO”), an industry-wide standard measure of REIT operating performance. We believe FFO provides investors with additional information concerning our operating performance and a basis to compare our performance with that of other REITs. We determine FFO in accordance with the standards established by the National Association of Real Estate Investment Trusts (“NAREIT”), as net income (loss) attributable to common stockholders (computed in accordance with GAAP), plus depreciation and amortization of real estate and other assets, amortization of deferred financing costs, impairments of real estate assets, provisions for loan losses and losses from sales of real estate, reduced by gains from sales of real estate and foreclosures of loans, accretion of discounts on loans and extraordinary items, and after adjustments for unconsolidated ventures.

Our calculation of FFO may not be comparable to similar measures reported by other REITs. This non-GAAP financial measure should not be considered as an alternative to net income as a measure of our operating performance or to cash flows computed in accordance with GAAP as a measure of liquidity, nor is it indicative of cash flows from operating and financial activities.

We urge investors to carefully review the GAAP financial information included as part of our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and quarterly earnings releases.

The following table reconciles FFO to comparable GAAP financial measures:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
<b>Funds from Operations</b>				
Net income attributable to common stockholders	\$ 384,321	\$ 783,823	\$ 15,296,817	\$ 4,355,270
Adjustments:				
Depreciation and amortization of real estate and other assets	526,178	549,189	1,712,136	1,642,922
Depreciation allocated to non-controlling interests	(28,800)	(32,241)	(90,569)	(96,806)
Amortization of deferred financing costs	96,749	42,335	266,862	78,261
Accretion of discount on loan to interest income	—	(36,600)	(536,816)	(85,403)
Provisions for impairment of real estate assets	—	123,500	1,256,434	179,040
Provision for loan losses	44,316	117,680	472,359	141,032
Gain on sales of real estate assets	—	(113,113)	(15,031,299)	(2,740,105)
Gain on sale allocated to non-controlling interest	—	—	2,479,268	—
Gain on foreclosure of loan	—	—	—	(257,020)
Adjustments for unconsolidated ventures	(44,605)	(43,686)	(45,483)	(42,357)
FFO attributable to common stockholders	<u>\$ 978,159</u>	<u>\$ 1,390,887</u>	<u>\$ 5,779,709</u>	<u>\$ 3,174,834</u>
Basic and diluted FFO per common share	<u>\$ 0.09</u>	<u>\$ 0.13</u>	<u>\$ 0.54</u>	<u>\$ 0.29</u>

Note: FFO for the nine months ended September 30, 2015 includes the collection of past due interest related to an impaired loan that the Company foreclosed on during 2014 of approximately \$1,723,000.

## Asset Quality

A consequence of lending activities is that losses will be experienced and that the amount of such losses will vary from time to time, depending on the risk characteristics of the loan portfolio as affected by economic conditions and the financial experiences of borrowers. Many of these factors are beyond our control. There is no precise method of predicting specific losses or amounts that ultimately may be charged off on specific loans or on segments of the loan portfolio.

The conclusion that a Company loan may become uncollectible, in whole or in part, is a matter of judgment. Although institutional lenders are subject to regulations that, among other things, require them to perform ongoing analyses of their loan portfolios (including analyses of loan-to-value ratios, reserves, etc.), and to obtain current information regarding their borrowers and the securing properties, we are not subject to these regulations and have not adopted these practices. Rather, management, in connection with the quarterly closing of our accounting records and the preparation of the financial statements, evaluates our loan portfolio. The allowance for loan losses is established through a provision for loan losses based on management's evaluation of the risk inherent in our loan portfolio and current economic conditions. Such evaluation, which includes a review of all loans on which the management determines that full collectability may not be reasonably assured, considers among other matters the following:

- prevailing economic conditions;
- our historical loss experience;
- the types and dollar amounts of loans in the portfolio;
- borrowers' financial condition and adverse situations that may affect the borrowers' ability to pay;
- evaluation of industry trends;
- review and evaluation of loans identified as having loss potential; and
- estimated net realizable value or fair value of the underlying collateral.

Based upon this evaluation, a determination is made as to whether the allowance for loan losses is adequate to cover probable incurred credit losses. Additions to the allowance for loan losses are made by charges to the provision for loan losses. Loan losses deemed to be uncollectible are charged against the allowance for loan losses. Recoveries of previously charged off amounts are credited to the allowance for loan losses. As of September 30, 2015, management believes that the allowance for loan losses of approximately \$3,342,000 is adequate in amount to cover probable incurred losses. Because of the number of variables involved, the magnitude of swings possible and management's inability to control many of these factors, actual results may and do sometimes differ significantly from estimates made by management. As of September 30, 2015, four loans totaling \$10,290,000 were impaired. This includes two past maturity loans totaling \$8,614,000. After management's evaluation of the loan portfolio, we recorded an increase in the allowance for loan losses of approximately \$472,000 during the nine months ended September 30, 2015 (decrease in specific loan loss allowance of \$70,000 and increase in general allowance of \$542,000). Management believes that the specific allowance for loan losses is appropriate given the estimated fair values of the underlying collateral of impaired loans.

## Liquidity and Capital Resources

Liquidity is a measure of our ability to meet potential cash requirements, including ongoing commitments to repay borrowings, fund and maintain our assets and operations, make distributions to our stockholders and other general business needs.

We believe our available cash and restricted cash balances, other financing arrangements, and cash flows from operations will be sufficient to fund our liquidity requirements for the next 12 months.

We require liquidity to:

- fund future loan investments;
- to improve and maintain real estate properties;
- to repay principal and interest on our borrowings;
- to pay our expenses, including compensation to our Manager;
- to pay U.S. federal, state, and local taxes of our TRSs;
- to distribute a minimum of 90% of our REIT taxable income and to make investments in a manner that enables us to maintain our qualification as a REIT; and
- to make tax payments associated with undistributed capital gains.

We intend to meet these liquidity requirements primarily through the following:

- the use of our cash and cash equivalent balances of \$6,708,000 as of September 30, 2015;
- cash generated from operating activities, including interest income from our loan portfolio and income generated from our real estate properties;
- proceeds from the sales of real estate properties;
- proceeds from our revolving lines of credit;
- proceeds from the construction loan obtained by TOTB North;
- proceeds from future borrowings, including additional lines of credit; and
- proceeds from potential future offerings of our equity securities.

The following table summarizes our cash flow activity for the periods presented:

	<b>Nine Months Ended September 30,</b>	
	<b>2015</b>	<b>2014</b>
Net cash provided by operating activities	\$ 5,726,118	\$ 2,406,528
Net cash provided by (used in) investing activities	9,916,226	(25,569,109)
Net cash (used in) provided by financing activities	(10,348,203)	19,064,522

During the nine months ended September 30, 2015, our cash and cash equivalents increased approximately \$5,294,000 primarily due to proceeds received from the sales of four real estate properties and an additional advance taken on the TSV loan net of repayments of debt and originations of loans during the nine month period.

#### *Operating Activities*

Cash flows from operating activities are primarily rental and other income from real estate properties, net of real estate expenses, and interest received from our investments in loans, partially offset by payment of operating expenses. For the nine months ended September 30, 2015, cash flows from operating activities increased \$3,320,000, compared to the nine months ended September 30, 2014. The increase reflects increased cash flow from rental properties as a result of increased occupancy and rental rates, completion and leasing of the TSV retail complex during the fourth quarter of 2014 and increased interest income on performing loans and collected on impaired loans during 2015.

#### *Investing Activities*

Net cash provided by investing activities for both periods presented reflect our investing activity. For the nine months ended September 30, 2015, cash flows from investing activities increased \$35,485,000. Approximately \$9,916,000 was provided by investing activities during the nine month period as \$66,564,000 was received from the sales of real estate properties and the payoff of loans, which was partially offset by an aggregate of \$56,684,000 that was used for investment in loans, improvements to real estate properties and transfer to restricted cash during the period.

### *Financing Activities*

Net cash used in financing activities totaled approximately \$10,348,000 for the nine months ended September 30, 2015 and consisted primarily of \$2,496,000 of net repayments on our lines of credit, \$2,484,000 of distributions to non-controlling interests, \$5,253,000 of treasury stock purchases and \$3,981,000 of dividends paid to stockholders, which was offset by \$3,628,000 of advances net of repayments on notes payable.

### *Dividends*

We intend to make regular quarterly distributions to holders of our common stock. U.S. federal income tax law generally requires that a REIT annually distribute at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding net capital gains, and to the extent that it annually distributes less than 100% of its REIT taxable income in any taxable year, and that it pay tax at regular corporate rates on that undistributed portion. We intend to make regular quarterly distributions to our stockholders in an amount equal to or greater than our REIT taxable income, if and to the extent authorized by our Board of Directors. Before we make any distributions, whether for U.S. federal income tax purposes or otherwise, we must first meet both our operating requirements and debt service on our debt payable. If our cash available for distribution is less than our REIT taxable income, we could be required to sell assets or borrow funds to make cash distributions or we may make a portion of the required distribution in the form of a taxable stock distribution or distribution of debt securities.

### *Off-Balance Sheet Arrangements*

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured investment vehicles, special purpose entities or VIEs, established to facilitate off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities or entered into any commitment or intend to provide additional funding to any such entities.

### *Contractual Obligations and Commitments*

There were no material changes outside of the ordinary course of business in the contractual obligations and commitments as reported in our Annual Report on Form 10-K for the year ended December 31, 2014. All of our debt obligations are described in more detail in Note 7 — “Lines of Credit Payable” and Note 8 — “Notes and Loans Payable on Real Estate.” Refer to Note 13 — “Commitments and Contingencies” and below for a description of our other contractual obligations as of September 30, 2015.

### *Company Debt*

The terms of the Company debt are described in more detail in Note 7 — “Lines of Credit Payable” and Note 8 — “Notes and Loans Payable on Real Estate”.

### **CB&T Line of Credit**

As of September 30, 2015, the total amount available to borrow under the CB&T Credit Facility was \$17,993,000 and the balance outstanding was \$8,954,000 (leaving \$9,039,000 available). As of the date of this filing, the total amount available to borrow under the CB&T Credit Facility is \$25,915,000 and the balance outstanding is \$13,737,000 (leaving \$12,178,000 available). Interest on borrowings under the CB&T Credit Facility are payable monthly and all amounts outstanding under the facility are to be repaid not later than February 5, 2016 and advances may be made up to that date.

### **Opus Line of Credit**

As of September 30, 2015, the total amount available to borrow under the Opus Credit Facility was \$12,626,000 and there was no balance outstanding (leaving \$12,626,000 available). As of the date of this filing, the total amount

available to borrow is approximately \$12,626,000 and the balance outstanding is \$3,000,000 (leaving \$9,626,000 available). Commencing on May 1, 2016, in addition to the required monthly interest payments, we are required to make mandatory monthly principal payments and all amounts under the facility are to be repaid not later than April 1, 2017. Advances under the Opus Credit Facility may be made by Opus until April 1, 2016.

#### **TOTB North, LLC Construction Loan**

The North Loan will provide up to \$21,304,000, subject to customary conditions, and the balance of the North Loan was approximately \$10,946,000 as of September 30, 2015 and approximately \$12,237,000 as of the date of this filing. The initial maturity date (“Maturity Date”) of the North Loan is June 12, 2017, which may be extended at the option of TOTB North for two additional one year periods subject to certain conditions. Monthly interest only payments are required until the Amortization Commencement date (as defined in the agreements), at which time monthly principal payments are also required and the balance of the loan is due on the Maturity Date.

#### **TOTB Miami, LLC Loan Payable**

The full amount available under the TOTB Miami Loan has been borrowed, and the balance of the TOTB Miami Loan was approximately \$12,754,000 as of September 30, 2015 and approximately \$12,705,000 as of the date of this filing. The initial maturity date (the “Maturity Date”) of the TOTB Miami Loan is November 16, 2017, which may be extended at the option of TOTB Miami for two additional one year periods subject to certain conditions. Principal and interest is payable monthly and the balance of the loan is due on the Maturity Date.

#### **Tahoe Stateline Venture, LLC Loan Payable**

The balance of the TSV Loan was approximately \$14,098,000 as of September 30, 2015 and \$14,045,000 as of the date of this filing. TSV borrowed \$10,445,000 at the first closing under the TSV Loan and an additional \$3,830,000 in September 2015. TSV makes monthly payments of principal and accrued interest and the balance of the loan is due on the maturity date, which is January 1, 2021.

#### **720 University, LLC Note Payable**

We had a secured note payable with a bank through our investment in 720 University with a balance of \$9,741,000 as of December 31, 2014. The note required amortized monthly payments of \$56,816 at a fixed rate of 5.07%, with the balance of unpaid principal due on March 1, 2015. In November 2014, 720 University entered into an agreement to sell the property that collateralized this note, and the buyer extended a new interest-only, secured loan to 720 University to repay the existing note payable. The refinancing closed in January 2015. The principal amount of the new loan was \$9,771,263 and it accrued interest at 6.0% per annum until paid off with the closing of the sale of the property to the buyer on June 15, 2015.

#### **Tahoe Stateline Venture, LLC Notes Payable**

We had two secured notes payable in the aggregate amount of \$3,400,000 as of September 30 2015. One note with a principal balance of \$2,900,000 as of September 30, 2015 requires semi-annual interest-only payments and is due in December 2016, and one note with a principal balance of \$500,000 at September 30, 2015 requires quarterly interest-only payments and is due in August 2017.

#### ***Commitments and Contingencies***

As of September 30, 2015, we have commitments to advance additional funds to borrowers of construction, rehabilitation and other loans (including interest reserves) in the total amount of approximately \$6,719,000.

We have an obligation to pay all required costs to remediate and monitor contamination of the real properties owned by 1850 De La Cruz, LLC (“1850”). As part of the Operating Agreement executed by the Company and its joint venture partner in 1850, Nanook, we have indemnified Nanook against all obligations related to the expected costs to monitor and remediate the contamination. In 2008, we accrued an amount that a third party consultant had estimated will need to be paid to monitor and remediate the site. The majority of clean-up activities were completed during 2012 as part of the tenant’s construction of a new building on the site. Thus, approximately \$460,000 was

paid by us from the previously established liability, and an additional \$100,000 was accrued during the year ended December 31, 2012 as a result of an updated estimate of future costs to be incurred. If additional amounts are required, it will be an obligation of the Company. As of September 30, 2015 and December 31, 2014, approximately \$39,000 and \$60,000, respectively, of this obligation remains accrued on our books. We expect that all costs for this remediation will be paid from cash reserves.

During the course of due diligence performed by a potential buyer of TOTB in 2012, a low level of arsenic was found in the ground water of a monitoring well located on the property. While the level of arsenic exceeds the minimum level acceptable for drinking water standards, the water under this property is subject to tidal influence and is not used for domestic consumption. TOTB has retained an environmental consultant to perform additional testing and analysis with the goal of petitioning the appropriate governmental agency to issue a no further action letter for this property due to the low level of contamination and the low quality of the ground water under the property. At this time, the costs of any potential remediation and/or monitoring are unknown and cannot be estimated. As of September 30, 2015 and December 31, 2014, approximately \$104,000 and \$79,000, respectively, had been accrued and/or paid for testing and analysis.

We have entered into various contracts for design, architectural, engineering and foundation work for the phase II development of the land owned by Zalanta. The aggregate amount of these contracts as of the date of this filing is approximately \$4,333,000 of which approximately \$2,244,000 has been incurred as of September 30, 2015. We expect that all costs for this project will be paid from cash reserves, new debt and/or the lines of credit.

We have entered into contracts for the construction, demolition and concrete remediation, design, architectural and engineering services related to the renovation of the vacant apartment building owned by TOTB North in the aggregate amount of approximately \$21,042,000 of which approximately \$13,963,000 has been incurred to September 30, 2015 in addition to other capitalized costs related to the construction project of \$1,638,000 (total of \$15,061,000). The Company expects that all costs for this project will be paid from cash reserves or the recently obtained construction loan. It is possible that additional change orders will be submitted and construction costs may be higher than expected.

We have entered into contracts for new bathrooms and modular offices and improvements to the bridge that accesses the marina held within Brannan Island, LLC in the aggregate amount of approximately \$791,000 of which approximately \$633,000 has been incurred to September 30, 2015. We expect that all costs for the project will be paid from cash reserves or advances from the lines of credit. It is possible that additional change orders will be submitted and construction costs may be higher than expected.

### **Contingency Reserves**

We are required to maintain cash, cash equivalents and marketable securities as contingency reserves in an aggregate amount of at least 1.50% of Capital (as defined in our charter). Although the Manager believes the contingency reserves are adequate, it could become necessary for us to sell or otherwise liquidate certain of our investments or other assets to cover such contingencies on terms which might not be favorable to us. The contingency reserves held in cash and cash equivalents were approximately \$4,009,000 and \$3,876,000 as of September 30, 2015 and December 31, 2014, respectively.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and real estate values. The primary market risks that we are exposed to are real estate risk and interest rate risk.

#### **Interest Rate Risk**

Interest rate risk is highly sensitive to many factors, including governmental monetary tax policies, domestic and international economic and political considerations and other factors beyond our control.

Our operating results are exposed to the risks related to interest rate fluctuations as the results depend to a significant extent on the differences between income from our loans and our borrowing costs. We generally originate fixed rate loan investments and partially finance those investments with floating rate liabilities. Our investments in fixed rate assets are generally exposed to changes in value due to interest rate fluctuations; however, the short maturity and low debt to investments of our loan portfolio are intended to partially offset that risk. Our average weighted maturity of loans as of September 30, 2015 is approximately twelve months. In addition, our outstanding variable rate debt to loan investments as of September 30, 2015 is 42%.

The following table projects the potential impact on our interest expense for a 12-month period assuming an instantaneous increase of 100 basis points in 3 Month LIBOR and one percent in the Prime Rate based on balances outstanding as of September 30, 2015:

	As of September 30, 2015		
	Variable Rate Loans tied to 3 Mo. Libor	Variable Rate Loans tied to Prime Rate	Total
Aggregate Principal Balance of Debt	\$ 23,699,917	\$ 8,954,000	\$ 32,653,917
Effect of 100 basis point increase in 3 Mo. Libor (1)	\$ 236,999	\$ —	\$ 236,999
Effect of one percent increase in the Prime Rate	—	89,540	89,540
Totals	\$ 236,999	\$ 89,540	\$ 326,539

(1) \$10,945,502 of debt has a floor higher than the applicable rate as of September 30, 2015.

In the event of a significant rising interest rate environment and/or economic downturn, default on our loan portfolio could increase and result in losses to us. Such delinquencies or defaults could also have an adverse effect on the spreads between interest-earning assets and interest-bearing liabilities.

### Credit Risks

Our loans and investments are also subject to credit risk. The performance and value of our loans and investments depend upon the borrowers' ability to operate the properties that serve as our collateral so that they produce cash flows adequate to pay interest and principal due to us and the borrowers' ability to refinance the loans or sell the underlying collateral upon maturity. To monitor this risk, our Manager's asset management team reviews our investment portfolios and in certain instances is in regular contact with our borrowers, monitoring performance of the collateral and enforcing our rights as necessary.

In addition, we are exposed to the risks generally associated with the commercial real estate market, including variances in occupancy rates, capitalization rates, absorption rates, and other macroeconomic factors beyond our control. We seek to manage these risks through our underwriting and asset management processes.

### Counterparty Risk

The nature of our business requires us to hold our cash and cash equivalents and obtain financing from various financial institutions. This exposes us to the risk that these financial institutions may not fulfill their obligations to us under these various contractual arrangements. We mitigate this exposure by depositing our cash and cash equivalents and entering into financing and agreements with high quality credit institutions.

The nature of our loans and investments also expose us to the risk that our counterparties do not make required interest and principal payments on scheduled due dates. We seek to manage this risk through our credit analysis prior to making an investment and actively monitoring the asset portfolios that serve as our collateral.

## **Real Estate Risk**

Commercial mortgage assets may be viewed as exposing an investor to greater risk of loss than residential mortgage assets since such assets are typically secured by larger loans to fewer obligors than residential mortgage assets. Multi-family and commercial property values and net operating income derived from such properties are subject to volatility and may be affected adversely by a number of factors, including, but not limited to, events such as natural disasters including hurricanes and earthquakes, acts of war and/or terrorism and others that may cause unanticipated and uninsured performance declines and/or losses to us or the owners and operators of the real estate securing our investment; national, regional and local economic conditions (which may be adversely affected by industry slowdowns and other factors); local real estate conditions (such as an oversupply of housing, retail, industrial, office or other commercial space); changes or continued weakness in specific industry segments; construction quality, construction delays, construction cost, age and design; demographic factors; retroactive changes to building or similar codes; and increases in operating expenses (such as energy costs). In the event net operating income decreases, a borrower may have difficulty repaying our loans, which could result in losses to us. In addition, decreases in property values reducing the value of collateral and a lack of liquidity in the market, could reduce the potential proceeds available to a borrower to repay our loans, which could also cause us to suffer losses. Even when the net operating income is sufficient to cover the related property's debt service, there can be no assurance that this will continue to be the case in the future.

## **Item 4. Controls and Procedures**

Management of the Company carried out an evaluation, with the participation of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the fiscal quarter ended September 30, 2015. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2015, which is the end of the period covered by this quarterly report on Form 10-Q, the Company's disclosure controls and procedures are effective.

There have been no changes in the Company's internal control over financial reporting in the fiscal quarter ending September 30, 2015 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

In the normal course of business, the Company may become involved in various types of legal proceedings including, but not limited to, assignment of rents, bankruptcy proceedings, appointment of receivers, unlawful detainers, and judicial foreclosure. These proceedings may seek to enforce the provisions of the deeds of trust, collect the debt owed under the promissory notes, or to protect, or recoup the Company's investment from the real property secured by the deeds of trust. The Company believes that it is not party to any pending legal or arbitration proceedings that would have a material effect on its financial condition or results of operations or cash flows, although it is possible that the outcome of any such proceedings could have a material impact on net income in any particular period.

### **Item 1A. Risk Factors**

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

## **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table summarizes information about the Company's repurchases of its shares of common stock, based on settlement date, during the quarterly period ended September 30, 2015:

### **Issuer Repurchase of Equity Securities<sup>i</sup>**

<b>Period</b>	<b>Total Number of Shares Purchased<sup>ii</sup></b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs</b>
July 1 through July 31	210,801	\$ 14.77	210,801	Dollar amount: \$4,397,133 <sup>iii</sup>
August 1 through August 31	77,216	\$ 14.64	77,216	Dollar amount: \$3,270,699 <sup>iii</sup>
September 1 through September 30	72,246	\$ 13.95	72,246	Dollar amount: \$2,266,739 <sup>iii</sup>
<b>Total</b>	<b>360,263</b>	<b>\$ 14.58</b>	<b>360,263</b>	

<sup>i</sup> On May 27, 2015, the Board of Directors publicly announced a new Repurchase Plan that enables the Company to buy up to \$7.5 million of its common stock. Purchases began in July 2015. The Repurchase Plan is set to expire on May 12, 2016, although the Company may terminate the Repurchase Plan at any time.

<sup>ii</sup> The Company has entered into agreements pursuant to SEC Rule 10b5-1 authorizing a third-party broker to purchase shares on the Company's behalf from time to time, including without limitation during normal blackout periods, in accordance with trading instructions included in such agreements.

<sup>iii</sup> Dollar amount does not include brokerage commissions to be paid of \$0.05 per share.

## **Item 6. Exhibits**

### **(a) Exhibits:**

- \* 3.1 Articles of Amendment and Restatement of Owens Realty Mortgage, Inc., dated January 23, 2013, and related Certificate of Correction dated September 17, 2013, incorporated herein by reference to the Annual Report on Form 10-K for the year ended December 31, 2014, which was filed with the SEC on March 16, 2015
- \* 3.2 Bylaws of Owens Realty Mortgage, Inc., incorporated herein by reference to Annex C to Proxy Statement/Prospectus on Form S-4 which was filed with the SEC on February 13, 2013
- \* 3.3 Articles Supplementary, dated November 13, 2014, relating to the election to be subject to Subtitle 8 of Title 3 of the Maryland General Corporation Law, incorporated by reference to exhibit 3.1 of the current report on Form 8-K filed with the SEC on November 13, 2013
- \* 4.1 Form of Common Stock Certificate, incorporated herein by reference to exhibit 4.1 to Proxy Statement/Prospectus on Form S-4 which was filed with the SEC on January 25, 2013
- \*\* 31.1 Certification of CEO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \*\* 31.2 Certification of CFO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \*\* 32 Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*\*\*101.INS XBRL Instance Document
- \*\*\*101.SCH XBRL Taxonomy Extension Schema Document
- \*\*\*101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

\*\*\*101.LAB XBRL Taxonomy Extension Labels Linkbase Document  
\*\*\*101.PRE XBRL Taxonomy Extension Presentation Linkbase Document  
\*\*\*101.DEF XBRL Taxonomy Extension Definition Linkbase Document

\*Previously filed.

\*\* Filed herewith.

\*\*\*This exhibit is being furnished rather than filed, and shall not be deemed incorporated by reference into any filing, in accordance with Item 601 of Regulation S-K.

### **SIGNATURES**

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.

#### **OWENS REALTY MORTGAGE, INC.**

Dated: November 9, 2015

By: /s/ William C. Owens  
William C. Owens, Chief Executive Officer and President  
(Principal Executive Officer)

Dated: November 9, 2015

By: /s/ Bryan H. Draper  
Bryan H. Draper, Chief Financial Officer, Treasurer and Secretary  
(Principal Financial and Accounting Officer)