



## **OWENS REALTY MORTGAGE, INC. FILES DEFINITIVE PROXY STATEMENT AND SENDS LETTER TO STOCKHOLDERS**

WALNUT CREEK, Calif., June 8, 2018 -- Owens Realty Mortgage, Inc. (NYSE American: ORM) (the "Company") today announced that it has filed with the Securities and Exchange Commission (the "SEC") its definitive proxy materials in connection with the Company's 2018 Annual Meeting of Stockholders (the "2018 Annual Meeting") and is mailing the definitive proxy materials to its stockholders. The Company's stockholders of record as of the close of business on May 31, 2018, will be entitled to vote at the 2018 Annual Meeting, which will be held at 10:00 a.m. Pacific Daylight Time, on July 16, 2018.

The Company's board of directors (the "Board") also sent a letter to stockholders urging them to vote on the WHITE proxy card "**FOR**" the Company's highly qualified slate of nominees:



The full copy of the letter can be found below.

### **VOTE FOR ALL OF OWENS REALTY MORTGAGE'S HIGHLY QUALIFIED DIRECTOR NOMINEES ON THE WHITE PROXY CARD TODAY**

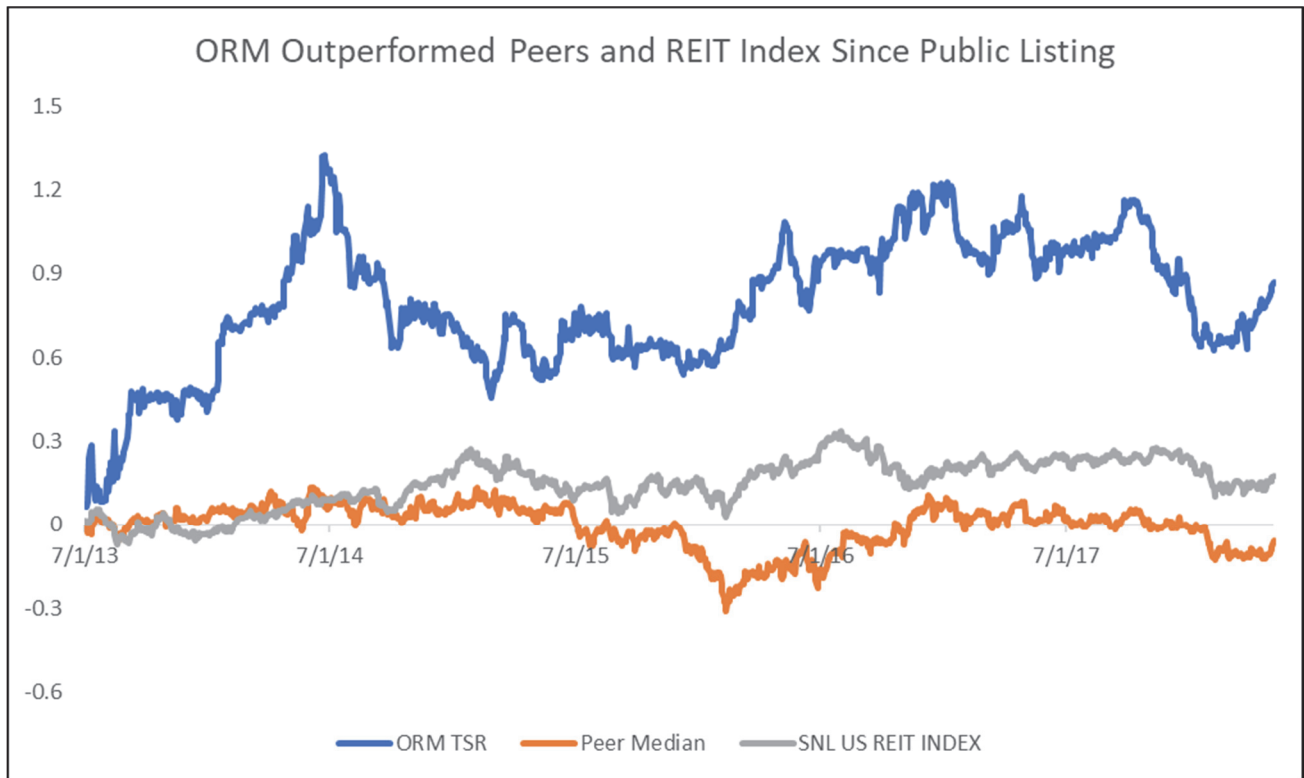
June 8, 2018

Dear Fellow Stockholders:

The 2018 Annual Meeting of Stockholders will be held on Monday, July 16, 2018. At this year's annual meeting, you will be asked to make a critical decision regarding the future of Owens Realty Mortgage. As you may know, Eric Hovde, Financial Institution Partners III, LP, Opal Advisors and certain of their affiliates (collectively, the "Hovde Group") have threatened to replace two of the Company's highly experienced incumbent directors – Bryan Draper (who is also our CEO) and James Kessler. The Hovde Group's only articulated plan, after ousting our

CEO from the Board, is to deploy a strategy that will be tantamount to forcing a liquidation of the Company, primarily to permit the Hovde Group to exit its investment in the Company as soon as possible. This “short-term” plan will eliminate the possibility for all stockholders to realize the long-term value of their investments. Our Board believes pursuing our business plan will yield a more attractive long-term value for stockholders than pursuing a short-term liquidation.

The Hovde Group’s plan will also derail the substantial progress the Board and management team (led by our CEO, Mr. Draper) continues to make in executing our strategic plan. In fact, since the Company’s public listing as a REIT in 2013 through May 9, 2018 (the date of the first public filing by the Hovde Group), our strategic plan has achieved an 87.0% total stockholder return. Over the same period, the median of the Company’s peers fell by 6.0%. The Company’s outperformance of its peers highlights the execution of our strategic plan.



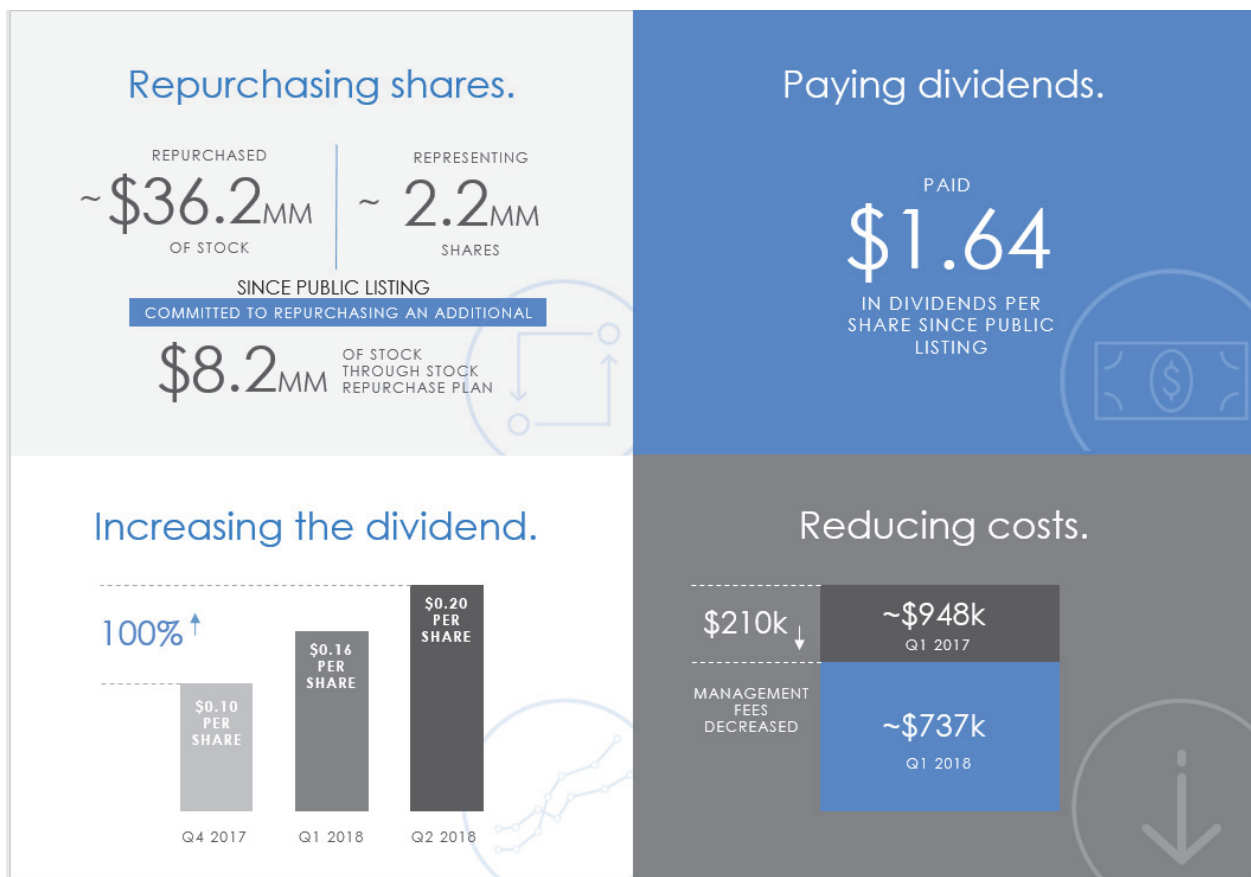
Company Peers: Arbor Realty Trust, Ares Commercial Real Estate Corp., Ladder Capital Corp., Sutherland Asset Management, iStar Inc.

We urge you to protect the value of your investment by voting today by telephone, by internet, or by signing, dating and returning the enclosed WHITE proxy card **“FOR”** BOTH of Owens’ highly qualified director nominees – Bryan Draper and James Kessler.

In addition to continuing to deliver substantial returns to stockholders, your Board has executed on other aspects of its strategic plan, which we believe will maximize the value of your investment in the Company. A key component of our strategy requires us to dispose of

our real estate assets in a tax efficient manner in accordance with REIT tax rules. These rules limit us to sell these assets over the next couple of years. As we continue to dispose of real estate according to these rules and to maximize the price received upon such sales, we remain focused on reallocating the capital from sale proceeds to our commercial loan portfolio.

Your Board’s commitment also remains steadfast to returning significant value to stockholders in the form of share buybacks and dividends. Since our public listing in 2013, we have repurchased approximately \$36.2 million of stock, including commissions and fees, representing approximately 2.2 million shares, or nearly 20% of the shares outstanding when our common stock was first listed. We are committed to continuing the repurchase of shares through the plan which had a balance of \$8.2 million as of April 30, 2018. Moreover, the Company has increased the dividend to stockholders from \$0.10 per share in Q4 2017 to \$0.16 per share in Q1 2018, and a further increase to \$0.20 per share for Q2 2018, representing a 100% increase from the fourth quarter 2017. By implementing these strategies, your Board continues to make progress in narrowing the gap between stock price and stockholders’ equity. In particular, this gap has closed by approximately \$3 in the past several months alone.



Cost savings as year-over-year for quarters ending March 31, 2017 and March 31, 2018

We remain committed to extensive engagement with stockholders and to incorporating their valuable feedback. As previously disclosed, the Board and management, through the

Compensation Committee consisting completely of independent directors, and Owens Financial Group, the Company's manager (the "Manager"), reached an agreement to amend the Manager's compensation structure, including making permanent the recent interim management fee adjustment along with an additional adjustment that will decrease the fee when stockholders' equity exceeds \$300 million, payment to the Company of 30% of all loan fees and late payment charges paid to the Manager in connection with its mortgage lending activities for the Company, with the exception of certain administrative fees, and the elimination of servicing fees and certain reimbursable expenses.

Along with the changes to the structure of the Company's external management agreements, we continue to implement a host of corporate governance enhancements that were set in motion in early 2017. This includes, among others, an ongoing search process to identify a female director candidate, involving input from stockholders. Your Board also recently approved policies with respect to Board diversity, majority voting with respect to uncontested director elections, director and officer stock ownership/retention guidelines, and anti-hedging and anti-pledging policies. Finally, Bill Owens stepped down as Chairman and assumed the role of executive Chairman Emeritus. Your former lead independent director, Dennis Schmal, now serves as independent Chairman of your Board.

It should be noted that, while continuing to implement our strategic plan and make changes to our management structure and corporate governance enhancements, your Board and management team have remained significant stockholders of the Company owning a combined 4.43% of outstanding shares. In fact, out of the 11 open trading windows since the Company's listing on July 1, 2013, Section 16 insiders purchased the Company's stock in 8 of these windows. Together, it is the Board's strong belief that these actions align the Board's and management's interests with all stockholders, positioning the Company to maximize long-term value.

We have for quite some time maintained a constructive dialogue with the Hovde Group, as we enjoy with many of our stockholders. In fact, the Nominating and Corporate Governance Committee of the Board (the "Nominating Committee"), consisting entirely of independent directors, completed extensive interviews and background checks of the Hovde Group's candidates. At the end of this process, the Nominating Committee and the full Board concluded that adding the Hovde Group candidates to the Board would not be in the best interests of the Company and its stockholders. This is particularly the case because, as explained to the Hovde Group, we had concerns about its nominees' intentions to carry out the Hovde Group's strategy of effectively forcing a liquidation of the Company. In an effort to avoid a costly and distracting proxy fight, we made the Hovde Group very reasonable settlement proposals in April and May.

We were disappointed that the Hovde Group rejected these settlement proposals, but have indicated that we nonetheless remain committed to constructively engaging with them. Your Board remains deeply concerned that the Hovde Group's proposals will lead to a premature liquidation of the Company that will cause irreversible damage to the long-term value of your

investments. If elected, the Hovde Group's nominees will also be replacing Mr. Draper's Board seat, eliminating the primary link between your Board and the Company's management team.

As a stockholder, you have the ability to protect your investment by voting for our highly qualified nominees – Mr. Draper (also the Company's CEO) and Mr. Kessler. Mr. Draper's extensive experience in the commercial mortgage financing and real estate industries, including REO dispositions, credit facilities, and risk oversight, along with his CPA certification and accounting and financial expertise make him well qualified to serve as a director of the Company. Likewise, Mr. Kessler's extensive experience in real estate investment, development, business operations and management industries, including his positions in two publicly traded REITs, strengthens our Board's collective qualifications, skills, experience and viewpoints. Mr. Draper and Mr. Kessler bring decades of industry-specific credentials that contribute greatly to the composition of your Board, the ongoing success of the Company and the long-term value of your investment.

We are extremely honored to serve on behalf of you, our stockholders. Your Board and management team are committed to constructive engagement with our stockholders and maximizing the value of your investment.

On behalf of the Board, thank you for your continued support.

Very truly yours,

The Owens Realty Mortgage Board

**About Owens Realty Mortgage, Inc.**

Owens Realty Mortgage, Inc., a Maryland corporation, is a specialty finance mortgage company organized to qualify as a real estate investment trust ("REIT") that focuses on the origination, investment, and management of commercial real estate mortgage loans. We provide customized, short-term acquisition and transition capital to small balance and middle-market investors that require speed and flexibility. Our primary objective is to provide investors with attractive current income and long-term stockholder value. Owens Realty Mortgage, Inc., is headquartered in Walnut Creek, California, and is externally managed and advised by Owens Financial Group, Inc.

Additional information can be found on the Company's website at [www.owensmortgage.com](http://www.owensmortgage.com).

**Forward Looking Statements**

This press release may contain "forward-looking statements" within the meaning of the safe harbor provisions of the United States Private Securities Litigation Reform Act of 1995. Forward-looking statements about the Company's plans, strategies, prospects, and anticipated events, including the transactions or other items discussed in this Current Report, are based on current information, estimates, and projections; they are subject to risks and uncertainties, as

well as known and unknown risks, which could cause actual results to differ from expectations, estimates and projections and, consequently, readers should not rely on these forward-looking statements as predictions of future events. Words such as "expect," "target," "assume," "estimate," "project," "budget," "forecast," "anticipate," "intend," "plan," "may," "will," "could," "should," "believe," "predicts," "potential," "continue," and similar expressions are intended to identify such forward-looking statements.

Readers are cautioned not to place undue reliance upon any forward-looking statements, which speak only as of the date made. The Company does not undertake or accept any obligation to release publicly any updates or revisions to any forward-looking statement to reflect any change in its expectations or any change in events, conditions or circumstances on which any such statement is based. Additional information concerning these and other risk factors is contained in the Company's most recent filings with the Securities and Exchange Commission including those appearing under the heading "Item 1A. Risk Factors" in the Company's most recent Annual Report on Form 10-K and each subsequent Quarterly Report on Form 10-Q. All subsequent written and oral forward-looking statements concerning the Company or matters attributable to the Company or any person acting on its behalf are expressly qualified in their entirety by the cautionary statements above.

#### **Important Additional Information**

The Company, its directors and certain of its executive officers are participants in the solicitation of proxies from the Company's stockholders in connection with matters to be considered at the Company's 2018 Annual Meeting of Stockholders (the "2018 Annual Meeting"). The Company has filed a definitive proxy statement and WHITE proxy card with the U.S. Securities and Exchange Commission (the "SEC") in connection with its solicitation of proxies from the Company's stockholders. STOCKHOLDERS OF THE COMPANY ARE STRONGLY ENCOURAGED TO READ SUCH PROXY STATEMENT, ACCOMPANYING WHITE PROXY CARD AND ALL OTHER DOCUMENTS FILED WITH THE SEC CAREFULLY AND IN THEIR ENTIRETY WHEN THEY BECOME AVAILABLE AS THEY WILL CONTAIN IMPORTANT INFORMATION. Information regarding the identities of the Company's directors and executive officers, and their direct or indirect interests, by security holdings or otherwise, are set forth in the proxy statement and other materials filed with the SEC in connection with the 2018 Annual Meeting. Stockholders can obtain the proxy statement, any amendments or supplements to the proxy statement, and any other documents filed by the Company with the SEC at no charge at the SEC's website at [www.sec.gov](http://www.sec.gov). These documents are also available at no charge in the "SEC Filings & Reports" section of the Company's website at [www.owensmortgage.com](http://www.owensmortgage.com).



**OWENS REALTY MORTGAGE, INC.**

**2221 Olympic Boulevard  
Walnut Creek, California 94595**

Dear Stockholders:

On behalf of the Board of Directors, it is my pleasure to invite you to the 2018 annual meeting of stockholders (the “Annual Meeting”) of Owens Realty Mortgage, Inc. a Maryland corporation (“ORM” or the “Company”), to be held at the Walnut Creek Marriott, 2355 N. Main Street, Walnut Creek, CA 94596, on July 16, 2018, at 10:00 a.m. Pacific Daylight Time, to consider and vote on the following matters:

1. To elect two (2) Class II directors, each to serve for a term continuing until the annual meeting of stockholders held in 2021 and until their respective successors are duly elected and qualified; and
2. To ratify the appointment of Crowe Horwath LLP as the Company’s independent registered public accounting firm for the year ending December 31, 2018.

Stockholders will also transact such other business as may properly come before the Annual Meeting or any adjournments or postponements thereof.

Your vote will be especially important at the Annual Meeting because, as you may know, Eric Hovde, Financial Institutions Partners III, LP, and certain of their affiliates (collectively, the “Hovde Group”), have notified the Company that the Hovde Group intends to nominate a slate of two nominees for election as directors in opposition to the nominees recommended by our Board. The Board unanimously recommends that you vote **FOR** each of the director nominees named in the Company’s Proxy Statement on its enclosed **WHITE** proxy card. The Board does **NOT** endorse the election of any of the Hovde Group nominees and strongly urges you **NOT** to sign or return any proxy card sent to you by or on behalf of the Hovde Group.

You may receive proxy solicitation materials from the Hovde Group. The Company is not responsible for the accuracy of any information provided by or relating to the Hovde Group or its nominees contained in solicitation materials filed or disseminated by or on behalf of the Hovde Group or any other statements that the Hovde Group may make.

**Again, the Board does NOT endorse the Hovde Group nominees and strongly and unanimously recommends that you NOT sign or return any proxy card sent to you by or on behalf of the Hovde Group. If you have previously voted using a proxy card sent to you by the Hovde Group, you can subsequently revoke that proxy by following the instructions on the enclosed WHITE proxy card to vote over the Internet or by telephone or by completing, signing and dating the proxy card and mailing it in the postage pre-paid envelope provided. Only your latest dated proxy will count. Any proxy may be revoked at any time prior to its exercise at the Annual Meeting, as described in the accompanying Proxy Statement.**

***THE BOARD UNANIMOUSLY RECOMMENDS A VOTE FOR THE ELECTION OF BOTH OF THE BOARD’S NOMINEES ON PROPOSAL 1 AND FOR PROPOSAL 2 USING THE ENCLOSED WHITE PROXY CARD.***

***THE BOARD URGES YOU NOT TO SIGN, RETURN OR VOTE ANY PROXY CARD SENT TO YOU BY OR ON BEHALF OF THE HOVDE GROUP.***

It is important that your shares be represented at the meeting whether or not you are personally able to attend. Accordingly, after reading the attached Notice of Annual Meeting and Proxy Statement, please promptly submit your

proxy as described on your **WHITE** proxy card or **WHITE** voting instruction form. If you choose to submit your proxy to vote your shares by the **WHITE** proxy card or **WHITE** voting instruction form, please sign, date and mail the **WHITE** proxy card or **WHITE** voting instruction form in the enclosed postage-paid return envelope. You may also submit a proxy to vote by telephone or Internet. Instructions for submitting a proxy over the Internet or by telephone are provided on the enclosed **WHITE** proxy card. Your cooperation is greatly appreciated.

We appreciate your continued interest in the Company. We look forward to greeting you in person at the Annual Meeting and meeting as many of our stockholders as possible. If you have any questions or require any assistance with voting your shares, or if you need additional copies of the proxy materials, please contact:

# Georgeson

A COMPUTERSHARE COMPANY

1290 Avenue of the Americas, 9<sup>th</sup> Floor  
New York, NY 10104  
(888) 206-5970 (Toll Free)  
Email: ORM@Georgeson.com

Regardless of how few shares of common stock of the Company that you own, your vote is important. Thank you for your continued support, interest and investment in ORM.

Very truly yours,

/s/ Daniel J. Worley

Daniel J. Worley  
*Senior Vice President and Secretary*

Walnut Creek, California  
June 8, 2018

The enclosed Notice of Annual Meeting of Stockholders and Proxy Statement are first being made available to stockholders of record beginning June 8, 2018.





**OWENS REALTY MORTGAGE, INC.**

**2221 Olympic Boulevard  
Walnut Creek, California 94595**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD ON JULY 16, 2018**

NOTICE IS HEREBY GIVEN that the 2018 annual meeting of stockholders (the "Annual Meeting") of Owens Realty Mortgage, Inc. a Maryland corporation ("ORM" or the "Company"), will be held at the Walnut Creek Marriott, 2355 N. Main Street, Walnut Creek, CA 94596, on July 16, 2018, at 10:00 a.m. Pacific Daylight Time, to consider and vote on the following matters:

1. To elect two (2) Class II directors, each to serve for a term continuing until the annual meeting of stockholders held in 2021 and until their respective successors are duly elected and qualified; and
2. To ratify the appointment of Crowe Horwath LLP as the Company's independent registered public accounting firm for the year ending December 31, 2018.

Stockholders will also transact such other business as may properly come before the Annual Meeting or any adjournments or postponements thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice of Annual Meeting. The Board recommends: a vote "**FOR**" each of the two nominees for director named in the accompanying Proxy Statement and a vote "**FOR**" proposal 2 on the enclosed **WHITE** proxy card.

Only stockholders of record of the Company at the close of business on May 31, 2018 are entitled to receive notice of, and vote at, the Annual Meeting and any postponements or adjournments thereof. The Annual Meeting may be adjourned from time to time. At any adjourned meeting, action with respect to matters specified in this notice may be taken without further notice to stockholders, unless required by law or the bylaws of the Company.

The Company urges you to vote on the **WHITE** proxy card promptly. You may vote by completing, signing and returning the enclosed **WHITE** proxy card in the envelope provided, which requires no postage if mailed in the United States. Internet and telephone voting procedures are discussed in the Proxy Statement and on the **WHITE** proxy card. For shares held through a bank, broker or other nominee, you must follow the instructions provided by the bank, broker or other nominee regarding how to instruct your bank, broker or other nominee to vote your shares. If you attend the Annual Meeting, you may withdraw your proxy and vote in person if you so choose.

To attend the Annual Meeting in person, please register in advance by sending an email to [investors@owensmortgage.com](mailto:investors@owensmortgage.com) or by phone at (925) 935-3840. Attendance at the Annual Meeting will be limited to persons presenting proof of stock ownership as of the record date and government-issued photo identification (such as a valid driver's license or passport). *If you hold shares directly in your name as the stockholder of record, proof of ownership would include a copy of your account statement. If you hold shares through an intermediary, such as a broker, bank or other nominee, proof of stock ownership would include a proxy from your broker, bank or other nominee or a copy of your brokerage or bank account statement. Additionally, if you intend to vote your shares at the meeting, you must request a "legal proxy" from your broker, bank or other nominee and bring this legal proxy to the meeting.*

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**IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON JULY 16, 2018:** The Proxy Statement and our Annual Report on Form 10-K are available free of charge on the internet at [www.owensmortgage.com](http://www.owensmortgage.com). On this site, you will be able to

access the Proxy Statement, our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, and any amendments or supplements to the foregoing material that are required to be furnished to stockholders.

Your vote will be especially important at the Annual Meeting. Eric Hovde, Financial Institutions Partners III, LP, and certain of their affiliates (collectively, the “Hovde Group”), have notified the Company that it intends to nominate a slate of two nominees for election as directors in opposition to the nominees recommended by our Board. The Board unanimously recommends a vote “**FOR**” the election of each of the director nominees named in the accompanying Proxy Statement and on the enclosed **WHITE** proxy card. The Board does not endorse the election of any of the Hovde Group’s nominees, and strongly urges you **NOT** to sign or return any proxy card(s) or voting instruction form(s) that you may receive from the Hovde Group or any of its representatives or affiliates. You may receive proxy solicitation materials from the Hovde Group, including a proxy statement and proxy cards. The Board unanimously recommends that you disregard them. We are not responsible for the accuracy of any information provided by or relating to the Hovde Group or the nominees contained in any proxy solicitation materials filed or disseminated by, or on behalf of, the Hovde Group or any other statements that the Hovde Group or its representatives have made or may otherwise make. If you wish to vote as recommended by the Board, then you should only submit **WHITE** proxy cards.

The nominees of the Board for election as directors of the Company are listed in the accompanying Proxy Statement and **WHITE** proxy card. IT IS IMPORTANT THAT YOUR SHARES BE REPRESENTED AT THE ANNUAL MEETING REGARDLESS OF WHETHER OR NOT YOU PLAN TO ATTEND. ACCORDINGLY, AFTER READING THE ACCOMPANYING PROXY STATEMENT, PLEASE FOLLOW THE INSTRUCTIONS ON THE ENCLOSED **WHITE** PROXY CARD AND PROMPTLY SUBMIT YOUR PROXY BY TELEPHONE, THE INTERNET OR MAIL AS DESCRIBED ON THE **WHITE** PROXY CARD. PLEASE NOTE THAT EVEN IF YOU PLAN TO ATTEND THE ANNUAL MEETING, WE RECOMMEND THAT YOU VOTE USING THE ENCLOSED **WHITE** PROXY CARD PRIOR TO THE ANNUAL MEETING TO ENSURE THAT YOUR SHARES WILL BE REPRESENTED. EVEN IF YOU VOTE YOUR SHARES PRIOR TO THE ANNUAL MEETING, IF YOU HAVE PREVIOUSLY SIGNED A PROXY CARD SENT TO YOU BY THE HOVDE GROUP OR ANY OF ITS AFFILIATES IN RESPECT OF THE ANNUAL MEETING, YOU CAN REVOKE THAT PROXY AND SUBMIT A PROXY TO VOTE FOR THE BOARD’S NOMINEES BY SIGNING, DATING AND RETURNING THE ENCLOSED **WHITE** PROXY CARD OR BY FOLLOWING THE INSTRUCTIONS PROVIDED IN THE **WHITE** PROXY CARD TO SUBMIT A PROXY TO VOTE YOUR SHARES OVER THE INTERNET OR BY TELEPHONE OR BY VOTING IN PERSON AT THE ANNUAL MEETING. SIGNING, DATING AND RETURNING ANY PROXY CARD THAT THE HOVDE GROUP OR ANY OF ITS AFFILIATES MAY SEND TO YOU, EVEN WITH INSTRUCTIONS TO VOTE “WITHHOLD” WITH RESPECT TO THE HOVDE GROUP’S NOMINEES, WILL CANCEL ANY PROXY YOU MAY HAVE PREVIOUSLY SUBMITTED TO HAVE YOUR SHARES VOTED FOR THE BOARD’S NOMINEES ON A **WHITE** PROXY CARD AS ONLY YOUR LATEST PROXY CARD OR VOTING INSTRUCTION FORM WILL BE COUNTED.

IF YOU ARE A RECORD HOLDER OF SHARES, OR AN OWNER WHO OWNS SHARES IN “STREET NAME” AND OBTAINS A “LEGAL” PROXY FROM YOUR BROKER, BANK, TRUSTEE OR NOMINEE, YOU STILL MAY ATTEND THE ANNUAL MEETING AND VOTE YOUR SHARES OR REVOKE YOUR PRIOR VOTING INSTRUCTIONS.

**The Board urges you to sign, date and return only the enclosed WHITE proxy card. Please submit your proxy even if you plan to attend the Annual Meeting. To submit a proxy to vote your shares over the Internet or by telephone, please follow the instructions on the enclosed WHITE proxy card.**

Georgeson, LLC (“Georgeson”) is assisting us with our effort to solicit proxies. If you have any questions or require assistance in authorizing a proxy or voting your shares of our common stock, please contact Georgeson at (888) 206-5970 (toll free for stockholders and banks and brokers) or by email at [ORM@Georgeson.com](mailto:ORM@Georgeson.com). We are not aware of any other business, or any other nominees for election as directors, that may properly be brought before the Annual Meeting.

Regardless of the number of shares of our common stock that you own, your vote will be very important. Thank you for your continued support, interest and investment in ORM.

By Order of the Board of Directors,

/s/ Daniel J. Worley

Daniel J. Worley

*Senior Vice President and Secretary*

Walnut Creek, California  
June 8, 2018  
Enclosures

Please sign, date and promptly return the enclosed **WHITE** proxy card in the envelope provided, or grant a proxy and give voting instructions by telephone or the Internet, so that you may be represented at the Annual Meeting. Instructions are on your **WHITE** proxy card or on the voting instruction form provided by your broker.

Brokers cannot vote on any of the Proposals without your instructions.

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The accompanying Proxy Statement provides a detailed description of the business to be conducted at the Annual Meeting. We urge you to read the accompanying Proxy Statement, including the appendices and any documents incorporated by reference, carefully and in their entirety. If you have any questions concerning the business to be conducted at the Annual Meeting, would like additional copies of the Proxy Statement or need help submitting a proxy for your shares, please contact Georgeson, the Company's proxy solicitor:

Georgeson

A COMPUTERSHARE COMPANY

1290 Avenue of the Americas, 9<sup>th</sup> Floor  
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Email: ORM @Georgeson.com

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**OWENS REALTY MORTGAGE, INC.**  
**2221 Olympic Boulevard**  
**Walnut Creek, California 94595**

**PROXY STATEMENT**  
**FOR ANNUAL MEETING OF STOCKHOLDERS**  
**TO BE HELD ON JULY 16, 2018**

This Proxy Statement is being furnished to stockholders in connection with the solicitation of proxies by the Board of Directors (“Board” or “Board of Directors”) of Owens Realty Mortgage, Inc., a Maryland corporation (“ORM”, the “Company”, “we”, “our” or “us”), for use at ORM’s 2018 annual meeting of stockholders (the “Annual Meeting”) to be held at the Walnut Creek Marriott, 2355 N. Main Street, Walnut Creek, CA 94596, on July 16, 2018, at 10:00 a.m., Pacific Daylight Time, or at any postponements or adjournments thereof. We refer to holders of our common stock (“Common Stock”) as of May 31, 2018, or the record date, as “stockholders.” This Proxy Statement, the accompanying **WHITE** proxy card and our annual report to stockholders, which includes our Annual Report on Form 10-K with audited financial statements for the year ended December 31, 2017, are first being sent to our stockholders beginning June 8, 2018.

**QUESTIONS AND ANSWERS ABOUT THE ANNUAL MEETING**

*Why am I receiving these materials?* ORM’s Board of Directors is providing these proxy materials to you in connection with ORM’s Annual Meeting to be held on July 16, 2018. Stockholders are requested to vote on the proposals described in this Proxy Statement.

*What is included in these materials?* These materials include:

- our Proxy Statement and a **WHITE** proxy card for the Annual Meeting; and
- our 2017 Annual Report on Form 10-K, which includes our audited consolidated financial statements.

*What proposals are being presented at the Annual Meeting?* ORM intends to present the following proposals for stockholder consideration and voting at the Annual Meeting:

- **Proposal 1: Election of Two (2) Directors:** the election of the two (2) members of Class II of ORM's Board of Directors, each to serve until the annual meeting of stockholders in 2021 and until their respective successors are duly elected and qualified; and
- **Proposal 2: Ratification of Appointment of Independent Accounting Firm:** The ratification of the appointment of Crowe Horwath LLP as ORM's independent registered public accounting firm for the year ending December 31, 2018.

The Board is not aware of any matters to be presented for action at the Annual Meeting other than the matters set forth herein. If any other matters requiring a vote of stockholders arise at the Annual Meeting, it is the intention of the persons named in the proxies to vote on such matter in accordance with their discretion.

***What are the ORM Board's voting recommendations?***

ORM's Board of Directors unanimously recommends that you vote by proxy using the **WHITE** proxy card with respect to the proposals as follows:

- **Proposal 1: Election of Two (2) Directors: "FOR"** the election of each of the nominees listed in this Proxy Statement to serve as a Class II Board member; and
- **Proposal 2: Ratification of Appointment of Independent Accounting Firm: "FOR"** the ratification of the appointment of Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2018.

***Why is the Board making such recommendations?***

We describe each proposal and the Board's reason for its recommendation with respect to each proposal elsewhere in this Proxy Statement.

You are receiving this Proxy Statement as a stockholder of the Company as of May 31, 2018, the record date for purposes of determining the stockholders entitled to receive notice of and vote at the Annual Meeting. As further described below, we request that you promptly use the enclosed **WHITE** proxy card to vote, by telephone, via the Internet or by mail, in the event you desire to express your support of or opposition to the proposals.

***When and where is the meeting?***

The Annual Meeting will be held at the Walnut Creek Marriott, 2355 N. Main Street, Walnut Creek, CA 94596, on July 16, 2018, at 10:00 a.m., Pacific Daylight Time.

***Who is soliciting my vote?***

The Board, on behalf of the Company, is soliciting your proxy to vote your shares of our Common Stock on all matters scheduled to come before the Annual Meeting, whether or not you attend in person. By completing, signing, dating and returning the **WHITE** proxy card or voting instruction form, or by submitting your proxy and voting instructions by telephone or via the Internet, you are authorizing the persons named as proxies to vote your shares of our Common Stock at the Annual Meeting as you have instructed. Proxies will be solicited on behalf of the Board by the Company's directors, director nominees and certain executive officers and other employees of the Company. Such persons are listed in Annex A to this Proxy Statement.

Additionally, the Company has retained Georgeson, a proxy solicitation firm, which may solicit proxies on the Board's behalf. You may also be solicited by advertisements in periodicals, press releases issued by us and postings on our corporate website or other websites. Information contained on our corporate website is not part of this Proxy Statement. In addition, none of the information on the other websites, if any, listed in this Proxy Statement is part of this Proxy Statement.

***Will there be a proxy contest at the Annual Meeting?***

Yes, the Hovde Group has nominated two individuals for election at the Annual Meeting in opposition to the highly qualified nominees proposed by our Board. The Hovde Group's nominees have **NOT** been endorsed by our Board. You may receive proxy solicitation materials from the Hovde Group, including a proxy statement and proxy cards. The Board unanimously recommends that you disregard them. **If you wish to vote as recommended by the Board, then you should only submit the WHITE proxy card.**

**Voting to “WITHHOLD” with respect to either of the Hovde Group’s nominees on the Hovde Group’s proxy card is not the same as voting for the Board’s nominees because a vote to “WITHHOLD” with respect to either of Hovde Group’s nominees on the proxy card will revoke any proxy you previously submitted.** If you have already voted using the Hovde Group’s proxy card, you have every right to change your vote by voting by Internet or by telephone by following the instructions on the **WHITE** proxy card, or by completing and mailing the enclosed **WHITE** proxy card in the enclosed pre-paid envelope. Only the latest-dated validly executed proxy that you submit will be counted. Any proxy may be revoked at any time prior to its exercise at the meeting. See “*May I revoke my proxy or change my vote?*” below. If you have any questions or require any assistance with voting your shares, please contact Georgeson, toll free at (888) 206-5970 or collect by email at ORM @Georgeson.com.

We are not responsible for the accuracy of any information provided by or relating to the Hovde Group or the nominees contained in any proxy solicitation materials filed or disseminated by, or on behalf of, the Hovde Group or any other statements that the Hovde Group or its representatives have made or may otherwise make.

The Board is pleased to nominate for election as director the two persons—Bryan H. Draper and James M. Kessler—named in this Proxy Statement and on the enclosed **WHITE** proxy card. We believe our two director nominees have the breadth of relevant and diverse experiences, integrity and commitment necessary to continue to grow the Company for the benefit of all Company stockholders.

*What does it mean if I receive more than one set of proxy materials?*

Since the Hovde Group has submitted alternative director nominees to the Board in opposition to the nominees proposed by our Board, we may conduct multiple mailings prior to the Annual Meeting to ensure stockholders have our latest proxy information and materials to vote. In that event, we will send you a new **WHITE** proxy card or voting instruction form with each mailing, regardless of whether you have previously voted. You may also receive multiple sets of proxy materials, including multiple **WHITE** proxy cards. If you hold shares in more than one account, please vote the **WHITE** proxy card for every account you own. The latest dated proxy you submit will be counted, and **IF YOU WISH TO VOTE AS RECOMMENDED BY THE BOARD, THEN YOU SHOULD ONLY SUBMIT WHITE PROXY CARDS.**

*What do I do if I receive a proxy card or voting instructions from the Hovde Group?*

**The Board strongly urges you NOT to sign or return any proxy cards or voting instruction forms that you may receive from the Hovde Group.** We are not responsible for the accuracy of any information provided by or relating to the Hovde Group or its nominees contained in any proxy solicitation materials filed or disseminated by, or on behalf of, the Hovde Group or any other statements that the Hovde Group or its representatives have made or may otherwise make. If you do vote “Withhold” on the Hovde Group’s nominees using the proxy card sent to you by the Hovde Group, then your vote will not be counted as a vote for any of the director nominees recommended by our Board but will result in the revocation of any previous vote you may have cast on the **WHITE** proxy card. **If you wish to vote**

**pursuant to the recommendations of our Board, then you should disregard any proxy card that you receive other than the WHITE proxy card.** If you have already voted using the proxy card provided by the Hovde Group, you have every right to change your vote by completing and returning the enclosed **WHITE** proxy card or by voting by telephone, attending the Annual Meeting in person, or via the Internet by following the instructions provided on the enclosed **WHITE** proxy card. Only the latest proxy you submit will be counted. If you have any questions or need assistance voting, please call Georgeson, our proxy solicitor, at (888) 206-5970.

***What is a quorum?***

A quorum is necessary to hold a valid meeting. The presence, in person or by proxy, of holders of Common Stock entitled to cast a majority of all the votes entitled to be cast shall constitute a quorum for the Annual Meeting. Since there were 8,888,620 outstanding shares of Common Stock as of May 31, 2018, the record date for the Annual Meeting, we will need at least 4,444,311 votes present in person or by proxy at the Annual Meeting for a quorum to exist. Each share of Common Stock outstanding as of the record date is entitled to one vote. Abstentions and broker non-votes will be counted for purposes of establishing a quorum. If there are not sufficient votes present for a quorum or to approve or ratify any of the proposals at the time of the Annual Meeting, we expect that the meeting will be adjourned to permit further solicitation of proxies by the Company.

***What is the difference between a record holder and a beneficial owner?***

If at the close of business on the record date your shares were registered directly in your name, you are considered the “record holder” of your shares. If, on the other hand, at the close of business on the record date your shares were held in an account at a brokerage firm, bank, dealer, or other similar organization or other nominee, then you are the beneficial owner of shares held in “street name” and the proxy materials, as applicable, are being forwarded to you by that organization. The organization holding your account is considered the stockholder of record for purposes of voting at the Annual Meeting. As a beneficial owner, you have the right to direct that organization on how to vote the shares in your account. If you do not provide that organization specific direction on how to vote, your shares held in the name of that organization may not be voted and will not be considered as present and entitled to vote on any matters to be considered at the Annual Meeting. If you hold your shares in “street name,” please instruct your bank, broker or other nominee how to vote your shares using the **WHITE** voting instruction form provided by your bank, broker or other nominee so that your vote can be counted. The **WHITE** voting instruction form provided by your bank, broker or other nominee may also include information about how to submit your voting instructions over the Internet or telephonically, if such options are available.

***What is the effect of abstentions and broker “non-votes”?***

Shares represented by proxies received but marked as abstentions and shares held in a broker’s account that are voted by the broker or other nominee on some but not all matters will be treated as shares present for purposes of determining the presence of a quorum.

However, if you hold your shares in street name and do not provide voting instructions to your broker, your shares will not be voted on any proposal on which your broker does not have discretionary authority to vote (a “broker



non-vote”). The listing standards and related rules of the NYSE American (the “NYSE American rules”) determine whether the proposals are routine or not routine. If a proposal is routine, a broker holding shares for an owner in street name may vote for the proposal without voting instructions. The only proposal that would be considered routine if you do not receive proxy materials from the Hovde Group would be the ratification of the selection of Crowe Horwath LLP as our independent registered public accounting firm. If a proposal is not routine, the broker may vote on the proposal only if the owner has provided voting instructions. If a broker does not receive voting instructions for a non-routine proposal, the broker will return a proxy card without a vote on that proposal, which is usually referred to as a “broker non-vote.” We do not anticipate any of the proposals presented at the Annual Meeting will allow brokers to exercise discretionary voting power. Broker non-votes are not counted in the tabulations of the votes cast or present at the Annual Meeting and entitled to vote on any of the proposals and, therefore, will have no effect on the outcome of the proposals.

***What vote is required in order to approve each proposal?***

The proposals to be voted on at the Annual Meeting have the following voting requirements:

- **Proposal 1: Election of Two (2) Directors:** Because we are facing a contested election, the election of directors to our Board requires approval of a plurality of all the votes cast. This means that the director nominees receiving the highest number of “FOR” votes of the shares cast, up to the number of directors to be elected by such shares, will be elected. As a result, the two director nominees receiving the most “for” votes at the Annual Meeting will be elected. In voting on the election of directors, you may vote “FOR” or “WITHHOLD” from voting as to each person nominated by the Board.

Broker non-votes, if any, and abstentions will not be treated as votes cast for the election of a director and will have no effect on the results of the vote, although they will be considered present for the purpose of determining the presence of a quorum.

- **Proposal 2: Ratification of Appointment of Independent Accounting Firm:** the affirmative vote of a majority of the votes cast at the Annual Meeting is required to ratify the appointment of Crowe Horwath LLP to serve as our independent registered public accounting firm for the year ending December 31, 2018. For purposes of the vote on Proposal 2, Broker non-votes, if any, and abstentions will not be treated as votes cast for Crowe Horwath LLP and will have no effect on the results of the vote, although they will be considered present for the purpose of determining the presence of a quorum.

***Who is entitled to vote?***

The Board of Directors has fixed the close of business on May 31, 2018, as the record date, and only stockholders of record at the close of business on the record date are entitled to receive notice of and to vote at the Annual Meeting and any adjournments or postponements thereof. On the record date, there were 8,888,620 shares of our Common Stock issued, outstanding and entitled to vote at the Annual Meeting.

***How many votes do I have?***

Holders of record of our Common Stock on the record date will be entitled to one vote per share. Stockholders may not cumulate votes in the election of directors. Georgeson will tabulate affirmative and negative votes and abstentions on behalf of ORM. ORM expects to retain one or more independent contractors to serve as the Inspector of Election for the Annual Meeting.

***How do I attend the Annual Meeting?***

To attend the Annual Meeting in person, please register in advance by sending an email to [investors@owensmortgage.com](mailto:investors@owensmortgage.com) or by phone at (925) 935-3840. For directions to the Annual Meeting please call (925) 935-3840.

Attendance at the Annual Meeting will be limited to persons presenting proof of stock ownership on the record date and government-issued photo identification (such as a valid driver's license or passport). If you hold shares directly in your name as the stockholder of record, proof of ownership would include a copy of your account statement. If you hold shares through an intermediary, such as a broker, bank or other nominee, proof of stock ownership would include a proxy from your broker, bank or other nominee or a copy of your brokerage or bank account statement.

We will be unable to admit anyone who does not present government-issued photo identification or refuses to comply with our rules of conduct for the Annual Meeting. These rules provide, among other things, that no cameras, recording equipment, electronic devices, large bags or packages will be permitted at the Annual Meeting. You are encouraged to submit a **WHITE** proxy card to have your shares voted regardless of whether or not you plan to attend the Annual Meeting.

Your vote is important. Please submit your **WHITE** proxy card even if you plan to attend the Annual Meeting.

***How do I vote?***

The process for voting your Common Stock depends on how your Common Stock is held. Generally, you may hold Common Stock in your name as a "record holder" or in an account with a bank, broker, or other nominee (i.e., in "street name").

If your ORM shares are registered in your name, you may vote your shares in person at the Annual Meeting or by proxy whether or not you attend the Annual Meeting. To vote by proxy, you must either:

- **By mail.** Sign and date the enclosed **WHITE** proxy card, and return it in the enclosed postage-paid envelope;
- **By telephone.** Vote by telephone by placing a toll-free call from the U.S. or Canada to 1-800-337-3503 as described in the enclosed **WHITE** proxy card; or
- **Over the Internet.** Vote over the Internet at [www.proxy-direct.com](http://www.proxy-direct.com) as described in the enclosed **WHITE** proxy card.
- **In person at the Annual Meeting.** Stockholders are invited to attend the Annual Meeting and vote in person at the Annual Meeting. If you are a beneficial owner of shares you must obtain a legal proxy from the bank, broker or other nominee of your shares to be entitled to vote those shares in person at the Annual Meeting. If

you are a record holder, you are encouraged to complete, sign and date the enclosed **WHITE** proxy card and mail it in the enclosed postage-paid envelope regardless of whether or not you plan to attend the Annual Meeting. If you hold your shares in “street name,” you are encouraged to follow the voting instructions provided by your bank, broker or other nominee to ensure that your shares are represented and voted at the Annual Meeting.

Please note that telephone and Internet voting will close at 11:59 p.m., Pacific Daylight Time, on July 15, 2018.

Please note that you may vote by proxy prior to July 16, 2018 and still attend the Annual Meeting. Even if you currently plan to attend the Annual Meeting in person, we recommend that you also submit your proxy as described above so that your vote will be counted if you later decide not to attend the Annual Meeting.

If you hold your Common Stock in street name, you may vote by following the instructions on the voting instruction card provided to you by your bank, broker or other nominee. If you intend to vote your shares at the Annual Meeting, you must request a “legal proxy” from your broker, bank or other nominee and bring this legal proxy to the meeting.

***How can I revoke my proxy or change my vote?***

A control number, located on the instructions included with the **WHITE** proxy card, is designated to verify your identity and allow you to vote your shares and confirm that your voting instructions have been recorded properly. If you submit your proxy over the Internet or by telephone, there is no need to return a signed **WHITE** proxy card. However, you may change your voting instructions by subsequently completing, signing and delivering the **WHITE** proxy card.

If you are a stockholder of record, you may revoke your proxy prior to the vote at the Annual Meeting. You may enter a new vote by using the Internet or the telephone or by mailing a new proxy card or new voting instruction card bearing a later date (which will automatically revoke your earlier voting instructions), or by attending the Annual Meeting and voting in person. Your attendance at the Annual Meeting in person will not cause your previously granted proxy to be revoked unless you specifically so request.

Notices of revocation of proxies delivered by mail must be sent and delivered by July 15, 2018 to the Company’s principal offices at 2221 Olympic Boulevard, Walnut Creek, CA 94595, Attention: Daniel Worley, Secretary.

***Who will count the vote?***

A representative of Georgeson will tabulate the votes. ORM expects to retain one or more independent contractors to act as the independent inspector of election.

***Who will bear the cost of soliciting votes for the Annual Meeting?***

ORM will pay the cost of soliciting proxies on the form accompanying these proxy materials, including the costs of preparing and mailing these proxy materials. Such expenses will also include the charges and expenses of banks, brokerage firms and other custodians, nominees or fiduciaries for forwarding solicitation materials regarding the Annual Meeting to beneficial

owners of the Company's Common Stock. In addition to the use of mail, the solicitation of proxies or votes may be made in person, by telephone or by electronic communication by ORM's directors and officers and by regular employees of Owens Financial Group, Inc., the Company's external manager (the "Manager"), who will not receive any additional compensation for such solicitation activities. Other than the persons described in this Proxy Statement, no specific class of employees of the Company will be employed to solicit stockholders in connection with this proxy solicitation. However, in the course of their regular duties, employees may be asked to perform clerical or ministerial tasks in furtherance of this solicitation. Any such directors, officers or employees will not be additionally compensated, but may be reimbursed for their out-of-pocket expenses in connection therewith. In addition, ORM may reimburse brokerage firms and other persons representing beneficial owners of shares for their reasonable expenses in forwarding solicitation material to such beneficial owners.

ORM has retained the services of Georgeson, LLC ("Georgeson") to aid in the solicitation of proxies. ORM estimates that it will pay Georgeson a fee not to exceed \$150,000 for its services plus reimbursement of customary disbursements and expenses. Georgeson expects that approximately 35 of its employees will assist in the solicitation. Our aggregate expenses, including legal fees and fees and expenses of Georgeson, excluding salaries and wages of our regular employees, are expected to be approximately \$300,000, of which \$50,000 has been incurred as of the date of this Proxy Statement.

Annex A sets forth information relating to our directors and director nominees as well as certain of our officers and employees who are considered "participants" in our solicitation under the rules of the SEC by reason of their position as directors and director nominees of the Company or because they may be soliciting proxies on our behalf.

***When will the voting results of the Annual Meeting be announced?***

The final voting results will be reported in a Current Report on Form 8-K, which will be filed with the Securities and Exchange Commission ("SEC") within four business days after the Annual Meeting. If our final voting results are not available within four business days after the Annual Meeting, we will file a Current Report on Form 8-K reporting the preliminary voting results and subsequently file the final voting results in an amendment to the Current Report on Form 8-K within four business days after the final voting results are known to us.

***Whom should I call if I have questions about the Annual Meeting?***

Georgeson is assisting us with our effort to solicit proxies. If you have any questions or require any assistance with voting your shares, please contact:

**Georgeson**

A COMPUTERSHARE COMPANY

1290 Avenue of the Americas, 9<sup>th</sup> Floor  
New York, NY 10104  
(888) 206-5970 (Toll Free)  
Email: [ORM@Georgeson.com](mailto:ORM@Georgeson.com)

*How can I obtain additional copies of these materials or copies of other documents?*

Complete copies of this Proxy Statement and 2017 Annual Report, which includes our Annual Report on Form 10-K for the year ended December 31, 2017, are also available at [www.proxy-direct.com](http://www.proxy-direct.com). You may also contact Georgeson for additional copies. You are encouraged to access and review all of the important information contained in the proxy materials before voting.

**THE BOARD UNANIMOUSLY RECOMMENDS A VOTE FOR THE ELECTION OF BOTH OF THE BOARD'S NOMINEES ON PROPOSAL 1 USING THE ENCLOSED WHITE PROXY CARD.**

**THE BOARD UNANIMOUSLY RECOMMENDS VOTING FOR PROPOSAL 2.**

## BACKGROUND OF THE SOLICITATION

Between 2016 and 2018, the Company's senior management team spoke with representatives of the Hovde Group on several occasions as part of the Company's regular engagement efforts.

On June 1, 2017, Gary I. Furukawa, the founder, senior partner and chief investment officer of Freestone Capital Management, LLC ("Freestone"), a 7.6% stockholder, sent an open letter to the Board, that in part, called for immediate liquidation of the Company, and expressed concerns with the Company's business strategy and stock price performance.

On June 13, 2017, the Company issued a press release announcing that the Board authorized a new stock repurchase program, which enabled the Company to repurchase up to \$10 million of its Common Stock over six months beginning July 13, 2017. In connection with the stock repurchase plan, the Compensation Committee had been engaged in a months-long internal analysis and evaluation of strategic options related to its external management structure, with the assistance of FTI Consulting, Inc. ("FTI"), a leading independent consultant. In the same release, the Company announced an increased quarterly dividend of \$0.10 per share of Common Stock for the quarter ended June 30, 2017.

On June 15, 2017, William Owens, who was at the time serving as the Company's Chairman of the Board, sent an open letter to Freestone that acknowledged the stockholder's feedback and responded that the Board has serious concerns regarding the consequences of liquidation, including adverse economic and tax implications. In addition, Mr. Owens reiterated the Company's commitment to closing the gap between the Company's stock price and book value, as evidenced by the Company's stock repurchase program that it had announced on June 13, 2017 and the Company's ongoing strategy of disposing of its real estate assets in a responsible manner, and reallocating proceeds into commercial loan investments.

On August 8, 2017, as part the ongoing effort to analyze and evaluate strategic options related to the Company's external management structure, the Company issued a press release announcing an agreement between the Board and the Manager to adjust the methodology used to calculate the annual fee payable to the Manager. This fee reduction generated approximately \$198,000 of cost savings for the Company for the quarter ended September 30, 2017.

In August 2017, in conjunction with the Company's view of the importance of corporate governance, the Company began to consider potential corporate governance enhancements, which among other things, included increasing gender diversity on the Company's Board.

On December 29, 2017, following extensive deliberation by the Board, the Company entered into a settlement agreement with Freestone and certain of its affiliates pursuant to which the Company agreed to purchase Common Stock held by Freestone in a privately negotiated transaction. The Board determined this strategy would permit the Company to repurchase these shares at a price that would be accretive to the Company's book value, continue to pursue its strategic plan already successfully underway and achieving results, avoid a costly and distracting proxy fight and remain intensely focused on maximizing long-term value for all stockholders.

On January 5, 2018, Eric Hovde spoke with Bryan Draper, President, Chief Executive Officer and Director of the Company, and Daniel Worley, Senior Vice President and Corporate Secretary of the Company, and informed the Company of his intention to nominate a slate of directors for the Annual Meeting. (Eric Hovde did not elaborate on his concerns regarding the Company's strategy or business.)

On January 9, 2018, Eric Hovde and James Hua, of Opal Advisors, LLC and a member of the Hovde Group, requested that the Company provide director questionnaires for a potential nomination for election of Eric Hovde's brother, Steven Hovde, and James Hua as Class II directors at the Annual Meeting.

On January 10, 2018, the Company sent each of Steven Hovde and Mr. Hua director questionnaires to complete and return to the Board.

On January 11, 2018, at the request of Dan Engel of Engel Ventures, LLC ("Engel"), Mr. Worley sent Mr. Engel the Company's bylaws and director questionnaires to complete and return to the Board.

On January 12, 2018, the last date on which stockholder nominations were due with respect to the Company's Annual Meeting, the Hovde Group delivered a formal notice to the Board expressing its intent to nominate and solicit proxies in support of two Class II director candidates, Steven Hovde and Mr. Hua, for election to the Board. According to the nomination notice, as of January 12, 2018, the Hovde Group owned approximately 3.7% of the Company's outstanding shares of Common Stock.

Also, on January 12, 2018, Engel delivered a formal notice to the Board expressing its intent to nominate and solicit proxies in support of two Class II director candidates, Mr. Engel and Michael Levine, for election to the Board at the Company's Annual Meeting. As of January 12, 2018, Engel was not a record stockholder.

On January 17, 2018, Eric Hovde contacted Mr. Draper by telephone to discuss the Hovde Group's nominations and (to discuss for the first time) his concerns with the Company's business strategy and stock price performance. Mr. Draper invited Mr. Hovde to speak directly with the Board regarding his concerns, which was subsequently arranged.

On January 18, 2018, the Company's outside counsel sent a letter to each of the Hovde Group and Engel detailing deficiencies in their respective nomination notices. Per the Company's bylaws, the nomination notice brought by Engel was insufficient, as Engel was not a stockholder of record as of the date it gave its nomination notice.

On January 25, 2018, the Hovde Group delivered to the Company's outside counsel supplemental materials with respect to its nomination notice such that the previously identified deficiencies had been sufficiently cured.

On February 13, 2018, Mr. Draper and Dennis Schmal, who was at the time serving as the Company's Lead Independent Director, spoke by telephone with Eric Hovde. During this meeting, Eric Hovde expressed concerns regarding the Company's business strategy and stock price performance, including an indication by Eric Hovde that in order to avoid a proxy contest, the Company should use substantially all available cash from operations to repurchase shares of the Company's Common Stock until the stock price reached \$20.00 per share.

The Board met on February 27, 2018 to consider Eric Hovde's proposal.

On February 28, 2018, Mr. Draper spoke by telephone with Eric Hovde. During this meeting, Mr. Draper and Eric Hovde discussed a range of topics relating to the Company's business strategy, his director nominees, and Eric Hovde's proposal that the Company use substantially all available cash from operations to repurchase stock. They also discussed coordinating schedules for the Company to conduct formal interviews with Steven Hovde and James Hua.

On March 13, 2018 the Company issued a press release announcing, among other things, the Company's adoption of a \$10 million stock repurchase plan and an increased quarterly dividend of \$0.16 per share of Common Stock for the quarter ending March 31, 2018.

Also, on March 13, 2018, Eric Hovde spoke with Mr. Draper via telephone to express his disapproval with the Company's business strategy, including the decision to increase the quarterly dividend to stockholders, and to reiterate his proposal that substantially all of the Company's available cash from operations should be used to repurchase stock.

On March 16, 2018, the Nominating and Corporate Governance Committee met with Mr. Hua to conduct a formal interview.

On March 30, 2018, the Nominating and Corporate Governance Committee met with Steven Hovde to conduct an initial formal interview.

On April 2, 2018, the Nominating and Corporate Governance Committee met with Steven Hovde via telephone to complete his interview. During Steven Hovde's interview, he informed the Company that he and Eric Hovde owned a combined \$10 million of book value (over 5%) of Common Stock of the Company. Neither Steven Hovde nor Eric

Hovde had, or subsequently has, made a filing on Schedule 13D reporting his respective ownership or the ownership of the Hovde Group of the Company's Common Stock.

Also on April 2, 2018, the Compensation Committee, the Nominating & Corporate Governance Committees and the Board each met separately to discuss and approve the Amendment No. 1 to the Company's Management Agreement (the "Amendment") and discuss potential corporate governance enhancements that the Company had first considered in August 2017, such as including the consideration of a formal diversity policy and an anti-pledging policy, and, in the case of the Nominating & Corporate Governance Committee and the Board, discuss the nominations put forth by the Hovde Group and receive updates on the search for a female director nominee initiated by the Company in March 2018.

Also, on April 2, 2018, Mr. Schmal reached out to Eric Hovde to schedule a call to discuss the Board's response to his proposal and to clarify Steven Hovde's statement that Eric Hovde and Steven Hovde own a combined \$10 million of book value of Common Stock.

On April 3, 2018, Eric Hovde confirmed to the Company via email that Eric Hovde and Steven Hovde owned a combined 325,000 shares of Common Stock as of April 3, 2018, approximately half of what Steven Hovde had originally told the Company.

On April 3, 2018, the Board and the Company announced that, as part of the previously announced effort to address the management compensation structure of the Company that began in January 2017, the Company and the Manager entered into the Amendment that, among other things, revised the Manager's compensation structure to make permanent the recent interim management fee adjustment and eliminate service fees and certain expense reimbursements payable to the Manager, and gives 30% of all loans fees and late payment charges to the Company, with the exception of certain administrative fees. The Amendment was unanimously approved by the Board and by the Audit Committee and Compensation Committee of the Board, each of which committees is composed exclusively of independent Board members. In connection with its consideration of the terms of the Amendment and related matters, the Compensation Committee considered input received from stockholders, independent financial advisors, independent legal counsel and Management, and the analysis of multiple options relating to the Company's internal and external management compensation structure.

On April 4, 2018, Mr. Schmal informed Eric Hovde via telephone that, after careful consideration, the Nominating Committee and Board concluded they would not recommend the addition of the Hovde Group nominees to the Board. Mr. Schmal made the Hovde Group a settlement proposal that contemplated, among other things, that the Hovde Group would have direct involvement in the designation of a female director that would replace an existing management director, thereby increasing the percentage of independent directors on the Board from 60% to 80%. The settlement proposal also contemplated that the new director would sit on a Board committee and lead the review of Eric Hovde's proposal that the Company use substantially all available cash from operations to repurchase stock. During the conversation, Mr. Schmal committed that a Board committee would consider larger stock repurchases. Eric Hovde noted to Mr. Schmal that he was underwhelmed by the settlement proposal, rejecting the concept of designating a female director to the Board.

On April 6, 2018, the Company's outside counsel met telephonically with Eric Hovde to discuss, among other things, the settlement proposal made by Mr. Schmal on April 4th. Eric Hovde indicated that he was underwhelmed by the settlement proposal, reiterated his concerns with the Company and its business, strategy and Manager. The Company's outside counsel listened to Eric Hovde's concerns and discussed with him the corporate governance enhancements that he could help the Company make via the settlement proposal. Eric Hovde again rejected the concept of designating a female director to the Board.

On April 11, 2018, the Company's outside counsel met telephonically with Eric Hovde. The Company's counsel presented the Company's position that it stands behind its original settlement proposal. Eric Hovde proposed that either (x) the Company repurchase shares of the Company's Common Stock held by the Hovde Group and Steven Hovde, Mr. Hua or himself join the Board or (y) Steven Hovde, Mr. Hua or himself join the Board only until the Hovde Group (i) tenders shares into a Dutch tender offer within \$16.00 to \$18.00 per share; or (ii) sold its shares soon after the completion



of a Dutch tender offer within that price range. Further, he reiterated his concerns of the Company's business strategy and, again, rejected the concept of the Hovde Group designating a female director to the Board. The Company's outside counsel confirmed he would share Eric Hovde's proposals with the Company and also presented the Company's position that it would entertain increasing the amount of cash used to repurchase stock as part of the Company's repurchase program already in place and offered to negotiate a block trade of Common Stock at a prevailing market price through the Company's current 10b5-1 plan.

On April 18, 2018, the Company's outside counsel met telephonically with Eric Hovde. On the call, Eric Hovde brought a new request that the Company buy all of the Hovde Group's shares for \$18.25 per share within 7-10 days, which represented approximately an 18% premium to the Company's stock price on that date. The Company's outside counsel committed to bring this proposal to the Company. Eric Hovde also reiterated his original repurchase proposal and his proposal for the Company to conduct a Dutch tender offer, to which the Company's outside counsel explained the transaction costs of a Dutch tender offer would be prohibitive.

On April 24, 2018, outside counsel for the Company called Eric Hovde to reject his buyout proposal and Eric Hovde formally rejected the Company's settlement proposal and withdrew the Hovde Group's settlement proposal.

On April 25, 2018, the Company issued a press release announcing an increase in the Company's quarterly common stock dividend to \$0.20 per share for the second quarter of 2018.

On May 7, 2018, William C. Owens, then Chairman of the Board, informed the Board of his decision to step down from his role as Chairman, effective at the close of business on May 7, 2018. Upon the recommendation of the Company's Nominating and Corporate Governance Committee, and after considering the best interests of the Company and its stockholders, the Board appointed Mr. Schmal, the Board's lead independent director at the time, as Chairman of the Board, effective at the close of business on May 7, 2018. Mr. Owens remains on the Board and serves as executive Chairman Emeritus of the Company.

Also, on May 7, 2018, the Board approved amendments to the Company's Corporate Governance Guidelines that, among other things, added a provision stating that the Nominating and Corporate Governance Committee, when expanding the size of the Board or filling a vacancy on the Board, would formally commit to interviewing at least one candidate who brings gender, race or ethnic diversity to the Board. The Board also approved other revisions to the Company's Corporate Governance Guidelines including the adoption of a majority voting standard for uncontested director elections, a Board diversity policy and an anti-pledging policy.

On May 8, 2018, the Hovde Group issued an open letter to the Company's stockholders stating, among other things, its intention to nominate Steven Hovde and Mr. Hua to the Company's Board.

On May 9, 2018, the Company issued a press release announcing, among other things, the Hovde Group's rejection of the Company's multiple settlement proposals and that the Nominating and Corporate Governance Committee and the full Board concluded that adding the Hovde Group candidates to the Board would not be in the best interests of the Company and its stockholders.

On May 10, 2018, the Hovde Group released an open letter to the Company's stockholders in response to the press release issued by the Company on May 9th.

Also, on May 10, 2018, the Company held its first quarter 2018 earnings conference call to discuss first quarter 2018 results and the Board's previously disclosed strategic plan for the Company. During the conference call, representatives of the Hovde Group directed inquiries to the Company's senior management to which senior management responded.

On May 24, 2018, the Company filed a preliminary proxy statement with the SEC soliciting proxies from the Company's stockholders to vote for the two incumbent Class II director nominees, and for the ratification of the

appointment of Crowe Horwath LLP as the Company's independent registered public accounting firm for the year ending December 31, 2018.

On June 1, 2018, the SEC notified the Company that it would not review the preliminary proxy statement.

On June 8, 2018, the Company filed a definitive proxy statement with the SEC.

### **PROPOSAL 1: ELECTION OF TWO (2) DIRECTORS**

On November 12, 2013, the Company acted by resolution of the Board of Directors to elect to be subject to all of the provisions of Sections 3-803, 3-804 and 3-805 of Title 3, Subtitle 8 of the Maryland General Corporation Law ("MGCL"). As a result of the Company's election to be subject to Section 3-803 of the MGCL, the Board is classified into three separate classes of directors. Directors in each class are elected for a staggered term of three-years each, with a term of office of only one of these three classes of directors expiring each year. Previously, the Board consisted of a single class of directors, with directors required to stand for election every year.

Each of our Class II directors, Mr. Bryan H. Draper and Mr. James M. Kessler, has a term expiring at the Annual Meeting upon the election and qualification of his respective successor. There is also one Class I director, Mr. Gary C. Wallace, with a term continuing until the annual meeting of stockholders in 2020 and until his successor is elected and qualified, and two Class III directors with terms continuing until the annual meeting of stockholders in 2019 and until their respective successors are elected and qualified. The Class III directors are Mr. Dennis G. Schmal and Mr. William C. Owens. At each annual meeting of stockholders, the successors to the class of directors whose term expires at that annual meeting of stockholders will be elected to hold office for a term continuing until the annual meeting of stockholders held in the third year following the year of their election and until their successors are elected and qualified, or until their earlier death, resignation or removal.

The Nominating and Corporate Governance Committee of the Board has recommended, and the Board has nominated, Messrs. Draper and Kessler (the "Nominees") to stand for election at the Annual Meeting and to hold office until the annual meeting of stockholders to be held in 2021 and until their respective successors are duly elected and qualified. Each Nominee has agreed to serve as a nominee, to serve as a director if elected and has consented to being named as a nominee in this Proxy Statement. Accordingly, the Board has no reason to believe that either Nominee will be unable or unwilling to serve. **If either Nominee should decline or be unable to serve as a director, it is intended that the proxy will be voted for the election of such person as is nominated as a replacement by the Nominating and Corporate Governance Committee and by the Board. The Board has no reason to believe that any replacement nominee or nominees will be required.**

### **Information about the Director Nominees and the Continuing Directors**

The Board is comprised of five members divided into three classes serving staggered terms. Gary C. Wallace is the Class I director, Bryan H. Draper and James M. Kessler are the Class II directors nominated for election at this Annual Meeting, and William C. Owens and Dennis G. Schmal are the Class III directors. Our charter (the "Charter") and bylaws, and the provisions of Section 3-804 of Title 3, Subtitle 8 of the MGCL applicable to the Company, provide that only the Board may increase or decrease the number of directors, but the number of directors may never be less than the minimum required by the MGCL (which is one) nor (unless our bylaws are amended) more than 15.

As a result of our adoption of the provisions of Section 3-804 of Title 3, Subtitle 8 of the MGCL, any vacancies occurring on our Board, including vacancies occurring as a result of the death, resignation, or removal of a director, or due to an increase in the size of the Board, may be filled only by the affirmative vote of a majority of the remaining directors in office, even if the remaining directors do not constitute a quorum, and any director elected to fill a vacancy will serve for the remainder of the full term of the directorship in which the vacancy occurred and until a successor is duly elected and qualifies.

Messrs. Draper and Kessler, the Nominees for election as directors at the Annual Meeting, have each been evaluated by the Nominating and Corporate Governance Committee pursuant to the guidelines described below under "Governance of Our Company—Director Qualifications" and the determination has been made that each of the Nominees fulfills and

exceeds the qualities that we look for in members of our Board. There is no familial relationship among any of the members of our Board or our executive officers. Messrs. Draper and Owens are affiliated with our Manager and are not independent under the NYSE American rules. Each of Mr. Schmal, Mr. Wallace and Mr. Kessler is independent as defined in the NYSE American rules. See “Governance of Our Company— Director Independence.”

The Board has, and continues to, conduct a careful and thoughtful search process to designate a female director candidate who possesses the requisite skills and experience needed to assist in executing the Company’s strategic growth plans.

The information set forth below is as of May 31, 2018 for the Company’s director Nominees and each of the Company’s continuing directors. The business address of the Nominees and each of the continuing directors is c/o Owens Realty Mortgage, Inc., 2221 Olympic Boulevard, Walnut Creek, California 94595.

***Nominees for Class II Directors (Terms expire at the 2018 Annual Meeting):***

***Bryan H. Draper*** – Mr. Draper, age 60, has served as our President and CEO since January 2016 and as a member of our Board since Owens Mortgage Investment Fund, a California Limited Partnership merged with and into ORM, with ORM as the surviving corporation (the “Merger”), on May 20, 2013. Mr. Draper served as the Secretary and Treasurer of the Company from its inception in 2012 until January 2016, and as our Chief Financial Officer from January 2013 to January 2016. He has also been Chief Financial Officer and Corporate Secretary of our Manager since December 1987 and a member of the Board of Directors of the Manager since January 1997. Mr. Draper is also currently the Chief Financial Officer of Investors Yield, Inc. (a California Trust Company) which is owned 100% by the Manager. Mr. Draper is expected to continue as a director and Corporate Secretary and Chief Financial Officer of the Manager until he resigns or is replaced by a vote of the Manager’s stockholders and board of directors, respectively. Mr. Draper is a certified public accountant and is responsible for all accounting, finance, and tax matters for the Manager. Mr. Draper received a Master’s degree in business administration from the University of Southern California in 1981.

Mr. Draper’s extensive experience in the commercial mortgage financing and real estate industries, including REO dispositions, credit facilities, and risk oversight, his deep knowledge of our business as our Chief Executive Officer, as our former Chief Financial Officer and as the Chief Financial Officer of our Manager, as well as his CPA certification and expertise in accounting and financial matters make him well qualified to serve a director of the Company and strengthens our Board’s collective qualifications, skills, experience and viewpoints.

***James M. Kessler*** – Mr. Kessler, age 65, has been a member of our Board since the consummation of the Merger on May 20, 2013. He has been the President of Stonehenge Property Group, a private real estate development and advisory services company, since its inception in August 2005. Mr. Kessler founded Stonehenge Property Group and is responsible for all of its operations including budgets, business plans, property acquisition and development, financing and leasing. From January 2004 to July 2005, he was the founder and principal of Highland Development Company, a retail acquisition and development company that was part of the Marcus & Millichap group of companies. From April 2002 to October 2003, Mr. Kessler served as the Chief Operating Officer of ScanlanKemperBard Companies, a private real estate investment firm. From July 1999 to February 2002, he served as the Chief Development Officer of Federal Realty Investment Trust, a publicly traded REIT. While at Federal Realty Investment Trust, Mr. Kessler was responsible for establishing and managing regional and satellite offices, development, redevelopment, construction, operations, asset management and leasing. From December 1989 to July 1999, Mr. Kessler was the Chief Development Officer of Burnham Pacific Properties/The Martin Group, a publicly traded REIT. From 1985 to December 1989, he served as the Director of Marketing of Transpacific Development, a private real estate development and management company. Mr. Kessler received his bachelor’s degree in business administration and management from Golden Gate University in 1981.

Mr. Kessler’s extensive experience in the real estate investment, development, business operations, and management industries and his senior management positions in two publicly traded REITs make him well qualified to serve as a director of the Company and strengthens our Board’s collective qualifications, skills, experience and viewpoints.

## **Conclusion and Recommendation; Vote Required**

This election of directors is considered a contested election. Accordingly, each Nominee for election to the Board will be elected only if such nominee receives the affirmative vote of a plurality of the total votes cast. This means that the two individuals nominated for election to the Board at the Annual Meeting who receive the largest number of properly cast “FOR” votes (among votes properly cast in person or by proxy) will be elected as directors. In director elections, stockholders may either vote “FOR” or withhold voting authority with respect to director nominees. Shares of Common Stock voting “withhold” are counted for purposes of determining a quorum. However, if you withhold authority to vote with respect to the election of either or both of the two nominees, your shares of Common Stock will not be voted with respect to those nominees indicated. Therefore, “withhold” votes will not affect the outcome of the election of directors. Broker non-votes, if any, and abstentions will not be treated as votes cast for the election of a director and will have no effect on the results of the vote, although they will be considered present for the purpose of determining the presence of a quorum.

**THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE “FOR” THE ELECTION OF THE CLASS II NOMINEES NAMED ABOVE.**

### ***Class I Director (Term expires at the 2020 Annual Meeting):***

**Gary C. Wallace** – Mr. Wallace, age 63, has been a member of our Board since July 22, 2016. Mr. Wallace has provided consulting services to various banks, private equity firms, venture capital firms and the Public Company Accounting Oversight Board since his retirement from KPMG in 2005. He has also served as a member of the Board and Chairman of the Audit Committee of Plaza Bancorp and Plaza Bank from June 26, 2015 until November 2017. From February 2014 until February 2017, Mr. Wallace served as a member of the Board and Chairman of the Audit Committee of Orient Bancorp and Bank of the Orient. From 2012 until June 26, 2015, Mr. Wallace served as a Director of Manhattan Bancorp and Bank of Manhattan, N.A. Mr. Wallace joined KPMG in 1975 and retired as a KPMG Audit Partner Specialist in Banking and Investment Services in 2005, having served as head of the Northern California Financial Institutions Practice. As a KPMG Audit Partner, Mr. Wallace served as engagement partner and associate SEC reviewing partner for banks, real estate, venture capital, private equity, hedge fund and investment companies ranging in size from startups to entities with over fifty billion dollars in assets. Mr. Wallace received a Bachelor of Science degree in Business Administration, Summa Cum Laude, from California State University – East Bay in 1975.

Mr. Wallace’s extensive experience in audit, accounting and other financial matters, as well as deep familiarity with the financial services industry, corporate governance issues, regulatory matters, and risk management make him well qualified to serve as a director of the Company and strengthens our Board’s collective qualifications, skills, experience and viewpoints.

### ***Class III Directors (Terms expire at the 2019 Annual Meeting):***

**William C. Owens** – Mr. Owens, age 67, has served as our executive Chairman Emeritus since May 7, 2018 and as member of our Board since ORM’s inception in 2012. Mr. Owens also served as our executive Chairman of the Board from ORM’s inception in 2012 until May 7, 2018, as our President from our inception until January 2016, and as our Chief Executive Officer from January 2013 until January 2016. He has been President of our Manager since April 1996 and is a member of the Board of Directors and the Loan Committee of the Manager and its Chief Executive Officer. Mr. Owens is expected to continue as a director and President and Chief Executive Officer of the Manager until he resigns or is replaced by a vote of the Manager’s stockholders and board of directors, respectively. From 1979 until April 1996, he served as a Senior Vice President of the Manager. Mr. Owens is also currently the President of Investors Yield, Inc. (a California Trust Company) which is owned 100% by the Manager. Mr. Owens has been active in real estate construction, development, and mortgage financing since 1973. Prior to joining Owens Mortgage Company in 1979, Mr. Owens was involved in mortgage banking, property management and real estate development. As President of the Manager, Mr. Owens is responsible for the overall activities and operations of the Manager, including corporate investment, operating policy and planning. In addition, he is responsible for loan production, including the underwriting and review of potential loan investments. Mr. Owens graduated from Westmont College in 1973 and is a licensed real estate broker.

Mr. Owens' extensive experience in the mortgage financing and real estate industries, his deep knowledge of our business as our executive Chairman Emeritus, as our former Chief Executive Officer and as the Chief Executive Officer of our Manager, and his prior leadership experience make him well qualified to serve as a director of the Company and strengthens our Board's collective qualifications, skills, experience and viewpoints.

**Dennis G. Schmal** – Mr. Schmal, age 71, has been a member of our Board since the consummation of the Merger on May 20, 2013, and was appointed Chairman of the Board on May 7, 2018. In May of 2015, Mr. Schmal began service as a director and as chair of the audit committee of a public technology company, Blue Calypso, Inc., which deregistered and became a private company in March 2017. Mr. Schmal currently serves as a director of Blue Calypso, Inc., however, he no longer serves on the audit committee and the company's operations have substantially ceased. Mr. Schmal also serves as a director of the public investment funds overseen by the following three asset management complexes: the AssetMark GuideMark/GuidePath Funds, where he has served as a director since 2006 and is chairman of the audit committee; the Wells Fargo GAI Hedge Funds where he has served as a director since 2008 and is a member of the audit committee; and the Cambria ETF Series where he has served as a director since 2013 and is chairman of the audit committee. Mr. Schmal served as a director and a member of the audit (chairman), nominating, and compensation committees of Merriman Holdings, Inc., a securities and investment banking firm from August 2003 until July 2016. From May 2005 until July 2014, Mr. Schmal served as chairman of the board of directors of Pacific Metrics Corporation, a private company in the educational assessment/software field. Mr. Schmal served as chairman of the board of directors of a technology industry startup, Sitoa Global Inc., from January 2012 until April 2013. From August 2004 to November 2011, he served as a member of the board of directors, audit committee (chairman) and compensation committee of Varian Semiconductor, a semiconductor equipment manufacturer. From October 2008 to May 2011, he served as a director and chairman of the audit committee of Grail Advisors EFT Trust, an exchange traded fund complex. From September 2006 to May 2008, Mr. Schmal served as a director and chairman of the audit committee of North Bay Bancorp, a bank holding company. From February 1972 to April 1999, Mr. Schmal was employed by Arthur Andersen LLP, primarily as a partner overseeing the delivery of accounting and audit services. During his career with Arthur Andersen LLP, Mr. Schmal specialized in working with companies in the financial services sector, including the commercial banking, securities/investment banking and asset management industries. Mr. Schmal received a Bachelor of Science in Business Administration – Finance and Accounting Option from California State University, Fresno in 1972 and holds a CPA certificate (retired).

Mr. Schmal's extensive experience serving on boards and the audit and other key committees of multiple private and public companies, as well as his extensive expertise in regulatory, accounting and financial matters, risk management, and corporate governance, make him well qualified to serve as Chairman of the Board of the Company and strengthens our Board's collective qualifications, skills, experience and viewpoints.

## **PROPOSAL 2: RATIFICATION OF APPOINTMENT OF INDEPENDENT ACCOUNTING FIRM**

The audit committee of our Board (the "Audit Committee") has appointed Crowe Horwath LLP as our independent registered public accounting firm for the year ending December 31, 2018 and is submitting the selection of Crowe Horwath LLP to our stockholders for ratification. Crowe Horwath LLP has audited our financial statements for each of the fiscal years since and including 2013. Neither our bylaws nor other governing documents or applicable law require stockholder ratification of the Audit Committee's appointment of Crowe Horwath LLP as our independent registered public accounting firm. However, our Board is submitting the appointment of Crowe Horwath LLP to our stockholders for ratification as a matter of good corporate practice.

This vote is non-binding, as the Audit Committee has the sole authority to retain and dismiss the Company's independent registered public accounting firm. If our stockholders fail to ratify the appointment of Crowe Horwath LLP at the Annual Meeting, the Audit Committee will consider whether or not to appoint a different independent registered public accounting firm. Even if the appointment is ratified, the Audit Committee, in its discretion, may direct the appointment of a different independent registered public accounting firm at any time during the year if it determines that such a change would be in our best interests.

The Company expects that a representative of Crowe Horwath LLP will be present at the Annual Meeting, will have the opportunity to make a statement if so desired and will be available to respond to appropriate inquiries from stockholders.

### Principal Accountant Fees and Services

The following table summarizes the aggregate fees (including related expenses) earned by our independent registered public accounting firm, Crowe Horwath LLP, for the fiscal years ended December 31, 2017 and 2016:

	<b>Fiscal Year Ended December 31, 2017</b>	<b>Fiscal Year Ended December 31, 2016</b>
Audit Fees	\$ 255,000	\$ 229,000
Audit-Related Fees	1,200	13,200
Tax Fees	107,068	119,483
All Other Fees	<u>17,780</u>	<u>2,696</u>
<b>Total</b>	<b>\$ <u>381,048</u></b>	<b>\$ <u>364,379</u></b>

**Audit Fees.** Audit fees consist of fees and expenses billed by Crowe Horwath LLP related to the audit of our consolidated financial statements included in Form 10-K, the audit of our internal control over financial reporting and the reviews of the interim consolidated financial statements included in the Form 10-Q's, including services normally provided by an accountant in connection with statutory and regulatory filings or engagements.

**Audit Related Fees.** Audit-related fees are fees and expenses billed for assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements and are not reported under "Audit Fees."

**Tax Fees.** Tax fees billed to us by Crowe Horwath LLP are for tax compliance and consulting fees, which typically consist of fees billed for professional services for tax return preparation and other tax compliance.

**All Other Fees.** All other fees consist of fees for products and services other than the services reported above, including consulting fees paid for a cost segregation study and accounting guidance subscriptions paid.

All services rendered by Crowe Horwath LLP were pre-approved by the Audit Committee for 2017 in accordance with its pre-approval policy, and the Audit Committee concluded that the provision of such services by Crowe Horwath LLP was compatible with the maintenance of that firm's independence in the conduct of its audit functions. The Audit Committee charter requires that the committee review and pre-approve each audit or permissible non-audit engagement or accounting project involving the independent public accountant, and the related fees or ranges of fees, prior to commencement of the engagement or project subject to certain exceptions if the services meet pre-approval policies that may be established under the charter. The Audit Committee may delegate its pre-approval authority to one or more of its members and, if such delegation occurs, then such member(s) are required to report any pre-approval decisions to the Audit Committee at its next-scheduled meeting.

## **Conclusion and Recommendation; Vote Required**

The affirmative vote of a majority of all of the votes cast at the Annual Meeting is required to ratify the appointment of our independent public accountant. Abstentions and broker non-votes will not be counted as votes cast and will have no effect on the result of the vote, although they will be considered present for the purpose of determining the presence of a quorum.

**THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE “FOR” RATIFICATION OF THE APPOINTMENT OF CROWE HORWATH LLP AS OUR INDEPENDENT PUBLIC ACCOUNTANT FOR THE YEAR ENDING DECEMBER 31, 2018.**

## **REPORT OF THE AUDIT COMMITTEE**

The Board of Directors has appointed an Audit Committee presently composed of three directors, Messrs. Wallace, Kessler and Schmal, who each served on the Audit Committee throughout 2017. Each of the committee members is independent as defined in the NYSE American rules, and the Board has determined that Mr. Wallace is an “audit committee financial expert” (as defined in Item 407 of Regulation S-K under the Securities Act of 1933, as amended (the “Securities Act”)).

The Audit Committee’s responsibility is one of oversight as set forth in its charter, which is available on the Company’s web site at [www.owensmortgage.com](http://www.owensmortgage.com). It is not the duty of the Audit Committee to prepare the Company’s financial statements, to plan or conduct audits or to determine that the Company’s financial statements are complete and accurate and are in accordance with generally accepted accounting principles. The Company’s management is responsible for preparing the Company’s financial statements and for maintaining effective internal control over financial reporting. The Company’s independent registered public accounting firm is responsible for auditing the financial statements and the effectiveness of the Company’s internal control over financial reporting and for expressing an opinion as to whether those audited financial statements present fairly, in all material respects, the Company’s financial position, results of operations and cash flows in conformity with generally accepted accounting principles, and for expressing an opinion as to whether the Company maintained, in all material respects, effective internal control over financial reporting.

At a meeting held subsequent to December 31, 2017, the Audit Committee reviewed and discussed with management and Crowe Horwath LLP, the Company’s independent registered public accounting firm, the audited financial statements of the Company as of and for the year ended December 31, 2017, and the related report prepared by Crowe Horwath LLP. The Audit Committee met with Crowe Horwath LLP, with and without management present, to discuss the results of their audit. Management represented to the Audit Committee that the Company’s consolidated financial statements as of and for the year ended December 31, 2017 were prepared in accordance with accounting principles generally accepted in the United States and that the Company maintained effective internal control over financial reporting as of December 31, 2017.

The Audit Committee has discussed with Crowe Horwath LLP the matters required to be discussed by PCAOB Auditing Standard No. 1301, which included among other things a discussion of Crowe Horwath LLP’s judgments about the quality (not just the acceptability) of the Company’s accounting principles as applied to financial reporting.

The Audit Committee has received from Crowe Horwath LLP the written statements required by PCAOB Rule No. 3526, “Communications with Audit Committees Concerning Independence,” and has discussed Crowe Horwath LLP’s independence with Crowe Horwath LLP, and has considered the compatibility of non-audit services with the auditor’s independence. The Audit Committee also received regular updates on the amount of fees and scope of audit and other services provided by Crowe Horwath LLP.

Based on the review and discussions referred to above, and subject to the limitations on the Audit Committee’s role and responsibilities referred to above and in its charter, the Audit Committee recommended to the Board of Directors that the audited consolidated financial statements as of and for the year ended December 31, 2017, be included in our Annual Report on Form 10-K for the year ended December 31, 2017, for filing with the SEC. The Audit Committee also

appointed Crowe Horwath LLP as the Company's independent registered public accounting firm for the year ending December 31, 2018 and is presenting this appointment to the Company's stockholders for ratification.

*By the Audit Committee:*

Gary C. Wallace, Chair  
James Matthew Kessler  
Dennis George Schmal

*The foregoing Report of the Audit Committee shall not be deemed under the Securities Act or the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to be (i) "soliciting material" or "filed" or (ii) incorporated by reference by any general statement into any filing made by us with the SEC, except to the extent that we specifically incorporate such report by reference.*

## GOVERNANCE OF OUR COMPANY

The primary responsibility of our Board of Directors is to oversee the affairs of the Company for the benefit of our Company's stockholders. To assist it in fulfilling its duties, the Board has delegated certain authority to the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee. The duties and responsibilities of these standing committees are described below under "Committees of the Board."

Members of our Board keep informed of our business by participating in meetings of our Board and its committees, by reviewing analyses, reports and other materials provided to them and through discussions with our Manager and our executive officers. Our Board has developed and recently revised corporate governance practices to help it fulfill its responsibilities on behalf of our stockholders. These governance practices are set forth in our Corporate Governance Guidelines (the "Guidelines"), and in our Charter, bylaws, policies and committee charters, which are further described below.

In connection with the previously announced review of our corporate governance practices, the Board approved revisions to the Guidelines that created, among other things, a director resignation policy setting forth the Board's expectation that any director that fails to receive the required majority vote in an uncontested election will promptly tender his or her resignation to the Board for its consideration, a Board diversity policy, an anti-pledging policy and stock ownership guidelines for the Company's directors and executive officers.

### Governance Snapshot

Our policies and practices comply with the listing requirements of the NYSE American and the requirements of the Sarbanes-Oxley Act of 2002. Our Board and Nominating and Corporate Governance Committee regularly evaluate our corporate governance policies and practices in light of changing regulatory requirements and evolving best practices.

- **Engaged Board.** Our Board met nine times in 2017 and our independent directors meet regularly without the presence of management.
- **Independent Chairman.** The Chairman of our Board is independent of us and our Manager.
- **Majority Independent Board.** The only members of management that serve on our Board are our President and CEO and our executive Chairman Emeritus. Three of five directors, or 60% of the Board, are independent of us and our Manager.
- **Independent Standing Committees.** All members of the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are independent of us and our Manager.



- **Board Diversity.** Our Board has implemented a formal policy regarding board diversity to further our goal of achieving a Board with diverse skills and backgrounds that support its responsibilities on behalf of our stockholders. The Board has, and continues to, conduct a careful and thoughtful search process to designate a female director candidate who possesses the requisite skills and experience needed to assist in executing the Company’s strategic growth plans. The Nominating and Corporate Governance Committee and the Board considers the effectiveness of this policy and the effectiveness of the Board generally in the course of nominating directors for election.
- **Majority Voting for Directors/Director Resignation Policy.** Our bylaws require that directors nominated in an uncontested election be elected by a majority of the votes cast. Directors failing to get a majority of the votes cast are required to tender their resignation for consideration by the Board and the Nominating and Corporate Governance Committee.
- **Share Retention Requirements.** The Board believes that meaningful ownership of our Common Stock by our directors and executive officers helps to align the interests of the Company’s directors and executive officers with those of our stockholders and, accordingly, has adopted formal share ownership guidelines applicable to all of our directors and executive officers.
- **Anti-Hedging and Anti-Pledging Policies.** The Company’s Corporate Governance Guidelines place restrictions on the ability of the Company’s directors and executive officers to enter into hedging transactions with respect to the Company’s securities and from holding the Company’s securities in margin accounts or otherwise pledging such securities as collateral for loans.
- **Stockholder Outreach.** Our Board is committed to building and maintaining long-term relationships with our stockholders as we build value for the long-term. To that end, we have continued with our efforts regarding stockholder outreach and dialogue throughout the year and beyond.
- **Maryland Control Share Acquisition Act Not Applicable.** Our bylaws provide that the Maryland Control Share Acquisition Act is not applicable to the Company.
- **Resolution Opting out of Maryland Business Combination Act.** Our Board has adopted a resolution exempting from the provisions of the Maryland Business Combination Act: (i) any business combination between the Company and any other person, provided that the business combination is first approved by a majority of the directors of the Company (including a majority of the directors who are not affiliates or associates of such person), (ii) any business combination between the Company and the Manager, or any of the Manager’s affiliates and associates and (iii) any person acting in concert with any of the foregoing.
- **No Poison Pill.** We do not have a stockholder rights plan or “poison pill.”
- **Active Standing Committees.** The charters of our Board committees clearly establish the respective roles and responsibilities of the committees and the committees meet regularly.
- **Code of Business Conduct and Ethics.** Our Board has adopted a Code of Business Conduct and Ethics that applies to all of our directors, officers and employees and personnel of the Manager.
- **Employee Hotline.** We have a toll-free hotline available to all employees, and our Audit Committee has established procedures for the anonymous submission of any employee complaint, including those relating to accounting, internal controls or auditing matters.

Additional information regarding our corporate governance is provided in the following paragraphs and elsewhere in this Proxy Statement.

## Meetings of the Board

Our Board is currently comprised of five members: Bryan H. Draper, William C. Owens, Dennis G. Schmal, James M. Kessler and Gary C. Wallace. The Board conducts its business through regular meetings and through actions taken by written consent in lieu of meetings. During 2017, the Board held nine meetings. Each director attended at least 75% of the meetings of the Board and of the committees on which he or she served and that were held in 2017. Although we do not have a policy requiring director attendance at the Annual Meeting, directors are encouraged to attend the Annual Meeting. All of our directors attended the Company's 2017 annual meeting of stockholders.

## Director Independence

The Guidelines provide that a majority of the directors serving on our Board must be "independent" as defined by the NYSE American rules. Based upon its review of all relevant facts and circumstances, the Board has affirmatively determined that three of our current directors representing 60% of the Board members, Dennis G. Schmal, Gary C. Wallace and James M. Kessler, qualify as independent directors under applicable SEC and NYSE American rules. Only two of our directors, our President and CEO Bryan H. Draper and our executive Chairman Emeritus William C. Owens, are affiliated with the Manager.

In addition, each of our Board's Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee is composed entirely of independent directors as required by the charters of those committees. These independent committees of our Board also have the authority under their respective charters to hire independent advisors and consultants, at our expense, to assist them in performing their duties.

The independent Board members have decided to hold meetings periodically without the affiliated directors or other persons who are members of management present. Our independent directors meet during our Board's quarterly in-person meetings and may hold additional meetings at the request of any independent director. The presiding director at each such meeting is the Chairman of the Board (or lead director if our Chairman is not independent), or in his or her absence, the person the Chairman of the Board (or lead director if our Chairman is not independent) so appoints.

## The Company has an Independent Chairman of the Board

The positions of Chairman of the Board and CEO are held by different persons as Mr. Draper is our CEO and Mr. Schmal currently serves as the independent Chairman of the Board. The Board believes that the arrangement of separating the roles of Chairman of the Board and CEO is in the best interest of the Company and its stockholders at this time because it allows the Company the benefit of the distinct abilities and experience of both individuals and provides the appropriate balance between strategy development and independent oversight of management. Because the Company currently has an independent non-executive Chairman of the Board, no lead independent director has been appointed.

## Committees of the Board

The Board has established three standing committees: the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee. Messrs. Wallace, Kessler and Schmal are the current members of each committee. Our Board has determined, based upon its qualitative assessment of his relevant level of knowledge and business experience that Mr. Wallace (the chairman of the Audit Committee) qualifies as an "audit committee financial expert" for purposes of, and as defined by, applicable SEC rules and has the requisite accounting or related financial management expertise required by the NYSE American rules. In addition, our Board has determined that all of the members of the Audit Committee are financially literate as required by the NYSE American rules.

The primary functions of our committees are described below.

**Audit Committee.** This committee, which met five times during 2017, among other things acts on behalf of the Board of Directors in overseeing:

- our accounting and financial reporting processes;
- the integrity of our financial statements and the audit and reporting processes;

- our system of disclosure controls and procedures and internal control over financial reporting;
- our compliance with financial, legal and regulatory requirements;
- the qualifications and independence of our independent registered public accounting firm; and
- the Company's overall risk profile.

The Audit Committee is also responsible for engaging our independent registered public accounting firm, approving professional services provided by the independent registered public accounting firm and considering the range of audit and non-audit fees, and reviewing with management and the independent auditors our interim and audited annual financial statements as well as approving the filing of our financial statements. The Audit Committee's purpose and responsibilities are more fully set forth in the committee's charter, which was adopted by the Board of Directors on May 20, 2013 and is available on our web site at [www.owensmortgage.com](http://www.owensmortgage.com). The Audit Committee's meetings include, whenever appropriate, executive sessions with our independent external auditors without the presence of management.

**Compensation Committee.** This committee, which met fourteen times during 2017, among other things acts on behalf of the Board of Directors to:

- discharge the Board's responsibilities relating to compensation to be paid by us to our directors which is considered on at least an annual basis;
- discharge the Board's responsibilities relating to compensation, if any, to be paid by us to our executive officers;
- oversee the compensation and fees payable to, and the performance of, the Manager under the Company's Charter and the existing management agreement dated May 20, 2013, and amended by Amendment No. 1 dated April 2, 2018 (as amended, the "Management Agreement") with our Manager, which Management Agreement is described in this Proxy Statement under "Related Party Transactions"; and
- produce any report on executive compensation required to be included in our proxy statement for our annual meetings of stockholders.

The Compensation Committee's purpose and responsibilities are more fully set forth in the committee's charter, which was adopted by the Board of Directors on May 20, 2013, and amended and restated by the Board on January 4, 2016, and is available on our web site at [www.owensmortgage.com](http://www.owensmortgage.com).

During 2017, the Compensation Committee retained FTI as its independent compensation consultant. The Compensation Committee requested that FTI provide the Committee with a peer group analysis to compare the compensation terms for our Manager and for our independent directors against the compensation terms in place at a peer group of our competitors, such peer group to be developed by FTI. The Compensation Committee also asked FTI to develop recommendations regarding the compensation of our Manager and of our independent directors, and to develop a peer group analysis and additional information relating to the compensation of certain executive officers of the Company in the event they were retained by the Company directly as employees. Additionally, in 2017, FTI was engaged by the Compensation Committee to perform other financial advisory services unrelated to executive or director compensation. The Company paid \$217,283 and \$35,000 in 2017 to FTI for financial advisory services and executive/director compensation advisory services, respectively. The decision to engage FTI for, and the determination of the scope of, these financial and compensation services was made solely by the Compensation Committee without the recommendation of management.

**Nominating and Corporate Governance Committee.** This committee, which met three times during 2017, among other things acts on behalf of the Board of Directors to:

- identify qualified director candidates, consistent with criteria approved by the Board and included in the committee's charter and to recommend nominees for election to the Board;
- develop and recommend to the Board corporate governance guidelines (including the Guidelines) and principles, and the implementation and monitoring of compliance with such corporate governance guidelines and principles;
- review matters involving the general operation of the Board, including Board size and composition and committee composition and structure;
- recommend the directors to serve on each committee of the Board;
- oversee the annual assessment of the Board and committee performances, and the performance of individual directors;

- oversee compliance with our stock ownership guidelines for directors and executive officers; and
- ensure the Company is in compliance with the NYSE American rules.

For a discussion of the Nominating and Corporate Governance Committee’s process for identifying, evaluating and selecting director nominees, including nominees recommended by stockholders, see “Governance of Our Company—Director Qualifications” in this Proxy Statement. The Nominating and Corporate Governance Committee’s purpose and responsibilities are more fully set forth in the committee’s charter, which was adopted by the Board on May 20, 2013 and is available on our web site at [www.owensmortgage.com](http://www.owensmortgage.com).

### **Majority Voting and Resignation Requirements**

We have amended our bylaws to provide that, in any uncontested election of directors, a nominee for director is elected only if such nominee receives the affirmative vote of a majority of the total votes cast for and against the election of such nominee. The majority voting standard does not apply in contested elections, and directors are elected by a plurality of the votes cast in a contested election.

Our Corporate Governance Guidelines provide that a director nominated for re-election who fails to receive the required majority vote in an uncontested election must tender his or her offer to resign to our Board for its consideration. The Nominating and Corporate Governance Committee will act promptly to determine whether it is advisable to accept the director’s resignation and will submit the recommendation for prompt consideration by our Board. Our Board will act on the tendered offer of resignation no later than 120 days following the date of the stockholders’ meeting at which the election occurred and will promptly and publicly disclose its decision. The director whose offer of resignation is under consideration will abstain from participating in any decision regarding his or her offer of resignation. If the Board accepts the director’s resignation, it may fill the resulting vacancy as provided in our bylaws.

Because we are facing a contested election, the election of directors to our Board requires approval of a plurality of the shares of our Common Stock represented in person or by proxy and entitled to vote on the proposal. This means that the director nominees receiving the highest number of “for” votes of the shares entitled to be voted for them, up to the number of directors to be elected by such shares, will be elected. As a result, the two director nominees receiving the most “for” votes at the Annual Meeting will be elected. In voting on the election of directors, you may vote “FOR” or “WITHHOLD” from voting as to each person nominated by the Board. However, because directors are elected by a plurality vote, votes withheld from a director nominee and broker non-votes will have no effect on the outcome of the vote with respect to the election of the directors. Abstentions and broker non-votes will not be counted as votes cast, although they will be considered present for the purpose of determining the presence of a quorum.

The Board unanimously recommends a vote “**FOR**” the election of each of the director nominees named in the accompanying Proxy Statement and on the enclosed **WHITE** proxy card, and strongly urges you **NOT** to sign or return any proxy card(s) or voting instruction form(s) that you may receive from the Hovde Group or any of its representatives or affiliates.

### **Executive and Director Stock Retention Requirements**

Effective May 7, 2018, we adopted share retention requirements for our executives and directors. The Board believes that meaningful ownership of the Company’s Common Stock by its directors and executive officers helps to align the interests of the Company’s directors and executive officers with those of its stockholders and is consistent with the Company’s commitment to sound corporate governance. Therefore, directors and executive officers are required to own shares of the Company’s Common Stock pursuant to the Company’s director and executive stock ownership guidelines.

### **Prohibition on Hedging and Pledging of Stock**

Our executives and directors are prohibited from hedging their ownership or offsetting any decline in the market value of our Common Stock, including by trading in publicly-traded options, puts, calls, or other derivative instruments related to our shares or otherwise engaging in hedging or monetization transactions in which they would continue to own

the underlying Company security without all the risks or rewards of ownership, such as forward contracts. Further, our executives, directors and personnel of the Manager are prohibited from pledging our Common Stock.

### **Active Stockholder Outreach**

We believe that engaging with our stockholders is fundamental to our commitment to good governance and important to our success. Throughout the year, we seek opportunities to connect with our stockholders to gain and share valuable insights into current and emerging business and governance trends. During 2017, we held over 23 phone or in-person meetings with multiple stockholders to discuss various key corporate matters, including our capital allocation, REO projects, commercial lending environment, loan criteria, interest rates and other risk management practices, share repurchases, and our governance practices. Our engagement activities take place throughout the year and we also conduct quarterly earnings calls where we try to answer many of the questions that we receive during our investor outreach.

### **Board Role in Risk Oversight**

Senior management and our Manager are responsible for the day-to-day management of risks we face. Our Board of Directors has overall responsibility for overseeing risk management with a focus on the more significant risks facing us. In this regard, the Board and its standing committees regularly meet with senior management and the Manager to review material strategic, operational, financial, compensation and compliance risks. The Board has also delegated certain risk management oversight responsibility to its Board committees.

Our Audit Committee assists the Board in fulfilling its oversight responsibilities for our accounting and financial reporting processes and the audits of our financial statements, as detailed in the discussion of its responsibilities above. The Audit Committee also is responsible for reviewing and discussing with management our major financial risk exposures and the steps management has taken to monitor and control such exposures, including our policies and practices with respect to risk assessment and risk management. The Audit Committee receives regular reports from management on the status of our internal controls and ensures that appropriate steps are being taken to mitigate any identified risk.

The Compensation Committee assists our Board by considering and addressing risk as it relates to compensation and benefit decisions, including through its review of our Manager's performance, compensation and the Management Agreement with our Manager, as detailed in the discussion of its responsibilities above. The Nominating and Corporate Governance Committee assists our Board by considering and addressing risk as it relates to corporate governance matters and other matters, as detailed in the discussion of its responsibilities above. The Compensation Committee, Nominating and Corporate Governance Committee and the Audit Committee routinely report their findings to the full Board at the next regularly scheduled Board meeting following their committee meetings and when appropriate.

The Company believes that the extent of the Board's (and its committees') role in risk oversight complements the Board's leadership structure because it allows the Company's independent directors, through the three fully independent Board committees, executive sessions with the independent auditors, and otherwise, to exercise oversight of risk without conflicts of interest that might discourage critical review.

### **Code of Business Conduct and Ethics**

We have adopted a Code of Business Conduct and Ethics, which requires our directors, employees (if any), officers (including our Chief Executive Officer and Chief Financial Officer), and the personnel of our Manager, to abide by high standards of business conduct and ethics. The Code of Business Conduct and Ethics covers a variety of topics, including those required by the SEC and the NYSE American rules. Topics covered include, but are not limited to, conflicts of interest, confidentiality of information, and compliance with laws and regulations. The Code of Business Conduct and Ethics is available for viewing on our web site at [www.owensmortgage.com](http://www.owensmortgage.com), and a copy may also be obtained by stockholders, free of charge, by writing to us at Owens Realty Mortgage, Inc., 2221 Olympic Boulevard, Walnut Creek, CA 94595, Attention: Daniel Worley, Secretary. The Code of Business Conduct and Ethics was adopted by the Board of Directors on May 20, 2013 and amended and restated on February 3, 2016.

## Corporate Governance Guidelines

Our Board has adopted the Guidelines that address significant issues of corporate governance and set forth procedures and policies by which our Board of Directors carries out certain of its responsibilities. The Guidelines address, among the areas, the composition, functions and key responsibilities and standing committees of our Board, director qualification standards, Board diversity, access to management and independent advisors, director compensation, our policy on anti-hedging and anti-pledging, management succession, director orientation and continuing education and the annual performance evaluation and review of our Board and its committees. The Guidelines are available for viewing on our website at [www.owensmortgage.com](http://www.owensmortgage.com). We will also provide the Guidelines, free of charge, to stockholders who request them by writing to us at Owens Realty Mortgage, Inc., 2221 Olympic Blvd, Walnut Creek, CA 94595, Attention: Daniel Worley, Secretary. The Guidelines were adopted by the Board of Directors on May 20, 2013 and amended and restated by the Board on May 7, 2018.

## Director Qualifications

The Board believes that it should be comprised of directors with complementary backgrounds, and that directors should, at a minimum, have expertise that will strengthen our Board's collective qualifications, skills, experience and viewpoints. Directors should possess the highest personal and professional ethics and should be willing and able to devote the required amount of time to our business. The Board is committed to seeking to attain diversity and balance among directors with respect to race, gender and ethnicity, as well as with respect to viewpoints, background, skills and experience. To that end, the Nominating and Corporate Governance Committee, when expanding the size of the Board or filling a vacancy on the Board, has formally committed to interviewing at least one candidate who brings gender, race or ethnic diversity to the Board.

Although there is no formal list of required qualifications governing the suitability of individual candidates (both new candidates and current Board members), the Nominating and Corporate Governance Committee, in recommending candidates for election, and the Board, in approving (and, in the case of vacancies, appointing) such candidates, will take into account many factors, including the following:

- the independence of the candidate from the Manager and whether the candidate meets the criteria for membership of the audit or other committees;
- personal and professional integrity, ethics and values;
- experience in corporate management, such as serving as an officer or former officer of a publicly held company, and a general understanding of marketing, finance and other elements relevant to the success of a publicly traded company in today's business environment;
- experience in the Company's industry and with relevant social policy concerns;
- experience as a board member of another publicly held company;
- diversity (of both background and experience);
- academic expertise in an area of the Company's operations;
- practical and mature business judgment, including the ability to make independent analytical inquiries; and
- adequate time availability to fulfill the Board director commitment.

When seeking candidates for director, the Nominating and Corporate Governance Committee may solicit suggestions from management, incumbent directors or others. While there is no formal policy for considering candidates that are recommended by stockholders, candidates recommended in writing and in a timely manner by stockholders entitled to vote in the election of directors will be considered and evaluated by the Nominating and Corporate Governance Committee under the same criteria applied to other candidates. The committee or its chairman will interview a candidate if it is believed the candidate might be suitable to be a director. The Nominating and Corporate Governance Committee may also ask the candidate to meet with management. If the Nominating and Corporate Governance Committee believes a candidate would be a valuable addition to the Board, it will recommend the candidate's election to the full Board.

## **Stockholder Communications with Directors**

Our Board has adopted an Investor Relations Policy, available on its website at [www.owensmortgage.com](http://www.owensmortgage.com), that establishes a process by which stockholders or other interested parties may communicate in writing with our full Board, any individual member or any committee or other group of our Board, or our independent directors as a group. Any such communications should be addressed to the Board or any such individual directors or group or committee of directors by either name or title (provided that communications intended for the independent directors as a group may be addressed to the independent directors as a group or to the independent Chairman of the Board, who is currently Dennis G. Schmal and addressed to Owens Realty Mortgage, Inc., 2221 Olympic Blvd., Walnut Creek, CA 94595, Attention: Investor Relations.

All communications to directors received as set forth in the Investor Relations Policy will be opened by the office of the Company's Corporate Compliance Officer for the sole purpose of determining whether the contents represent a message to the Company's directors. Any contents that are not in the nature of advertising, promotions of a product or service or patently offensive material will be forwarded promptly to the addressee. In the case of communications to any individual director, the full Board of Directors, or any group or committee of directors, the office of the Corporate Compliance Officer will make sufficient copies of the contents to send to each addressee. Any such communications may be made anonymously. Communications regarding accounting matters may be sent in writing to the Company's main address, attention Chief Financial Officer, or by calling the Company's telephone hotline: (855) 380-8849.

## **Related Party Transaction Policy and Procedures**

The Company has adopted a written policy for approval of transactions and arrangements between the Company and the Company's current and recent former directors, director nominees, current and recent former executive officers, greater than five percent stockholders and their immediate family members, and entities where any of the foregoing persons is employed or serves as a general partner, principal or in a similar position (each, a "Related Party").

The policy provides that the Audit Committee reviews certain transactions subject to the policy and determines whether or not to approve or ratify those transactions. In doing so, the Audit Committee takes into account, among other things, whether the transaction is on terms comparable to those that could be obtained in arm's length dealings with an unrelated third party under similar circumstances, the extent of the Related Party's interest in the transaction, and the conflicts of interest provisions and corporate opportunity provisions of the Company's Code of Business Conduct and Ethics. The Related Party transaction must be approved or ratified by the Audit Committee in accordance with the provisions of the policy and in accordance with relevant provisions of the Company's Charter, bylaws and applicable provisions of the MGCL.

The Audit Committee has considered and adopted standing pre-approvals under the policy for certain limited transactions with Related Parties that meet specific criteria. Information on transactions subject to pre-approval is to be provided to the Audit Committee at its next regularly scheduled meeting. Pre-approved transactions are limited to:

- compensation to an executive officer or director of the Company if (a) the related compensation is required to be reported in the Company's proxy statement under the SEC's compensation disclosure requirements or (b) the executive officer is not an immediate family member of another executive officer or director of the Company, the related compensation would be reported in the Company's proxy statement under the SEC's compensation disclosure requirements if the executive officer was a "named executive officer," and the Compensation Committee approved (or recommended that the Board approve and the Board has approved) such compensation;
- certain transactions in the Company's ordinary course of business where the Related Party's interest arises only from: (a) the Related Party's position as a director of another entity that is a party to the transaction; (b) from direct or indirect ownership by such Related Party and all other Related Parties, in the aggregate, of less than a 5% equity interest in another person (other than a partnership) that is a party to the transaction; (c) from both such position described in (a) and ownership described in (b); or (d) from the Related Party's position as a limited partner in a partnership in which all Related Parties in the aggregate have an interest of less than 5% and the Related Party is not a general partner of and does not have another position in such partnership;

- certain transactions in the Company’s ordinary course of business where the Related Party’s interest arises solely from the ownership of the Company’s Common Stock and holders of the Company’s Common Stock received the same benefit on a pro rata basis; and
- certain transactions involving a Related Party where the rates or charges involved are determined by competitive bids, or transactions involving the rendering of services as a common or contract carrier, or as a public utility, at rates or charges fixed in conformity with law or a governmental authority.

**Compensation Committee Interlocks and Insider Participation**

Messrs. Wallace, Schmal and Kessler served as members of the Compensation Committee during 2017 and none of them served as an officer, former officer or employee of ours or had a relationship disclosable under Item 404 of Regulation SK. Further, during 2017, none of our executive officers served as a member of the board of directors or compensation committee (or equivalent) of any other entity, that has one or more executive officers serving as one of our directors or on our Compensation Committee. Accordingly, during 2017, no interlocking relationship existed between any member of our Board or our Compensation Committee and any member of the board of directors or compensation committee of any other company.

**INFORMATION REGARDING OUR EXECUTIVE OFFICERS**

The Board of Directors generally elects officers annually following our annual meeting of stockholders to serve until the meeting of the Board following the next annual meeting. Set forth below is certain information about each executive officer as of May 31, 2018. The business address of each executive officer is c/o Owens Realty Mortgage, Inc., 2221 Olympic Blvd., Walnut Creek, CA 94595.

<u>Name</u>	<u>Age</u>	<u>Information about Executive Officers</u>
<i>William C. Owens</i>	67	Mr. Owens has served as our executive Chairman Emeritus, since May 7, 2018 and as a member of our Board since the Company’s inception in 2012. Mr. Owens served as our executive Chairman of the Board until May 7, 2018. Mr. Owens also served as our President from our inception in 2012 until January 2016, and as our Chief Executive Officer from January 2013 until January 2016. He has also been President and Chief Executive Officer of the Manager since April 1996 and is a member of the Board of Directors and the Loan Committee of the Manager.
<i>Bryan H. Draper</i>	60	Mr. Draper is a certified public accountant and has served as our President and CEO since January 2016 and as a member of our Board since the consummation of the Merger on May 20, 2013. Mr. Draper served as the Secretary and Treasurer of the Company from its inception in 2012 until January 2016, and as our Chief Financial Officer from January 2013 to January 2016. He has also been Chief Financial Officer and Corporate Secretary of the Manager since December 1987 and a member of the Board of Directors of the Manager since January 1997. Further information about Mr. Draper may be found under “Proposal 1: Election of Two (2) Directors - Information about the Director Nominees and the Continuing Directors” in this Proxy Statement.
<i>William E. Dutra</i>	56	Mr. Dutra has served as an Executive Vice President of the Manager since March 2014 and member of the Board of Directors and the Loan Committee of the Manager since January 1997. Mr. Dutra previously served as a Senior Vice President of the Manager and has been one of its employees since February 1986. Mr. Dutra has responsibility for loan committee review, loan underwriting and loan production.



<b>Melina A. Platt</b>	52	Ms. Platt was appointed as the Company’s Chief Financial Officer and Treasurer in January 2016 and has been the Controller of the Manager since May 1998. Ms. Platt is a certified public accountant and is responsible for all accounting, finance, and regulatory agency filings of the Company. Ms. Platt was previously a Senior Manager with KPMG LLP.
<b>Daniel J. Worley</b>	47	Mr. Worley has served as a Senior Vice President of the Manager since June 2013 and is responsible for capital markets, investor relations, regulatory compliance, and governance. Mr. Worley has served as Secretary of the Company since January 2016 and was Assistant Secretary of the Company from June 2013 until January 2016. In addition, he is a member of the senior management team and participates in executive management and strategy. Prior to joining the Company, from July 2012 to June 2013, he served as a consultant to Owens Mortgage Investment Fund. From July 2010 to October 2011, he was the Chief Strategy Officer at Mason-McDuffie Real Estate where his responsibilities included executive management, strategy, corporate development, governance, and legal matters. From May 2001 to October 2010, he co-founded and served as the Chief Operating Officer of NorthPoint Financial Group/SmartZip Analytics where his responsibilities included executive management, strategy and governance. From January 1998 to May 2001, he was the Managing Director of the Berkeley Center for Advanced Technology where his responsibilities included venture fund management, investment due diligence, investment oversight and investor relations.
<b>Brian M. Haines</b>	40	Mr. Haines has served as a Senior Vice President of the Manager since January 2014 and as a Loan Officer of the Manager since 2007. Mr. Haines’ focus is on originating and structuring debt investments, developing and fostering broker relationships and asset management oversight. Prior to joining the Manager, Mr. Haines co-owned and operated a private lending firm headquartered in Northern California. He is a director of the Bay Area Mortgage Association (BAMA) and an active member of the Urban Land Institute (ULI) and California Mortgage Association (CMA).

## EXECUTIVE COMPENSATION

### Compensation Discussion and Analysis

We are managed by our Manager pursuant to the terms of our Charter and the Management Agreement between the Company and our Manager. Until July 1, 2017, management fees were paid by the Company to the Manager monthly not to exceed 2.75% annually of the average unpaid balance of our loans at the end of each of the 12 months in the calendar year (the “Prior Management Fee”). During the period from July 1, 2017 through March 31, 2018, the Prior Management Fee was reduced to the Interim Management Fee (the “Interim Management Fee”), which was a monthly management fee equal to 1/12<sup>th</sup> of 1.50% of the Company’s Stockholders’ Equity, subject to the additional details of the calculation as described in “Related Party Transactions – Management Fees and Expenses –*Interim Fee Reduction and Amendment of the Management Agreement to Further Reduce Management Fees and Expenses.*” Effective April 1, 2018, the Management Agreement was amended to adopt the Interim Management Fee along with an additional adjustment such that the monthly management fee payable equals (i) one-twelfth (1/12), multiplied by (ii) (a) 1.50% of the first \$300,000,000 of the Company’s Stockholders’ Equity, plus (b) 1.25% of the Company’s Stockholders’ Equity that is greater than \$300,000,000. See “Related Party Transactions – Management Fees and Expenses” for additional details of the revised management fee calculation and for a description of certain relevant terms of the Charter and the Management Agreement, including a description of certain additional changes to the fees and expenses payable to our Manager.

We have two full-time employees and one part-time employee that work for one of our subsidiaries, none of whom are executive officers. We do not have agreements with any of our executive officers or any employees of our Manager with respect to their compensation. Our executive officers are employees of our Manager and do not receive

cash, equity or other compensation from us for serving as our executive officers. We did not pay any compensation to our executive officers nor did we make any grants of options, equity or other plan-based awards of any kind to them during 2017 or through the date of this Proxy Statement. We do not provide any of our executive officers with pension benefits or nonqualified deferred compensation plans. We do not have any employment agreements with any persons and are not obligated to make any payments to any of our executive officers upon termination of employment or a change in control of us.

## COMPENSATION COMMITTEE REPORT

Our Compensation Committee reviewed and discussed with our management the “Compensation Discussion and Analysis” contained in this Proxy Statement. Based on that review and discussions, our Compensation Committee recommends to the Board of Directors that the “Compensation Discussion and Analysis” be included in this Proxy Statement.

*By the Compensation Committee:*  
Dennis George Schmal, Chair  
James Matthew Kessler  
Gary C. Wallace

*The foregoing Compensation Committee Report shall not be deemed under the Securities Act or the Exchange Act to be (i) “soliciting material” or “filed” or (ii) incorporated by reference by any general statement into any filing made by us with the SEC, except to the extent that we specifically incorporate such report by reference.*

## PAY RATIO DISCLOSURE

We estimate that the total annual compensation for our median employee was \$27,000 for 2017. The Company does not, however, pay salary, bonus, equity or other compensation to its principal executive officer (or any of its officers), and the pay ratio disclosure required by Item 402(u) of Regulation SK is not calculable without any such compensation.

## COMPENSATION OF INDEPENDENT DIRECTORS

Our independent directors are Messrs. Kessler, Schmal and Wallace. Messrs. Kessler and Schmal were appointed to the Board in May 2013 and Mr. Wallace was appointed in July 2016, and each of them serves as a member of our Audit, Nomination and Corporate Governance and Compensation committees. Mr. Schmal was our Lead Director until his appointment as the independent Chairman of the Board effective May 7, 2018. Mr. Schmal is also the Chairman of the Nomination and Corporate Governance and Compensation Committees, and Mr. Wallace serves as Chairman of our Audit Committee.

We pay directors’ fees only to those directors who are independent under the NYSE American rules. From January 1 through June 30, 2017, each independent director was paid a cash retainer at an annual rate of \$35,000 and, commencing July 1, 2017, the cash retainer paid to the independent directors was increased to an annual rate of \$50,000, in each case, payable quarterly in advance. During 2017, our lead independent director (Mr. Schmal) was paid a supplemental retainer at an annual rate of \$2,500, payable quarterly in advance. In addition, during 2017 our independent directors received the following supplemental annual retainers for their service on committees, in each case, payable quarterly in advance:

- Audit Committee Chair (Mr. Wallace) — \$7,500;
- Compensation Committee Chair (Mr. Schmal) — \$7,500; and
- Nominating and Corporate Governance Committee Chair (Mr. Schmal) — \$5,000.

We also reimburse all members of our Board for their travel expenses incurred in connection with their attendance at our Board, committee and stockholder meetings.

## 2017 Director Compensation Table

The following table summarizes the compensation received by our independent directors for the fiscal year ended December 31, 2017.

<u>Name</u>	<u>Fees Earned or Paid in Cash(\$)</u>	<u>Total(\$)</u>
James M. Kessler	\$42,500	\$42,500
Dennis G. Schmal	\$57,500	\$57,500
Gary C. Wallace	\$50,000	\$50,000

## SECURITY OWNERSHIP OF MANAGEMENT AND CERTAIN BENEFICIAL OWNERS

The following table sets forth certain information regarding the beneficial ownership of the Common Stock as of May 31, 2018 (unless otherwise indicated), of each current director and director nominee, each of our executive officers, our executive officers and directors as a group and each stockholder known to management to own beneficially more than 5% of the outstanding shares of our Common Stock. Unless otherwise indicated, we believe that the beneficial owner set forth in the table has sole voting and investment power.

<u>Name and Address of Beneficial Owner<sup>(1)</sup></u>	<u>Number of Shares Beneficially Owned</u>	<u>Percentage of Common Stock Beneficially Owned<sup>(2)</sup></u>
<b><i>Beneficial owners of more than 5%:</i></b>		
Nantahala Capital Management, LLC <sup>(3)</sup> 19 Old Kings Highway South, Suite 200 Darien, CT 06820	628,697	7.07%
BlackRock, Inc. <sup>(4)</sup> 55 East 52 <sup>nd</sup> Street New York, NY 10055	497,967	5.60%
<b><i>Executive officers and directors:</i></b>		
William C. Owens <sup>(5)(6)</sup>	199,542	2.24%
Bryan H. Draper <sup>(7)</sup>	112,717	1.27%
James M. Kessler <sup>(8)</sup>	29,074	*
Dennis G. Schmal	3,000	*
Gary C. Wallace	2,000	*
Daniel J. Worley <sup>(9)</sup>	4,125	*
William E. Dutra <sup>(10)</sup>	30,589	*
Melina A. Platt	3,910	*
Brian M. Haines <sup>(11)</sup>	8,503	*
<b><i>All executive officers and directors as a group (9 persons)</i></b>	<u>393,460</u>	<u>4.43%</u>

\*Less than one percent.

- (1) The address of each of the executive officers and directors listed above is c/o Owens Realty Mortgage, Inc., 2221 Olympic Boulevard, Walnut Creek, California 94595.
- (2) The percentage reported in this column has been calculated based upon 8,888,620 shares of Common Stock outstanding on May 31, 2018.
- (3) This information, other than the percentage ownership calculation which was calculated based upon 8,888,620 shares of Common Stock outstanding on May 31, 2018, is based on a Schedule 13G/A filed with the SEC on February 14, 2018, by Nantahala Capital Management, LLC, a Massachusetts limited liability company (“Nantahala”), Wilmot

Harkey and Daniel Mack (collectively the “Reporting Persons”). The Reporting Persons report that Nantahala may be deemed to be beneficial owner of 628,697 shares of Common Stock held by funds and separately managed accounts under its control that, each of Messrs. Harkey and Mack may also be deemed the beneficial owner of those shares and that each of the Reporting Persons has shared voting and dispositive power over all 628,697 shares.

- (4) This information, other than the percentage ownership calculation which was calculated based upon 8,888,620 shares of Common Stock outstanding on May 31, 2018, is based on a Schedule 13G/A filed with the SEC on February 9, 2018, by BlackRock, Inc., a Delaware corporation (“BlackRock”). BlackRock discloses that it may be deemed to be beneficial owner of 497,967 shares of Common Stock held by certain of its subsidiaries and affiliates that constitute a group, that it has sole voting power over 492,095 of the shares and sole dispositive power over all 497,967 shares.
- (5) Mr. Owens owns 62.5% of Owens Financial Group, Inc., our Manager and shares voting power at the Manager with Mr. Draper, Mr. Dutra and Mr. Haines, each of whom owns the following percentage of the Manager: Draper – 16.305%; Dutra – 16.305%; and Haines – 4.89%. Mr. Owens’ is reporting beneficial ownership of 83,049 shares of Common Stock held by the Manager directly and 13,736 shares of Common Stock held by Investors Yield, Inc. (a wholly-owned subsidiary of the Manager), with respect to which he has shared voting and investment power. Mr. Owens disclaims beneficial ownership of these securities except to the extent of his pecuniary interest therein.
- (6) Includes 360 shares of Common Stock held by Owens Trust dated February 24, 1998, the trustee of which is Mr. Owens. Also includes 4,637 shares of Common Stock held by Belmar, a California limited partnership of which Mr. Owens owns 49.22%. Mr. Owens disclaims beneficial ownership of these securities except to the extent of his pecuniary interest therein. Also includes: (i) 6,361 shares of Common Stock held indirectly by Mr. Owens spouse; (ii) 11,572 shares of Common Stock held in an Individual Retirement Account of which Mr. Owens is sole beneficiary; and (iii) 66,460 shares of Common Stock owned indirectly through the Owens Financial Group 401(k) Plan.
- (7) Includes 4,543 shares of Common Stock held by Draper Family Partnership of which Mr. Draper is a 50% owner. Mr. Draper disclaims beneficial ownership of these securities except to the extent of his pecuniary interest therein. Also includes: (i) 49,213 shares of Common Stock held by Draper Family Trust dated May 16, 2000 of which Mr. Draper is co-trustee; (ii) 3,275 shares of Common Stock indirectly by Mr. Draper’s spouse; (iii) 55,686 shares of Common Stock held in Individual Retirement Accounts of which Mr. Draper is sole beneficiary. Does not include 83,049 shares of Common Stock held by the Manager directly and 13,736 shares of Common Stock held by Investors Yield, Inc.
- (8) Mr. Kessler owns 29,074 shares of Common Stock through two trusts. Mr. Kessler has sole voting and investment power over 17,836 shares of Common Stock held in one of those trusts and shared voting and investment power over shares of Common Stock held in the other trust.
- (9) Includes 1,325 shares of Common Stock owned indirectly through the Owens Financial Group 401(k) Plan and 800 shares of Common Stock owned indirectly through Mr. Worley’s children.
- (10) Includes 2,689 shares of Common Stock held by The Dutra Trust of which Mr. Dutra is a co-trustee and 27,900 shares of Common Stock owned indirectly through the Owens Financial Group 401(k) Plan. Does not include 83,049 shares of Common Stock held by the Manager directly and 13,736 shares of Common Stock held by Investors Yield, Inc.
- (11) Includes 1,248 shares of Common Stock held in an Individual Retirement Account and 3,973 shares of Common Stock owned indirectly through the Owens Financial Group 401(k) Plan. Does not include 83,049 shares of Common Stock held by the Manager directly and 13,736 shares of Common Stock held by Investors Yield, Inc.

## RELATED PARTY TRANSACTIONS

### Ownership of the Manager

The voting common stock of our Manager, Owens Financial Group, Inc., is owned as follows: 62.5% by William C. Owens, 16.305% by Bryan H. Draper, 16.305% by William E. Dutra and 4.89% by Brian M. Haines.

### Management Fees and Expenses

We have entered into a Management Agreement with our Manager, Owens Financial Group, Inc., which describes the services to be provided by our Manager. The compensation payable to the Manager for those services and certain other important provisions relating to the Manager are described in our Charter, provided, however that the Board and Manager adjusted the Prior Management Fee to the Interim Management Fee on an interim basis during the period from July 1, 2017 to March 31, 2018. Effective April 1, 2018, the Board and the Manager amended the Management Agreement to adopt the Interim Management Fee and make certain additional changes to reduce the management fee payable as described below in “*Interim Fee Reduction and Amendment of Management Agreement to Further Reduce Management Fees and Expenses*”. The Manager manages our day-to-day operations and business, subject to the supervision and oversight of our Board of Directors. The Manager is required to act in accordance with policies and restrictions contained in the Company’s Charter and such additional investment policies as may be adopted by our Board of Directors.

The Management Agreement continues in effect for the duration of the existence of the Company, unless earlier terminated by the affirmative vote of the holders of a majority of the outstanding shares of Common Stock, by the Manager in response to an amendment to its compensation that it does not consent to, automatically in certain circumstances relating to the assignment of the Management Agreement, or by either party for cause as defined therein.

The Management Agreement provides that the fees payable to the Manager as described in the Charter may not be changed without the approval of the Board (including a majority of the independent members of the Board), the holders of a majority of the outstanding shares of Common Stock and the Manager; provided that stockholder approval is not required to adjust the Manager’s compensation so long as such adjustment will not have a significant adverse impact on the stockholders of the Company. The Charter and the Management Agreement provide for the payment of the following fees by the Company and by borrowers:

***Fees paid by the Company.*** The Manager is entitled to receive the following fees from the Company:

- ***Management Fee.*** Until July 1, 2017, the Prior Management Fee was paid by the Company to the Manager monthly not to exceed 2.75% annually of the average unpaid balance of our loans at the end of each of the 12 months in the calendar year. Since this fee was paid monthly, it could exceed 2.75% in one or more months, but the total fee in any one year was limited to a maximum of 2.75%, and any amount paid above this had to be repaid by the Manager to the Company. The Manager was entitled to receive a management fee on all loans, including those that were delinquent. Effective July 1, 2017 through March 31, 2018, the Board and the Manager adjusted the Prior Management Fee on an interim basis to the reduced Interim Management Fee which was a monthly management fee equal to 1/12<sup>th</sup> of 1.50% of the Company’s Stockholders’ Equity, subject to the additional details of the calculation as described below in “*Interim Fee Reduction and Amendment of Management Agreement to Further Reduce Management Fees and Expenses*”.

Effective April 1, 2018, the Company and the Manager amended the Management Agreement to adopt the Interim Management Fee adjustment along with an additional adjustment such that the monthly management fee payable equals (i) one-twelfth (1/12), multiplied by (ii) (a) 1.50% of the first \$300,000,000 of the Company’s Stockholders’ Equity, plus (b) 1.25% of the Company’s Stockholders’ Equity that is greater than \$300,000,000. See “*Interim Fee Reduction and Amendment of Management Agreement to Further Reduce Management Fees and Expenses*” below for additional details of the new management fee calculation, and for a description of certain additional changes to the fees and expenses payable to our Manager.

Management fees amounted to approximately \$3,546,000 and \$3,286,000 for the years ended December 31, 2017 and 2016, respectively. Of the \$3,546,000 in management fees paid in 2017, our Manager has informed us that approximately \$1,704,000 (48%) was allocated by the Manager to pay the five (5) employees of the Manager that would have qualified as our “named executive officers” under SEC Regulation SK 402(a)(3) had they been employed and paid by the Company. Of this compensation paid to such employees of the Manager, 62% was fixed salary and bonus and 38% was in the form of variable/incentive payments consisting of sales commissions on origination of loans.

- Loan Servicing Fee. The Manager may act as servicing agent with respect to the Company’s mortgage loans. Until April 1, 2018, the Manager was entitled to receive from ORM a monthly servicing fee, which, when added to all other fees paid in connection with the servicing of a particular loan, could not exceed the lesser of the customary, competitive fee 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 year of the unpaid balance of ORM’s mortgage loans at the end of each month. Servicing fees amounted to approximately \$362,000 and \$299,000 for the years ended December 31, 2017 and 2016, respectively. Effective April 1, 2018, no further servicing fees are payable to the Manager as described in “*Interim Fee Reduction and Amendment of Management Agreement to Further Reduce Management Fees and Expenses*” below.

**Fees paid by borrowers.** The Manager is entitled to receive directly from borrowers the following fees:

- Acquisition and Origination Fees. Until April 1, 2018, the Manager or its affiliates was entitled to receive and retain all fees and commissions paid or payable to it by any party other than ORM and any subsidiary in connection with ORM making or investing in mortgage loans. Included in the computation of such fees or commission is any selection fee, mortgage placement fee, nonrecurring management fee and any origination fee, loan fee or points paid by borrowers to the Manager or any fee of a similar nature, however designated. Such fees earned by the Manager amounted to approximately \$2,492,000 and \$2,514,000 on loans originated or extended of approximately \$122,240,000 and \$101,594,000 for the years ended December 31, 2017 and 2016, respectively. Effective April 1, 2018, such fees are to be shared with the Company as described in “*Interim Fee Reduction and Amendment of Management Agreement to Further Reduce Management Fees and Expenses*” below.
- Late Payment Charges. The Manager is entitled to receive and retain all additional charges paid by borrowers on delinquent loans and loans past maturity held by ORM, including additional interest and late payment fees. The amounts paid to or collected by the Manager for late payment charges totaled approximately \$83,000 and \$83,000 for the years ended December 31, 2017 and 2016, respectively. Effective April 1, 2018, such fees and charges are to be shared with the Company as described in “*Interim Fee Reduction and Amendment of Management Agreement to Further Reduce Management Fees and Expenses*” below.
- Other Miscellaneous Fees. ORM remits other miscellaneous fees to the Manager, which are collected from loan payments, loan payoffs or advances from loan principal (i.e. funding, demand and partial release fees). Such fees remitted to the Manager totaled approximately \$23,000 and \$20,000 for the years ended December 31, 2017 and 2016, respectively.

The Manager is entitled to be reimbursed by ORM for any expenses (subject to certain exceptions outlined in the Charter and the Management Agreement) paid by the Manager, including, without limitation, legal and accounting expenses, filing fees, printing costs, and goods, services and materials used by or for ORM. Additionally, until April 1, 2018, the Manager was entitled to reimbursements for salaries for non-management and non-supervisory services. For the years ended December 31, 2017 and 2016, ORM recorded expenses totaling approximately \$381,000 and \$440,000, respectively, related to expense reimbursements to the Manager. ORM also reimbursed certain of the Manager’s officers for allowed expenses in the total amount of \$2,000 and \$0 during the years ended December 31, 2017 and 2016, respectively. Effective April 1, 2018, the parties agreed to certain changes in the expenses paid to the Manager as described in “*Interim Fee Reduction and Amendment of Management Agreement to Further Reduce Management Fees and Expenses*” below.

ORM paid Investors Yield, Inc. (a wholly owned subsidiary of the Manager) approximately \$1,000 and \$9,000 in trustee's fees related to certain foreclosure proceedings on ORM loans during the years ended December 31, 2017 and 2016, respectively.

***Interim Fee Reduction and Amendment of the Management Agreement to Further Reduce Management Fees and Expenses***

Interim Management Fee Reduction. During the period from July 1, 2017 through March 31, 2018, the Manager and the Board agreed to reduce the Prior Management Fee to a monthly "Interim Management Fee" calculated as follows:

1. The "Interim Management Fee" is equal to (i) one-twelfth (1/12) multiplied by (ii) 1.50% of the "Opening Stockholders' Equity Balance" (defined below), with such Opening Stockholders' Equity Balance to be adjusted by the Manager in the following manner:

(A) at the end of a calendar month to reflect any changes that result from any of the events specified in clause (A) in the definition of "Stockholders' Equity" (defined below) during such calendar month from the Opening Stockholders' Equity Balance; and

(B) at the end of a calendar quarter to reflect any changes that result from the components specified in clauses (B), (C) or (D) in the definition of "Stockholders' Equity" (defined below) for such calendar quarter from the Opening Stockholders' Equity Balance.

Since the Management Fee is paid monthly during the period, and the components of Stockholders' Equity specified in clauses (B), (C) and (D) in the definition of "Stockholders' Equity" will not be known until the end of the quarter in question, the Manager shall use the prior quarter's value as an estimate for each monthly payment and will effect a reconciliation at the end of the quarter, so that the actual aggregate Management Fee paid for each quarter will be based on the values of the components specified in clauses (B), (C) and (D) in the definition of "Stockholders' Equity" at the end of that particular quarter as if the components specified in clauses (B), (C) and (D) were known at each month end.

2. As used in the calculation of the Interim Management Fee, "Stockholders' Equity" means:

(A) the sum of the net proceeds from any issuances of the Company's equity securities since inception (including the book value of the Company's Common Stock and Additional Paid-in Capital at inception of the Company) less any amount that the Company pays for repurchases of its equity securities (determined as of the most recent month end), plus

(B) the Company's consolidated retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less

(C) any unrealized gains, losses or other items that do not affect realized net income as of the most recently completed calendar quarter as adjusted to exclude

(D) one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between the Manager and the Company's Independent Directors and after approval by a majority of the Company's Independent Directors.

3. As used in the calculation of the Interim Management Fee, "Opening Stockholders' Equity Balance" means Stockholders' Equity at the end of the most recently completed calendar quarter. "Independent Directors" means the members of the Company's Board of Directors who are not officers, employees or directors of the Manager or any person directly or indirectly controlling or controlled by the Manager, and who are otherwise "independent" in accordance with the applicable rules of the NYSE American.

4. The Manager shall compute each installment of the Interim Management Fee reasonably promptly at the end of each calendar month during the Interim Adjustment Period. A copy of the computations, including a comparison of the Interim Management Fee to the Prior Management Fee, made by the Manager to calculate such installment shall thereafter promptly be delivered to the Board of Directors.
5. The adjustments during the interim period did not include any change to the loan servicing fees or expense reimbursements payable by the Company to the Manager, and the Manager also continue to receive the fees paid by our borrowers to the Manager.

This adjustment resulted in a reduced management fee of approximately \$440,000 during the last six months of 2017.

Amendment of the Management Agreement to Further Reduce Management Fees and Expenses. Effective April 1, 2018, the Management Agreement was amended by Amendment No. 1 (the "Amendment") to implement the following changes to the Manager's compensation structure:

- *Reduced Management Fee:* The Amendment revises the management fee by making permanent the recent "Interim Management Fee" adjustment described above along with an additional adjustment such that the "Management Fee," calculated and payable to the Manager monthly in arrears, equals (i) one-twelfth (1/12) multiplied by (ii) (a) 1.50% of the first \$300,000,000 of the Company's Stockholders' Equity (as defined in the Amendment), and (b) 1.25% of the Stockholders' Equity that is greater than \$300,000,000.
- *Company to Receive 30% of Loan Fees:* The Company will receive thirty-percent (30%) of the gross fees and commissions paid to the Manager in connection with the Company making or investing in mortgage loans, including thirty-percent (30%) of the gross fees paid in connection with the extension or modification of any loans, with the exception of certain miscellaneous administration fees collected in association with loan funding, demand, and partial release fees, with the remaining seventy-percent (70%) of such fees to be paid to the Manager.
- *Company to Receive 30% of Late Payment Charges:* The Company will receive thirty-percent (30%) of all late payment charges from borrowers on loans owned by the Company, with the remaining seventy-percent (70%) to be paid to the Manager.
- *Elimination of Service Fees:* The Company will no longer pay the Manager any servicing fees for the Manager's services as servicing agent with respect to any of its mortgage loans.
- *Elimination of Certain Expense Reimbursements:* The Company will no longer reimburse the Manager for salary and related salary expense of the Manager's non-management and non-supervisory personnel.

### **Repurchase of Freestone Shares**

On December 29, 2017, the Company entered into the Settlement Agreement with Freestone, a stockholder group that beneficially owned more than 5% of our outstanding Common Stock, pursuant to which the Company agreed to purchase the 810,937 shares of Common Stock held by Freestone in a privately negotiated transaction for \$19.25 per share, resulting in an aggregate purchase price of approximately \$15.6 million. Pursuant to the terms of the Settlement Agreement, for a period of five years following the date of the Settlement Agreement, Freestone agreed to customary standstill restrictions relating to share purchases, support of proxy contests and other activist campaigns, calling of special meetings, and related matters. For a period of two years following the date of the Agreement, the Company and Freestone also agreed to abide by customary covenants not to sue and non-disparagement provisions. In addition, the Company and Freestone each released the other from all claims that the releasing party has, had or may have against the released party that relate to the investment by Freestone in the Company.



## **Office Lease**

ORM does not have any separate offices. The Manager operates from its executive offices at 2221 Olympic Boulevard, Walnut Creek, California 94595, or the Executive Office. The lessor of the Executive Office is Olympic Blvd. Partners, a California General Partnership (“OBP”), of which the Manager is a 50% general partner. The Executive Office is the sole asset of OBP. The lease agreement, or the Office Lease, between OBP and the Manager for the Executive Office has a term extending until December 31, 2019. The Manager pays rent in the amount of \$15,975 per month to OBP under the Office Lease. For each of the years ended December 31, 2017 and 2016, Owens Financial Group paid \$191,700 to OBP for use of the Executive Office. The Executive Office was subject to a deed of trust in the amount of \$616,780 as of December 31, 2017 with monthly payments of interest and principal of \$3,988. The loan was repaid in full in March 2018.

## **SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Exchange Act requires our directors, executive officers and holders of more than 10% of the outstanding shares of Common Stock (“10% Holders”) to file with the SEC and the NYSE American initial reports of ownership and reports of changes in ownership of Common Stock and other equity securities of ORM. Directors, executive officers and 10% Holders are required by the SEC’s regulations to furnish us with copies of all Section 16(a) forms and amendments thereto filed during any given year.

Based on the review of copies of the Section 16(a) reports and amendments thereto furnished to us and/or written representations from our directors, executive officers and 10% Holders, we believe that for the year ended December 31, 2017 our directors, executive officers and 10% Holders complied with all Section 16(a) filing requirements applicable to them.

## **PROPOSALS OF STOCKHOLDERS**

Proposals received from stockholders in accordance with Rule 14a-8 under the Exchange Act will be given careful consideration by our Nominating and Corporate Governance Committee and our Board of Directors. If a stockholder intends to present a proposal at the 2019 annual meeting of stockholders pursuant to Rule 14a-8 under the Exchange Act, in order for such stockholder proposal to be included in our proxy statement for that meeting, the stockholder proposal must be received by our Secretary at Owens Realty Mortgage, Inc., on or before February 8, 2019. If such proposal is in compliance with all of the requirements of Rule 14a-8 under the Exchange Act, the proposal will be included in our proxy statement and proxy card relating to such annual meeting. Such proposals should be submitted by certified mail, return receipt requested to the Secretary. Nothing in this paragraph shall be deemed to require us to include any stockholder proposal that does not meet all the requirements for such inclusion established by the SEC in effect at that time.

In order for a stockholder proposal submitted outside of Rule 14a-8, including any proposal of business or nominations for the Board of Directors made by stockholders, to be considered at the 2019 annual meeting of stockholders, our bylaws require, among other things, that such proposal must be made by written notice (setting forth all information required by our current bylaws) and received by our Secretary not earlier than the 150<sup>th</sup> day nor later than 5:00 p.m., Pacific Time, on the 120<sup>th</sup> day prior to June 8, 2019. Accordingly, to submit a director candidate for consideration for nomination at our 2019 annual meeting of stockholders, stockholders must submit the recommendation, in writing and in accordance with our bylaws by February 8, 2019, but in no event earlier than January 9, 2019.

## **DELIVERY AND HOUSEHOLDING OF PROXY MATERIALS**

The rules of the SEC permit companies and intermediaries (such as brokerage firms, banks, broker-dealers or other similar organizations) to satisfy the delivery requirements for proxy statements and annual reports with respect to two or more stockholders sharing the same address by delivering a single set of proxy materials (i.e. the proxy statement and annual report) addressed to those stockholders. This process, which is commonly referred to as “householding,” potentially means extra convenience for stockholders and cost savings for companies.

A number of brokers with account holders who are our stockholders will be “householding” our proxy materials. A single set of proxy materials may be delivered to multiple stockholders sharing the same address unless contrary instructions have been received from the impacted stockholders. Once a stockholder has received notice from its broker that they will be “householding” communications to such stockholder’s address, “householding” will continue until such stockholder revokes consent to “householding” or is notified otherwise. If, at any time, a stockholder no longer wishes to participate in “householding” and would prefer to receive a separate set of our proxy materials, such stockholder should so notify us by directing written requests to: Owens Realty Mortgage, Inc., 2221 Olympic Blvd., Walnut Creek, CA 94595, Attention: Daniel Worley, our Secretary or by calling our Investor Relations Department at (925) 935-3840. In addition, if so requested, we will also undertake to promptly deliver a separate set of proxy materials to any stockholder for whom such proxy materials were subject to “householding.” Stockholders who currently receive multiple copies of our proxy materials at their address and would like to request “householding” of their communications should contact us as specified above or their respective brokers.

#### **FINANCIAL STATEMENTS AND OTHER SEC FILINGS AVAILABLE**

**A COPY OF OUR 2017 ANNUAL REPORT ON FORM 10-K CONTAINING AUDITED FINANCIAL STATEMENTS WAS DELIVERED OR MADE AVAILABLE WITH THIS PROXY STATEMENT. ADDITIONAL COPIES OF OUR 2017 ANNUAL REPORT ON FORM 10-K (WITHOUT EXHIBITS, UNLESS OTHERWISE REQUESTED) ARE AVAILABLE IN PRINT, FREE OF CHARGE, TO STOCKHOLDERS REQUESTING A COPY BY WRITING TO DANIEL WORLEY, OUR SECRETARY, AT OWENS REALTY MORTGAGE, INC., 2221 OLYMPIC BOULEVARD, WALNUT CREEK, CALIFORNIA 94595, OR BY CALLING (925) 935-3840. YOU MAY REVIEW OUR FILINGS WITH THE SEC BY VISITING THE SEC’S HOME PAGE ON THE INTERNET AT WWW.SEC.GOV OR BY VISITING THE INVESTOR RELATIONS SECTION OF OUR WEB SITE AT WWW.OWENSMORTGAGE.COM.**

#### **OTHER MATTERS**

The Board of Directors does not intend to bring other matters before the Annual Meeting except items incident to the conduct of the meeting. However, on all matters properly brought before the meeting by the Board of Directors or others, it is the intention of the persons named as proxies in the accompanying proxy card, or their substitutes, to vote in accordance with their discretion on such matters.

## ANNEX A

### **Additional Information Regarding Participants in the Solicitation**

Under applicable SEC rules and regulations, members of the Board, the Board's nominees, and certain officers and other employees of the Company are "participants" with respect to the Company's solicitation of proxies in connection with the Annual Meeting. The following sets forth certain information about such persons (the "Participants").

#### **Directors and Director Nominees**

The names and present principal occupation of our director nominees, each a Participant, are set forth in the section entitled "Proposal 1: Election of Two (2) Directors" under the heading "Information about the Director Nominees and the Continuing Directors" of this Proxy Statement. The business address for the Company's current directors and director nominees is c/o Owens Realty Mortgage, Inc., 2221 Olympic Boulevard, Walnut Creek, California 94595.

#### **Officers and Employees**

Executive officers and employees of the Company who are Participants are William E. Dutra, Brian M. Haines, Melina A Platt and Daniel J. Worley. The business address for each is c/o Owens Realty Mortgage, Inc., 2221 Olympic Boulevard, Walnut Creek, California 94595. Their principal occupations are stated in the section entitled "Information Regarding Our Executive Officers" in this Proxy Statement.

#### **Information Regarding Ownership of the Company's Securities by Participants**

The number of the Company's securities beneficially owned by the Participants as of May 31, 2018 is set forth in the section entitled "Securities Ownership of Management and Certain Beneficial Owners" in this Proxy Statement.

#### **Information Regarding Transactions in the Company's Securities by Participants**

The following table sets forth information regarding purchases and sales of the Company's securities by the Participants within the past two years. No part of the purchase price or market value of these securities is represented by funds borrowed or otherwise obtained for the purpose of acquiring or holding such securities.

<b>Name</b>	<b>Date</b>	<b>Title of Security</b>	<b>Number of Shares</b>	<b>Transaction</b>
Bryan Draper	05/31/2018	Common Stock	397	Open Market Purchase
	05/30/2018	Common Stock	200	Open Market Purchase
	05/30/2018	Common Stock	100	Open Market Purchase
	05/30/2018	Common Stock	2,000	Open Market Purchase
	05/30/2018	Common Stock	11,806	Open Market Purchase
	05/30/2018	Common Stock	1,997	Open Market Purchase
	05/30/2018	Common Stock	503	Open Market Purchase
	05/29/2018	Common Stock	100	Open Market Purchase
	05/29/2018	Common Stock	100	Open Market Purchase
	05/29/2018	Common Stock	403	Open Market Purchase

	05/29/2018	Common Stock	594	Open Market Purchase
	05/29/2018	Common Stock	1,767	Open Market Purchase
	05/29/2018	Common Stock	33	Open Market Purchase
	06/09/2016	Common Stock	4,725	Open Market Purchase
William E. Dutra	05/29/2018	Common Stock	5,000	Discretionary transaction in accordance with Rule 16b-3(f)
	06/13/2016	Common Stock	5,000	Discretionary transaction in accordance with Rule 16b-3(f)
Brian M. Haines	05/29/2018	Common Stock	100	Open Market Purchase
	05/29/2018	Common Stock	495	Open Market Purchase
William C. Owens	05/30/2018	Common Stock	2,064	Discretionary transaction in accordance with Rule 16b-3(f)
	05/30/2018	Common Stock	936	Discretionary transaction in accordance with Rule 16b-3(f)
	05/30/2018	Common Stock	557	Open Market Purchase
	05/30/2018	Common Stock	1,571	Open Market Purchase
	05/30/2018	Common Stock	2,000	Open Market Purchase
	05/30/2018	Common Stock	6,429	Open Market Purchase
	06/13/2016	Common Stock	1,349	Discretionary transaction in accordance with Rule 16b-3(f)
	06/09/2016	Common Stock	4,651	Discretionary transaction in accordance with Rule 16b-3(f)
Melina A. Platt	06/01/2018	Common Stock	1,000	Open Market Purchase
Gary C. Wallace	05/31/2018	Common Stock	500	Open Market Purchase
Daniel J. Worley	05/29/2018	Common Stock	550	Discretionary transaction in accordance with Rule 16b-3(f)
	05/29/2018	Common Stock	50	Discretionary transaction in accordance with Rule 16b-3(f)
	05/29/2018	Common Stock	400	Open Market Purchase
	05/29/2018	Common Stock	100	Open Market Purchase
	05/29/2018	Common Stock	300	Open Market Purchase
	05/29/2018	Common Stock	100	Open Market Purchase
	05/29/2018	Common Stock	300	Open Market Purchase
	06/10/2016	Common Stock	325	Discretionary transaction in accordance with Rule 16b-3(f)

### Miscellaneous Information Concerning Participants

Other than as set forth in this Annex A or elsewhere in this Proxy Statement and based on the information provided by each Participant, none of the Participants or their associates (i) beneficially owns (within the meaning of Rule 13d-3 under the Securities Exchange Act of 1934), directly or indirectly, or owns of record but not beneficially, any shares of Common Stock or other securities of the Company or any of its subsidiaries or (ii) has any substantial interest, direct or indirect, by security holdings or otherwise, in any matter to be acted upon at the Annual Meeting. In addition, neither the Company nor any of the Participants listed above is now or has been within the past year a party to any contract, arrangement or understanding with any person with respect to any of the Company's securities, including, but not limited to, joint ventures, loan or option arrangements, puts or calls, guarantees against loss or guarantees of profit, division of losses or profits or the giving or withholding of proxies. No Participant has been convicted in a criminal proceeding (excluding traffic violations and similar misdemeanors) during the past ten years.

Other than as set forth in this Annex A or elsewhere in this Proxy Statement and based on the information provided by each Participant, neither the Company nor any of the Participants listed above or any of their associates have or will have (i) any arrangements or understandings with any person with respect to any future employment by the Company or its

affiliates or with respect to any future transactions to which the Company or any of its affiliates will or may be a party or (ii) a direct or indirect material interest in any transaction or series of similar transactions since the beginning of our last fiscal year or any currently proposed transactions, or series of similar transactions, to which the Company or any of its subsidiaries was or is to be a party in which the amount involved exceeds \$120,000.

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**FORM 10-K**

[X] (Mark One)  
**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the Fiscal Year Ended December 31, 2017**

**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)

<p style="text-align:center">Maryland _____ (State or Other Jurisdiction of Incorporation or Organization)</p>	<p style="text-align:center">46-0778087 _____ (I.R.S. Employer Identification No.)</p>
<p style="text-align:center">2221 Olympic Boulevard Walnut Creek, California _____ (Address of Principal Executive Offices)</p>	<p style="text-align:center">94595 _____ (Zip Code)</p>
<p style="text-align:center">(925) 935-3840 _____ Registrant's Telephone Number, Including Area Code</p>	

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, par value \$0.01 per share	NYSE American

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ] No [X]

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 Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of voting and non-voting equity held by non-affiliates of the registrant was approximately \$167,822,000 on the last business day of the registrant's most recently completed second fiscal quarter, June 30, 2017, based on the closing sales price of \$16.96 on that date for shares of the registrant's common stock as reported by the NYSE American. For this computation, the registrant has excluded the market value of all shares of its common stock reported as beneficially owned by executive officers and directors of the registrant and certain other stockholders; such an exclusion shall not be deemed to constitute an admission that any such person is an "affiliate" of the registrant.

As of March 9, 2018, there were 9,091,454 shares of the registrant's common stock outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

None



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## EXPLANATORY NOTE REGARDING THIS ANNUAL REPORT

As previously announced, as part of a plan to reorganize our business operations so that, among other things, we could elect to qualify as a real estate investment trust (a “REIT”) for federal income tax purposes, effective May 20, 2013, Owens Mortgage Investment Fund, a California Limited Partnership (the “Predecessor” or “OMIF”) merged with and into Owens Realty Mortgage, Inc., a Maryland corporation (the “Registrant”) with the Registrant as the surviving corporation (the “Merger”) and the Registrant commenced conducting all of the business conducted by the Predecessor. Upon consummation of the Merger, limited partners of the Predecessor received one share of common stock, par value \$0.01 per share, of the Registrant (the “Common Stock”), for every 25 limited partner units of the Predecessor that they owned, and certain units of the Predecessor representing the general partner interest of Owens Financial Group, Inc. were also exchanged for Common Stock as is discussed in further detail in our consolidated financial statements under “Note 1 - Organization” in Item 8 of this Annual Report on Form 10-K (“Annual Report”). The rights of the stockholders of the Registrant are governed by Maryland law and the charter, bylaws and other governing documents of the Registrant.

The shares of Common Stock issued pursuant to the Merger were registered under the Securities Act of 1933, as amended (the “Securities Act”), pursuant to a Registration Statement on Form S-4 (File No. 333-184392), which was declared effective by the Securities and Exchange Commission (the “SEC”) on February 12, 2013. Pursuant to Rule 12g-3(a) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), the Registrant is deemed to be the successor issuer to the Predecessor and the Registrant’s Common Stock was subsequently registered under Section 12(b) of the Exchange Act and is listed on the NYSE American.

References to Owens Realty Mortgage, Inc. and its subsidiaries, “ORM,” the “Company,” “we,” “us,” or “our” in this Annual Report (including in the consolidated financial statements and notes thereto in this Annual Report) have the following meanings, unless we specifically state or the context requires otherwise:

- For periods prior to May 20, 2013: the Predecessor and its subsidiaries;
- For periods from and after May 20, 2013: ORM and its subsidiaries.

### **PART I**

#### **Item 1. BUSINESS**

We are a specialty finance company that focuses on the origination, investment and management of commercial real estate loans, primarily in the Western U.S. We provide customized, short-term loans to small and middle-market investors and developers that require speed and flexibility. We also hold investments in real estate properties. Our investment objective is to provide investors with attractive current income and long-term shareholder value. Our Common Stock is traded on the NYSE American under the symbol “ORM”.

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. OFG provides us with all of the services vital to our operations and our executive officers and other staff are all employed by OFG pursuant to the management agreement between the Company and the Manager (the “Management Agreement”) and the Company’s charter. The Management Agreement requires OFG to manage our business affairs in conformity with the policies and investment guidelines that are approved and monitored by our Board of Directors. Our Board of Directors is composed of a majority of independent directors. The Audit, Nominating and Corporate Governance and Compensation Committees of the Board are composed exclusively of independent directors.

The Company was incorporated in Maryland on August 9, 2012. Effective May 20, 2013, OMIF, a California Limited Partnership formed in 1984 merged with and into the Company, with the Company as the surviving corporation in the Merger, and the Company commenced conducting all of the business conducted by OMIF at the effective time of the Merger. The Merger was conducted to reorganize our business operations so that, among other things, we could elect to qualify as a real estate investment trust (a “REIT”) for federal income tax purposes. As a qualified REIT we are generally not subject to federal income tax on that portion of our REIT taxable income that is distributed to our stockholders, provided that at least 90% of taxable income is distributed and provided that certain other requirements are met. Certain of our assets that produce non-qualifying income are held in taxable REIT subsidiaries. Unlike other subsidiaries of a REIT, the income of a taxable REIT subsidiary is subject to federal and state income taxes.

OFG arranges, services and maintains the loan and real estate portfolios for the Company. Our loans are secured by mortgages or deeds of trust on unimproved, improved, income-producing and non-income-producing real property, such as condominium projects, apartment complexes, shopping centers, office buildings, and other commercial or industrial properties. No single Company loan may exceed 10% of our assets as of the date the loan is made.

The following table shows the total Company stockholders' equity, loans, real estate properties and net income (loss) attributable to common stockholders as of or for the years ended December 31, 2017, 2016, 2015, 2014 and 2013:

	<b>ORM Stockholders' Equity</b>	<b>Loans</b>	<b>Real Estate Properties</b>	<b>Net Income Attributable to Common Stockholders</b>
2017.....	\$ 200,989,727	\$ 146,171,650	\$ 80,466,125	\$ 8,679,848
2016.....	\$ 215,527,877	\$ 129,682,311	\$ 113,123,398	\$ 24,409,770
2015.....	\$ 194,979,998	\$ 106,743,807	\$ 153,838,412	\$ 23,569,116
2014.....	\$ 184,571,858	\$ 68,033,511	\$ 163,016,805	\$ 7,929,629
2013.....	\$ 179,874,410	\$ 58,796,293	\$ 135,315,964	\$ 8,732,897

As of December 31, 2017, we held investments in 61 loans, secured by liens on title and leasehold interests in real property. 54% of the loans are located in Northern California. The remaining 46% are located in Southern California, Arizona, Colorado, Hawaii, Illinois, Indiana, Michigan, Nevada, Ohio, Texas, Washington and Wisconsin.

The following table sets forth the types and maturities of loans held by us as of December 31, 2017:

**TYPES AND MATURITIES OF LOANS  
(As of December 31, 2017)**

	<b>Number of Loans</b>	<b>Amount</b>	<b>Percent</b>
Senior loans	58	\$ 142,782,492	97.68%
Junior loans	3	3,389,158	2.32%
	<u>61</u>	<u>\$ 146,171,650</u>	<u>100.00%</u>
Maturing on or before December 31, 2017 (past maturity)	13	\$ 14,692,398	10.05%
Maturing on or between January 1, 2018 and December 31, 2019	43	123,991,601	84.83%
Maturing on or between January 1, 2020 and March 1, 2028	5	7,487,651	5.12%
	<u>61</u>	<u>\$ 146,171,650</u>	<u>100.00%</u>
Commercial	44	\$ 127,873,281	87.48%
Residential	13	13,170,795	9.01%
Land	4	5,127,574	3.51%
	<u>61</u>	<u>\$ 146,171,650</u>	<u>100.00%</u>

We have established an allowance for loan losses of approximately \$1,828,000 as of December 31, 2017. The above amounts reflect the gross amounts of our loans without regard to such allowance.

The average loan balance of the loan portfolio is \$2,396,000 as of December 31, 2017. Of such investments, 15% earn a variable rate of interest and 85% earn a fixed rate of interest. All were negotiated according to our investment standards.

We have other assets in addition to loans, comprised principally of the following, as of December 31, 2017:

- \$5,671,000 in cash and cash equivalents and restricted cash required to transact our business and/or in conjunction with contingency and escrow reserve requirements;
- \$80,466,000 in real estate held for sale and investment;
- \$3,207,000 in deferred tax assets;
- \$2,141,000 in investment in limited liability company;
- \$2,430,000 in interest and other receivables;
- \$27,000 in deferred financing costs, net; and
- \$725,000 in other assets.

### **Delinquencies**

Management does not regularly examine the existing loan portfolio to see if acceptable loan-to-value ratios are being maintained because the majority of loans in our portfolio mature in a period of only 1-2 years. Management performs an internal review on a loan secured by property in the following circumstances:

- payments on the loan become delinquent;
- the loan is past maturity;
- it learns of physical changes to the property securing the loan or to the area in which the property is located; or
- it learns of changes to the economic condition of the borrower or of leasing activity of the property securing the loan.

A review normally includes conducting a physical evaluation of the property securing the loan and the area in which the property is located, and obtaining information regarding the property's occupancy. In some circumstances, management may determine that a more extensive review is warranted, and may obtain an updated appraisal, updated financial information on the borrower or other information. As of December 31, 2017, we obtained updated appraisals on certain of the properties securing our trust deed investments and certain of our wholly- and majority- owned real estate properties.

As of December 31, 2017 and 2016, we had nine and two loans, respectively, that were impaired totaling approximately \$8,534,000 and \$4,884,000, respectively. This included matured loans totaling \$7,107,000 and \$4,656,000 as of December 31, 2017 and 2016, respectively. In addition, seven loans totaling approximately \$7,585,000 and \$8,686,000 were past maturity but not considered impaired as of December 31, 2017 and 2016, respectively (combined total of impaired and past maturity loans of \$16,119,000 and \$13,570,000, respectively). Of the impaired and past maturity loans none were in the process of foreclosure and none involved borrowers who were in bankruptcy as of December 31, 2017 and 2016. We foreclosed on no loans during the year ended December 31, 2017. We foreclosed on one loan during the year ended December 31, 2016 with a principal balance of \$1,079,000 and obtained the property via the trustee sale.

There was one loan with a principal balance of \$1,145,000 modified as a troubled debt restructuring during the year ended December 31, 2017. There were no loans modified as troubled debt restructurings during the years ended December 31, 2016 and 2015.

Of the \$4,884,000 in loans that were impaired as of December 31, 2016, both loans remained impaired (balance of \$1,030,000 as of December 31, 2017).

Following is a table representing our delinquency/impairment experience and foreclosures as of and during the years ended December 31, 2017, 2016, 2015, 2014 and 2013:

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Delinquent/Impaired Loans	\$ 8,534,000	\$ 4,884,000	\$ 8,694,000	\$ 22,316,000	\$ 31,738,000
Loans Foreclosed	\$ —	\$ 1,079,000	\$ —	\$ 7,671,000	\$ 26,187,000
Total Loans	\$ 146,172,000	\$ 129,682,000	\$ 106,744,000	\$ 68,034,000	\$ 58,796,000
Percent of Delinquent Loans to Total Loans	5.84%	3.77%	8.14%	32.80%	53.98%

If the delinquency rate increases on loans held by us, our interest income will be reduced by a proportionate amount. If a loan held by us is foreclosed on, we will acquire ownership of real property and the inherent benefits and detriments of such ownership.

### **Compensation to the Manager**

The Manager receives various forms of compensation and reimbursement of expenses from the Company and compensation from borrowers as set forth in the Company’s charter and Management Agreement and summarized below.

#### Compensation and Reimbursement from the Company

##### *Management Fees*

Up until July 1, 2017, management fees have been paid by the Company to the Manager monthly not to exceed 2.75% annually of the average unpaid balance of our loans at the end of each of the 12 months in the calendar year (the “Existing Management Fee”). Since this fee was paid monthly, it could exceed 2.75% in one or more months, but the total fee in any one year was limited to a maximum of 2.75%, and any amount paid above this had to be repaid by the Manager to the Company. The Manager was entitled to receive a management fee on all loans, including those that were delinquent. The Manager believed this was justified by the added effort associated with such loans. In certain past years, the Manager had chosen not to take the maximum allowable compensation; however, in recent years, the Manager elected to take the maximum compensation

In August 2017, our Board and the Manager agreed to adjust the Existing Management Fee on an interim basis to a monthly management fee that equals 1/12<sup>th</sup> of 1.50% of the Company’s Stockholders’ Equity, subject to the additional details of the calculation as described in “Related Party Transactions – Management Fees and Expenses – *Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*” in Item 13 of this Annual Report (the “Interim Management Fee”). The Interim Management Fee is payable during the period commencing July 1, 2017 and ending on March 31, 2018 (the “Interim Adjustment Period”), and is intended to reduce the management fees that would otherwise be payable by the Company during the Interim Adjustment Period.

##### *Servicing Fees*

The Manager may act as servicing agent on any or all of the loans held by the Company and expects to continue to service all such loans. In consideration for acting as the servicing agent, the Manager receives from the Company a monthly servicing 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 in the community where the loan is placed for the provision of such services on that type of loan or up to 0.25% per year of the unpaid balance of loans held by the Company at the end of each month. The Manager has historically been paid the maximum servicing fee allowable.

##### *Reimbursement of Other Expenses*

The Manager is reimbursed by the Company for the actual cost of goods and materials used for or by the Company and obtained from unaffiliated entities and the actual cost of services of non-management and non-supervisory personnel related to the administration of the Company (subject to certain limitations contained in our Management Agreement).

### Compensation from Borrowers

In addition to compensation from the Company, the Manager also receives compensation from borrowers under our loans arranged by the Manager.

### *Acquisition and Origination Fees*

The Manager is entitled to receive and retain all acquisition and origination fees paid or payable by borrowers for services rendered in connection with the evaluation and consideration of potential investments of the Company (including any selection fee, mortgage placement fee, nonrecurring management fee, and any origination fee, loan fee, or points paid by borrowers, or any fee of a similar nature). The acquisition and origination fees are paid by borrowers, and thus, are not an expense of the Company. These fees may be paid at the placement, extension or refinancing of the loan or at the time of final repayment of the loan. The amount of these fees is determined by competitive conditions and the Manager and may have a direct effect on the interest rate borrowers are willing to pay the Company.

### *Late Payment Charges*

The Manager is entitled to receive all late payment charges paid by borrowers on delinquent loans held by the Company (including additional interest and late payment fees). The late payment charges are paid by borrowers and collected by the Company with regular monthly loan payments or at the time of loan payoff. These are recorded as a liability (Due to Manager) when collected and are not recognized as an expense of the Company. Generally, on the majority of our loans, the late payment fee charged to the borrower for late payments is 10% of the payment amount. In addition, on the majority of our loans, the additional interest charge required to be paid by borrowers once a loan is past maturity is in the range of 3%-5% (paid in addition to the pre-default interest rate).

### *Other Miscellaneous Fees*

We remit other miscellaneous fees to the Manager, which are collected from loan payments, loan payoffs or advances from loan principal (i.e. funding, demand and partial release fees).

The Manager may voluntarily accept compensation that is less than the maximum fees and compensation described above, so long as no such change will result in a significant adverse impact on the stockholders of the Company.

### Proposal to Amend Management Agreement and Permanently Reduce Management Fees and Expenses

On March 13, 2018, we announced that our Board and the Manager have reached a non-binding agreement in principle to amend the Management Agreement to make the following changes to the Manager's compensation structure (the "Amendment Proposal"): (1) to make permanent the Interim Management Fee adjustment along with an additional adjustment such that the monthly management fee payable will equal (i) one-twelfth (1/12) multiplied by (ii) (a) 1.50% of the first \$300,000,000 of the Company's Stockholders' Equity and (b) 1.25% of the Company's Stockholders' Equity that is greater than \$300,000,000, (2) to share with the Company 30% of all loan origination, acquisition and other fees and late payment charges paid in connection with our loans, with the remaining 70% of such fees and charges to be paid to the Manager, (3) to eliminate the payment of servicing fees to the Manager for the Manager's services as servicing agent with respect to our loans, and (4) to eliminate the expense reimbursement to the Manager for certain expenses, including the salary and related salary expense of the Manager's non-management and non-supervisory personnel. While the Company and the Manager caution that no assurances can be made regarding the timing or certainty of entering a definitive agreement relating to the Amendment Proposal, if a definitive agreement implementing the Amendment Proposal is not executed by March 31, 2018, the Manager has agreed that the Company will only be obligated to pay, and the Manager will only be entitled to receive, the reduced management fee contemplated under paragraph (1) above of the Amendment Proposal from and after April 1, 2018. The foregoing summary of the Amendment Proposal is subject to the additional details as described in "Related Party Transactions – Management Fees and Expenses – *Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*" in Item 13 of this Annual Report.

## **Principal Investment Objectives**

Our principal investment objectives are to preserve the capital of the Company and to provide periodic cash distributions to stockholders. It is not our intent to provide tax-sheltered income.

We invest in real estate loans primarily in the Western United States. The loans we invest in are selected for us by OFG from loans originated by OFG or non-affiliated mortgage brokers. When OFG or a non-affiliated mortgage broker originates a loan for us, the borrower is identified, the loan application is processed and the loan is made available to us. We believe that our loans are attractive to borrowers because of the expediency of OFG's loan approval process, which is approximately ten to twenty days.

We generally employ similar underwriting standards as conventional lenders, such as banks. However, as a specialty finance lender, we are more willing to invest in real estate loans to borrowers that conventional lenders may have rejected for not being creditworthy. When making these loans we attempt to mitigate the added risk by requiring greater equity in the property. Borrowers are willing to pay us higher interest rates than conventional lenders charge to obtain these loans. In addition, we usually are able to generate higher fees and charge higher interest rates for our loans because we typically can underwrite and close a loan more rapidly than a conventional lender. The loans we invest in are typically short in duration, usually less than three years, and bridge the acquisition or improvement of properties that undergo an economic transformation. The short maturity terms of our loans add a degree of risk, as the borrowers are forced to find suitable replacement financing or to sell their property in order to pay off the loan.

## **Investment in Real Estate Loans**

Our acquisition and investment policies are to invest at least 86.5% of our capital in real estate loans and activities related thereto. Due to the declining economy and reductions in real estate values prior to 2013, we experienced increased foreclosures which resulted in our ownership of significantly more real estate than in the past. Therefore, while we initially adhered to our policies of investing at least 86.5% of our capital in real estate loans, economic conditions beyond our control have resulted in less than 86.5% of our capital being accounted for as investments in real estate loans. As of December 31, 2017, approximately 60% of our assets were classified as investments in real estate loans (net of allowance for loan losses). Additionally, we must maintain a contingency reserve in an aggregate amount of at least 1.5% of our capital pursuant to our charter.

Our loans are predominantly secured by first mortgage or deed of trust liens on the underlying properties purchased or developed with the funds that we make available. We sometimes refer to these real properties as the security properties. We invest primarily in loans on commercial, industrial and multi-family residential income-producing real property. Substantially all loans are arranged by OFG, which is licensed by the State of California as a real estate broker and California Finance Lender. During the course of its business, OFG is continuously evaluating prospective investments. OFG originates loans from mortgage brokers, previous borrowers, and by personal solicitations of new borrowers. We may purchase or participate in existing loans that were originated by other lenders. Such a loan might be obtained by us from a third party at an amount equal to or less than its face value. OFG evaluates all potential loan investments to determine if the security for the loan, loan-to-value ratio and other applicable factors meet our investment criteria and policies. OFG locates, identifies and arranges virtually all loans we invest in and makes all investment decisions on our behalf. In evaluating prospective loan investments, OFG considers such factors as the following:

- the ratio of the amount of the investment to the value of the property by which it is secured;
- the property's potential for capital appreciation;
- expected levels of rental and occupancy rates;
- current and projected cash flow generated by the property;
- potential for rental rate increases;
- the marketability of the investment;
- geographic location of the property;
- the condition and use of the property;
- the property's income-producing capacity;



- the quality, experience and creditworthiness of the borrower;
- general economic conditions in the area where the property is located; and
- any other factors that OFG believes are relevant.

## **Types of Loans**

We invest in first, second, and third mortgage and deed of trust loans, wraparound and participating mortgage and deed of trust loans, construction mortgage and deed of trust loans on real property, and loans on leasehold interest mortgages and deeds of trust. We do not ordinarily make or invest in mortgage and deed of trust loans with a maturity of more than 15 years, and most loans have terms of one to three years. Virtually all loans provide for monthly payments of interest and some also provide for principal amortization. Most of our loans provide for payments of interest only and a payment of principal in full at the end of the loan term. OFG does not originate loans with negative amortization provisions. We do not have any policies directing the portion of our assets that may be invested in construction or rehabilitation loans, loans secured by leasehold interests and second, third and wrap-around mortgage and deed of trust loans. However, OFG recognizes that these types of loans are riskier than first deeds of trust on income-producing, fee simple properties and will seek to minimize the amount of these types of loans in our portfolio. Additionally, OFG will consider that these loans are riskier when determining the rate of interest on the loans.

### ***First Mortgage Loans***

First mortgage and deed of trust loans are secured by first deeds of trust on real property. Such loans are generally for terms of one to three years. In addition, such loans do not usually exceed 75% of the appraised value of improved real property and 50% of the appraised value of unimproved real property.

### ***Second and Wraparound Mortgage Loans***

Second and wraparound mortgage and deed of trust loans are secured by second or wraparound deeds of trust on real property which is already subject to prior mortgage indebtedness, in an amount which, when added to the existing indebtedness, does not generally exceed 75% of the appraised value of the secured property. A wraparound loan is one or more junior mortgage loans having a principal amount equal to the outstanding balance under the existing mortgage loans, plus the amount actually to be advanced under the wraparound mortgage loan. Under a wraparound loan, we generally make principal and interest payments on behalf of the borrower to the holders of the prior mortgage loans.

### ***Third Mortgage Loans***

Third mortgage and deed of trust loans are secured by third deeds of trust on real property which is already subject to prior first and second mortgage indebtedness, in an amount which, when added to the existing indebtedness, does not generally exceed 75% of the appraised value of the secured property.

### ***Construction and Rehabilitation Loans***

Construction and rehabilitation loans are loans made for both original development and renovation of property. Construction and rehabilitation loans invested in by us are generally secured by first deeds of trust on real property for terms of six months to two years. In addition, if the secured property is being developed, the amount of such loans generally will not exceed 75% of the post-development appraised value. We will not usually disburse funds on a construction or rehabilitation loan until work in the previous phase of the project has been completed, and an independent inspector has verified completion of work to be paid for. In addition, we require the submission of signed labor and material lien releases by the contractor in connection with each completed phase of the project prior to making any periodic disbursements of loan proceeds. As of December 31, 2017, our loan portfolio contains fourteen construction/rehabilitation loans with aggregate outstanding principal balances totaling \$21,751,000.

### ***Leasehold Interest Loans***

Loans on leasehold interests are secured by an assignment of the borrower's leasehold interest in the particular real property. Such loans are generally for terms of from six months to 15 years. Leasehold interest loans generally do not exceed 75% of the value of the leasehold interest at origination. The leasehold interest loans are either amortized over a period that is

shorter than the lease term or have a maturity date prior to the date the lease terminates. These loans permit OFG to cure any default under the lease. As of December 31, 2017, our loan portfolio does not contain any leasehold interest loans.

### **Prepayment Penalties and Exit Fees**

Generally, the loans we invest in do not contain prepayment penalties or exit fees. If our loans are at a high rate of interest in a market of falling interest rates, the failure to have a prepayment penalty provision or exit fee in the loan allows the borrower to refinance the loan at a lower rate of interest, thus providing a lower yield to us on the reinvestment of the prepayment proceeds. While our loans do not contain prepayment penalties, many instead require the borrower to notify OFG of the intent to payoff within a specified period of time prior to payoff (usually 30 to 120 days). If this notification is not made within the proper time frame, the borrower may be charged interest for that number of days that notification was not received.

### **Balloon Payment**

As of December 31, 2017, 99.9% of our loans provide for a “balloon payment” on the principal amount due upon maturity of the loan (including both interest only and amortizing loans with a balloon payment). As of December 31, 2017, one loan (0.1% of total loans) was a fully amortizing loan with a principal balance of approximately \$214,000 and a remaining term of 216 months. There are no specific criteria used in evaluating the credit quality of borrowers for loans requiring balloon payments. Furthermore, a substantial period of time may elapse between the review of the financial statements of the borrower and the date when the balloon payment is due. As a result, there is no assurance that a borrower will have sufficient resources to make a balloon payment when due. To the extent that a borrower has an obligation to pay the loan principal in a large lump sum payment, its ability to repay the loan may be dependent upon its ability to sell the property, obtain suitable refinancing or otherwise raise a substantial amount of cash. As a result, these loans can involve a higher risk of default than amortizing loans (where principal is paid at the same time as the interest payments).

### **Repayment of Loans on Sales of Properties**

We may require a borrower to repay a loan upon the sale of the secured property rather than allow the buyer to assume the existing loan. This may be done if OFG determines that repayment appears to be advantageous to us based upon then-current interest rates, the length of time that the loan has been held by us, the credit-worthiness of the buyer and our objectives and policies. The net proceeds from any sale or repayment are invested in new loans, held as cash or distributed at such times and in such intervals as OFG, in its sole discretion, determines.

### **Fixed Rate Loans**

Approximately 84.8% (\$123,883,000) and 92.4% (\$119,876,000) of our loans as of December 31, 2017 and 2016, respectively, bear interest at a fixed rate. The weighted average interest rate of such loans as of December 31, 2017 and 2016 was approximately 7.7% and 7.9%, respectively.

### **Variable and/or Split Rate Loans**

Approximately 15.2% (\$22,289,000) and 7.6% (\$9,806,000) of our loans as of December 31, 2017 and 2016, respectively, bear interest at a variable rate or include terms whereby the interest rate is increased at a later date. Currently, variable rate loans use the Prime rate (4.50% and 3.75% at December 31, 2017 and 2016), the three-month LIBOR rate (1.69% and 1.00% at December 31, 2017 and 2016, respectively) and the six-month LIBOR rate (1.84% and 1.32% at December 31, 2017 and 2016, respectively). OFG may negotiate spreads over these indices of 3.0% to 9.0%, although there is no assurance that spreads will not be lower or higher depending upon market conditions at the time the loan is made.

It is possible that the interest rate index used in a variable rate loan will rise (or fall) more slowly than the interest rate of other loan investments available to us. OFG attempts to minimize this interest rate differential by tying variable rate loans to indices that are sensitive to fluctuations in market rates. Additionally, most variable rate loans originated by OFG contain provisions under which the interest rate cannot fall below the initial rate.

Variable rate loans generally have interest rate caps. We anticipate that the interest rate cap will be a ceiling that is 2% to 4% above the starting rate with a floor rate equal to the starting rate. For these loans, there is the risk that the market rate may exceed the interest cap rate.

Variable rate loans of five to ten year maturities are not assumable without the prior consent of OFG. We do not expect to invest in or purchase a significant amount of assumable loans. To minimize our risk, any borrower assuming an existing loan will be subject to the same underwriting criteria as the original borrower.

### **Debt Coverage Standard for Loans**

Loans on commercial property generally require the net annual estimated cash flow to equal or exceed the annual payments required on the loan.

### **Loan Limit Amount**

We limit the amount of our investment in any single loan, and the amount of our investment in loans to any one borrower, to 10% of our total assets as of the date the loan is made or purchased.

### **Loans to Affiliates**

We will not provide loans to OFG or an affiliate except for in connection with any advance of expenses or indemnification permitted by our charter, bylaws and the Management Agreement

### **Purchase of Loans from Affiliates**

We may purchase loans deemed suitable for acquisition from OFG or its affiliates only if:

- OFG makes or purchases such loans in its own name and temporarily holds title thereto for the purpose of facilitating the acquisition of such loans, and provided that such loans are purchased by us for a price no greater than the cost of such loans to OFG (except for compensation in accordance with the terms of the Management Agreement and the charter);
- There is no other benefit arising out of such transactions to OFG;
- Such loans are not in default, and;
- Such loans otherwise satisfy, among other things, the following requirements:
  - We will not make or invest in loans on any one property if at the time of acquisition of the loan the aggregate amount of all loans outstanding on the property, including loans by the Company, would exceed an amount equal to 80% of the appraised value of the property as determined by independent appraisal, unless substantial justification exists because of the presence of other documented underwriting criteria.
  - We will limit any single loan and limit the loans to any one borrower to not more than 10% of our total assets as of the date the loan is made or purchased.
  - We will not invest in or make loans on unimproved real property in an amount in excess of 25% of our total assets.

### **Competition**

Our major competitors in providing specialty finance loans are specialty finance companies, private debt funds, banks, conduit lenders (and to a lesser extent other mortgage REITs, institutional investors and other entities). No particular competitor dominates the market. Many of the companies against which we compete have substantially greater financial, technical and other resources than us. Furthermore, additional mortgage REIT's with investment objectives similar to ours and other competitors may be organized in the future. Competition in our market niche depends upon a number of factors, including price and interest rates of the loan, speed of loan processing, cost of capital, reliability, quality of service and support services. While we are seeing increasing amounts of competition from new and established competitors in our loan markets, we remain competitive in large part because OFG generates substantially all loans and is able to provide expedited loan approval, processing and funding. OFG has been in the business of making or investing in loans since 1951.

## **Regulation of the Manager**

We are managed by OFG. OFG, in its capacity as our Manager, is subject to the oversight of our Board of Directors pursuant to the terms and conditions of the Management Agreement and our charter. OFG's operations as a mortgage broker are subject to extensive regulation by federal, state and local laws and governmental authorities. OFG conducts its real estate mortgage business under a license issued by the State of California. Under applicable California law, the division has broad discretionary authority over OFG's activities.

## **Employees**

The Company does not have employees, other than two full-time and one part-time employee(s) that work directly for its wholly-owned subsidiary, Brannan Island, LLC. OFG provides all of the employees (including our officers) necessary for our operations pursuant to the Management Agreement. As of December 31, 2017, OFG had eleven full-time and five part-time employees. All employees are at-will employees and none are covered by collective bargaining agreements.

## **Distribution of Company Information**

Our Internet address is [www.owensmortgage.com](http://www.owensmortgage.com). We use our web site as a routine channel for distribution of important information, including news releases, SEC filings, and certain other financial information. We post filings on our web site as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC, including our annual and quarterly reports on Forms 10-K and 10-Q and current reports on Form 8-K; our proxy statements; and any amendments to those reports or statements. All such postings and filings are available on our web site free of charge. The SEC's web site, [www.sec.gov](http://www.sec.gov), contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. We also make available our code of business conduct and ethics, corporate governance guidelines, committee charters, certain Company presentations and fact sheets, and press releases. The content on any web site referred to in this Annual Report is not incorporated by reference in this Annual Report unless expressly noted.

Our Investor Relations Department can be contacted at 2221 Olympic Blvd., Walnut Creek, CA 94595, Attn: Investor Relations, or by email at [investors@owensmortgage.com](mailto:investors@owensmortgage.com).

## **Item 1A. RISK FACTORS**

You should consider carefully the risks described below, together with the other information contained in this Annual Report, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and related notes. If any of the identified risks actually occurs, or is adversely resolved, our consolidated financial statements could be materially adversely impacted in a particular fiscal quarter or year and our business, financial condition and results of operations may suffer materially. As a result, the trading price of our Common Stock and your investment in the Company may suffer.

The risks described below are not the only risks we face. Additional risks and uncertainties, including those not currently known to us or that we currently deem to be immaterial also could materially adversely affect our business, financial condition and results of operations.

### **Risks Related to Relationship with Our Manager**

***We will rely on our Manager, Owens Financial Group, Inc., to manage our day-to-day operations and select our loans for investment.***

Our ability to achieve our investment objectives and to make distributions to you depends upon OFG's performance in obtaining, processing, making and brokering loans for us to invest in and determining the financing arrangements for borrowers. You will have no opportunity to evaluate the financial information or creditworthiness of borrowers, the terms of loans, the real property that is our collateral or other economic or financial data concerning our loans. Furthermore, the Manager is authorized to make most investments without prior approval of the Company's board of directors. The Manager has great latitude within the broad investment guidelines in determining the types of assets that are proper investments for the Company, which could result in investment returns that are substantially below expectations or that result in losses, which would materially and adversely affect the Company's business operations and results. Furthermore, OFG has no fiduciary

obligations to us or our stockholders, has conflicts of interest arising as a result of our fee structure, and is not required to devote its employees full time to our business and may devote time to business interests competitive with our business.

***We depend on key personnel of our Manager with long standing business relationships, the loss of whom could threaten our ability to operate our business successfully.***

Our future success depends, to a significant extent, upon the continued services of OFG as our manager and OFG's officers and employees. The loss of services of one or more members of OFG's management team could harm our business and prospects, including the services of William C. Owens (Chairman of ORM and Chief Executive Officer of OFG), Bryan H. Draper (Chief Executive Officer of ORM and Chief Financial Officer of OFG), William E. Dutra (Executive Vice President of OFG), Melina A. Platt (Chief Financial Officer of ORM and Controller of OFG), Daniel J. Worley (Senior Vice President of ORM) and Brian M. Haines (Senior Vice President of OFG), each of whom would likely be difficult to replace because of their extensive experience in the field, extensive market contacts and familiarity with our business. None of these individuals is subject to an employment, non-competition or confidentiality agreement with us or OFG, and we do not maintain "key man" life insurance policies on any of them. Our future success also depends in large part upon OFG's ability to hire and retain additional highly skilled managerial and operational personnel. OFG may require additional operations people who are experienced in obtaining, processing, making and brokering loans and who also have contacts in the relevant markets. If OFG were unable to attract and retain key personnel, the ability of OFG to make prudent investment decisions on our behalf may be impaired.

***Our Manager's liability is limited under the Management Agreement, and we have agreed to indemnify our Manager against certain liabilities. As a result, we could experience poor performance or losses for which our Manager would not be liable.***

Pursuant to the Management Agreement, OFG does not assume any responsibility other than to render the services called for thereunder and is not responsible for any action of our Board of Directors in following or declining to follow its advice or recommendations. Under the terms of the Management Agreement, none of OFG, its officers, stockholders, directors, employees or advisors, among others, will be liable to us or any subsidiary of ours, to our Board of Directors, or to our or any subsidiary's stockholders, members or partners for any acts or omissions made pursuant to the Management Agreement, except for acts or omissions constituting bad faith, willful misconduct, gross negligence or reckless disregard of OFG's duties under the Management Agreement, as determined by a final court order. In addition, we have agreed to indemnify, to the fullest extent permitted by law, OFG, its officers, stockholders, directors, employees and advisors, among others, from all losses (including attorneys' fees) arising from any acts or omissions of such person made in good faith in the performance of OFG's duties under the Management Agreement and not constituting bad faith, willful misconduct, gross negligence or reckless disregard of such duties.

***Our Manager serves pursuant to a long-term Management Agreement that may be difficult to terminate and may not reflect arm's-length negotiations.***

We entered into a long-term Management Agreement with OFG. The Management Agreement was negotiated by related parties and may not reflect terms as favorable as those subject to arm's-length bargaining. The Management Agreement will continue in force for the duration of the existence of Owens Realty Mortgage, Inc., unless terminated earlier pursuant to the terms of the Management Agreement. The Management Agreement may be terminated prior to the termination of our existence: (a) upon the affirmative vote of the holders of a majority of the outstanding shares of Common Stock; (b) by OFG pursuant to certain procedures set forth in the Management Agreement relating to changes in compensation; (c) automatically in the event of an assignment of the Management Agreement by OFG (with certain exceptions), unless consented to by the Company with the approval of our Board of Directors and holders of a majority of the outstanding shares of Common Stock entitled to vote on the matter; (d) by us upon certain conditions set forth in the Management Agreement, including a breach thereof by OFG; or (e) by OFG upon certain conditions set forth in the Management Agreement, including a breach thereof by the Company. Consequently, it may be difficult to terminate our Management Agreement and replace OFG in the event that its performance does not meet our expectations or for other reasons, unless the conditions for termination of the Management Agreement are satisfied.

***Our Manager will face conflicts of interest arising from our fee structure.***

OFG will receive fees from borrowers that would otherwise increase our returns. Because OFG receives all of these fees, our interests will diverge from those of OFG and William C. Owens (as well as Bryan H. Draper, William E. Dutra and other

members of management that have a significant ownership interest in OFG) when OFG decides whether we should charge the borrower higher interest rates or OFG should receive higher fees from borrowers.

OFG earned a total of approximately \$3,908,000, \$3,585,000 and \$2,238,000 for the fiscal years ended December 31, 2017, 2016 and 2015, respectively, from ORM for managing the Company and servicing its loans. In addition, OFG earned a total of approximately \$2,598,000, \$2,617,000 and \$1,993,000 in fees from borrowers for the fiscal years ended December 31, 2017, 2016 and 2015, respectively. The total amount earned by OFG that is paid by borrowers represents fees on loans originated or extended for the Company (including loan fees, late payment charges and miscellaneous fees).

During the Interim Adjustment Period the Existing Management Fee, which is calculated as a percentage of our loan balances and could potentially incentivize our Manager to cause us to make loans to increase management fees, has been reduced to the monthly Interim Management Fee that equals 1/12<sup>th</sup> of 1.50% of the Company's Stockholders' Equity, subject to the additional details of the calculation as described in "Related Party Transactions – Management Fees and Expenses – *Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*" in Item 13 of this Annual Report. On March 13, 2018, the Manager and our Board announced an Amendment Proposal to revise certain aspects of the Manager's compensation structure, and as part of that announcement they have agreed to make permanent, effective April 1, 2018, the Interim Management Fee adjustment along with an additional adjustment such that the monthly management fee payable will equal (i) one-twelfth (1/12) multiplied by (ii) (a) 1.50% of the first \$300,000,000 of the Company's Stockholders' Equity and (b) 1.25% of the Company's Stockholders' Equity that is greater than \$300,000,000. Additional details of this permanent fee reduction, and other aspects of the Amendment Proposal, are described in "Related Party Transactions – Management Fees and Expenses – *Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*" in Item 13 of this Annual Report.

***Our Manager will face conflicts of interest concerning the allocation of its personnel's time.***

Our Manager and William C. Owens, who owns 62.5% of the outstanding shares of stock of OFG as of December 31, 2017, although unlikely, may also sponsor other real estate programs having investment objectives and policies similar to ours. As a result, OFG and William C. Owens (as well as Bryan H. Draper, William E. Dutra and other members of management that have a significant ownership interest in OFG) may have conflicts of interest in allocating their time and resources between our business and other activities. During times of intense activity in other programs and ventures, OFG and its key people may devote less time and resources to our business than they ordinarily would. Our Management Agreement with OFG does not specify a minimum amount of time and attention that OFG and its key people are required to devote to the Company. Thus, OFG may not spend sufficient time managing our operations, which could result in our not meeting our investment objectives. Currently, OFG does not sponsor other real estate programs or any other programs that have an objective and policies similar to those of the Company.

***Under the Management Agreement, termination of our Manager for cause requires that we provide 30 days' prior written notice to our Manager.***

Termination of the Management Agreement with our Manager for cause, including in the event that OFG engages in fraud or embezzlement, misappropriates funds or intentionally breaches the Management Agreement, requires us to provide 30 days' prior written notice to OFG. Accordingly, if OFG engages in any of the foregoing activities (or any other activities resulting in a for cause termination), our inability to terminate the Management Agreement for at least 30 days may result in inefficiencies and uncertainties that could ultimately have a material adverse effect on our business, financial condition and results of operations.

***Our management has limited experience operating a REIT, and we cannot assure you that our management's past experience will be sufficient to successfully manage our business as a REIT. If we fail to comply with REIT requirements, we would incur U.S. federal income taxes at the corporate level, which would reduce our distributions to you.***

We have a short operating history as a REIT, and our management has limited experience in complying with the income, asset and other limitations imposed by the REIT provisions of the Internal Revenue Code of 1986, as amended (the "Code"). These provisions are complex, and the failure to comply with these provisions in a timely manner could prevent us from qualifying as a REIT or could force us to pay unexpected taxes and penalties. In such event, our net income would be reduced and we would have less funds available for distribution to you.

If we fail to qualify as a REIT, we would be subject to U.S. federal income tax at regular corporate rates. Also, unless the

IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first fail to qualify. If we fail to qualify as a REIT, we would have to pay significant income taxes and therefore would have less money available for investments or for distributions to our stockholders. This would likely have a significant adverse effect on the value of our Common Stock. In addition, we would no longer be required to make distributions to our stockholders to maintain preferential U.S. federal income taxation as a REIT.

***We do not have a policy that expressly prohibits our directors, officers, security holders or affiliates from engaging for their own account in business activities of the types conducted by us.***

We do not have a policy that expressly prohibits our directors, officers, security holders or affiliates from engaging for their own account in business activities of the types conducted by us. However, our code of business conduct and ethics contains a conflicts of interest policy that, unless waived in accordance with the code, prohibits our directors and executive officers, as well as personnel of OFG who provide services to us, from engaging in any transaction that involves an actual conflict of interest with us. In addition, our Management Agreement with OFG does not prevent our Manager and its affiliates from engaging in additional management or investment opportunities, some of which could compete with us.

***Our Manager's lack of experience with certain real estate markets could impact its ability to make prudent investments on our behalf.***

While we invest in real estate loans throughout the United States, the majority of our loans are in the Western United States. Real estate markets vary greatly from location to location, and the rights of secured real estate lenders vary from state to state. OFG may originate loans for us in markets where they have limited experience. In those circumstances, OFG intends to rely on independent real estate advisors and local legal counsel to assist them in making prudent investment decisions. You will not have an opportunity to evaluate the qualifications of such advisors, and no assurance can be given that they will render prudent advice to OFG.

## **Risks Related to Our Business**

***Our results are subject to fluctuations in interest rates and other economic conditions and a significant increase in interest rates could harm our business.***

Our results of operations will vary with changes in interest rates and with the performance of the relevant real estate markets. If the economy is healthy, we expect that more investors will borrow money to acquire, develop or renovate real property. However, if the economy grows too fast, interest rates may increase too quickly and the cost of borrowing may cause real estate values to decline. Alternatively, if the economy enters a recession, real estate development may slow. A slowdown in real estate activity may reduce the opportunities for real estate lending and we may have fewer loans to make or acquire, thus reducing our revenues and the distributions you receive.

If, at a time of relatively low interest rates, a borrower should prepay obligations that have a higher interest rate from an earlier period, we will likely not be able to reinvest the funds in loans earning that higher rate of interest. In the absence of a prepayment fee, we will receive neither the anticipated revenue stream at the higher rate nor any compensation for its loss. This is a risk if the loans we invest in do not have prepayment penalties or exit fees.

As of December 31, 2017, most of our loans do not have a prepayment penalty or exit fee. Based on our Manager's historical experience, we expect that at least 90% of our loans will continue to not have a prepayment penalty. Should interest rates decrease, our borrowers may prepay their outstanding loans with us in order to receive a more favorable rate. This may reduce the amount of income we have available to distribute to you.

In the event of a significant rising interest rate environment, the costs of borrowing may increase rapidly, which may negatively impact new loan originations by reducing demand for real estate lending. Additionally, increases in market interest rates may result in a decrease in the liquidity and value of our loans, most of which are made at a fixed rate, and our real estate holdings, and could make it more difficult for borrowers of our mortgage loans to refinance the loans with third party lenders or otherwise repay our loans.

***A prolonged economic slowdown or severe recession could harm our business.***

The risks associated with our business are more acute during periods of economic slowdown or recession because these periods can be accompanied by decreased demand for consumer credit and declining real estate values. Because we are a

non-conventional lender willing to invest in riskier loans, rates of delinquencies, foreclosures and losses on our loans could be higher than those generally experienced in the mortgage lending industry during periods of economic slowdown or recession. Any sustained period of increased delinquencies, foreclosures or losses could adversely affect our ability to originate, purchase and securitize loans, which could significantly harm our financial condition, liquidity and results of operations.

***Our reserves for loan losses may prove inadequate, which could have a material adverse effect on our financial results.***

We maintain an allowance for loan loss reserve to protect against probable, incurred losses and conduct a review of the appropriateness of the allowance for loan losses on a quarterly basis. This allowance is our Manager's estimate of probable credit losses inherent in the Company's loan portfolio that have been incurred as of the balance sheet date for the relevant quarter. The allowance is established through a provision for loan losses which is charged to expense. The overall allowance consists of two primary components: specific reserves related to impaired loans that are individually evaluated for impairment and general reserves for inherent losses related to loans that are not considered impaired and are collectively evaluated for impairment.

Our allowance for loan loss reserve reflects the Manager's then-current estimation of the probability and severity of losses within our portfolio, based on this quarterly review. Our determination of loan loss reserves relies on significant estimates regarding the fair value of loan collateral and other factors. The estimation of these fair values is a complex and subjective process. As such, there can be no assurance that the Manager's judgment will prove to be correct and that reserves will be adequate over time to protect against future losses. Such losses could be caused by factors including, but not limited to, unanticipated adverse changes in the economy or events adversely affecting specific assets, borrowers, industries in which our borrowers operate or markets in which our borrowers or their properties are located. If our allowance for loan loss reserves proves inadequate we will suffer additional losses which may have a material adverse effect on our financial performance, results of operations and amount of dividends paid. For additional information relating to the determination of our allowance for loan losses see the discussions under Item 7 – "Critical Accounting Policies – Allowance for Loan Losses, Impaired Loans and Non-accrual Status," "Financial Condition – Allowance For Loan Losses" and "Asset Quality" in this Annual Report.

***We face competition for real estate loans that may reduce available returns and fees available.***

Our competitors consist primarily of specialty finance companies, private debt funds, commercial banks and conduit lenders (and to a lesser extent, other mortgage REITs, institutional investors and other entities). Many of the companies against which we and OFG compete have substantially greater financial, technical and other resources than us or OFG. If our competitors decrease interest rates on their loans or make funds more easily accessible, we may be required to reduce our interest rates, which would reduce our revenues and the distributions you receive.

***We may have difficulty protecting our rights as a secured lender.***

We believe that our loan documents will enable us to enforce our commercial arrangements with borrowers. However, the rights of borrowers and other secured lenders may limit our practical realization of those benefits. For example:

- Judicial foreclosure is subject to the delays of protracted litigation. Although we expect non-judicial foreclosure to be quicker, our collateral may deteriorate and decrease in value during any delay in foreclosing on it;
- The borrower's right of redemption during foreclosure proceedings can deter the sale of our collateral and can for practical purposes require us to manage the property;
- Unforeseen environmental hazards may subject us to unexpected liability and procedural delays in exercising our rights;
- The rights of senior or junior secured parties in the same property can create procedural hurdles for us when we foreclose on collateral;
- We may not be able to pursue deficiency judgments after we foreclose on collateral; and



- State and federal bankruptcy laws can prevent us from pursuing any actions, regardless of the progress in any of these suits or proceedings.

***Loan defaults, delinquencies and foreclosures will decrease our revenues and net income and your distributions.***

We are in the business of investing in real estate loans, and, as such, we are subject to risk of defaults by borrowers. Our performance will be directly impacted by any defaults on the loans in our portfolio. As a specialty finance lender willing to invest in loans to borrowers who may not meet the credit standards of conventional lenders, the rate of default on our loans could be higher than those generally experienced in the real estate lending industry. Any sustained period of increased defaults could adversely affect our business, financial condition, liquidity and the results of our operations, and ultimately your distributions. We seek to mitigate the risk by estimating the value of the underlying collateral and insisting on low loan-to-value ratios. However, we cannot assure you that these efforts will fully protect us against losses on defaulted loans. Any subsequent decline in real estate values on defaulted loans could result in less security than anticipated at the time the loan was originally made, which may result in our not recovering the full amount of the loan. Any failure of a borrower to repay loans or interest on loans will reduce our revenues and your distributions and the value of your interest in the Company. In most instances, we obtain a new appraisal at the date of loan origination. In limited instances, we will accept an appraisal that is dated within twelve months of the date of loan origination, which may not reflect a decrease in the value of the real estate due to events subsequent to the date of the appraisals.

As of December 31, 2017, our portfolio had approximately \$8,534,000 in delinquent and/or impaired loans (compared to \$4,884,000 as of December 31, 2016). We also had approximately \$20,737,000 of non-income producing real estate held for sale or investment for a total of \$29,271,000 in non-performing assets, which represented approximately 15% of our total capital as of December 31, 2017.

It is possible that we will continue to experience reduced net income or further losses in the future, thus negatively impacting future distributions. As non-delinquent loans are paid off by borrowers, interest income received by us may be reduced. In addition, we may foreclose on more delinquent loans, thereby obtaining ownership of more real estate that may result in larger operating losses. Management will attempt to sell many of these properties but may need to sell them for losses or wait until market values recover in the future.

***Our underwriting standards may be more lenient than those of conventional lenders, which could result in a higher percentage of foreclosed properties, which could reduce the amount of distributions to you.***

Our underwriting standards and procedures may be more lenient than those of conventional lenders in that we will invest in loans secured by property that may not meet the underwriting standards of conventional real estate lenders or make loans to borrowers who may not meet the credit standards of conventional lenders. This may lead to more non-performing assets in our loan portfolio and create additional risks to your return. We approve real estate loans more quickly than other lenders. We rely on third-party reports and information such as appraisals and environmental reports to assist in underwriting loans. We may accept documentation that was not specifically prepared for us or commissioned by us. In addition, in limited instances we may accept an appraisal that is dated within twelve months of the date of loan origination. This creates a greater risk of the information contained therein being out of date or incorrect. Generally, we will spend less time than conventional lenders assessing the character and credit history of our borrowers and the property that secures our loans. Due to the accelerated nature of our loan approval process, there is a risk that the credit inquiry we perform will not reveal all material facts pertaining to the borrower and the security. There may be a greater risk of default by our borrowers, which may impair our ability to make timely distributions to you and which may reduce the amount we have available to distribute to you.

***We typically make “balloon payment” loans, which are riskier than loans with payments of principal over an extended period of time.***

The loans we invest in or purchase generally require the borrower to make a “balloon payment” on the principal amount upon maturity of the loan. A balloon payment is a large principal balance that is payable after a period of time during which the borrower has repaid none or only a small portion of the principal balance. As of December 31, 2017, 99.9% of our loans required balloon payments at the end of their terms. Loans with balloon payments are riskier than loans with even payments of principal over an extended time period like 15 or 30 years because the borrower’s repayment depends on its ability to sell the property profitably, obtain suitable refinancing or otherwise raise a substantial amount of cash when the loan comes due. There are no specific criteria used in evaluating the credit quality of borrowers for loans requiring balloon payments. Furthermore, a substantial period of time may elapse between the review of the financial statements of the borrower and the

date when the balloon payment is due. As a result, there is no assurance that a borrower will have sufficient resources to make a balloon payment when due.

***Incorrect original collateral assessment (valuation) could result in losses and decreased distributions to you.***

Appraisals are obtained from qualified, independent appraisers on all properties securing trust deeds, which may have been commissioned by the borrower and may precede the placement of the loan with us. However, there is a risk that the appraisals prepared by these third parties are incorrect, which could result in defaults and/or losses related to these loans.

Completed, written appraisals are not always obtained on our loans prior to original funding, due to the quick underwriting and funding required on the majority of our loans. Although the loan officers often discuss value with the appraisers and perform other due diligence and calculations to determine property value prior to funding, there is a risk that we may make a loan on a property where the appraised value is less than estimated, which could increase the loan's loan-to-value, or LTV, ratio and subject us to additional risk.

We may make a loan secured by a property on which the borrower previously commissioned an appraisal. Although we generally require such appraisal to have been made within one year of funding the loan, there is a risk that the appraised value is less than the actual value, increasing the loan's LTV ratio and subjecting us to additional risk.

***Investments in construction and rehabilitation loans may be riskier than loans secured by operating properties.***

As of December 31, 2017, our loan portfolio contains fourteen construction or rehabilitation loans with principal balances aggregating \$21,751,000, and we have commitments to fund an additional \$30,495,000 in the future on these loans and others (including interest reserves). We may make additional construction and rehabilitation loan commitments in the future. Construction and rehabilitation loans may be riskier than loans secured by properties with an operating history, because:

- the application of the loan proceeds to the construction or rehabilitation project must be assured;
- the completion of planned construction or rehabilitation may require additional financing by the borrower; and
- permanent financing of the property may be required in addition to the construction or rehabilitation loan.

***Investments in loans secured by leasehold interests may be riskier than loans secured by fee interests in properties.***

Although our loan portfolio does not contain any loans secured by leasehold interests as of December 31, 2017, we have made such loans in the past, and we may resume leasehold-secured lending in the future. Loans secured by leasehold interests are riskier than loans secured by real property because the loan is subordinate to the lease between the property owner (lessor) and the borrower, and our rights in the event the borrower defaults are limited to stepping into the position of the borrower under the lease, subject to its requirements of rents and other obligations and period of the lease.

***Investments in second, third and wraparound mortgage and deed of trust loans may be riskier than loans secured by first deeds of trust.***

Second, third and wraparound mortgage and deed of trust loans (those under which we generally make the payments to the holders of the prior liens) are riskier than first mortgage and deed of trust loans because:

- their position is subordinate in the event of default; and
- there could be a requirement to cure liens of a senior loan holder, and, if this is not done, we would lose our entire interest in the loan.

As of December 31, 2017, our loan portfolio contained 2.3% in second mortgage and deed of trust loans and 0% in third mortgage and deed of trust loans. As of December 31, 2017, we were not invested in any wraparound mortgage or deed of trust loans.

***Larger loans result in less diversity and may increase risk.***

As of December 31, 2017, we were invested in a total of 61 loans, with an aggregate book value of approximately \$146,172,000. The average book value of those loans was approximately \$2,396,000, and the median book value was \$1,565,000. Nine of such loans had a book value each of 3% or more of the aggregate book value of all loans, and the largest loan relationship had a total book value of 9.1% of all loans.

As a general rule, we can decrease risk of loss from delinquent loans by investing in a greater total number of loans. Investing in fewer, larger loans generally decreases diversification of the portfolio and increases risk of loss and possible reduction of return to investors in the case of a delinquency of such a loan.

***Loan repayments are less likely in a volatile market environment.***

In a market in which liquidity is essential to our business, loan repayments have been a significant source of liquidity for us. However, in recent years, many financial institutions curtailed new lending activity and real estate owners have had and may continue to have difficulty refinancing their loans at maturity. If borrowers are not able to refinance our loans at their maturity, the loans could go into default and the liquidity that we would receive from such repayments will not be available. Furthermore, without a properly functioning commercial real estate finance market, borrowers that are performing on their loans may be forced to extend such loans if allowed, which will further delay our ability to access liquidity through repayments.

***We depend upon real estate security to secure our real estate loans, and we may suffer a loss if the value of the underlying property declines.***

We depend upon the value of real estate security to protect us on the loans that we make. We utilize the services of independent appraisers to value the security underlying our loans. However, notwithstanding the experience of the appraisers, mistakes can be made, or the value of the real estate may decrease due to subsequent events. Our appraisals are generally dated within 12 months of the date of loan origination and may have been commissioned by the borrower. Therefore, the appraisals may not reflect a decrease in the value of the real estate due to events subsequent to the date of the appraisals. For a construction loan most of the appraisals will be prepared on an as-if developed basis. If the loan goes into default prior to completion of the project, the market value of the property may be substantially less than the appraised value. Additional capital may be required to complete a project in order to realize the full value of the property. If a default occurs and we do not have the capital to complete a project, we may not recover the full amount of our loan.

***By becoming the owner of property, we may incur additional obligations, which may reduce the amount of funds available for distribution.***

We intend to own real property only if we foreclose on a defaulted loan and purchase the property at the foreclosure sale. Acquiring a property at a foreclosure sale may involve significant costs. If we foreclose on a security property, we expect to obtain the services of a real estate broker and pay the broker's commission in connection with the sale of the property. We may incur substantial legal fees and court costs in acquiring a property through contested foreclosure and/or bankruptcy proceedings. In addition, significant expenditures, including property taxes, maintenance costs, renovation expenses, mortgage payments, insurance costs and related charges, must be made on any property we own, regardless of whether the property is producing any income.

Under applicable environmental laws, any owner of real property may be fully liable for the costs involved in cleaning up any contamination by materials hazardous to the environment. Even though we might be entitled to indemnification from the person that caused the contamination, there is no assurance that the responsible person would be able to indemnify us to the full extent of our liability. Furthermore, we would still have court and administrative expenses for which we may not be entitled to indemnification.

***Foreclosures subject us to additional risks associated with owning real estate.***

We have obtained title to a number of real estate assets that previously served as collateral on defaulted loans. These assets expose us to additional risks, including, without limitation:

- earning less income and reduced cash flows on foreclosed properties than could be earned and received on loans;

- incurring costs to carry, and in some cases make repairs or improvements to these assets, which requires additional liquidity and results in additional expenses that could exceed our original estimates and impact our operating results;
- not being able to realize sufficient amounts from sales of the properties to avoid losses;
- not being able to sell properties, which are not liquid assets, in a timely manner when we need to increase liquidity through asset sales;
- properties being acquired with one or more co-owners (called tenants-in-common) where development or sale requires written agreement or consent by all; without timely agreement or consent, we could suffer a loss from being unable to develop or sell the property;
- maintaining occupancy of the properties;
- controlling operating expenses;
- coping with general and local market conditions;
- complying with changes in laws and regulations pertaining to taxes, use, zoning and environmental protection;
- possible liability for injury to persons and property;
- possible uninsured losses related to environmental events such as earthquakes, floods and/or mudslides; and
- possible liability for environmental remediation.

During the years ended December 31, 2017 and 2016, we recorded impairment losses on three of our real estate properties held for sale and investment in the aggregate amount of approximately \$1,423,000 and \$3,228,000, respectively.

***Development on properties we acquire creates risks associated with developing real estate that we do not have as a lender.***

Some of the properties that we acquire, primarily through foreclosure proceedings, may face competition from newer, more updated properties. In order to remain competitive and increase occupancy at these properties and/or make them attractive to potential purchasers, we may develop, make significant capital improvements and/or incur costs associated with correcting deferred maintenance with respect to these properties. This could be done singly or in combination with other persons or entities through a joint venture, limited liability company or partnership, with OFG and/or unrelated third parties. The cost of these improvements and deferred maintenance items may impair our financial performance and liquidity and create the following additional risks:

- Reliance upon the skill and financial stability of third party developers and contractors;
- Inability to obtain governmental permits;
- Delays in construction of improvements;
- Increased costs during development and the need to obtain additional financing to pay for the development and reduced liquidity and capital available for us to invest in new loans; and
- Economic and other factors affecting the timing or price of sale or the leasing of developed property, including competition with entities seeking to dispose of similar properties.

***We may be required to make significant capital expenditures to improve our foreclosed properties in order to retain and attract tenants, causing a decline in operating revenue and reducing cash available for investment in loans, debt service and distributions to you.***

If adverse economic conditions continue in the real estate market, we expect that, upon expiration of leases at our properties, we will be required to make rent or other concessions to tenants, and/or accommodate requests for renovations, build-to-suit remodeling and other improvements. As a result, we may have to make significant capital or other expenditures in order to retain tenants whose leases expire and to attract new tenants. Additionally, we may need to raise capital to make such expenditures. If we are unable to do so or capital is otherwise unavailable, we may be unable to make the required expenditures. This could result in non-renewals by tenants upon expiration of their leases, which would result in declines in revenue from operations and reduce cash available for loan investments, debt service and distributions to you.

***With respect to properties we acquire through foreclosure, we may be unable to renew leases or re-lease space as leases expire on favorable terms or at all, which could have a material adverse effect on our financial condition, results of operations, cash flow, cash available for distribution to you, per share trading price of our Common Stock and our ability to satisfy our debt service obligations.***

Because we compete with a number of real estate operators in connection with the leasing of our properties, the possibility exists that one or more of our tenants will extend or renew its lease with us when the lease term expires on terms that are less favorable to us than the terms of the then-expiring lease, or that such tenant or tenants will not renew at all. Because we depend, in large part, on rental payments from our tenants, if one or more tenants renews its lease on terms less favorable to us or does not renew its lease, or if we do not re-lease a significant portion of the space made available, our financial condition, results of operations, cash flow, cash available for distribution, per-share trading price of our Common Stock and ability to satisfy our debt service obligations could be materially adversely affected.

***If any of our foreclosed properties incurs a vacancy, it could be difficult to sell or re-lease.***

One or more of our properties may incur a vacancy by either the continued default of a tenant under its lease or the expiration of one of our leases. Certain of our properties may be specifically suited to the particular needs of a tenant (e.g., a retail bank branch or distribution warehouse), and major renovations and expenditures may be required in order for us to re-lease vacant space for other uses. We may have difficulty obtaining a new tenant for any vacant space we have in our properties. If the vacancy continues for a long period of time, we may suffer reduced revenues, resulting in less cash available to be distributed to you. In addition, the resale value of a property could be diminished because the market value of a particular property will depend principally upon the value of the leases of such property.

***Our properties may be subject to impairment charges.***

We periodically evaluate our real estate investments for impairment indicators. The judgment regarding the existence of impairment indicators is based on factors such as market conditions, tenant performance and legal structure. For example, the early termination of, or default under, a lease by a tenant may lead to an impairment charge. If we determine that an impairment has occurred, we would be required to make an adjustment to the net carrying value of the property, which could have a material adverse effect on our results of operations in the period in which the impairment charge is recorded.

***Operating expenses of our properties acquired through foreclosure will reduce our cash flow and funds available for future distributions.***

For certain of our properties acquired through foreclosure, we are responsible for operating costs of the property. In some of these instances, our leases require the tenant to reimburse us for all or a portion of these costs, in the form of either an expense reimbursement or increased rent. Our reimbursement may be limited to a fixed amount or a specified percentage annually. To the extent operating costs exceed our reimbursement, our returns and net cash flows from the property and hence our overall operating results and cash flows could be materially adversely affected.

***We would face potential adverse effects from tenant defaults, bankruptcies or insolvencies.***

The bankruptcy of our tenants may adversely affect the income generated by our properties. If our tenant files for bankruptcy, we generally cannot evict the tenant solely because of such bankruptcy. In addition, a bankruptcy court could authorize a bankrupt tenant to reject and terminate its lease with us. In such a case, our claim against the tenant for unpaid

and future rent would be subject to a statutory cap that might be substantially less than the remaining rent actually owed under the lease, and it is unlikely that a bankrupt tenant would pay in full amounts it owes us under the lease. Any shortfall resulting from the bankruptcy of one or more of our tenants could adversely affect our cash flow and results of operations.

***Geographical concentration of loans may result in additional delinquencies.***

Northern California real estate secured approximately 54% of the total loans held by us as of December 31, 2017. Northern California consists of Monterey, Kings, Fresno, Tulare and Inyo counties and all counties north of those. In addition, 22%, 7%, 5%, 3%, 2% and 2% of total loans were secured by Southern California, Michigan, Texas, Colorado, Ohio and Washington real estate, respectively. Other loans with principal balances of 1% or less of total loans are secured by real estate in Arizona, Hawaii, Illinois, Indiana, Nevada and Wisconsin. These concentrations may increase the risk of delinquencies on our loans when the real estate or economic conditions of one or more of those areas are weaker than elsewhere, for reasons such as:

- economic recession in that area;
- overbuilding of commercial or residential properties; and
- relocations of businesses outside the area due to factors such as costs, taxes and the regulatory environment.

These factors also tend to make more commercial or residential real estate available on the market and reduce values, making suitable loans less available to us. In addition, such factors could tend to increase defaults on existing loans.

***Our loans are not insured or guaranteed by any governmental agency.***

Our loans are not insured or guaranteed by a federally-owned or -guaranteed mortgage agency. Consequently, our recourse if there is a default may only be to foreclose upon the real property securing a loan. The value of the foreclosed property may have decreased and may not be equal to the amount outstanding under the corresponding loan, resulting in a decrease of the amount available to distribute to you.

***Our loans permit prepayment, which may lower returns.***

The majority of our loans do not include prepayment penalties for a borrower paying off a loan prior to maturity. The absence of a prepayment penalty in our loans may lead borrowers to refinance higher interest rate loans in a market of falling interest rates. This would then require us to reinvest the prepayment proceeds in loans or alternative short-term investments with lower interest rates and a corresponding lower return to you.

***Equity or cash flow participation in loans could result in loss of our secured position in loans.***

We may obtain participation in the appreciation in value or in the cash flow from a secured property. If a borrower defaults and claims that this participation makes the loan comparable to equity (like stock) in a joint venture, we might lose our secured position as lender in the property. Other creditors of the borrower might then wipe out or substantially reduce our investment. We could also be exposed to the risks associated with being an owner of real property. We are not presently involved in any such arrangements.

If a third party were to assert successfully that one of our loans was actually a joint venture with the borrower, there might be a risk that we could be liable as joint venturer for the wrongful acts of the borrower toward the third party.

***We face intense competition, which may decrease or prevent increases in the occupancy and rental rates of our properties.***

We compete with numerous developers, owners and operators of retail, industrial and office real estate, many of which own properties similar to ours in the same markets in which our properties are located. If one of our properties becomes vacant and our competitors offer space at rental rates below current market rates, or below the rental rates we currently charge our tenants, we may lose existing or potential tenants and we may be pressured to reduce our rental rates below those we currently charge or to offer substantial rent abatements. As a result, our financial condition, results of operations, cash flow, per share trading price of our Common Stock and ability to satisfy our debt service obligations and to make distributions to you may be adversely affected.

***The Company cannot predict the unintended consequences and market reactions that may stem from broad-based governmental intervention in the economic and financial system or from regulatory reform of the oversight of financial markets.***

The U.S. government, the U.S. Federal Reserve (the "Federal Reserve"), the U.S. Treasury, the SEC and other governmental and regulatory bodies have taken or are taking various actions to address the underlying causes of, and to contain the fallout from, the global financial crisis in 2007 and 2008. For example, on July 21, 2010 former President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which has changed the regulation of financial institutions and the financial services industry. On February 3, 2017, President Trump signed an executive order for a broad review of federal regulation of the U.S. financial system by the Secretary of the Treasury, in consultation with the heads of the member agencies of the Financial Stability Oversight Council. While the outcome is uncertain, there have been several indications that the new administration will seek to deregulate the U.S. financial industry, including by altering the Dodd-Frank Act, which may, among other things, decrease the restrictions on banks and other financial institutions and allow them to compete with us for investment opportunities that were previously not available to them. The Company cannot predict, the ultimate content, timing, or effect of changes that may result from such review, nor is it possible at this time to estimate the impact of any potential resulting legislation which could have a dramatic impact on the Company's business, results of operations and financial condition.

***We may be unable to invest capital into new loans on acceptable terms or at all, which would adversely affect our operating results.***

We may not be able to identify loan opportunities that meet our investment criteria, and we may not be successful in closing the loans we identify, which would adversely affect our results of operations.

***We expect our real estate loans will not be marketable, and we expect no secondary market to develop.***

We do not expect our real estate loans to be marketable, and we do not expect a secondary market to develop for them. As a result, we will generally bear all the risk of our investment until the loans mature. This will limit our ability to hedge our risk in changing real estate markets and may result in reduced returns to our investors.

***Some losses that might occur to borrowers may not be insured and may result in defaults.***

Our loans require that borrowers carry adequate hazard insurance for our benefit. Some events, however, are uninsurable, or insurance coverage for them is economically not practicable. Losses from earthquakes, floods or mudslides, for example, which occur in California, may be uninsured and cause losses to us on entire loans. Since December 31, 2017, no such loan loss has occurred.

While we are named loss payee in all cases and will receive notification in event of a loss, if a borrower allows insurance to lapse, an event of loss could occur before we know of the lapse and have time to obtain insurance ourselves.

Insurance coverage may be inadequate to cover property losses, even though OFG imposes insurance requirements on borrowers that it believes are reasonable.

***If any of our insurance carriers become insolvent, we could be adversely affected.***

We carry several different lines of insurance, placed with several large insurance carriers. If any one of these large insurance carriers were to become insolvent, we would be forced to replace the existing insurance coverage with another suitable carrier, and any outstanding claims would be at risk for collection. In such an event, we cannot be certain that we would be able to replace the coverage at similar or otherwise favorable terms. Replacing insurance coverage at unfavorable rates and the potential of uncollectible claims due to carrier insolvency could adversely affect our results of operations and cash flows.

***The impact of any future terrorist attacks exposes us to certain risks.***

Any future terrorist attacks, the anticipation of any such attacks, and the consequences of any military or other response by the United States and its allies may have an adverse impact on the U.S. financial markets and the economy in general. We cannot predict the severity of the effect that any such future events would have on the U.S. financial markets, including the

real estate capital markets, the economy or our business. Any future terrorist attacks could adversely affect the credit quality of some of our loans and investments. Some of our loans and investments will be more susceptible to such adverse effects than others. We may suffer losses as a result of the adverse impact of any future terrorist attacks, and these losses may adversely impact our results of operations.

***Cybersecurity threats or other security breaches could compromise sensitive information belonging to us or our employees, borrowers, lessees, clients and other counterparties and could harm our business and our reputation.***

We and our Manager store sensitive data, including our proprietary business information and that of our borrowers, lessees, clients and other counterparties, and confidential information regarding employees, on our networks. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions that could result in unauthorized disclosure or loss of sensitive information. Because the techniques used to obtain unauthorized access to networks, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Furthermore, in the operation of our business we also use third-party vendors that store certain sensitive data and these third parties are subject to their own cybersecurity threats. Any security breach of our own or a third-party vendor's systems could cause us to be non-compliant with applicable laws or regulations, subject us to legal claims or proceedings, disrupt our operations, damage our reputation, and cause a loss of confidence in our products and services, any of which could adversely affect our business.

### **Risks Related to Our Financing**

***We have entered into Credit Facilities and other borrowing arrangements. Additional borrowings by us will increase your risk and may reduce the amount we have available to distribute to you.***

We have entered into three credit agreements with three different lenders, which agreements provide us with one line of credit, one construction loan and one term loan (the "Credit Facilities").

We may borrow funds under the Credit Facilities or from additional sources, if available, to expand our capacity to invest in real estate loans, make improvements to our real estate assets, or for other business purposes. Such borrowings will require us to carefully manage our cost of funds. No assurance can be given that we will be successful in this effort to manage our cost of funds or to obtain additional borrowings if needed. Should we be unable to repay the indebtedness and make the interest payments on the Credit Facilities or any other loans, the lenders will likely declare us in default and require that we repay all amounts owing under the applicable loan facility. Even if we are repaying the indebtedness in a timely manner, interest payments owing on the borrowed funds may reduce our income and the distributions you receive.

We may borrow funds from several sources in addition to the Credit Facilities, and the terms of any indebtedness we incur may vary. However, some lenders may require as a condition of making a loan to us that the lender will receive a priority on loan repayments received by us. As a result, if we do not collect 100% on our investments, the first dollars may go to our lenders and we may incur a loss which will result in a decrease of the amount available for distribution to you. In addition, we may enter into securitization arrangements in order to raise additional funds. Such arrangements could increase our leverage and adversely affect our cash flow and our ability to make distributions to you.

***We may not be able to access the debt or equity capital markets, or sell our real estate assets, on favorable terms, or at all, which would limit our liquidity and adversely affect our operating results.***

We require substantial capital and sufficient liquidity to fund and grow our business. Without capital and liquidity we would be unable to fund new loans, and could be unable to meet our scheduled debt payments and our funding commitments to borrowers. We have relied on proceeds from secured borrowings, repayments from our loan assets and proceeds from asset sales to fund our operations, meet our debt maturities and make new loans, and we expect to continue to rely primarily on these sources of liquidity for the foreseeable future.

While we had access to various sources of capital in 2017, our ability to access capital in 2018 and beyond will be subject to a number of factors, many of which are outside of our control, such as conditions prevailing in the credit, real estate and equity markets. There can be no assurance that we will have access to additional liquidity when needed or that future debt or equity financing will be available on terms that are acceptable to us. We may also encounter difficulty in selling assets or executing other capital raising strategies on acceptable terms in a timely manner. Our inability to obtain



adequate capital could have a material adverse effect on our business, financial condition, liquidity, and operating results, which might result in our inability to meet current loan funding commitments or customer demand for our loans, both of which could adversely affect our results of operations and financial condition.

***If the market value of the collateral pledged by us to a funding source declines, our financial condition could deteriorate rapidly.***

The loans and real estate assets that we pledge as collateral could have a rapid decrease in market value. If the value of the collateral we pledge were to decline, we may be required by the lending institutions we borrow from to provide additional collateral or pay down a portion of the funds advanced. We may not have the funds available to pay down such debt, which could result in defaults. Providing additional collateral, if available, to support these potential credit facilities would reduce our liquidity and limit our ability to leverage our assets. In the event we do not have sufficient liquidity to meet such requirements, lending institutions can accelerate the indebtedness, increase interest rates and terminate our ability to borrow. Furthermore, facility providers may require us to maintain a certain amount of uninvested cash or set aside unlevered assets to maintain a specified liquidity position which would allow us to satisfy our collateral obligations. As a result, we may not be able to leverage our assets as fully as we would choose, which could reduce our return on assets. In the event that we are unable to meet these collateral obligations, our financial condition could deteriorate rapidly.

***We may utilize a significant amount of additional debt to finance our operations, which may compound losses and reduce cash available for distributions to you.***

We may further leverage our portfolio through the use of securitizations, issuance of debt securities, additional bank credit facilities, repurchase agreements, and other borrowings. The leverage we may deploy will vary depending on our availability of funds, ability to obtain credit facilities, the loan-to-value and debt service coverage ratios of our assets, the yield on our assets and our financial performance. Substantially all of our assets are pledged as collateral for our borrowings. Our return on our investments and cash available for distribution to our stockholders may be reduced to the extent that changes in market conditions cause the cost of our financing to increase relative to the income that we can derive from our real estate assets.

***Our use of leverage may create a mismatch with the duration and index of the investments that we are financing.***

We attempt to structure our leverage such that we minimize the difference between the term of our investments and the leverage we use to finance such an investment. In the event that our leverage is for a shorter term than the financed investment, we may not be able to extend or find appropriate replacement leverage, and that would have an adverse impact on our liquidity and our returns. In the event that our leverage is for a longer term than the financed investment, we may not be able to repay such leverage or replace the financed investment with an optimal substitute or at all, which will negatively impact our returns. In addition, 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 partially offset that risk.

***An increase in our borrowing costs relative to the interest we earn on our interest earning and leveraged assets may adversely affect our profitability and the cash available for distributions to stockholders.***

We earn income based upon the spread between the interest income on our interest earning and leveraged assets and the interest expense we incur on our borrowings. Borrowing rates are currently at historically low levels that may not be sustained in the long run. Our Credit Facilities and certain other borrowings bear interest at variable rates, and we may incur additional debt in the future. An increase in market interest rates would increase our interest expense, and if we are unable to pass increases in our cost of funds through to our borrowers, would reduce the spread between the cost of our borrowings relative to the interest we earn on our leveraged loan assets, which might reduce earnings and cash available for distribution to you. In addition, these increases could adversely affect our financial position and the market price of our Common Stock.

***The covenants in our Credit Facilities might adversely affect us.***

Our Credit Facilities require us to satisfy certain affirmative and negative covenants and to meet numerous financial tests, and also contain certain default and cross-default provisions. If any future failure to comply with one or more of these

covenants resulted in the loss of one or more of these Credit Facilities and/or required the immediate repayment of advances under the Credit Facilities and we were unable to obtain suitable replacement financing, such loss could have a material, adverse impact on our financial position and results of operations and ability to make distributions to our stockholders.

***We may not be able to obtain leverage at the level or at the cost of funds necessary to optimize our return on investment.***

Our future return on investment may depend, in part, upon our ability to grow our portfolio of invested assets through the use of leverage at a cost of debt that is lower than the yield earned on our investments. We may obtain leverage through credit agreements, issuance of debt securities and other borrowings. Our future ability to obtain the necessary leverage on beneficial terms ultimately depends upon, among other things, global and regional market conditions and the quality of the portfolio assets that collateralize our indebtedness. Our failure to obtain and/or maintain leverage at desired levels, or to obtain leverage on attractive terms, would have a material adverse effect on our performance. Moreover, we may be dependent upon a few lenders to provide financing under credit agreements for our origination of loans, and there can be no assurance that these agreements will be renewed or extended at expiration.

***Prolonged disruptions in the financial markets could affect our ability to obtain financing on reasonable terms and have other adverse effects on us and the market price of our Common Stock.***

Commercial real estate is particularly adversely affected by a prolonged economic downturn and liquidity crisis. These circumstances may materially impact liquidity in the financial markets and result in the scarcity of certain types of financing and make certain financing terms less attractive. Our profitability will be adversely affected if we are unable to obtain cost-effective financing for our investments. A prolonged downturn in the stock or credit markets may cause us to seek alternative sources of potentially less attractive financing. In addition, these factors may make it more difficult for our borrowers to repay our loans as they may experience difficulties in selling assets, increased costs of financing or obtaining financing at all. These events in the stock and credit markets may also make it difficult or unlikely for us to raise capital through the issuance of debt securities or our Common Stock or preferred stock. These disruptions in the financial markets may also have a material adverse effect on the value of (and our ability to sell) our real estate assets and on the market value of our Common Stock, and may have other adverse effects on us or the economy in general.

### **Risks Related to Our Common Stock**

***Actions of activist stockholders against us could be disruptive and costly and the possibility that activist stockholders may wage proxy contests or seek representation on our Board could cause uncertainty about the strategic direction of our business.***

Stockholders may from time to time engage in proxy solicitations, advance stockholder proposals or board nominations or otherwise attempt to effect changes, assert influence or acquire some level of control over us. Our Board and management team strive to maintain constructive, ongoing communications with all of the Company's stockholders. And while we welcome stockholder views and opinions with the goal of enhancing value for all stockholders and the depth and breadth of our Board, an activist campaign, such as a proxy contest to replace members of our Board, could have an adverse effect on us because:

- Responding to such actions by activist stockholders can disrupt our operations, are costly and time-consuming, and divert the attention of our Board and senior management team from the pursuit of business strategies, which could adversely affect our results of operations and financial condition;
- Perceived uncertainties as to our future direction as a result of changes to the composition of our Board may lead to the perception of a change in the direction of the business, instability or lack of continuity which may be exploited by our competitors, cause concern to our current or potential borrower clients, may result in the loss of potential business opportunities and make it more difficult to attract and retain qualified personnel and business partners;
- these types of actions could cause significant fluctuations in our stock price based on temporary or speculative market perceptions or other factors that do not necessarily reflect the underlying fundamentals and prospects of our business; and
- if individuals are elected to our Board with a specific agenda, it may adversely affect our ability to effectively

implement our business strategy and create additional value for our stockholders.

***The public market for our Common Stock may be limited.***

There may be limited interest in investing in our Common Stock and, while we are listed on the NYSE American and our shares have been trading for a relatively short period, we cannot assure you that an established or liquid trading market for the Common Stock will develop or that it will continue if it does develop. In the absence of a liquid public market with adequate investor demand, you may be unable to liquidate your investment in our Common Stock.

***Sales of our Common Stock could have an adverse effect on our stock price.***

Sales of a substantial number of shares of our Common Stock could adversely affect the market price for our Common Stock. Subject to the restrictions on ownership and transfer in our charter, all of the shares of Common Stock issued in the Merger, other than any shares issued to an “affiliate” under the Securities Act, are freely tradable without restriction or further registration under the Securities Act. In addition, none of our shares outstanding at the date of the Merger were subject to lock-up agreements. We cannot predict the effect that future sales of our Common Stock will have on the market price of our Common Stock.

***The market price and trading volume of our Common Stock may be volatile.***

The market price of our Common Stock may be highly volatile and be subject to wide fluctuations. In addition, the trading volume in our Common Stock may fluctuate and cause significant price variations to occur. Given the level of redemption requests by limited partners prior to the Merger, there could be some continuing downward pressure on the market price of our Common Stock after the Merger as stockholders liquidate their investment in the Company. Additionally, the Company will be dissolved on December 31, 2034, unless our charter is amended. As we move closer to the dissolution date, we expect to stop making new loans, and we expect that our stock price will approach our book value per share though there can be no assurances that this will occur.

We cannot assure you that the market price of our Common Stock will not fluctuate or decline significantly in the future. Some of the factors, many of which are beyond our control, that could negatively affect our stock price or result in fluctuations in the price or trading volume of our Common Stock include:

- additional increases in loans defaulting or becoming non-performing or being written off;
- actual or anticipated variations in our operating results or our distributions to stockholders;
- sales of (or the inability to sell in a timely manner) and prices we receive for significant real estate properties;
- publication of research reports about us or the real estate industry, or changes in recommendations or in estimated financial results by securities analysts who provide research to the marketplace on us, our competitors or our industry;
- changes in market valuations of similar companies;
- changes in tax laws affecting REITs;
- adverse market reaction to any increased indebtedness we incur; and
- general market and economic conditions, including, among other things, actual and projected interest rates and the market for the types of assets that we hold or invest in.

***Market interest rates could have an adverse effect on our stock price.***

One of the factors that will influence the price of our Common Stock will be the distribution return on our Common Stock (as a percentage of the price of our Common Stock) relative to market interest rates. Thus, an increase in market interest rates may lead prospective purchasers of our Common Stock to expect a higher distribution yield, which would

adversely affect the market price of our Common Stock.

***Changes in market conditions could adversely affect the market price of our Common Stock.***

As with other publicly traded equity securities, the value of our Common Stock depends on various market conditions which may change from time to time. Among the market conditions that may affect the value of our Common Stock are the following:

- the general reputation of REITs and the attractiveness of our equity securities in comparison to other equity securities, including securities issued by other real estate related companies;
- our financial performance; and
- general stock and credit market conditions.

Management believes that the market value of our Common Stock is based primarily upon the market's perception of our growth potential and our current and potential future earnings dividends. Consequently, our Common Stock may trade at prices that are higher or lower than our book value per share of Common Stock. If our future earnings or dividends are less than expected, it is likely that the market price of our Common Stock will diminish.

***We may continue to incur increased costs as a result of being a listed company.***

Our Common Stock is listed on the NYSE American. As a listed company, we have incurred additional legal, accounting and other expenses that we did not incur as a non-listed company. We have also incurred costs associated with corporate governance requirements, as well as new accounting pronouncements and new rules implemented by the SEC, NYSE American, or any other applicable national securities exchange. Any expenses required to comply with evolving standards may result in increased general and administrative expenses and a diversion of management time and attention from our business. In addition, these laws and regulations could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially greater costs to obtain the same or similar coverage. We are currently evaluating and monitoring developments with respect to these laws and regulations and cannot predict or estimate the amount or timing of additional costs we may incur in responding to their requirements.

**United States Federal Income Tax Risks Relating to Our REIT Qualification**

***Our failure to qualify as a REIT would subject us to U.S. federal income tax, which would reduce amounts available for distribution to our stockholders.***

We are taxed as a REIT under the Code. Our qualification as a REIT requires us to satisfy numerous requirements (some on an annual and quarterly basis) established under highly technical and complex Code provisions for which there are only limited judicial or administrative interpretations and involves the determination of various factual matters and circumstances not entirely within our control. We intend that our organization and method of operation will qualify us as a REIT, but we may not be able to remain so qualified in the future. Future legislation, new regulations, administrative interpretations or court decisions could adversely affect our ability to qualify as a REIT or adversely affect our stockholders.

We intend to hold certain property foreclosed upon by OMIF prior to the REIT conversion through one or more wholly-owned corporate taxable REIT subsidiaries. Under the Code, no more than 25% of the value of the assets of a REIT may be represented by securities of one or more taxable REIT subsidiaries, and a taxable REIT subsidiary generally cannot operate a lodging or health care facility. These limitations may limit our ability to hold properties through taxable REIT subsidiaries. In the event that we determine that the foreclosed properties are held for investment and, therefore, are not subject to the 100% tax on prohibited transactions, there is no guarantee that the IRS will agree with our determination. Finally, in the event that any of our foreclosed properties constitute lodging or health care facilities that cannot be operated by a taxable REIT subsidiary, such properties will be operated by an "eligible independent contractor," as defined in Section 856(d)(9)(A) of the Code.

If we fail to qualify as a REIT in any taxable year, we would be subject to U.S. federal income tax on our taxable income at corporate rates, and we would not be allowed to deduct distributions made to our stockholders in computing our taxable income. We may also be disqualified from treatment as a REIT for the four taxable years following the year in which we failed to qualify. The additional tax liability would reduce our net earnings available for investment or distribution to

stockholders. In addition, we would no longer be required to make distributions to our stockholders. Even if we continue to qualify as a REIT, we will continue to be subject to certain U.S. federal, state and local taxes on our income and property.

***We cannot assure you that we will have access to funds to meet our distribution and tax obligations.***

In order to qualify as a REIT, we will be required each year to distribute to our stockholders at least 90% of our REIT taxable income (determined without regard to the dividends paid deduction and by excluding any net capital gain). Furthermore, we will be subject to corporate-level U.S. federal income taxation on our undistributed income and gain. We intend to make distributions to our stockholders of substantially all of our taxable income so as to comply with the 90% distribution requirement and limit corporate-level U.S. federal income taxation of the Company. We currently intend to retain all capital gain. Although we generally do not intend to make distributions in excess of our REIT taxable income, we may do so from time to time. A distribution of REIT taxable income or net capital gain generally will be a taxable distribution to you and not represent a return of capital for U.S. federal income tax purposes. If we make distributions in excess of our REIT taxable income and any net capital gain, the excess portion of these distributions generally would represent a non-taxable return of capital for such purposes up to your tax basis in your Common Stock and then generally capital gain. The portion of any distribution treated as a return of capital for U.S. federal income tax purposes would reduce your tax basis in your Common Stock by a corresponding amount. Differences in timing between taxable income and cash available for distribution could require us to borrow funds or raise capital by selling assets to enable us to meet these distribution requirements. We also could be required to pay taxes and liabilities in the event we were to fail to qualify as a REIT. Our inability to retain taxable income (resulting from these distribution requirements) generally may require us to refinance debt that matures with additional debt or equity. There can be no assurance that any of these sources of funds, if available at all, would be available to meet our distribution and tax obligations.

***Changes in the tax laws or other legislation could make investments in REITs less attractive and have a negative effect on us.***

The U.S. federal income tax laws governing REITs and the administrative interpretations of those laws are constantly under review and may be amended or changed at any time. We cannot predict when or if any new federal income tax law or administrative interpretation, or any amendment to any existing federal income tax law or administrative interpretation, will be adopted, promulgated or become effective and any such changes may take effect retroactively. We and our stockholders could be adversely affected by any such change in, or any new, federal income tax law or administrative interpretation.

***Stockholders and prospective investors are urged to consult with their tax advisors regarding the effects of recently enacted tax legislation and other legislative, regulatory and administrative developments.***

On December 22, 2017, President Trump signed into law H.R. 1, informally titled the Tax Cuts and Jobs Act (the "TCJA"). The TCJA makes major changes to the Code, including a number of provisions of the Code that affect the taxation of REITs and their stockholders. Among the changes made by the TCJA are permanently reducing the generally applicable corporate tax rate, generally reducing the tax rate applicable to individuals and other non-corporate taxpayers for tax years beginning after December 31, 2017 and before January 1, 2026, eliminating or modifying certain previously allowed deductions (including substantially limiting interest deductibility and, for individuals, the deduction for non-business state and local taxes), and, for taxable years beginning after December 31, 2017 and before January 1, 2026, providing for preferential rates of taxation through a deduction of up to 20% (subject to certain limitations) on most ordinary REIT dividends and certain trade or business income of non-corporate taxpayers. The TCJA also imposes new limitations on the deduction of net operating losses, which may result in us having to make additional taxable distributions to our stockholders in order to comply with REIT distribution requirements or avoid taxes on retained income and gains. The effect of the significant changes made by the TCJA is highly uncertain, and administrative guidance will be required in order to fully evaluate the effect of many provisions. The effect of any technical corrections with respect to the TCJA could have an adverse effect on us or our stockholders. Stockholders and prospective investors should consult their tax advisors regarding the implications of the TCJA on their investment in our common stock.

***Distributions from a REIT are currently taxed at a higher rate than corporate distributions.***

Currently, the maximum U.S. federal income tax rate on both distributions from certain domestic and foreign corporations and net capital gain for individuals is 23.8% (including the 3.8% net investment income tax). However, this rate of tax on distributions generally will not apply to our distributions (except those distributions identified by the Company as "capital gain dividends" which are taxable as long-term capital gain), and therefore such distributions generally will be taxed

as ordinary income. However, for taxable years beginning after December 31, 2017 and before January 1, 2026, new legislation provides for a deduction of up to 20% (subject to certain limitations) on most ordinary REIT dividends and certain trade or business income of non-corporate taxpayers. Ordinary income generally is subject to U.S. federal income tax at a maximum rate of 33.4% for individuals (including the 3.8% net investment income tax and after factoring in a 20% deduction for pass-through income). The higher tax rate on the Company's distributions may cause the market to devalue our Common Stock relative to stock of those corporations whose distributions qualify for the lower rate of taxation.

***A portion of our business is potentially subject to prohibited transactions tax.***

As a REIT, we are subject to a 100% tax on our net income from any "prohibited transactions." In general, prohibited transactions are sales or other dispositions of property, other than foreclosure property, but including loans, held as inventory or primarily for sale to customers in the ordinary course of business. Sales by us of property in the ordinary course of our business will generally constitute prohibited transactions. The Company might be subject to this tax if it was to sell a property or loan in a manner that was treated as a sale of inventory for U.S. federal income tax purposes. Therefore, in order to avoid the prohibited transactions tax, we may choose not to engage in certain sales of properties or loans, other than through a taxable REIT subsidiary, and will attempt to comply with the terms of safe-harbor provisions in the U.S. federal income tax laws prescribing when a sale of real property or a loan will not be characterized as a prohibited transaction, even though the sales might otherwise be beneficial to us. We cannot assure you however, that we can comply with the safe-harbor provisions or that we will not be subject to the prohibited transactions tax on some earned income.

***Taxable REIT subsidiaries are subject to corporate-level tax, which may devalue our Common Stock relative to other companies.***

Taxable REIT subsidiaries are corporations subject to corporate-level tax. Our use of taxable REIT subsidiaries may cause the market to value our Common Stock lower than the stock of other publicly traded REITs which may not use taxable REIT subsidiaries and lower than the equity of mortgage pools taxable as non-publicly traded partnerships, which generally are not subject to any U.S. federal income taxation on their income and gain.

***Our use of taxable REIT subsidiaries may have adverse U.S. federal income tax consequences.***

We must comply with various tests to qualify and continue to qualify as a REIT for U.S. federal income tax purposes, and our income from and investments in taxable REIT subsidiaries do not constitute permissible income and investments for purposes of some of the REIT qualification tests. While we will attempt to ensure that our dealings with our taxable REIT subsidiaries will not adversely affect our REIT qualification, we cannot assure you that we will successfully achieve that result. Furthermore, we may be subject to a 100% penalty tax, or our taxable REIT subsidiaries may be denied deductions, to the extent our dealings with our taxable REIT subsidiaries are not deemed to be arm's length in nature.

***We may endanger our REIT status if the distributions we receive from our taxable REIT subsidiaries exceed applicable REIT gross income tests.***

The annual gross income tests that must be satisfied to ensure REIT qualification may limit the amount of dividends that we can receive from our taxable REIT subsidiaries and still maintain our REIT status. Generally, not more than 25% of our gross income may be derived from non-real estate related sources, such as dividends from a taxable REIT subsidiary. If, for any taxable year, the dividends we receive from our taxable REIT subsidiaries, when added to our other items of non-real estate related income, represent more than 25% of our total gross income for the year, we could be denied REIT status, unless we were able to demonstrate, among other things, that our failure of the gross income test was due to reasonable cause and not willful neglect.

**Risks Related to Our Organization and Structure**

***Our charter restricts the ownership and transfer of our outstanding stock, which may have the effect of delaying, deferring or preventing a transaction or change of control of the Company***

In order for us to qualify as a REIT, no more than 50% of the value of outstanding shares of our stock may be owned, beneficially or constructively, by five or fewer individuals at any time during the last half of each taxable year other than the year for which we elect to be taxed as a REIT. Subject to certain exceptions, our charter prohibits any stockholder from owning actually, beneficially or constructively more than 9.8%, in value or in number of shares, whichever is more

restrictive, of the outstanding shares of our Common Stock, and 9.8% in value of the outstanding shares of all classes or series of our stock. The constructive ownership rules under the Code are complex. The outstanding stock owned by a group of related individuals or entities may be deemed to be constructively or beneficially owned by one individual or entity. As a result, the acquisition of less than 9.8% of our outstanding Common Stock or the outstanding shares of all classes or series of our stock by an individual or entity could cause that individual or entity to own constructively or beneficially in excess of the relevant ownership limits. Our charter also prohibits any person from owning shares of our stock that would result in our being “closely held” under Section 856(h) of the Code or otherwise cause us to fail to qualify as a REIT. Any attempt to own or transfer shares of our Common Stock in violation of these restrictions may result in the shares being automatically transferred to a charitable trust or may be void.

***Certain provisions of Maryland law may limit the ability of a third party to acquire control of the Company***

The charter and bylaws of the Company and the Maryland General Corporation Law (the “MGCL”) contain provisions that could delay, defer or prevent a transaction or a change in control of us that might involve a premium price for holders of our Common Stock or otherwise be in their best interests.

Subject to certain limitations, provisions of the MGCL prohibit certain business combinations between the Company and an “interested stockholder” (defined generally as any person who beneficially owns 10% or more of the voting power of our outstanding voting stock or an affiliate or associate of us who beneficially owns 10% or more of the voting power of our then outstanding stock at any time during the two-year period immediately prior to the date in question) or an affiliate of an interested stockholder for five years after the most recent date on which the stockholder became an interested stockholder. After the five-year period, business combinations between us and an interested stockholder or an affiliate of an interested stockholder must generally either provide a minimum price (as defined in the MGCL) to our stockholders in cash or other consideration in the same form as previously paid by the interested stockholder or be recommended by our Board of Directors and approved by the affirmative vote of at least 80% of the votes entitled to be cast by holders of our outstanding shares of voting stock and at least two-thirds of the votes entitled to be cast by stockholders other than the interested stockholder and its affiliates and associates. These provisions of the MGCL relating to business combinations do not apply, however, to business combinations that are approved or exempted by our Board of Directors prior to the time that the interested stockholder becomes an interested stockholder. As permitted by the MGCL, our Board of Directors has adopted a resolution exempting any business combination between us and any other person, provided that the business combination is approved by our Board of Directors (including a majority of directors who are not affiliates or associates of such persons), and between us and OFG and its affiliates and associates. However, our Board of Directors may repeal or modify this resolution at any time in the future, in which case the applicable provisions of this statute will become applicable to business combinations between us and interested stockholders.

The “control share” provisions of the MGCL provide that a holder of “control shares” of a Maryland corporation (defined as shares which, when aggregated with other shares controlled by the stockholder (except solely by virtue of a revocable proxy), entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a “control share acquisition” (defined as the direct or indirect acquisition of ownership or control of “control shares”) has no voting rights with respect to such shares except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding votes entitled to be cast by the acquirer of control shares, our officers and our employees who are also our directors. Our bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of shares of our stock. There can be no assurance that this provision will not be amended or eliminated at any time in the future.

***The Company has elected to implement a classified Board of Directors, require a two-thirds vote to remove a director and to implement other provisions of Title 3, Subtitle 8 of the MGCL that may have the effect of delaying, deferring or preventing a transaction or a change of control of the Company.***

On November 12, 2013, our Board of Directors elected to be subject to all of the provisions of Sections 3-803, 3-804 and 3-805 of Title 3, Subtitle 8 of the MGCL (“Subtitle 8”). As a result of this election, without stockholder approval and regardless of any provision in our charter or bylaws, our Board caused the following provisions of Subtitle 8 relating to our Board and the calling of stockholder meetings to be implemented, and these provisions may have the effect of delaying, deferring or preventing a transaction or a change of control of the Company that might be in our stockholders’ best interests:

- ***Board Classification.*** As a result of the election under Subtitle 8, our Board is classified into three separate classes of directors. At each annual meeting of the stockholders of the Company, the successors to the class of directors

whose term expires at that meeting will be elected to hold office for a term continuing until the annual meeting of stockholders held in the third year following the year of their election and until their successors are elected and qualified.

- *Removal of Directors.* As a result of the election to be subject to Section 3-804 of the MGCL, the removal of directors will require the affirmative vote of at least two-thirds of all of the votes entitled to be cast by the stockholders generally in the election of directors.
- *Board Size.* The election to be subject to Section 3-804 of the MGCL also provides that our Board has the exclusive right to set the number of directors on the Board. This election did not result in substantive change to the requirements already provided in the Company's charter and bylaws.
- *Vacancies on the Board.* As a result of the election to be subject to Section 3-804 of the MGCL, our Board has the exclusive right, by the affirmative vote of a majority of the remaining directors, even if the remaining directors do not constitute a quorum, to fill vacancies on the Board, and any director elected by the Board to fill a vacancy will hold office for the remainder of the full term of the class of directors in which the vacancy occurred and until his or her successor is elected and qualified.
- *Special Meetings Called at the Request of Stockholders.* As a result of the election to be subject to Section 3-805 of the MGCL, special meetings of stockholders called at the request of stockholders may now be called by the Secretary of the Company only on the written request of the stockholders entitled to cast at least a majority of all the votes entitled to be cast at the meeting.

***Our Board of Directors has the power to cause us to issue additional shares of our stock without stockholder approval.***

Our charter authorizes us to issue additional authorized but unissued shares of common or preferred stock. In addition, our Board of Directors may, without stockholder approval, amend our charter to increase the aggregate number of our shares of stock or the number of shares of stock of any class or series that we have authority to issue and classify or reclassify any unissued shares of common or preferred stock and set the preferences, rights and other terms of the classified or reclassified shares. As a result, our Board of Directors may establish a series of shares of common or preferred stock that could delay or prevent a transaction or a change in control that might involve a premium price for our shares of Common Stock or otherwise be in the best interests of our stockholders.

***Our rights and the rights of our stockholders to take action against our directors and officers are limited, which could limit your recourse in the event of actions not in your best interests.***

Maryland law provides that a director has no liability in that capacity if he or she performs his or her duties in good faith, in a manner he or she reasonably believes to be in our best interests and with the care that an ordinarily prudent person in a like position would use under similar circumstances. As permitted by the MGCL, our charter limits the liability of our directors and officers to us and our stockholders for money damages, except for liability resulting from:

- actual receipt of an improper benefit or profit in money, property or services; or
- a final judgment based upon a finding of active and deliberate dishonesty by the director or officer that was material to the cause of action adjudicated.

***Our charter authorizes us to obligate ourselves to indemnify our present and former directors and officers for actions taken by them in those and other capacities to the maximum extent permitted by Maryland law. Our bylaws require us to indemnify, to the maximum extent permitted by Maryland law, each present or former director or officer who is made, or threatened to be made, a party to any proceeding because of his or her service to us. In addition, we may be obligated to advance the defense costs incurred by our directors and officers.***

#### **Item 1B. UNRESOLVED STAFF COMMENTS**

None.



## **Item 2. PROPERTIES**

The Manager operates from its executive offices at 2221 Olympic Boulevard, Walnut Creek, CA 94595 (the “Executive Office”). The lessor is Olympic Blvd. Partners, a California Limited Partnership (“OBP”), of which the Manager is a 50% general partner. The Executive Office is the sole asset of OBP. The Executive Office is subject to a loan with a principal balance of \$616,780 as of December 31, 2017 with monthly payments of interest and principal of \$3,988 and a balloon payment of \$583,332 due on December 31, 2019. The Company does not have separate offices.

As of December 31, 2017, we hold title to sixteen real estate properties that were acquired through foreclosure including properties held within four wholly-owned limited liability companies and within two wholly-owned corporations (see below). As of December 31, 2017, the total carrying amount of these properties was \$80,466,000. Seven of the properties are being held for long-term investment and the remaining nine properties are currently being marketed for sale. We also have a 50% ownership interest in a limited liability company accounted for under the equity method that owns property located in Santa Clara, California with a carrying amount of \$2,141,000 as of December 31, 2017.

- The Company’s (or related entities) title to all properties is held as fee simple.
- There are mortgages or encumbrances to third parties on two of our real estate properties (see below for Tahoe Stateline Venture, LLC (“TSV”) and Zalanta Resort at the Village, LLC (“ZRV”).
- Of the sixteen properties held, eight of the properties are income-producing. Only minor renovations and repairs to the properties are currently being made or planned (other than continued tenant improvements on real estate held for sale and investment).
- The Manager believes that all properties owned by the Company are adequately covered by customary casualty insurance.

Real estate acquired through foreclosure may be held for a number of years before ultimate disposition primarily because we have the intent and ability to dispose of the properties for the highest possible price (such as when market conditions improve). During the time that the real estate is held, we may earn less income on these properties than could be earned on loans and may have negative cash flow on these properties.

Some of the properties we acquire, primarily through foreclosure proceedings, may face competition from newer, more updated properties. In order to remain competitive and increase occupancy at these properties and/or make them attractive to potential purchasers, we may have to make significant capital improvements and/or incur costs associated with correcting deferred maintenance with respect to these properties. The cost of these improvements and deferred maintenance items may impair our financial performance and liquidity. Additionally, we compete with any entity seeking to acquire or dispose of similar properties, including REITs, banks, pension funds, hedge funds, real estate developers and private real estate investors. Competition is primarily dependent on price, location, physical condition of the property, financial condition and operating results of current and prospective tenants, availability and cost of capital, construction and renovation costs, taxes, governmental regulations, legislation and trends in the national and local economies.

For purposes of assessing potential impairment of value during 2017, 2016 and 2015, we obtained updated appraisals or other valuation support on certain of our real estate properties held for sale and investment, which resulted in additional impairment losses on three, three and one properties, respectively, in the aggregate amount of approximately \$1,423,000, \$3,228,000 and \$1,589,000, respectively, recorded in the consolidated statements of operations.

Real estate properties held for sale as of December 31, 2017 and 2016 consisted of the following properties acquired through foreclosure:

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
Undeveloped, industrial land, San Jose, California - transferred to held for investment in 2017	\$ —	\$ 2,027,581
73 improved, residential lots, Auburn, California (held within Zalanta Resort at the Village, LLC)	4,121,867	3,781,867
Undeveloped, residential land, Coolidge, Arizona – transferred from held for investment in 2017	1,017,600	—
Golf course, Auburn, California (held within Lone Star Golf, Inc.)	1,999,449	1,970,437
3 improved residential lots, Coeur D’Alene, Idaho (previously 6 lots before lot line adjustments – transferred from held for investment in 2017	350,897	—
Unimproved, residential and commercial land, Gypsum, Colorado – sold in 2017	—	139,498
Marina and yacht club with 179 boat slips, Isleton, California (held within Brannan Island, LLC) – transferred from held for investment in 2017	2,207,675	—
Unimproved, residential and commercial land, Bethel Island, California (held within Sandmound Marina, LLC) – transferred from held for investment in 2017	2,338,233	—
Assisted living facility, Bensalem, Pennsylvania – transferred from held for investment in 2017	5,253,125	—
Commercial and residential land under development, South Lake Tahoe, California (held within Tahoe Stateline Venture, LLC) – sold in 2017	—	28,974,808
Retail complex and 23 residential condominium units, South Lake Tahoe, California (held within Zalanta Resort at the Village, LLC)*	32,260,603	34,805,253
Residential land, South Lake Tahoe, California (held within Zalanta Resort at the Village - Phase II, LLC) *	6,561,023	3,411,652
Office condominium complex, Oakdale, California (held within East G, LLC) – sold in 2017	—	732,539
	<u>\$ 56,110,472</u>	<u>\$ 75,843,635</u>

\* Note: During 2017, \$518,960 book value of land and \$2,571,536 of construction and related costs related to common areas in the ZRV project were transferred from ZRV to ZRV II pursuant to a cost sharing agreement between the two entities.

Real estate held for investment, net of accumulated depreciation, is comprised of the following properties as of December 31, 2017 and 2016:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Commercial buildings, Roseville, California	\$ 492,350	\$ 515,451
Undeveloped, industrial land, San Jose, California - transferred from held for sale in 2017	1,914,870	—
Undeveloped, residential land, Marysville, California – transferred to held for sale and sold in 2017	—	403,200
Undeveloped land, Auburn, California (formerly part of golf course owned by DarkHorse Golf Club, LLC)	103,198	103,198
One improved residential lot, West Sacramento, California – transferred to held for sale and sold in 2017	—	58,560
Undeveloped, residential land, Coolidge, Arizona – transferred to held for sale in 2017	—	1,017,600
Office condominium complex (13 and 15 units), Roseville, California	2,865,002	3,447,418
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)	2,263,348	2,311,792
6 improved residential lots, Coeur D’Alene, Idaho – transferred to held for sale in 2017	—	316,800
Retail Complex, South Lake Tahoe, California (held within Tahoe Stateline Venture, LLC)	16,623,238	16,829,995
Marina and yacht club with 179 boat slips, Isleton, California (held within Brannan Island, LLC) – transferred to held for sale in 2017	—	2,555,306
Unimproved, residential and commercial land, Bethel Island, California (held within Sandmound Marina, LLC) – transferred to held for sale in 2017	—	2,335,448
Marina with 52 boat slips and campground, Bethel Island, California (held within Sandmound Marina, LLC) – transferred to held for sale and sold in 2017	—	1,470,639
Assisted living facility, Bensalem, Pennsylvania - transferred to held for sale in 2017	—	5,820,709
	<u>\$ 24,355,653</u>	<u>\$ 37,279,763</u>

We presently have no plans to significantly improve any of our real estate properties, other than continued tenant improvements on certain properties.

The only real estate properties with book values in excess of 10% of our total assets or properties still owned as of December 31, 2017 with gross revenue in excess of 10% of our total revenue are the properties located in South Lake Tahoe, California (held within TSV and ZRV).

Other operating data related to the TSV retail complex is as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Average Annual Rental per Square Foot	\$ 67.48	\$ 61.45	\$ 50.71
Federal Tax Basis of Depreciable Assets (all Commercial Buildings and Improvements)	\$ 17,581,911	\$ 17,579,856	\$ 17,357,310
Depreciation Rate	Various MACRS	Various MACRS Straight Line	Various MACRS Straight Line
Depreciation Method	Straight Line	Straight Line	Straight Line
Depreciable Life	5-39 Years	5-39 Years	5-39 Years
Realty Tax Rate (1)	1.0871%	1.0860%	1.0907 %
Annual Realty Taxes	\$ 98,322	\$ 192,253	\$ 186,943

(1) Millage rate per Taxable Value.

Other operating data related to the ZRV retail units is as follows:

	2017		2016 (2)		2015 (2)
Average Annual Rental per Square Foot	\$ 66.00	\$	N/A	\$	N/A
Federal Tax Basis of Depreciable Assets (all Commercial Buildings and Improvements)	N/A	\$	N/A	\$	N/A
Depreciation Rate (3)	N/A		N/A		N/A
Depreciation Method (3)	N/A		N/A		N/A
Depreciable Life (3)	N/A		N/A		N/A
Realty Tax Rate (1)	1.0871%		N/A		N/A
Annual Realty Taxes	\$ 49,533	\$	N/A	\$	N/A

(1) Millage rate per Taxable Value.

(2) Construction of retail/residential complex was completed in 2017. Thus, this data is not applicable in 2015 and 2016.

(3) The ZRV properties are not being depreciated as all of the retail and residential units are held for sale.

The following table shows information regarding rental rates and lease expirations over the next ten years for TSV and ZRV and assumes that none of the tenants exercise renewal options or termination rights, if any, at or prior to scheduled expirations:

Year of Lease Expiration December 31,	Number of Leases Expiring Within the Year	Rentable Square Footage Subject to Expiring Leases	Final Annualized Base Rent Under Expiring Leases (1)	Percentage of Gross Annual Rental Represented by Such Leases
2019	5	11,497	\$ 842,862	48.1%
2020	2	1,635	112,270	6.4%
2022	1	4,553	341,060	19.5%
2024	1	5,777	362,531	20.7%
2027	1	1,011	92,328	5.3%
	10	24,473	\$ 1,751,051	100.0%

(1) "Final Annualized Base Rent" for each lease scheduled to expire represents the cash rental rate of base rents, excluding tenant reimbursements, in the final month prior to expiration multiplied by 12. Tenant reimbursements generally include payment of a portion of real estate taxes, operating expenses and common area maintenance and utility charges.

The following table presents occupancy data of our leased real estate properties held for investment as of December 31, 2017, 2016, 2015, 2014 and 2013 (where applicable):

<u>Property Description/Location</u>	<i>Occupancy % (1)</i>					
	<u>Year Foreclosed</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Commercial buildings, Roseville, California	2001	85.2%	91.2%	100.0%	81.2%	88.6%
Office condominium complex (13 units), Roseville, California	2008	72.6%	76.0%	62.9%	70.5%	45.3%
12 condominium and 3 commercial units, Tacoma, Washington	2011	80.4%	80.4%	80.4%	75.8%	37.9%
Retail complex, South Lake Tahoe, California (TSV)	2013	86.7%	91.1%	95.5%	75.0%	N/A
Retail complex, South Lake Tahoe, California (ZRV)	2013	22.5%	N/A	N/A	N/A	N/A
Industrial building/land, Santa Clara, California (1850 De La Cruz, LLC)	2005	100.0%	100.0%	100.0%	100.0%	100.0%

Notes:

(1) Calculated by dividing net rentable square feet included in leases signed on or before December 31, 2017 at the property by the aggregate net rentable square feet of the property.

As of December 31, 2017, virtually all of our leases on residential rental properties are either month-to-month leases or will expire in 2018. These leases currently represent approximately \$169,000 in annual rental revenue to the Company.

The following table shows information regarding rental rates and lease expirations over the next ten years and thereafter for our commercial and industrial rental properties at December 31, 2017 and assumes that none of the tenants exercise renewal options or termination rights, if any, at or prior to scheduled expirations. Seven of our twenty-three commercial leases and all of our residential leases are set to expire during 2018. We expect that new leases will be signed with existing or new tenants for the majority of these spaces and at rental rates that are at market and are at or above expiring rental amounts.

Year of Lease Expiration December 31,	Number of Leases Expiring Within the Year	Rentable Square Footage Subject to Expiring Leases	Final Annualized Base Rent Under Expiring Leases (1)
2018	7	61,795	\$ 523,834
2019	9	18,960	964,193
2020	4	12,355	176,557
2022	1	4,553	341,060
2024	1	5,777	362,531
2027	1	1,011	92,328
	23	104,451	\$ 2,460,503

- (1) “Final Annualized Base Rent” for each lease scheduled to expire represents the cash rental rate of base rents, excluding tenant reimbursements, in the final month prior to expiration multiplied by 12. Tenant reimbursements generally include payment of a portion of real estate taxes, operating expenses and common area maintenance and utility charges.

At December 31, 2017, our properties were leased to tenants that are engaged in a variety of businesses. The following table sets forth information regarding leases with the seven tenants with the largest amounts leased based upon Annualized Base Rent as of December 31, 2017:

Tenant Name	Leased Square Feet	Annualized Base Rent (1)	Expiration Date	Renewal Options
JKB Financial (Roseville, CA office)	5,954	\$ 100,027	2/28/2018	None
Finance of America (Roseville, CA office)	6,357	95,622	5/31/2018	None
Avis Rent A Car (1850 De La Cruz) (2) (3)	200,811	185,683	7/15/2018	2-5 yr. Options
Up Shirt Creek (TSV) (3)	4,689	337,017	9/30/2019	2-5 yr. Options
Powder House (TSV) (3)	5,778	415,288	9/30/2019	2-5 yr. Options
Powder House (ZRV)	4,553	300,498	4/30/2022	2-5 yr. Options
McP’s Pub Tahoe (TSV)	5,777	321,918	10/31/2024	2-5 yr. Options

- (1) Annualized Base Rent represents the current monthly Base Rent, excluding tenant reimbursements, for each lease in effect at December 31, 2017 multiplied by 12. Tenant reimbursements generally include payment of a portion of real estate taxes, operating expenses and common area maintenance and utility charges.
- (2) Amount of annualized base rent reported reflects ORM’s 50% membership interest in 1850 De La Cruz, LLC.
- (3) There are two leases for two separate and distinct parcels/units to these tenants with the same terms (leased square feet and annualized base rent combined). The 1850 De La Cruz property square footage is the area of the land under the leases.

### **Item 3. LEGAL PROCEEDINGS**

In the normal course of business, we may become involved in various types of legal proceedings such as assignment of rents, bankruptcy proceedings, appointment of receivers, unlawful detainers, judicial foreclosure, etc., to enforce the provisions of the deeds of trust, collect the debt owed under the promissory notes, or to protect, or recoup its investment from the real property secured by the deeds of trust. None of these actions would typically be of any material importance. As of December 31, 2017, we are not involved in any legal proceedings other than those that would be considered part of the normal course of business.

#### **Item 4. MINE SAFETY DISCLOSURES**

Not applicable.

### **PART II**

#### **Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

##### **Market Information for Common Stock**

Our Common Stock is listed on the NYSE American under the ticker symbol "ORM". The following table sets forth, for each of the indicated quarterly periods, the high and low sales prices for our Common Stock, as reported on the NYSE American.

	Sales Price	
	High	Low
<b>2016</b>		
First Quarter	\$ 16.07	\$ 13.41
Second Quarter	\$ 17.82	\$ 15.11
Third Quarter	\$ 17.32	\$ 15.66
Fourth Quarter	\$ 18.99	\$ 16.70
<b>2017</b>		
First Quarter	\$ 19.03	\$ 16.22
Second Quarter	\$ 18.59	\$ 16.08
Third Quarter	\$ 18.50	\$ 16.74
Fourth Quarter	\$ 18.50	\$ 15.63

The closing sale price for our Common Stock, as reported on the NYSE American on March 9, 2018 was \$14.29 per share.

##### **Holdings**

As of March 9, 2018, we had 9,091,454 shares of our Common Stock outstanding held by approximately 557 record holders. The number of record holders does not necessarily bear any relationship to the number of beneficial owners of our Common Stock.

##### **Dividends**

We have elected to be taxed as a REIT for federal income tax purposes and, as such, anticipate that we will distribute annually at least 90% of our REIT taxable income, excluding net capital gains. Through the calendar year ended December 31, 2017, we have paid dividends quarterly and made distributions of approximately \$3,789,000 and \$3,279,000 during 2017 and 2016, respectively (including amounts accrued as of December 31, 2017 and 2016). In addition, we paid approximately \$640,000, \$583,000 and \$1,314,000 in dividends to shareholders in 2017, 2016 and 2015 in the form of income taxes on capital gains.

Dividends are declared and paid at the discretion of our Board of Directors and depend on our taxable net income, cash available for distribution, financial condition, ability to maintain our qualification as a REIT and such other factors that our Board of Directors may deem relevant. No assurance can be given as to the amounts or timing of future distributions as such distributions are subject to our taxable earnings, financial condition, capital requirements and such other factors as our Board of Directors deems relevant. For a discussion of factors which may adversely affect our ability to pay dividends and for information regarding the sources of funds used for dividends, see "Item 1A – Risk Factors" and "Item 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations".

The following table sets forth the regular quarterly dividends declared and paid per share of Common Stock during 2017 and 2016 (does not include Federal tax payments made on behalf of shareholders and reported as dividends in the consolidated financial statements):

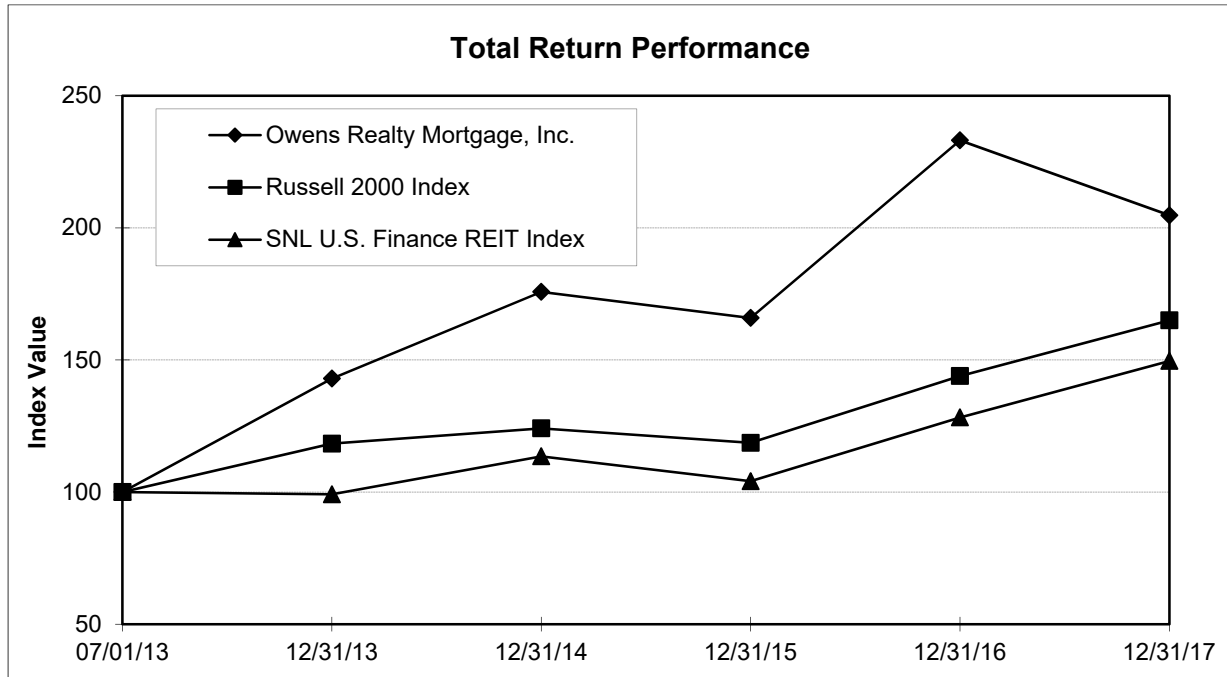
	2017	2016
<b>Dividends Declared:</b>		
First Quarter	\$ 0.08	\$ 0.08
Second Quarter	\$ 0.10	\$ 0.08
Third Quarter	\$ 0.10	\$ 0.08
Fourth Quarter	\$ 0.10	\$ 0.08

**Securities Authorized for Issuance under Equity Compensation Plans**

None.

**Performance Graph**

The following graph is a comparison of the cumulative total stockholder return on shares of the Company's Common Stock, the Russell 2000 Index, and the SNL U.S. Finance REIT Index, a published industry index, from July 1, 2013 (the day we commenced trading on the NYSE American) to December 31, 2017. The graph assumes that \$100 was invested on July 1, 2013 in our Common Stock, the Russell 2000 Index and the SNL U.S. Finance REIT and that all dividends were reinvested without the payment of any commissions. There can be no assurance that the performance of the Company's shares will continue in line with the same or similar trends depicted in the graph below. The information included in the graph and table below was obtained from SNL Financial LC, Charlottesville, VA ©2018.



<b>Index</b>	<b>Period Ended</b>					
	<b>7/01/13</b>	<b>12/31/13</b>	<b>12/31/14</b>	<b>12/31/15</b>	<b>12/31/16</b>	<b>12/31/17</b>
Owens Realty Mortgage, Inc.	100.00	142.94	175.80	165.92	233.14	204.77
Russell 2000	100.00	118.32	124.11	118.63	143.91	164.99
SNL U.S. Finance REIT	100.00	99.13	113.52	104.10	128.23	149.62

In accordance with SEC rules, this section entitled "Performance Graph" shall not be incorporated by reference into any of our future filings under the Securities Act or the Exchange Act except to the extent that we specifically incorporate such disclosure by reference in any such filings, and shall not be deemed to be "soliciting material" or to be "filed" under the Securities Act or the Exchange Act.

Recent Sales of Unregistered Securities

None.

Repurchases of Common Stock

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 December 31, 2017:

**Issuer Repurchase of Equity Securities**

<b>Period (2017)</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs<sup>i</sup></b>	<b>Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs<sup>ii</sup></b>
October 1 through October 31	12,774	\$ 17.99	12,774	Dollar amount: \$6,584,376
November 1 through November 30	55,607	\$ 17.02	55,607	Dollar amount: \$5,641,435
December 1 through December 31	758,199 <sup>iii</sup>	\$ 18.90	89,141	Dollar amount: \$0 <sup>iv</sup>
<b>Total</b>	<b>826,580</b>	<b>\$ 18.75</b>	<b>157,522</b>	

<sup>i</sup> On June 13, 2017, the Board of Directors publicly announced the 2017 Repurchase Plan permitting the Company to buy up to \$10.0 million of its Common Stock. Purchases began in July 2017. In connection with this plan, the Company 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. The 2017 Repurchase Plan was terminated by the Company effective December 29, 2017, before its scheduled expiration date of January 15, 2018.

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

<sup>iii</sup> Includes 669,058 shares of the total of 810,937 shares of Common Stock (the "Freestone Shares") acquired by the Company from Freestone Capital Management, LLC and certain of its affiliates (collectively, "Freestone") pursuant to a settlement agreement, dated December 29, 2017 (the "Settlement Agreement"), among the Company and the Freestone parties. The purchase of the additional 141,879 Freestone Shares pursuant to the Settlement Agreement are not included in the table as that part of the transaction was settled in January 2018 (the purchase of these shares was accrued as forward contract liability in the consolidated financial statements as of December 31, 2017). Under the terms of the Settlement Agreement, the Company acquired the Freestone Shares in a privately negotiated transaction for \$19.25 per share, resulting in an aggregate purchase price of approximately \$15.6 million. For a period of five years following the date of the Settlement Agreement, Freestone agreed to customary standstill restrictions relating to share purchases, support of proxy contests and other activist campaigns, calling of special meetings, and related matters. For a period of two years following the date of the Settlement Agreement, the Company and Freestone also agreed to abide by customary covenants not to sue and non-disparagement provisions.

<sup>iv</sup> The dollar amount available under the 2017 Repurchase Plan at December 29, 2017 was \$4,199,544, however, the 2017 Repurchase Plan was terminated by the Company effective December 29, 2017 and the remaining funds were used to



purchase the Freestone Shares discussed above. The table does not include an additional 4,000 shares that were purchased prior to termination of the 2017 Repurchase Plan, as the transactions settled in January 2018.

### **Item 6. SELECTED FINANCIAL DATA**

The following tables present selected historical consolidated financial information and should be read in conjunction with the more detailed information contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our historical consolidated financial statements, including the related notes, included elsewhere in this Annual Report. Prior period amounts have been reclassified to conform to current period presentation.

	<b>As of or For the Years Ended December 31,</b>				
	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
<b>Operating Data:</b>					
Interest income	\$ 10,840,730	\$ 8,922,142	\$ 8,277,004	\$ 5,382,019	\$ 3,020,884
Rental income	4,505,385	7,977,400	12,791,096	12,268,214	11,223,260
Other revenues	<u>187,013</u>	<u>179,449</u>	<u>175,451</u>	<u>170,018</u>	<u>165,211</u>
Total revenue	<u>15,533,128</u>	<u>17,078,991</u>	<u>21,243,551</u>	<u>17,820,251</u>	<u>14,409,355</u>
Real estate operating expenses	4,980,900	7,045,848	8,510,110	8,158,038	8,150,944
Depreciation and amortization	1,138,515	1,258,305	2,052,181	2,255,577	2,485,587
Management fees	3,546,085	3,286,470	2,051,134	1,726,945	1,664,076
Interest expense	1,587,695	2,859,294	1,938,113	1,161,822	513,750
(Reversal of) provision for loan losses	(360,012)	1,284,896	(1,026,909)	(1,869,733)	(7,822,112)
Impairment losses on real estate properties	1,423,286	3,227,807	1,589,434	179,040	666,240
Other expenses	<u>2,596,641</u>	<u>1,882,338</u>	<u>1,618,266</u>	<u>1,821,601</u>	<u>1,828,484</u>
Total expenses	<u>14,913,110</u>	<u>20,844,958</u>	<u>16,732,329</u>	<u>13,433,290</u>	<u>7,486,969</u>
Operating income (loss)	620,018	(3,765,967)	4,511,222	4,386,961	6,922,386
Gain on sales of real estate, net	14,728,921	24,497,763	21,818,553	3,243,359	2,942,861
Gain on foreclosure of loans	—	—	—	464,754	952,357
Settlement expense	<u>(2,627,436)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income (loss) before income taxes	12,721,503	20,731,796	26,329,775	8,095,074	10,817,604
Income tax (expense) benefit	<u>(4,041,655)</u>	<u>7,248,977</u>	<u>(93,335)</u>	<u>—</u>	<u>—</u>
Net income	8,679,848	27,980,773	26,236,440	8,095,074	10,817,604
Net income attributable to non-controlling interests	<u>—</u>	<u>(3,571,003)</u>	<u>(2,667,324)</u>	<u>(165,445)</u>	<u>(2,084,707)</u>
Net income attributable to common stockholders	<u>\$ 8,679,848</u>	<u>\$ 24,409,770</u>	<u>\$ 23,569,116</u>	<u>\$ 7,929,629</u>	<u>\$ 8,732,897</u>
Earnings per common share (basic and diluted)	<u>\$ 0.85</u>	<u>\$ 2.38</u>	<u>\$ 2.22</u>	<u>\$ 0.74</u>	<u>\$ 0.78</u>
Dividends declared per common share	<u>\$ 0.38</u>	<u>\$ 0.32</u>	<u>\$ 0.41</u>	<u>\$ 0.27</u>	<u>\$ 0.25</u>

**Balance Sheet Data:**

Loans, net	\$ 144,343,844	\$ 126,975,489	\$ 104,901,361	\$ 65,164,156	\$ 54,057,205
Real estate held for sale	56,110,472	75,843,635	100,191,166	59,494,339	5,890,131
Real estate held for investment	24,355,653	37,279,763	53,647,246	103,522,466	129,425,833
Other assets	14,201,304	19,463,568	13,254,472	13,742,960	17,268,412
Total assets	239,011,273	259,562,455	271,994,245	241,923,921	206,641,581
Total indebtedness	31,747,433	38,361,934	66,374,544	49,019,549	13,917,585
Total liabilities	38,021,546	44,034,578	72,485,398	53,177,310	20,415,275
Non-controlling interests	—	—	4,528,849	4,174,753	6,351,896
Total equity	200,989,727	215,527,877	199,508,847	188,746,611	186,226,306
Book value per share	\$ 22.10	\$ 21.03	\$ 19.03	\$ 17.14	\$ 16.66

**Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Forward Looking Statements**

Some of the information in this Form 10-K may contain forward-looking statements. Words such as “may,” “will,” “should,” “expect,” “anticipate,” “intend,” “believe,” “plan,” “estimate,” “continue” and variations of such words and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, uncertain events or assumptions, and other characterizations of future events, strategies or circumstances are forward-looking statements. These forward-looking statements are subject to risks and uncertainties, including those described throughout this filing and particularly in “Risk Factors” in Part I, Item 1A of this Form 10-K, that could cause actual results to differ materially from those projected or described 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 primarily in the Western U.S. 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 OFG, 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 SEC 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 business and 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 American 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 investment 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 owned significantly more real estate than in the past, which has reduced cash flow and net income. As of December 31, 2017, approximately 6% of our loans were impaired and/or past maturity, up from 4% as of December 31, 2016. As of December 31, 2017, we owned approximately \$80.5 million (book value) of real estate held for sale or investment, which is approximately 34% of total assets, a decrease of \$32.7 million or 12.6% of total assets as compared to December 31, 2016. During 2017, we sold eight real estate properties (two partial) for aggregate net sales proceeds of \$56,329,000 (including notes receivable totaling \$450,000) and net gains totaling \$14,729,000. We will continue to attempt to sell certain of our properties but may need to sell them for losses. 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 currently believes that only one of our delinquent loans will result in a credit loss to the Company (and has caused the Company to record a specific allowance for loan losses on such loan), real estate values could decrease further. Management continues to perform frequent evaluations of collateral values for our loans 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 increase or decrease in the near term, and such changes could be material.

### ***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 through active portfolio management and execution of our business plan which is outlined below:

- Capitalize on market lending opportunity by leveraging 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***

Our ability to execute our business strategy, particularly the growth of our loan portfolio, is dependent on many factors, including our ability to access financing on favorable terms. The previous economic downturn had a significant negative impact on both us and our borrowers. If similar economic conditions recur in the future, it may limit our options for obtaining financing on favorable terms and may also adversely impact the creditworthiness of our borrowers which could result in their inability to repay their loans.

The commercial real estate markets continue to improve, but uncertainty remains as a result of global market instability, the current political climate, changes in the Federal tax code, regulatory reform and other matters and their potential impact on the U.S. economy and commercial real estate markets. In addition, the growth in multifamily rental rates seen over the past few years are showing signs of stabilizing. If real estate values decline again and/or rent growth subsides, it may limit our new loan originations since borrowers often use increases in the value of, and revenues produced from, their existing properties to support the purchase or investment in additional properties. Declining real estate values may also significantly increase the likelihood that we will have difficulty selling our existing real estate assets in a timely manner, and that we will incur losses on our loans in the event of default because the value of our collateral may be insufficient to cover our investment in the loan. Any sustained period of increased payment delinquencies, foreclosures or losses could adversely affect both our interest income from loans as well as our ability to originate loans, which would significantly impact our revenues, results of operations, financial condition, business prospects and our ability to make distributions to our stockholders.

The economic environment over the past few years has seen continued improvement in commercial real estate values which has generally increased payoffs and reduced the credit exposure in our loan portfolio. We have made, and continue to make, modifications and extensions to loans when it is economically feasible to do so. In some cases, a modification is a more viable alternative to foreclosure proceedings when a borrower cannot comply with loan terms. In doing so, lower borrower interest rates, combined with non-performing loans, would lower our net interest margins when comparing interest income to our costs of financing. If the markets were to deteriorate and another prolonged economic downturn was to occur, we believe there could be additional loan modifications and delinquencies, which may result in reduced net interest margins and additional losses throughout our sector.

We believe that improvement in commercial real estate values has also resulted in increased values of some of our real estate assets. 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 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.

Recent increases in market interest rates have increased interest expense under our Credit Facility and certain other of our borrowings that bear interest at variable rates. Due to competitive conditions in our markets, we have been unable to pass increases in our cost of funds through to our borrowers on the majority of our recent loan investments and, accordingly, the interest rates we receive on our loans has remained relatively unchanged. This increase in our cost of funds without corresponding increases in the rates we charge our borrowers will result in a smaller interest margin and, if these conditions continue, may adversely affect our results of operations in the future.

### **Critical Accounting Policies**

We consider the accounting policies discussed below to be critical to an understanding of how we report our financial condition and results of operations because their application places the most significant demands on the judgment of our management.

Our consolidated financial statements are prepared in accordance with GAAP, which requires the use of estimates and assumptions that involve the exercise of judgment and 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, (2) the valuation of real estate held for sale and investment (at acquisition and subsequently) and (3) the recoverability of deferred income tax assets.

### **Allowance for Loan Losses, Impaired Loans and Non-accrual Status**

We maintain an allowance for loan losses on our investments in mortgage loans. A loan is impaired when it is probable that we may not collect all principal and interest payments according to the contractual terms of the loan agreement. As part of the detailed loan review, we consider many factors about the specific loan, including payment history, asset performance, borrower's financial capability and other characteristics. Management evaluates loans for non-accrual status each reporting period. A loan is placed on non-accrual status when the loan payment deficiencies exceed 90 days, or earlier if collection of principal and interest is substantially in doubt. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest remains accrued until the loan becomes current, is paid off or is foreclosed upon. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest. Cash receipts on nonaccrual loans are used to reduce any outstanding accrued interest, and then are recorded as interest income, except when such payments are specifically designated as principal reduction or when management does not believe our investment in the loan is fully recoverable. When a loan is considered impaired, management estimates impairment based on the fair value of the collateral less estimated costs to sell, generally through the use of appraisals. The determination of the general reserve for loans that are not considered impaired and are collectively evaluated for impairment is based on estimates made by management including consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in our service areas, industry experience and trends, geographic concentrations, estimated collateral values, our underwriting policies, the character of the loan portfolio, and probable incurred losses inherent in the portfolio taken as a whole. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth but actual results may vary and there is no assurance that the allowance for loan losses will be sufficient. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance.

### **Real Estate Held for Sale**

Real estate held for sale includes real estate acquired in full or partial settlement of loan obligations, generally through foreclosure, that is being marketed for sale. Real estate held for sale is recorded at acquisition at the property's estimated fair value less estimated costs to sell.

*Classification as Held for Sale*—A real estate asset is classified as held for sale in the period when (i) management approves a plan to sell the asset, (ii) the asset is available for immediate sale in its present condition, subject only to usual and customary terms, (iii) a program is initiated to locate a buyer and actively market the asset for sale at a reasonable price, and (iv) completion of the sale is probable within one year. Real estate held for sale is stated at the lower of its carrying amount or estimated fair value less disposal cost, with any write-down to fair value less estimated costs to sell recorded as an impairment loss. For any subsequent increase in fair value less disposal cost, the impairment loss may be reversed, but only up to the amount of cumulative loss previously recognized. Depreciation is not recorded on assets classified as held for sale.

If circumstances arise that were previously considered unlikely and, as a result, we decide not to sell the real estate asset previously classified as held for sale, the real estate asset is reclassified as held for investment. Upon reclassification, the real estate asset is measured at the lower of (i) its carrying amount prior to classification as held for sale, adjusted for depreciation expense that would have been recognized had the real estate been continuously classified as held for investment, or (ii) its estimated fair value at the time we decide not to sell.

*Real Estate Sales*—We evaluate if real estate sale transactions qualify for recognition under the full accrual method, considering whether, among other criteria, the buyer's initial and continuing investments are adequate to demonstrate a commitment to pay, any receivable due to the Company is not subject to future subordination, the Company has transferred to the buyer the usual risks and rewards of ownership and the Company does not have a substantial continuing involvement with the sold real estate. At the time the sale is consummated, a gain or loss is recognized as the difference between the sale price less disposal cost and the carrying value of the real estate.

### **Real Estate Held for Investment**

Real estate held for investment includes real estate purchased or acquired in full or partial settlement of loan obligations, generally through foreclosure, that is not being marketed for sale and is either being operated, such as rental properties; is being managed through the development process, including obtaining appropriate and necessary entitlements and permits and construction; or are idle properties awaiting more favorable market conditions or properties we cannot sell without placing

our REIT status at risk or become subject to prohibited transactions penalty tax. Real estate held for investment is recorded at acquisition at the property's estimated fair value less estimated costs to sell. Depreciation of buildings and improvements is provided on the straight-line method over the estimated remaining useful lives of buildings and improvements. Depreciation of tenant improvements is provided on the straight-line method over the shorter of their estimated useful lives or the lease terms. Costs related to the improvement of real estate held for sale and investment are capitalized, whereas those related to holding the property are expensed. We evaluate real estate held for investment periodically or whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. We evaluate cash flows and determine impairments on an individual property basis. In making this determination, we often obtain new appraisals and/or review, among other things, current and future cash flows associated with each property, market information, market prices of similar properties recently sold or currently being offered for sale, and other quantitative and qualitative factors. If an impairment indicator exists, we evaluate whether the expected future undiscounted cash flows is less than the carrying amount of the property, and if we determine that the carrying value is not recoverable, an impairment loss is recorded for the difference between the estimated fair value less estimated costs to sell and the carrying amount of the property.

### **Income Taxes**

We have elected to be taxed as a REIT. As a result of our REIT qualification and distribution policy, we do not generally expect to pay U.S. federal corporate level income taxes. Many of the REIT requirements, however, are highly technical and complex. To qualify as a REIT, we must meet a number of organizational and operational requirements, including a requirement that we distribute annually at least 90% of our REIT taxable income, determined without regard to net capital gains, to our stockholders. If we have previously qualified as a REIT and fail to qualify as a REIT in any subsequent taxable year and do not qualify for certain statutory relief provisions, we will be subject to U.S. federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and may be precluded from qualifying as a REIT for four subsequent taxable years. Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state, local and foreign taxes on our income and property and to U.S. federal income and excise taxes on our undistributed REIT taxable income.

We have elected (or may elect) to treat certain of our existing or newly created corporate subsidiaries as taxable REIT subsidiaries (each a "TRS"). In general, a TRS of a REIT may hold assets that the REIT cannot hold directly and, subject to certain exceptions related to hotels and healthcare properties, may engage in any real estate or non-real estate related business. A TRS is treated as a regular corporation and is subject to federal, state, local and foreign taxes on its income and property.

*Deferred Income Taxes* - Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities, if any. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A deferred tax asset is also recognized for net operating loss carryforwards of TRS entities. A valuation allowance, if needed, reduces deferred tax assets to the amount that is "more likely than not" to be realized. Realization of deferred tax assets is dependent on the Company's TRS entities generating sufficient taxable income in future periods or employing certain tax planning strategies to realize such deferred tax assets. The estimate of the amount of deferred tax assets more likely than not to be realized often requires significant judgment on the part of management because realization may be dependent on the outcome of property sales and/or other events that are difficult to forecast.

*Tax Positions* - The accounting guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. A tax position is recognized as a benefit only if it is "more likely than not" that the position would be sustained in a tax examination, with a tax examination being presumed to occur. We have analyzed our various federal and state filing positions and believe that our income tax filing positions and deductions are well documented and supported. There was no reserve for uncertain tax positions recorded as of December 31, 2017 and 2016.

### **Significant Developments During 2017 and Subsequent Events**

*Loan Activity* – We originated 26 new loans totaling \$86,063,000 (when fully funded) with a weighted average interest rate of 7.7%. We received full or partial repayment on 27 loans in the total amount of \$69,723,000 with a weighted average interest rate of 8.1%. We extended the maturity dates of 15 loans with outstanding principal balances aggregating \$36,177,000 with a weighted average interest rate of 8.4%. We recorded charge-offs from the specific loan loss allowance on one impaired loan totaling \$546,000 and recorded a net decrease in the general allowance for loan losses of \$333,000 (net of

\$27,000 recovery of bad debts received), for a total decrease in the allowance of \$879,000.

*Real Estate Property Sales* – We sold eight real estate properties (two partially) for aggregate net sales proceeds of \$56,329,000 (including notes receivable totaling \$450,000) and net gains totaling \$14,729,000. The sale of seven condominium units at ZRV in 2017 resulted in the repayment of the construction note payable totaling \$10,580,000.

*Real Estate Construction Projects* – We completed the construction of the retail/condominium project owned by ZRV and incurred approximately \$10,277,000 in additional capitalized costs during 2017.

*Stock Repurchases* – We repurchased 341,086 shares of our Common Stock during 2017 pursuant to the 2017 Repurchase Plan at a total cost of \$5,820,000 and an average cost of \$17.06 per share.

*Freestone Settlement Agreement* – We repurchased 669,058 of the Freestone Shares during 2017 pursuant to the Settlement Agreement at a total cost of \$12,879,000. Approximately \$2,168,000 of this amount was recorded as settlement expense and the remaining \$10,712,000 as treasury stock. The remaining 141,879 of the Freestone Shares were purchased in January 2018 for a total cost of \$2,731,000 (\$2,271,000 treasury stock and \$460,000 settlement expense) that was recorded as a forward contract liability as of December 31, 2017 (see below).

*Interim Management Fee* – Effective July 1, 2017, we adjusted the Existing Management Fee on an interim basis to equal the Interim Management Fee, which is a monthly management fee that equals 1/12<sup>th</sup> of 1.50% of the Company's Stockholders' Equity, subject to the additional details of the calculation as described in "Related Party Transactions – Management Fees and Expenses – *Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*" in Item 13 of this Annual Report. The Interim Management Fee is payable during the Interim Adjustment Period that commenced July 1, 2017 and ends on March 31, 2018, and on April 1, 2018 the management fee payable to the Manager will be permanently reduced as described in "Related Party Transactions – Management Fees and Expenses – *Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*" in Item 13 of this Annual Report. This adjustment resulted in a reduced management fee of approximately \$440,000 during the last six months of 2017.

*Subsequent Events* – The following events have occurred during the first quarter of 2018 and are discussed in further detail in our consolidated financial statements under "Note 16 – Subsequent Events" in Item 8 of this Annual Report:

- We sold three condominium units at ZRV for net sales proceeds totaling \$3,725,000 (proceeds used to repay the construction loan) and gains totaling \$539,000.
- We repurchased 141,879 of the Freestone Shares pursuant to the Settlement Agreement in January 2018 at a total cost of \$2,731,000 (\$2,271,000 treasury stock and \$460,000 settlement expense). This amount was accrued as a forward contract liability as of December 31, 2017.
- Effective February 28, 2018, the maturity date of our line of credit with California Bank & Trust, First Bank and Umpqua Bank was extended from March 1, 2018 to June 1, 2018.
- On March 12, 2018, the Board approved a quarterly dividend of \$0.16 per share of Common Stock for the quarter ending March 31, 2018 (an increase from the \$0.10 per share dividend paid for the quarter ending December 31, 2017). The dividend will be paid on April 13, 2018 to stockholders of record at the close of business on March 31, 2018.
- On March 13, 2018, we announced (1) that our Board and the Manager have agreed to make permanent, effective April 1, 2018, the Interim Management Fee adjustment along with an additional adjustment such that the monthly management fee payable will equal (i) one-twelfth (1/12) multiplied by (ii) (a) 1.50% of the first \$300,000,000 of the Company's Stockholders' Equity and (b) 1.25% of the Company's Stockholders' Equity that is greater than \$300,000,000, and (2) a non-binding agreement in principle to make certain additional changes to the Manager's compensation structure as described in the Amendment Proposal. See "Related Party Transactions – Management Fees and Expenses – *Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*" in Item 13 of this Annual Report.

### Comparison of Results of Operations for Years Ended 2017 and 2016

The following table sets forth our results of operations for the years ended December 31, 2017 and 2016:

	Year Ended December 31,		Increase/(Decrease)	
	2017	2016	Amount	Percent
Revenues:				
Interest income on loans	\$ 10,840,730	\$ 8,922,142	\$ 1,918,588	22%
Rental and other income from real estate properties	4,505,385	7,977,400	(3,472,015)	(44)%
Other income	187,013	179,449	7,564	4%
Total revenues	<u>15,533,128</u>	<u>17,078,991</u>	<u>(1,545,863)</u>	<u>(9)%</u>
Expenses:				
Management fees to Manager	3,546,085	3,286,470	259,615	8%
Servicing fees to Manager	362,411	298,770	63,641	21%
General and administrative expense	2,234,230	1,568,890	665,340	42%
Rental and other expenses on real estate properties	4,980,900	7,060,526	(2,079,626)	(29)%
Depreciation and amortization	1,138,515	1,258,305	(119,790)	(10)%
Interest expense	1,587,695	2,859,294	(1,271,599)	(44)%
(Recovery of) provision for loan losses	(360,012)	1,284,896	(1,644,908)	nm
Impairment losses on real estate properties	1,423,286	3,227,807	(1,804,521)	(56)%
Total expenses	<u>14,913,110</u>	<u>20,844,958</u>	<u>(5,931,848)</u>	<u>(28)%</u>
Operating income (loss)	620,018	(3,765,967)	4,385,985	nm
Gain on sales of real estate, net	14,728,921	24,497,763	(9,768,842)	(40)%
Settlement expense	(2,627,436)	—	(2,627,436)	100%
Net income before income taxes	12,721,503	20,731,796	(8,010,293)	(39)%
Income tax (expense) benefit	(4,041,655)	7,248,977	(11,290,632)	nm
Net income	8,679,848	27,980,773	(19,300,925)	(69)%
Net income attributable to non-controlling interests	—	(3,571,003)	3,571,003	(100)%
Net income attributable to common stockholders	<u>\$ 8,679,848</u>	<u>\$ 24,409,770</u>	<u>\$ (15,729,922)</u>	<u>(64)%</u>

nm – not meaningful

#### Revenues

Interest income on loans increased \$1,919,000 (22% increase) to \$10,841,000 for the year ended December 31, 2017, as compared to \$8,922,000 for the year ended December 31, 2016. The increase was primarily due to an increase in the average balance of performing loans between the year ended December 31, 2017 and the year ended December 31, 2016 of approximately 26%.

Rental and other income from real estate properties decreased \$3,472,000 (44% decrease) to \$4,505,000 for the year ended December 31, 2017, as compared to \$7,977,000 for the year ended December 31, 2016, primarily due to the sale of four operating properties during the year ended December 31, 2016. These properties had rental income totaling approximately \$3,424,000 during the year ended December 31, 2016. There was also a decrease in income from our golf course located in Auburn, California of approximately \$166,000 during the year ended December 31, 2017 as compared to 2016.

#### Expenses

Management fees increased \$260,000 (8% increase) and servicing fees increased \$64,000 (21% increase) during the year ended December 31, 2017, as compared to 2016. The servicing fee increase was due to an increase in the average balance of loans in our portfolio of 21% during the year ended December 31, 2017, as compared to 2016. The management fees did not increase as much as the service fees as a result of the increased loan balances because, as discussed under “Significant Developments During 2017 and Subsequent Events” above, the Board and the Manager agreed to adjust the Existing Management Fee during the Interim Adjustment Period, and the new Interim Management Fee calculation (which commenced on July 1, 2017 and is based on stockholders’ equity) resulted in a management fee for the year ended December 31, 2017 that was approximately \$440,000 lower than the fee that would have been payable to the Manager using the Existing Management Fee calculation.



General and administrative expense increased \$665,000 (42% increase) during the year ended December 31, 2017, as compared to 2016. The increase was due primarily to higher legal and consulting expenses during the year ended December 31, 2017 as compared to 2016 relating to shareholder activism, regulatory compliance matters and evaluation of strategic options related to our external management structure.

Settlement expense increased \$2,627,000 during the year ended December 31, 2017, as compared to 2016, as a result of the purchase pursuant to the Settlement Agreement, at \$19.25 per share, of 669,058 Freestone Shares on December 29, 2017 and another 141,879 Freestone Shares on January 12, 2018. The market price of \$16.01 per share for all 810,937 Freestone Shares purchased was recorded as treasury stock (\$12,983,000 total), and the premium paid over the market price for those shares of \$3.24 per share (\$2,627,000 total) was recorded as settlement expense in the consolidated financial statements. See discussion under “*Forward Contract Liability – Share Repurchase*” below.

Rental and other expenses on real estate properties decreased \$2,080,000 (29% decrease) during the year ended December 31, 2017, as compared to 2016, primarily due to the sale of four operating properties during 2016. These properties had rental expenses totaling approximately \$2,766,000 during the year ended December 31, 2016. The decrease from the sale of these properties was offset by a one-time increase in property assessments levied on our mixed-use property located in Tacoma, Washington in the amount of approximately \$268,000, disbursements of \$285,000 related to certain operating expenses of our assisted living facility located in Bensalem, Pennsylvania and increased marketing and other operating costs related to the Zalanta condominiums at our property located in South Lake Tahoe, California during the year ended December 31, 2017. We will continue to have increased operating costs of the Zalanta property until such time as the remaining condominium units are sold and the commercial units are leased and/or sold.

Depreciation and amortization expense decreased \$120,000 (10% decrease) during the year ended December 31, 2017, as compared to 2016, primarily due to the discontinuation of depreciation on certain properties that were moved to Held for Sale during 2016 and 2017.

Interest expense decreased \$1,272,000 (44% decrease) during the year ended December 31, 2017 as compared to 2016, due to a decrease in the average balance on our line of credit during the year ended December 31, 2017, as compared to 2016, as we repaid the line of credit in full with the sale of the TSV land in April 2017 and did not advance on the line of credit again until the end of December 2017. The decrease was also due to the sale of the TOTB Miami properties and the repayment of the debt securing the properties during the third quarter of 2016, net of an increase in interest expense on the Zalanta construction loan as construction was completed in mid-2017 and capitalization of interest was discontinued.

The recovery of loan losses of \$360,000 during the year ended December 31, 2017 was the result of an analysis performed on the loan portfolio. The general loan loss allowance decreased \$333,000 during the year ended December 31, 2017 primarily due to a decrease in the balance of performing residential and land loans during the year which have a higher historical loss factor as compared to commercial loans. In addition, the Company received a recovery of bad debts of \$27,000 during 2017.

The provision for loan losses of \$1,285,000 during the year ended December 31, 2016 was the result of an analysis performed on the loan portfolio. The general loan loss allowance increased \$590,000 during the year ended December 31, 2016 due to an increase in the balance of performing loans during the year, an increase in the historical loss percentage on commercial loans and an increase in land loans in the portfolio which loan segment has a higher loss factor than the other segments. The specific loan loss allowance also increased \$694,000 (net) during the year ended December 31, 2016 due primarily to the recording of a specific loan loss allowance of \$733,000 as of December 31, 2016 on one impaired loan as a result of an updated analysis of the collateral value completed based on actual sales of units during 2016.

The impairment losses on real estate properties of \$1,423,000 and \$3,228,000, respectively, during the years ended December 31, 2017 and 2016 were the result of agreements to sell certain of our properties for prices that were lower than the book value or the result of updated appraisals or other valuation information obtained on certain of our real estate properties during those years.

#### *Gain on Sales of Real Estate*

Gain on sales of real estate decreased \$9,769,000 during the year ended December 31, 2017, as compared to 2016, as a result of the sale of eight real estate properties (two partially) during 2017, resulting in gains totaling \$14,729,000 (see further detail under “*Net Income Attributable to Non-Controlling Interests*” and “*Real Estate Properties Held for Sale and*

*Investment*” below). We sold seven real estate properties (three partially) during the year ended December 31, 2016, resulting in gains totaling \$24,498,000.

We believe, from period to period in the near term, there will be fluctuations in net income resulting from the lag time between the sale of our real estate assets and deployment of the proceeds into new loan investments.

#### *Income Tax (Expense) Benefit*

We recorded income tax expense related to our taxable REIT subsidiaries of \$4,042,000 during the year ended December 31, 2017 as compared to income tax benefit of \$7,249,000 during the year ended December 31, 2016. The income tax expense during the year ended December 31, 2017 was primarily the result of an increase in the valuation allowance recorded against deferred tax assets as a result of higher construction costs and lower expected gains from the sales of ZRV assets in the future (Federal and state tax expense of \$2,878,000) and due to a decrease in the Federal corporate tax rate from 34% to 21% in 2018 and beyond as a result of the Tax Cuts and Jobs Act signed into law by President Trump on December 22, 2017, which required us to remeasure our deferred tax assets at the lower rate (Federal tax expense of \$1,358,000). The income tax benefit during the year ended December 31, 2016 was a result of the transfer of two properties into ZRV and conversion of ZRV into a taxable REIT subsidiary, which made the income (loss) from these real estate assets taxable. Due to differences between the book and tax basis of the assets, a deferred tax asset and related income tax benefit totaling \$7,249,000 was recorded as of December 31, 2016. The Company’s effective tax rate for 2017 differed from the statutory tax rate primarily due to an increase in the valuation allowance on deferred tax assets and the change in the Federal corporate tax rate as discussed above. The Company’s effective tax rate for 2016 differed from the statutory tax rate because the three properties held within the ZRV TRS had differences between their respective book basis and tax basis and management projected that the Company would realize the benefits from deferred tax assets related to these basis differences. As a result, a \$7,249,000 deferred tax benefit was recorded during 2016. Management has estimated future taxable gains and losses on sale of ZRV real estate assets to determine how much of the deferred tax assets are realizable. This realizability analysis is inherently subjective and actual results could differ from these estimates.

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

Net income attributable to non-controlling interests decreased \$3,571,000 during the year ended December 31, 2017, as compared to 2016, because there was net income attributable to our joint venture partner (the Manager) in TOTB Miami, LLC of approximately \$3,571,000 during the year ended December 31, 2016, as opposed to \$0 during the year ended December 31, 2017, as the properties held within TOTB were sold in September 2016 and the LLC dissolved.

### Comparison of Results of Operations for Years Ended 2016 and 2015

The following table sets forth our results of operations for the years ended December 31, 2016 and 2015:

	Year Ended December 31,		Increase/(Decrease)	
	2016	2015	Amount	Percent
<b>Revenues:</b>				
Interest income on loans	\$ 8,922,142	\$ 8,277,004	\$ 645,138	8%
Rental and other income from real estate properties	7,977,400	12,791,096	(4,813,696)	(38)%
Income from investment in limited liability company	179,449	175,451	3,998	2%
Total revenues	<u>17,078,991</u>	<u>21,243,551</u>	<u>(4,164,560)</u>	<u>(20)%</u>
<b>Expenses:</b>				
Management fees to Manager	3,286,470	2,051,134	1,235,336	60%
Servicing fees to Manager	298,770	186,467	112,303	60%
General and administrative expense	1,568,890	1,278,994	289,896	23%
Rental and other expenses on real estate properties	7,045,848	8,510,110	(1,464,262)	(17)%
Depreciation and amortization	1,258,305	2,052,181	(793,876)	(39)%
Interest expense	2,859,294	1,938,113	921,181	48%
Bad debt expense from uncollectible rent	14,678	152,805	(138,127)	(90)%
Provision for (recovery of) loan losses	1,284,896	(1,026,909)	2,311,805	nm
Impairment losses on real estate properties	3,227,807	1,589,434	1,638,373	103%
Total expenses	<u>20,844,958</u>	<u>16,732,329</u>	<u>4,112,629</u>	<u>25%</u>
Operating (loss) income	(3,765,967)	4,511,222	(8,277,189)	nm
Gain on sales of real estate, net	24,497,763	21,818,553	2,679,210	12%
Net income before income taxes	20,731,796	26,329,775	(5,597,979)	(21)%
Income tax benefit (expense)	7,248,977	(93,335)	7,342,312	nm
Net income	27,980,773	26,236,440	1,744,333	7%
Net income attributable to non-controlling interests	(3,571,003)	(2,667,324)	(903,679)	34%
Net income attributable to common stockholders	<u>\$ 24,409,770</u>	<u>\$ 23,569,116</u>	<u>\$ 840,654</u>	<u>4%</u>

nm – not meaningful

#### Revenues

Interest income on loans increased \$645,000 (8% increase) to \$8,922,000 for the year ended December 31, 2016, as compared to \$8,277,000 for the year ended December 31, 2015. The increase was primarily due to an increase in interest income from performing loans as the average balance of performing loans increased between 2015 and 2016 by approximately 70%. This increase was partially offset by the fact that the 2015 period included approximately \$1,723,000 of interest income collected on an impaired loan that did not recur during 2016.

Rental and other income from real estate properties decreased \$4,814,000 (38% decrease) to \$7,977,000 for the year ended December 31, 2016, as compared to \$12,791,000 for the year ended December 31, 2015, primarily due to the sale of four operating properties during 2015 and five during 2016.

#### Expenses

Management fees increased \$1,235,000 (60% increase) and servicing fees increased \$112,000 (60% increase) during the year ended December 31, 2016, as compared to 2015, due to an increase in the average balance of loans in our portfolio of 60% during 2016, as compared to 2015.

The maximum management and servicing fees were paid to the Manager during years ended December 31, 2016 and 2015. The maximum management fee permitted under the Company's charter is 2.75% per year of the average unpaid balance of loans and, accordingly, management fees have historically increased proportionately as we deployed capital into loans and increased our loan balances. For the years 2016, 2015, 2014, 2013 and 2012, the management fees were 2.75%, 2.75%, 2.74% and 2.67% of the average unpaid balance of loans, respectively. As discussed under "Significant Developments During 2017 and Subsequent Events" above, the Board and the Manager have agreed to adjust the Existing Management Fee during the Interim Adjustment Period and thereafter using a management fee calculation that is based on stockholders' equity.

General and administrative expense increased \$290,000 (23% increase) during the year ended December 31, 2016, as compared to 2015, due primarily to higher legal, consulting, appraisal, director and audit fees during 2016 as compared to 2015.

Rental and other expenses on real estate properties decreased \$1,464,000 (17% decrease) during the year ended December 31, 2016, as compared to 2015, primarily due to the sale of four operating properties during 2015 and five during 2016. This decrease was offset by an increase in property tax expense and other holding costs on the TOTB North apartment building held within TOTB Miami that could no longer be capitalized to the basis of the project once construction was completed in March 2016 (and before it was sold in September 2016) and also due to an increase in marketing related expenses for the ZRV property currently under construction during 2016.

Depreciation and amortization expense decreased \$794,000 (39% decrease) during the year ended December 31, 2016, as compared to 2015, primarily due to the discontinuation of depreciation on certain properties that were moved to Held for Sale during 2015 and 2016.

Interest expense increased \$921,000 (48% increase) during the year ended December 31, 2016 as compared to 2015, due to a higher amount of interest incurred on our lines of credit as the balances were higher during the year ended December 31, 2016 as compared to 2015, due to an additional \$3,830,000 advance taken on the TSV loan with RaboBank (the "TSV Loan") during the third quarter of 2015 and due to the fact that interest incurred on the TOTB North construction loan could no longer be capitalized to the renovation project beginning in March 2016 as construction was completed (and before it was sold in September 2016).

The provision for loan losses of \$1,285,000 during the year ended December 31, 2016 was the result of an analysis performed on the loan portfolio. The general loan loss allowance increased \$590,000 during the year ended December 31, 2016 due to an increase in the balance of performing loans during the year, an increase in the historical loss percentage on commercial loans and an increase in land loans in the portfolio which loan segment has a higher loss factor than the other segments. The specific loan loss allowance also increased \$694,000 (net) during the year ended December 31, 2016 due primarily to the recording of a specific loan loss allowance of \$733,000 as of December 31, 2016 on one impaired loan as a result of an updated analysis of the collateral value completed based on actual sales of units during 2016.

The reversal of the provision for loan losses of \$1,027,000 during the year ended December 31, 2015 was the result of an analysis performed on the loan portfolio. The general loan loss allowance increased \$877,000 during the year ended December 31, 2015 due to an increase in the balance of performing loans during the year (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 \$1,904,000 during the year ended December 31, 2015, because new appraisals obtained during 2015 on two impaired loans reflected increased values of the underlying collateral, thus, resulting in a decrease in the specific allowance on these loans.

The impairment losses on real estate properties of \$3,228,000 and \$1,589,000, respectively, during the years ended December 31, 2016 and 2015 were the result of updated appraisals or other valuation information obtained on certain of our real estate properties during those years.

#### Gain on Sales of Real Estate

Gain on sales of real estate (excluding gain attributable to a non-controlling interest in 2016) increased \$2,679,000 during the year ended December 31, 2016, as compared to 2015, as a result of the sale of seven real estate properties during 2016 (three partially), resulting in net gains totaling \$24,498,000 (see further detail under "Net Income Attributable to Non-Controlling Interests" and "Real Estate Properties Held for Sale and Investment" below). The gain from the sale of one of these properties was offset by net income attributable to a non-controlling interest of approximately \$3,716,000, as a portion of the gain on sale of the property held within TOTB Miami, LLC was attributable to the non-controlling interest. During 2015, we sold eight real estate properties, resulting in gains totaling \$21,666,000 and recognized \$153,000 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 2015.

### Income Tax Benefit

Income tax benefit increased \$7,342,000 during the year ended December 31, 2016, as compared to 2015, as a result of the transfer of two properties into ZRV and conversion of ZRV into a taxable REIT subsidiary during the second quarter of 2016, which now makes the income (loss) from these real estate assets taxable. Due to differences between the book and tax basis of these assets and net losses experienced to date, a deferred tax asset and related income tax benefit totaling \$7,249,000 was recorded as of December 31, 2016. The Company's effective tax rate for the year ended December 31, 2016 differed from the statutory tax rate because the properties held within the ZRV TRS had differences between their respective book and tax basis and management now projects that the Company will realize the benefits from deferred tax assets related to these basis differences. The Company also has approximately \$5,514,000 of net Federal tax losses to date that can be carried forward to offset taxable income in future years. As a result, a \$7,249,000 deferred tax benefit was recorded during the year ended December 31, 2016 (as compared to income tax expense of \$93,000 during 2015).

### Net Income Attributable to Non-Controlling Interests

Net income attributable to non-controlling interests increased \$904,000 (34% increase) during the year ended December 31, 2016, as compared to 2015, due primarily to the sale of the condominium units and renovated apartment building owned by TOTB Miami, LLC during 2016 as a portion of the gain on sale of approximately \$3,716,000 was attributable to our joint venture partner in TOTB Miami. During 2015, we sold the shopping center owned by 720 University and a portion of the gain on sale of approximately \$2,479,000 was attributable to our joint venture partner in 720 University.

## **Financial Condition**

### ***December 31, 2017 and 2016***

#### **Loan Portfolio**

Our portfolio of loan investments increased from 55 as of December 31, 2016 to 61 as of December 31, 2017, and the average loan balance increased from \$2,358,000 as of December 31, 2016 to \$2,396,000 as of December 31, 2017.

As of December 31, 2017 and 2016, we had nine and two impaired loans, respectively, totaling approximately \$8,534,000 (5.8% of the portfolio) and \$4,884,000 (3.8%), respectively. This included matured loans totaling \$7,107,000 and \$4,656,000 as of December 31, 2017 and 2016, respectively. In addition, seven loans of approximately \$7,585,000 (5.2%) and \$8,686,000 (6.7%) were past maturity but less than ninety days delinquent in monthly payments as of December 31, 2017 and 2016, respectively (combined total of \$16,119,000 (11.0%) and \$13,570,000 (10.5%), respectively, that are past maturity and/or impaired). Of the impaired and past maturity loans, none were in the process of foreclosure and none involved loans to borrowers who were in bankruptcy. We foreclosed on no loans during the year ended December 31, 2017. We foreclosed on one loan during the year ended December 31, 2016 with a principal balance of approximately \$1,079,000 and obtained the property via the trustee sale.

Of the \$4,884,000 in loans that were impaired as of December 31, 2016, both remained impaired as of December 31, 2017 (balance of \$1,030,000 as of December 31, 2017).

As of December 31, 2017 and 2016, approximately \$145,958,000 (99.9%) and \$129,454,000 (99.8%) 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 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 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 and any accrued interest is due and payable, but the borrower has failed to make such payment of principal and/or accrued interest are referred to as "past maturity loans". As of December 31, 2017 and 2016, we had thirteen and eight past maturity loans totaling approximately \$14,692,000 and \$13,342,000, respectively.

There was one loan with a principal balance of \$1,145,000 modified as a troubled debt restructuring during the year ended December 31, 2017. There were no loans modified as troubled debt restructurings during the years ended December 31, 2016 and 2015.

As of December 31, 2017 and 2016, we held the following types of loan investments:

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
<u>By Property Type:</u>		
Commercial	\$ 127,873,281	\$ 102,442,111
Residential	13,170,795	19,001,677
Land	<u>5,127,574</u>	<u>8,238,523</u>
	<u>\$ 146,171,650</u>	<u>\$ 129,682,311</u>
<u>By Position:</u>		
Senior loans	\$ 142,782,492	\$ 126,873,673
Junior loans	<u>3,389,158</u>	<u>2,808,638</u>
	<u>\$ 146,171,650</u>	<u>\$ 129,682,311</u>

The types of property securing our commercial real estate loans are as follows as of December 31, 2017 and 2016:

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
<u>Commercial Real Estate Loans:</u>		
Office	\$ 29,480,103	\$ 33,608,898
Retail	32,329,395	19,959,635
Storage	15,807,016	13,015,175
Apartment	24,582,181	11,366,570
Hotel	11,777,351	9,567,143
Industrial	2,690,000	7,376,477
Warehouse	3,000,000	—
Marina	3,580,000	3,500,000
Assisted care	1,650,000	1,328,213
Church	—	1,175,000
Golf course	1,212,851	1,145,000
Restaurant	<u>1,764,384</u>	<u>400,000</u>
	<u>\$ 127,873,281</u>	<u>\$ 102,442,111</u>

Scheduled maturities of loan investments as of December 31, 2017 and the interest rate sensitivity of such loans are as follows:

	<u>Fixed</u> <u>Interest</u> <u>Rate</u>	<u>Variable</u> <u>Interest</u> <u>Rate</u>	<u>Total</u>
Year ending December 31:			
2017 (past maturity)	\$ 14,692,398	\$ —	\$ 14,692,398
2018	75,454,727	9,790,059	85,244,786
2019	33,521,816	5,225,000	38,746,816
2020	—	7,273,602	7,273,602
2021	—	—	—
2022	—	—	—
Thereafter (through 2028)	<u>214,048</u>	<u>—</u>	<u>214,048</u>
	<u>\$ 123,882,989</u>	<u>\$ 22,288,661</u>	<u>\$ 146,171,650</u>

Currently, our variable rate loans use as indices the Prime, three-month or six-month LIBOR rates (4.50%, 1.69% and 1.84% respectively, at December 31, 2017) or include terms whereby the interest rate we charge is increased at a later date. Premiums over these indices have varied from 3.0% to 9.0% and may be higher or lower depending upon market conditions at the time the loan is made.

The following is a schedule by geographic location of loan investments as of December 31, 2017 and 2016:

	<u>December 31, 2017</u>		<u>December 31, 2016</u>	
	<u>Balance</u>	<u>Percentage</u>	<u>Balance</u>	<u>Percentage</u>
California	\$ 110,884,117	75.86%	\$ 98,319,923	75.81%
Arizona	815,890	0.56%	4,655,517	3.59%
Colorado	4,380,616	3.00%	1,595,000	1.23%
Hawaii	1,450,000	0.99%	1,450,000	1.12%
Illinois	1,364,384	0.93%	—	—%
Indiana	388,793	0.27%	—	—%
Michigan	10,714,764	7.33%	10,337,157	7.97%
Nevada	1,653,107	1.13%	3,669,584	2.83%
Ohio	3,755,000	2.57%	3,627,506	2.80%
Texas	6,625,000	4.53%	6,027,624	4.65%
Washington	3,159,460	2.16%	—	—%
Wisconsin	980,519	0.67%	—	—%
	<u>\$ 146,171,650</u>	<u>100.00%</u>	<u>\$ 129,682,311</u>	<u>100.00%</u>

As of December 31, 2017 and 2016, our loans secured by real property collateral located in Northern California totaled approximately 54% (\$78,465,000) and 53% (\$69,179,000), 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.

Our investment in loans increased by \$16,489,000 (12.7%) during the year ended December 31, 2017 as a result of new loan originations during the year, net of loan payoffs. As of December 31, 2017 and 2016, we had fourteen and twenty-two construction/rehabilitation loans in our portfolio with aggregate outstanding principal balances totaling \$21,751,000 and \$46,330,000, respectively.

#### **Allowance for Loan Losses**

The allowance for loan losses (decreased) increased by approximately \$(879,000), \$864,000 and \$(1,027,000) (provision, net of reversals and charge-offs) during the years ended December 31, 2017, 2016 and 2015, respectively. The Manager believes that the allowance for loan losses is sufficient given the estimated underlying collateral values of impaired loans. 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 allowances for loan losses, but there can be no absolute assurance that the allowance is sufficient. Because any decision regarding the allowance for loan losses reflects judgment about the probability of future events, there is an inherent risk that such judgments will prove incorrect. In such event, 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 its 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 years ended December 31, 2017, 2016 and 2015 were as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Balance, beginning of period	\$ 2,706,822	\$ 1,842,446	\$ 2,869,355
(Recovery of) provision for loan losses	(360,012)	1,284,896	(1,026,909)
Charge-offs	(546,004)	(447,520)	—
Recoveries	27,000	27,000	—
Balance, end of period	<u>\$ 1,827,806</u>	<u>\$ 2,706,822</u>	<u>\$ 1,842,446</u>

As of December 31, 2017 and 2016, there was a general allowance for loan losses of \$1,641,098 and \$1,974,110, respectively, and a specific allowance for loan losses on one loan in the amount of \$186,708 and \$732,712, respectively.

### Real Estate Properties Held for Sale and Investment

As of December 31, 2017, we held title to sixteen properties that were acquired through foreclosure, with a total carrying amount of approximately \$80,466,000 (including properties held in four limited liability companies and two corporations), net of accumulated depreciation of \$3,317,000. As of December 31, 2017, properties held for sale total \$56,110,000 and properties held for investment total \$24,356,000. We foreclosed on no loans during the year ended December 31, 2017. We foreclosed on one loan during the year ended December 31, 2016 with a principal balance of approximately \$1,079,000 and obtained the property via the trustee sale. When we acquire property by foreclosure, we typically earn less income on those properties than could be earned on loans and we may not be able to sell the properties in a timely manner.

Changes in real estate held for sale and investment during the years ended December 31, 2017, 2016 and 2015 were as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Balance, beginning of period	\$ 113,123,398	\$ 153,838,412	\$ 163,016,805
Real estate acquired through foreclosure	—	700,800	—
Investments in real estate properties	11,274,904	29,061,735	25,274,125
Amortization of deferred financing costs capitalized to construction project	76,260	119,471	207,347
Sales of real estate properties	(41,505,148)	(66,183,589)	(31,099,086)
Impairment losses on real estate properties	(1,423,286)	(3,227,807)	(1,589,434)
Depreciation of properties held for investment	(1,080,003)	(1,185,624)	(1,971,345)
Balance, end of period	<u>\$ 80,466,125</u>	<u>\$ 113,123,398</u>	<u>\$ 153,838,412</u>

Eight of our sixteen properties do not currently generate revenue. Seven of the Company's twenty-three commercial leases are set to expire during 2018. All of the Company's twelve residential leases are either on a month-to-month basis or will expire in 2018. The Company expects that new leases will be signed with existing or new tenants for the majority of these spaces and at rental rates that are at market and are at or above expiring rental amounts.

For purposes of assessing potential impairment of value during 2017, 2016 and 2015, we obtained updated appraisals or other valuation support on several of our real estate properties held for sale and investment, which resulted in additional impairment losses on three, three and one property(ies), respectively, in the aggregate amount of approximately \$1,423,000, \$3,228,000 and \$1,589,000, respectively, recorded in the consolidated statements of operations.

### 2017 Sales Activity

During the year ended December 31, 2017, we sold eight real estate properties (two partially) and 1,000 square feet of commercial floor coverage area with details as follows:



	<u>Net Sales Proceeds**</u>	<u>Gain (Loss)</u>
Commercial and residential land under development, South Lake Tahoe, California (held within Tahoe Stateline Venture, LLC)	\$ 42,329,110	\$ 13,210,826
Seven condominium units, South Lake Tahoe, California (held within Zalanta Resort at the Village, LLC)	10,578,517	997,239
Two office condominium units, Roseville, California	978,431	515,959
Marina with 52 boat slips and campground, Bethel Island, California (held within Sandmound Marina, LLC)	967,825	(1,646)
Office condominium complex, Oakdale, California (held within East G, LLC)	732,389	(150)
Undeveloped, residential land, Marysville, California	398,483	(4,717)
One improved, residential lot, West Sacramento, California*	154,901	3,108
Unimproved, residential and commercial land, Gypsum, Colorado	139,467	(31)
1,000 square feet of commercial floor coverage area (held within Tahoe Stateline Venture, LLC)	<u>50,000</u>	<u>8,333</u>
	<u>\$ 56,329,123</u>	<u>\$ 14,728,921</u>

\* There is deferred gain related to this sale of \$93,233 as of December 31, 2017.

\*\* Includes carryback notes receivable totaling \$450,000.

### **2016 Sales Activity**

During the year ended December 31, 2016, we sold seven real estate properties (two partially) with details as follows:

	<u>Net Sales Proceeds**</u>	<u>Gain (Loss)</u>
Light industrial building, Paso Robles, California	\$ 6,023,679	\$ 4,557,979
Commercial building in building complex, Roseville, California	455,132	280,836
169 condominium units and 160 unit renovated and unoccupied apartment building, Miami, Florida (held within TOTB Miami, LLC)*	74,072,951	19,292,364
61 condominium units, Lakewood, Washington (held within Phillips Road, LLC)	5,030,384	846,998
2 improved, residential lots, Auburn, California (held within Zalanta Resort at the Village, LLC)	186,353	89,675
Medical office condominium complex, Gilbert, Arizona (held within Zalanta Resort at the Village, LLC)	3,793,870	(30,010)
Unimproved, residential and commercial land, Gypsum, Colorado (three separate sales)	<u>1,434,273</u>	<u>(540,079)</u>
	<u>\$ 90,966,642</u>	<u>\$ 24,497,763</u>

\* \$32,881,000 of proceeds were used to pay off debt securing the properties and \$7,934,000 was distributed to the non-controlling interest.

\*\* Includes carryback note receivable of \$1,595,000.

### **2015 Sales Activity**

During the year ended December 31, 2015, we sold eight real estate properties with details as follows:

	<b>Net Sales Proceeds**</b>	<b>Gain</b>
Retail complex, Greeley, Colorado (held within 720 University, LLC)*	\$ 20,318,559	\$ 8,642,156
133 condominium units, Phoenix, Arizona (held within 54 <sup>th</sup> Street Condos, LLC)	8,930,112	2,077,122
Industrial building, Sunnyvale, California (held within Wolfe Central, LLC)	8,284,081	4,920,957
Storage facility/business, Stockton, California	7,479,080	3,695,248
Commercial buildings, Sacramento, California	5,153,713	1,262,745
Undeveloped, residential land, Madera County, California	1,704,122	977,542
Retail buildings, San Jose, California	1,108,820	52,820
Marina, Oakley, California (held within The Last Resort and Marina, LLC)	273,841	37,341
	<u>\$ 53,252,328</u>	<u>\$ 21,665,931</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.

\*\* Including carryback note receivable of \$4,650,000.

In addition to the above table, we recognized gain of approximately \$153,000 during the year ended December 31, 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.

### **2017 Foreclosure Activity**

The Company foreclosed on no loans during the year ended December 31, 2017.

### **2016 Foreclosure Activity**

During the year ended December 31, 2016, the Company foreclosed on one loan secured by an office property located in Oakdale, California with a principal balance of approximately \$1,079,000 and obtained the property via the trustee's sale. In addition, accrued interest and advances made on the loan (for items such as legal fees and delinquent property taxes) in the total amount of approximately \$70,000 were capitalized to the basis of the property. A specific loan allowance has been previously established on this loan of approximately \$495,000. This amount was then recorded as a charge-off against the allowance for loan losses at the time of foreclosure, after a reduction of the previously established allowance in the amount of approximately \$47,000 as a result of an updated appraisal obtained (net charge-off of \$448,000). The property, along with a unit in the building purchased by the Company in 2015, was contributed into a new taxable REIT subsidiary, East G, LLC, in June 2016. The property was sold during 2017 and the LLC was dissolved.

### **2015 Foreclosure Activity**

The Company foreclosed on no loans during the year ended December 31, 2015.

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

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

We had an investment in a limited liability company, 720 University, LLC (720 University), which owned a commercial retail property located in Greeley, Colorado. We received 65% of the profits and losses in 720 University after priority return on partner contributions was allocated at the rate of 10% per annum. The assets, liabilities, income and expenses of 720 University were consolidated into the accompanying consolidated financial statements 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 in June 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 \$6,437,000 during the year ended December 31, 2015. 720 University was dissolved in December 2015.

### **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, to own and operate the complex. The complex consisted of three buildings, two of which were renovated and being leased, and in which 169 units remained unsold and one which has been contributed to a wholly-owned subsidiary of TOTB, TOTB North, and contained 160 vacant units that were recently renovated.

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. Income and loss allocations were made based on these percentages.

During 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 provided up to \$21,304,000 for the purpose of renovating and improving the apartment building. The construction project was substantially completed in March 2016. The loan was repaid in full with the closing of the sale of the TOTB property in September 2016 (see below).

During 2014, TOTB entered into a loan agreement whereby it borrowed \$13,000,000 secured by the 154 renovated and leased condominium units in the Pointe building. The loan bore interest at the floating daily three month LIBOR rate of interest plus 4.0% per annum, but in no event lower than 4.25%. Principal and interest was payable monthly with principal amortizing over 300 months. The loan was repaid in full with the closing of the sale of the TOTB property in September 2016 (see below).

All of the TOTB and TOTB North properties were sold in September 2016 for net sales proceeds of approximately \$74,073,000, resulting in gain of approximately \$19,292,000 (\$15,577,000 to the Company after the gain attributable to the non-controlling interest of approximately \$3,716,000).

The net income to the Company from TOTB was approximately \$14,977,000 and \$311,000 during the years ended December 31, 2016 and 2015, respectively.

### ***Equity Method Investment in Limited Liability Company***

#### **1850 De La Cruz, LLC**

During 2008, we entered into an 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. 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.

During the years ended December 31, 2017, 2016 and 2015, we received capital distributions from 1850 in the total amount of \$185,000, \$180,000 and \$177,000, respectively. The net income to the Company from its investment in 1850 De La Cruz was approximately \$185,000, \$179,000 and \$175,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

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

Cash and cash equivalents and restricted cash decreased from approximately \$6,934,000 as of December 31, 2016 to approximately \$5,671,000 as of December 31, 2017 (\$1,263,000 or 18.2% decrease) due primarily to cash used totaling \$157,341,000 for investment in loans and real estate properties, net repayment of debt, purchase of treasury stock and dividends paid, which was offset by cash received totaling \$155,634,000 from the sale of real estate properties, principal collected on loans and advances from notes payable and the line of credit.

### **Interest and Other Receivables**

Interest and other receivables increased from approximately \$2,164,000 as of December 31, 2016 to \$2,430,000 as of December 31, 2017 (\$266,000 or 12.3% increase) due primarily due primarily to growth in the loan portfolio during 2017.

### **Deferred Financing Costs**

Deferred financing costs accounted for as assets decreased from approximately \$172,000 as of December 31, 2016 to \$27,000 as of December 31, 2017 (\$145,000 or 84.4% decrease) due primarily to amortization of deferred financing costs during 2017.

### **Deferred Tax Assets, Net**

Deferred tax assets decreased from \$7,249,000 as of December 31, 2016 to approximately \$3,207,000 as of December 31, 2017 (\$4,042,000 or 55.8% decrease) due primarily to an increase in the valuation allowance recorded against deferred tax assets as a result of higher construction costs and lower expected gains from the sales of ZRV assets in the future and also due to a decrease in the Federal corporate tax rate from 34% to 21% in 2018 and beyond as a result of the Tax Cuts and Jobs Act signed into law by President Trump on December 22, 2017, which required us to remeasure our net deferred tax asset at the lower rate.

### **Dividends Payable**

Dividends payable increased from approximately \$1,402,000 as of December 31, 2016 to \$1,572,000 as of December 31, 2017 (\$170,000 or 12.1% increase) primarily due to an increase in Federal income taxes paid on undistributed capital gains on behalf of shareholders. In January 2017 a tax payment in the amount \$583,000 was made (for 2016 undistributed capital gains), whereas in January 2018 a tax payment in the amount of \$640,000 was made (for 2017 undistributed capital gains). In addition, there was an increase of \$112,000 in the regular quarterly dividend between the fourth quarter of 2016 and the fourth quarter of 2017.

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

Accounts payable and accrued liabilities decreased from approximately \$3,700,000 as of December 31, 2016 to \$1,390,000 as of December 31, 2017 (\$2,310,000 or 62.4% decrease), due primarily to decreased payables related to the construction activities on the property owned by ZRV now that construction has been completed.

### **Forward Contract Liability – Share Repurchase**

Forward contract liability increased from \$0 as of December 31, 2016 to \$2,731,000 as of December 31, 2017 due to the Settlement Agreement between the Company and Freestone for the purchase of 810,937 of the Freestone Shares. As of December 31, 2017, 669,058 of the Freestone Shares had been repurchased and the remaining 141,879 shares were repurchased on January 12, 2018; thus, requiring the Company to record a liability as of December 31, 2017.

### **Line of Credit Payable**

Line of credit payable decreased from \$4,976,000 as of December 31, 2016 to \$1,555,000 as of December 31 2017 (\$3,421,000 or 68.8% decrease) due primarily to repayments on the line of credit as a result of net proceeds received on the sales of real estate properties, net of new loan investments during the year ended December 31, 2017.

## Notes and Loans Payable on Real Estate

Notes and loans payable decreased from approximately \$33,386,000 as of December 31, 2016 to approximately \$30,192,000 as of December 31, 2017 (\$3,194,000 or 9.6% decrease) due primarily to principal payments of approximately \$13,580,000 made on ZRV's construction loan primarily from the sales of seven condominium units, net of additional advances for construction and interest totaling \$10,543,000 during 2017.

### 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 the control of the Company or its management. 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 supervised 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 management determines that full collectability may not be reasonably assured, considers among other matters:

- 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 in the Company's loan portfolio. 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 December 31, 2017, management believes that the allowance for loan losses of approximately \$1,828,000 is adequate in amount to cover probable incurred credit losses. Because of the number of variables involved, the magnitude of the 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 December 31, 2017, nine loans totaling approximately \$8,534,000 were impaired. Six of these loans of approximately \$7,107,000 were past maturity. During the year ended December 31, 2017, we recorded a net decrease in the allowance for loan losses of approximately \$879,000 (charge-off against the specific loan loss allowance of \$546,000 and decrease in general allowance of \$333,000, net of recovery of bad debts of \$27,000). Management believes that the allowance for loan losses is sufficient given the estimated fair value of the collateral underlying impaired and past maturity loans and based on historical loss and delinquency factors applied to performing loans by class.

### 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 develop, 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 annually 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 \$2,171,000 as of December 31, 2017;
- 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 line of credit;
- 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:

	Year Ended December 31,		
	2017	2016	2015
Net cash (used in) provided by operating activities	\$ (1,880,167)	\$ (943,292)	\$ 5,880,684
Net cash provided by (used in) investing activities	31,256,852	41,447,991	(9,376,732)
Net cash (used in) provided by financing activities	(27,640,112)	(41,326,298)	3,338,345

During the years ended December 31, 2017 and 2016, our unrestricted cash and cash equivalents increased (decreased) approximately \$1,737,000 and \$(822,000), respectively. The increase during 2017 was primarily due to more cash received from the sales of real estate properties and principal payments on loans as compared to cash used for investment for loans and improvements to real estate properties during the year. The decrease during 2016 was primarily due to more cash used for investments in loans and real estate properties and net repayment of debt as compared to cash received from the sales of real estate properties and principal payments on loans during the year.

#### *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 years ended December 31, 2017 and 2016, cash flows received from operating activities decreased \$937,000 and \$6,824,000, respectively, as compared to the previous year. The decrease during 2017 reflects the settlement expense related to the purchase of the Freestone Shares and higher management and service fees and general and administrative expenses, net of increased interest income earned on loans and lower interest expense during 2017, as compared to 2016. The decrease during 2016 reflects decreased cash flow from rental properties as a result of the sale of four operating properties during 2015 and five during 2016 and higher management and service fees, general and administrative expenses and interest expense during 2016 as compared to 2015.

#### *Investing Activities*

Net cash provided by (used in) investing activities for the periods presented reflect our investing activity. For the years ended December 31, 2017 and 2016, cash flows from investing activities decreased \$10,191,000 and increased \$50,825,000,

respectively, as compared to the previous year. Approximately \$31,257,000 was provided by investing activities during 2017 as \$128,145,000 was received from the sales of real estate properties, the payoff of loans and transfer from restricted cash, which was partially offset by an aggregate of \$97,057,000 that was used for investment in loans and improvements to real estate properties during the year. Approximately \$41,448,000 was provided by investing activities during 2016 as \$145,977,000 was received from the sales of real estate properties, the payoff of loans and transfer from restricted cash, which was partially offset by an aggregate of \$104,679,000 that was used for investment in loans and improvements to real estate properties during the year.

### *Financing Activities*

Net cash used in financing activities during 2017 totaled approximately \$27,640,000 and consisted primarily of \$6,850,000 of net repayments on our lines of credit and notes payable, \$16,532,000 of treasury stock purchases and \$4,245,000 of dividends paid to stockholders. Net cash used in financing activities during 2016 totaled approximately \$41,326,000 and consisted primarily of \$28,354,000 of net repayments on our lines of credit and notes payable, \$8,144,000 of distributions to non-controlling interests and \$4,593,000 of dividends paid to stockholders.

### *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, including capital gains, in any taxable year, 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, excluding net capital gains, 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*

The table below summarizes our known contractual obligations as of December 31, 2017 and in future periods in which we expect to settle such obligations. The table does not reflect the effect of actual repayments or draws on the obligations or any new financing obtained subsequent to year end.

<b><u>Contractual Obligations</u></b>	<b>Payment due by Period</b>				
	<b>Total</b>	<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>3-5 Years</b>	<b>More Than 5 Years</b>
Recourse indebtedness:					
Line of credit payable (1)	\$ 1,555,000	\$ 1,555,000	\$ —	\$ —	\$ —
Loan payable on real estate	13,242,514	369,959	790,927	12,081,628	—
Construction loan payable (2)	17,176,288	17,176,288	—	—	—
Total recourse indebtedness	<u>31,973,802</u>	<u>19,101,247</u>	<u>790,927</u>	<u>12,081,628</u>	<u>—</u>
Non-recourse indebtedness:					
Notes payable on real estate	—	—	—	—	—
Total non-recourse indebtedness	—	—	—	—	—
Total indebtedness	<u>31,973,802</u>	<u>19,101,247</u>	<u>790,827</u>	<u>12,081,628</u>	<u>—</u>
Interest payable (3)	2,261,845	1,164,433	1,054,925	42,487	—
Funding commitments to borrowers (4)	30,494,873	30,494,873	—	—	—
Total Obligations	<u>\$ 64,730,520</u>	<u>\$ 50,760,553</u>	<u>\$ 1,845,852</u>	<u>\$12,124,115</u>	<u>\$ —</u>

- (1) As of December 31, 2017, the Company had the ability to borrow \$27,259,000 on its line of credit.
- (2) Total available to advance for construction, interest and related costs as of December 31, 2017 is \$243,000 and this amount was advanced in January 2018.
- (3) Variable-rate indebtedness assumes a prime rate of 4.5% (actual rate at December 31, 2017) through the original maturity date of the financing. Interest payable is based on balances outstanding as of December 31, 2017.
- (4) Amounts represent the commitments we have made to fund borrowers in our existing lending arrangements as of December 31, 2017.

The table above does not reflect amounts due to the Manager pursuant to our charter or the Interim Management Fee, as described below, as the charter (or the calculation pursuant to the Interim Management Fee) does not provide for a fixed and determinable payment.

#### *Management Agreement and Charter*

The Manager provides services to the Company pursuant to the Management Agreement with the Manager dated May 20, 2013, and is entitled to receive a management fee, servicing fee, late fees, other miscellaneous fees, and the reimbursement of certain expenses as described in the Company's charter. In consideration of the management services rendered to the Company, up until July 1, 2017, OFG was entitled to receive from the Company the Existing Management Fee payable monthly, subject to a maximum of 2.75% per annum of the average unpaid balance of the mortgage loans at the end of each month in the calendar year. In August 2017, however, the Board and the Manager agreed to adjust the Existing Management Fee on an interim basis to the Interim Management Fee, which is a monthly management fee that equals 1/12<sup>th</sup> of 1.50% of the Company's Stockholders' Equity, subject to the additional details of the calculation as described in "Related Party Transactions – Management Fees and Expenses – *Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*" in Item 13 of this Annual Report. The Interim Management Fee is payable during the Interim Adjustment Period commencing July 1, 2017 and ending on March 31, 2018, and is intended to reduce the management fees payable by the Company during the Interim Adjustment Period.

OFG is also entitled to a monthly loan servicing 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 services on that type of loan, or up to 0.25% per annum of the unpaid principal balance of the loans. Pursuant to the charter, OFG also receives all late payment charges from borrowers on loans owned by the Company, as well as, other miscellaneous fees which are collected from loan payments, loan payoffs or advances from loan principal, payable in cash on a monthly basis following the end of each month.

In addition, 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, including tax, accounting, and legal expenses (subject to certain limitations in the Management Agreement). Expense reimbursements to OFG are made in cash on a monthly basis following the end of each month. The Company's reimbursement obligation is not subject to any dollar limitation.

By their terms, the Management Agreement and the terms of the charter compensation and expense reimbursement, subject to permitted amendments, remain in effect for the duration of the existence of the Company, unless earlier terminated by the affirmative vote of the holders of a majority of the outstanding shares of Common Stock, automatically, or by OFG, or by the Company in accordance with the Agreement.

On March 13, 2018, we announced that our Board and the Manager have reached a non-binding agreement in principle to amend the Management Agreement to make the following changes to the Manager's compensation structure as further detailed in the Amendment Proposal: (1) to make permanent the Interim Management Fee adjustment along with an additional adjustment such that the monthly management fee payable will equal (i) one-twelfth (1/12) multiplied by (ii) (a) 1.50% of the first \$300,000,000 of the Company's Stockholders' Equity and (b) 1.25% of the Company's Stockholders' Equity that is greater than \$300,000,000, (2) to share with the Company 30% of all loan origination, acquisition and other fees and late payment charges paid in connection with our loans, with the remaining 70% of such fees and charges to be paid to the Manager, (3) to eliminate the payment of servicing fees to the Manager for the Manager's services as servicing agent with respect to our loans, and (4) to eliminate the expense reimbursement to the Manager for certain expenses, including the salary and related salary expense of the Manager's non-management and non-supervisory personnel. While the Company and the Manager caution that no assurances can be made regarding the timing or certainty of entering a definitive agreement relating to the Amendment Proposal, if a definitive agreement implementing the Amendment Proposal is not executed by March 31, 2018, the Manager has agreed that the Company will only be obligated to pay, and the Manager will only be entitled to receive, the reduced management fee contemplated under paragraph (1) above of the Amendment Proposal from



and after April 1, 2018. The foregoing summary of the Amendment Proposal is subject to the additional details as described in “Related Party Transactions – Management Fees and Expenses – Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses” in Item 13 of this Annual Report.

### ***Company Debt***

The terms of the Company debt are discussed in further detail in our consolidated financial statements under “Note 7 – Lines of Credit Payable” and “Note 8 – Notes and Loans Payable on Real Estate” in Item 8 of this Annual Report.

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

As of December 31, 2017, the Company has one credit facility and as of that date, the total amount available to borrow under the CB&T Credit Facility was \$27,259,000 and the balance outstanding was \$1,555,000 (leaving \$25,704,000 available). As of March 9, 2018, the total amount available to borrow under the CB&T Credit Facility is \$33,518,000 and the balance outstanding is \$12,002,000 (leaving \$21,516,000 available). Interest on borrowings under the CB&T Credit Facility are payable monthly. Pursuant to the agreement of the parties, entered effective February 28, 2018, to extend the maturity date, all amounts outstanding under the facility are to be repaid not later than June 1, 2018 and advances may be made up to that date. The Company intends to renew this credit facility on a long-term basis by June 1, 2018.

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

The balance of the TSV Loan was approximately \$13,243,000 as of December 31, 2017 and \$13,152,000 as of March 9, 2018. TSV borrowed \$10,445,000 at the first closing under the TSV Loan and an additional \$3,830,000 in September 2015. No further funds are available to borrow under this loan agreement. 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.

### **ZRV Construction Loan**

The balance of the ZRV Loan was approximately \$17,176,000 as of December 31, 2017 and approximately \$13,689,000 as of March 9, 2018. As of December 31, 2017, there was approximately \$243,000 available to borrow on the ZRV Loan. Monthly interest only payments are required from an established interest reserve. In addition, commencing on August 18, 2017 and continuing on the last day of each quarter thereafter during the term of the Loan, \$6 million of principal is required to be repaid. The balance of the ZRV Loan is due on August 3, 2018. The Company expects to repay the balance of the ZRV loan in full with proceeds from the sales of condominium units by the maturity date. If the Company is not able to fully repay the ZRV Loan by that date, then it will use its cash reserves and/or advances on the CB&T Credit Facility to repay the remaining balance.

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

As of December 31, 2017, we have commitments to advance additional funds to borrowers of construction, rehabilitation and other loans (including interest reserves) in the total amount of approximately \$30,495,000.

### **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 the Company. The contingency reserves held in restricted cash and/or cash and cash equivalents were approximately \$3,464,000 and \$3,738,000 as of December 31, 2017 and 2016, respectively.

## **Item 7A. 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 interest rate risk and real estate 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 fixed rate loans as of December 31, 2017 was approximately 9 months though in the past we have extended the maturity date on certain loans which would increase our exposure to interest rate risk. In addition, our outstanding variable rate debt to loan investments as of December 31, 2017 was 13%. All of our variable rate investment loans and certain of our borrowings are subject to various interest rate floors. As a result, the impact of a change in interest rates may be different on our interest income than it is on our interest expense. As a result of the floors on our variable rate investment loans (which are a small part of our loan portfolio), and the short term nature of these loans, the impact of a change in prevailing interest rates on our income is unlikely to be material.

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 the LIBOR interest rate curve and one percent in the Prime Rate based on balances outstanding as of December 31, 2017:

	<b>As of or for the year ended December 31, 2017</b>		
	<b>Variable Rate Loans tied to LIBOR</b>	<b>Variable Rate Loans tied to Prime Rate</b>	<b>Total</b>
Aggregate Principal Balance of Debt	\$ <u>—</u>	\$ <u>18,731,288</u>	\$ <u>18,731,288</u>
Effect of 100 basis point increase in the LIBOR Curve	\$ —	\$ —	\$ —
Effect of one percent increase in the Prime Rate	<u>—</u>	<u>187,313</u>	<u>187,313</u>
Totals	\$ <u>—</u>	\$ <u>187,313</u>	\$ <u>187,313</u>

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 credit quality 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.

### **Prepayment Risk**

Our revenue and earnings may be affected by prepayment rates on our existing investment loans. When we originate our investment loans, we anticipate that we will generate an expected yield. When borrowers prepay their loans faster than we expect, there are no prepayment penalties and we may be unable to replace these loans with new investment loans that will generate yields which are as high as the prepaid mortgage loans.

## **Item 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

### **OWENS REALTY MORTGAGE, INC. INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stockholders and the Board of Directors of Owens Realty Mortgage, Inc.  
Walnut Creek, California

### Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Owens Realty Mortgage, Inc. (the "Company") as of December 31, 2017 and 2016, the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2017, and the related notes and financial statement schedules III and IV (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in the 2013 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in the 2013 *Internal Control – Integrated Framework* issued by COSO.

### Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

### Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*/s/ Crowe Horwath LLP*

We have served as the Company's auditor since 2011.

Sacramento, California

March 13, 2018

**OWENS REALTY MORTGAGE, INC.**

Consolidated Balance Sheets  
December 31,

<b>Assets</b>	<b>2017</b>	<b>2016</b>
Cash and cash equivalents	\$ 2,170,816	\$ 434,243
Restricted cash	3,500,000	6,500,000
Loans, net of allowance for loan losses of \$1,827,806 in 2017 and \$2,706,822 in 2016	144,343,844	126,975,489
Interest and other receivables	2,430,457	2,164,335
Other assets, net of accumulated depreciation and amortization of \$309,686 in 2017 and \$251,729 in 2016	725,341	803,676
Deferred financing costs, net of accumulated amortization of \$265,276 in 2017 and \$107,744 in 2016	26,823	171,855
Deferred tax assets, net	3,207,322	7,248,977
Investment in limited liability company	2,140,545	2,140,482
Real estate held for sale	56,110,472	75,843,635
Real estate held for investment, net of accumulated depreciation of \$3,316,753 in 2017 and \$3,151,427 in 2016	<u>24,355,653</u>	<u>37,279,763</u>
Total assets	<u>\$ 239,011,273</u>	<u>\$ 259,562,455</u>
<b>Liabilities and Equity</b>		
Liabilities:		
Dividends payable	\$ 1,572,047	\$ 1,402,496
Due to Manager	277,671	360,627
Accounts payable and accrued liabilities	1,390,329	3,699,859
Deferred gains	302,895	209,662
Forward contract liability – share repurchase	2,731,171	—
Line of credit payable	1,555,000	4,976,000
Notes and loans payable on real estate	<u>30,192,433</u>	<u>33,385,934</u>
Total liabilities	<u>38,021,546</u>	<u>44,034,578</u>
Commitments and Contingencies (Note 15)		
Equity:		
Stockholders' equity:		
Preferred stock, \$.01 par value per share, 5,000,000 shares authorized, no shares issued and outstanding at December 31, 2017 and 2016	—	—
Common stock, \$.01 par value per share, 50,000,000 shares authorized, 11,198,119 shares issued, 9,095,454 and 10,247,477 shares outstanding at December 31, 2017 and 2016	111,981	111,981
Additional paid-in capital	182,437,522	182,437,522
Treasury stock, at cost – 2,102,665 and 950,642 shares at December 31, 2017 and 2016	(31,655,119)	(12,852,058)
Retained earnings	<u>50,095,343</u>	<u>45,830,432</u>
Total stockholders' equity	<u>200,989,727</u>	<u>215,527,877</u>
Total liabilities and equity	<u>\$ 239,011,273</u>	<u>\$ 259,562,455</u>

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

**OWENS REALTY MORTGAGE, INC.**

Consolidated Statements of Income  
Years Ended December 31,

	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>Revenues:</b>			
Interest income on loans	\$ 10,840,730	\$ 8,922,142	\$ 8,277,004
Rental and other income from real estate properties	4,505,385	7,977,400	12,791,096
Other income	187,013	179,449	175,451
Total revenues	15,533,128	17,078,991	21,243,551
<b>Expenses:</b>			
Management fees to Manager	3,546,085	3,286,470	2,051,134
Servicing fees to Manager	362,411	298,770	186,467
General and administrative expense	2,234,230	1,568,890	1,278,994
Rental and other expenses on real estate properties	4,980,900	7,060,526	8,510,110
Depreciation and amortization	1,138,515	1,258,305	2,052,181
Interest expense	1,587,695	2,859,294	1,938,113
Bad debt expense from uncollectible rent	—	—	152,805
(Recovery of) provision for loan losses	(360,012)	1,284,896	(1,026,909)
Impairment losses on real estate properties	1,423,286	3,227,807	1,589,434
Total expenses	14,913,110	20,844,958	16,732,329
<b>Operating income (loss)</b>	620,018	(3,765,967)	4,511,222
Gain on sales of real estate, net	14,728,921	24,497,763	21,818,553
Settlement expense	(2,627,436)	—	—
<b>Net income before income tax expense</b>	12,721,503	20,731,796	26,329,775
Income tax (expense) benefit	(4,041,655)	7,248,977	(93,335)
<b>Net income</b>	8,679,848	27,980,773	26,236,440
Less: Net income attributable to non-controlling interests	—	(3,571,003)	(2,667,324)
 <b>Net income attributable to common stockholders</b>	 \$ 8,679,848	 \$ 24,409,770	 \$ 23,569,116
 <b>Per common share data:</b>			
Basic and diluted earnings per common share	\$ 0.85	\$ 2.38	\$ 2.22
Basic and diluted weighted average number of common shares outstanding	10,162,496	10,247,477	10,594,807
Dividends declared per share of common stock	\$ 0.38	\$ 0.32	\$ 0.41

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

**OWENS REALTY MORTGAGE, INC.**

Consolidated Statements of Stockholders' Equity  
Years Ended December 31, 2017, 2016 and 2015

	<u>Common Stock</u>		<u>Additional</u>	<u>Treasury Stock</u>		<u>Retained</u>	<u>Total</u>	<u>Non-</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Shares</u>	<u>Amount</u>				
			<u>Capital</u>				<u>Equity</u>	<u>Interests</u>	<u>Equity</u>
Balances, January 1, 2015	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	—	—	—	—	—	23,569,116	23,569,116	2,667,324	26,236,440
Dividends declared	—	—	—	—	—	(4,344,417)	(4,344,417)	—	(4,344,417)
Tax payment made on behalf of stockholders (Note 9)	—	—	—	—	—	(1,313,657)	(1,313,657)	—	(1,313,657)
Purchase of treasury stock	—	—	—	(520,524)	(7,502,902)	—	(7,502,902)	—	(7,502,902)
Contribution from non-controlling interest	—	—	—	—	—	—	—	279,184	279,184
Distributions to non-controlling interests	—	—	—	—	—	—	—	(2,592,412)	(2,592,412)
Balances, December 31, 2015	<u>11,198,119</u>	<u>\$ 111,981</u>	<u>\$ 182,437,522</u>	<u>(950,642)</u>	<u>\$ (12,852,058)</u>	<u>\$ 25,282,553</u>	<u>\$ 194,979,998</u>	<u>\$ 4,528,849</u>	<u>\$ 199,508,847</u>
Net income	—	—	—	—	—	24,409,770	24,409,770	3,571,003	27,980,773
Dividends declared	—	—	—	—	—	(3,279,193)	(3,279,193)	—	(3,279,193)
Tax payment made on behalf of stockholders (Note 9)	—	—	—	—	—	(582,698)	(582,698)	—	(582,698)
Contribution from non-controlling interest	—	—	—	—	—	—	—	44,207	44,207
Distributions to non-controlling interests	—	—	—	—	—	—	—	(8,144,059)	(8,144,059)
Balances, December 31, 2016	<u>11,198,119</u>	<u>\$ 111,981</u>	<u>\$ 182,437,522</u>	<u>(950,642)</u>	<u>\$ (12,852,058)</u>	<u>\$ 45,830,432</u>	<u>\$ 215,527,877</u>	<u>\$ —</u>	<u>\$ 215,527,877</u>
Net income	—	—	—	—	—	8,679,848	8,679,848	—	8,679,848
Dividends declared	—	—	—	—	—	(3,774,670)	(3,774,670)	—	(3,774,670)
Tax payment made on behalf of stockholders (Note 9)	—	—	—	—	—	(640,267)	(640,267)	—	(640,267)
Purchase of treasury stock	—	—	—	(1,152,023)	(18,803,061)	—	(18,803,061)	—	(18,803,061)
Balances, December 31, 2017	<u>11,198,119</u>	<u>\$ 111,981</u>	<u>\$ 182,437,522</u>	<u>(2,102,665)</u>	<u>\$ (31,655,119)</u>	<u>\$ 50,095,343</u>	<u>\$ 200,989,727</u>	<u>\$ —</u>	<u>\$ 200,989,727</u>

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



**OWENS REALTY MORTGAGE, INC.**  
Consolidated Statements of Cash Flows  
Years ended December 31,

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:			
Net income	\$ 8,679,848	\$ 27,980,773	\$ 26,236,440
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Gain on sales of real estate, net	(14,728,921)	(24,497,763)	(21,818,553)
Deferred income tax benefit	4,041,655	(7,248,977)	—
Income from investment in limited liability company	(185,063)	(179,450)	(175,451)
(Reversal of) provision for loan losses	(360,012)	1,284,896	(1,026,909)
Impairment losses on real estate properties	1,423,286	3,227,807	1,589,434
Depreciation and amortization	1,138,515	1,258,305	2,052,181
Amortization of deferred financing costs	317,419	456,168	367,471
Accretion of discount on loans	—	—	(536,816)
Changes in operating assets and liabilities:			
Interest and other receivables	(266,122)	(441,985)	(282,538)
Other assets	34,172	(420,759)	(122,622)
Accounts payable and accrued liabilities	(2,351,676)	(2,314,291)	(526,952)
Due to Manager	(82,956)	(48,016)	124,999
Forward contract liability	459,688	—	—
Net cash (used in) provided by operating activities	<u>(1,880,167)</u>	<u>(943,292)</u>	<u>5,880,684</u>
Cash flows from investing activities:			
Principal collected on loans	69,266,337	55,849,884	35,216,165
Investments in loans	(85,824,680)	(78,272,140)	(68,739,645)
Investment in real estate properties	(11,232,758)	(26,406,879)	(23,607,553)
Net proceeds from disposition of real estate properties	55,879,123	89,401,642	48,602,328
Purchases of vehicles and equipment	(16,170)	(29,887)	(48,402)
Distribution received from investment in limited liability company	185,000	180,000	177,000
Transfer from (to) restricted cash, net	<u>3,000,000</u>	<u>725,371</u>	<u>(976,625)</u>
Net cash provided by (used in) investing activities	<u>31,256,852</u>	<u>41,447,991</u>	<u>(9,376,732)</u>
Cash flows from financing activities			
Advances on notes payable	10,543,172	23,966,383	28,603,251
Repayments on notes payable	(13,972,820)	(36,380,880)	(20,055,762)
Advances on lines of credit	19,945,000	79,416,793	69,247,500
Repayments of lines of credit	(23,366,000)	(95,356,293)	(59,782,000)
Payment of deferred financing costs	(12,500)	(279,599)	(41,735)
Distributions to non-controlling interests	—	(8,144,059)	(2,592,412)
Contribution from non-controlling interest	—	44,207	279,184
Purchase of treasury stock	(16,531,578)	—	(7,502,902)
Dividends paid	<u>(4,245,386)</u>	<u>(4,592,850)</u>	<u>(4,816,779)</u>
Net cash (used in) provided by financing activities	<u>(27,640,112)</u>	<u>(41,326,298)</u>	<u>3,338,345</u>
Net increase (decrease) in cash and cash equivalents	1,736,573	(821,599)	(157,703)
Cash and cash equivalents at beginning of year	<u>434,243</u>	<u>1,255,842</u>	<u>1,413,545</u>
Cash and cash equivalents at end of year	<u>\$ 2,170,816</u>	<u>\$ 434,243</u>	<u>\$ 1,255,842</u>
<u>Supplemental Disclosures of Cash Flow Information</u>			
Cash paid during the year for interest (excluding amounts capitalized)	\$ 1,291,743	\$ 2,495,000	\$ 1,570,887
Cash paid during the year for interest that was capitalized	472,357	555,453	393,591
Cash paid during the year for income taxes	—	—	93,335
<u>Supplemental Disclosure of Non-Cash Activity</u>			

Increase in real estate from loan foreclosures	—	700,800	—
Decrease in loans, net of allowance for loan losses, from loan foreclosures	—	(631,232)	—
Decrease in interest and other receivables from adding balances to loans	—	(69,568)	—
Decrease in interest and other receivables from loan foreclosures	—	—	—
Increase in loans from sales of real estate	450,000	1,595,000	4,650,000
Amortization of deferred financing costs capitalized to construction project	(76,260)	(119,471)	(207,347)
Capital expenditures financed through accounts payable	(42,146)	(2,654,856)	(1,666,572)
Dividends declared but not paid	(1,572,047)	(1,402,496)	(2,133,455)
Repurchase of treasury stock accrued as forward contract liability	(2,271,483)	—	—

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

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

### **Notes to Consolidated Financial Statements**

#### **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 (the “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 now, by virtue of the Merger, directly or indirectly owns all of the assets and business formerly owned by OMIF and is a deemed successor issuer to OMIF pursuant to Rule 12g-3(a) under the Securities Exchange Act of 1934, as amended. For accounting purposes, the merger of OMIF with and into the Company 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. The consolidated financial statements reflect the extinguishment of OMIF’s partners’ capital and replacement with 11,198,119 shares of Common Stock and additional paid –in capital as if the Merger occurred on January 1, 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. 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 currently intends to distribute all of its REIT taxable income, excluding net capital gains. 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**

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

The consolidated financial statements include the accounts of the Company and its majority and wholly owned limited liability companies. All significant inter-company transactions and balances have been eliminated in consolidation. The Company also has a 50% ownership interest in a limited liability company accounted for under the equity method (see Note 4). 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 have been made to the 2015 and 2016 consolidated financial statements to conform to the 2017 presentation. None of the reclassifications had an impact on net income or equity.

##### **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 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.

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

#### Recently Issued Accounting Standards

In January 2017, the FASB issued Accounting Standards Update (“ASU”) 2017-01, “Business Combinations (Topic 805) – Clarifying the Definition of a Business”, or ASU 2017-01. The amendments in ASU 2017-01 clarify the definition of a business by more clearly outlining the requirements for an integrated set of assets and activities to be considered a business and by establishing a practical framework to determine when the integrated set of assets and activities is a business. This standard is effective for interim and annual reporting periods beginning after December 15, 2017. The Company does not believe that adoption of ASU 2017-01 will have a material impact on its consolidated financial statements.

In November 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-18, “Statement of Cash Flows (Topic 230) – Restricted Cash”, or ASU 2016-18. The amendments in ASU 2016-18 require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash and cash equivalents together when reconciling the beginning and end of period total amounts shown on the statement of cash flows. This standard is effective for interim and annual reporting periods beginning after December 15, 2017 on a retrospective basis to each period presented. The adoption of ASU 2016-18 will result in the Company including its restricted cash with cash and cash equivalents when reconciling the beginning and ending amounts shown on its consolidated statement of cash flows.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230) – Classification of Certain Cash Receipts and Cash Payments”, or ASU 2016-15. The amendments in ASU 2016-15 reflect eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. This standard is effective for interim and annual reporting periods beginning after December 15, 2017 and requires adoption on a retrospective basis to each period presented, unless it is impracticable to apply, in which case, the amendment is required to be applied prospectively as of the earliest date practicable. Presently, the Company believes that the only impact from the adoption of ASU 2016-15 will be that distributions it receives from its equity method investment will be reported in cash flows from operating activities rather than financing activities on its consolidated statement of cash flows.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326) – Measurement of Credit Losses on Financial Instruments”, or ASU 2016-13. The amendments in ASU 2016-13 eliminate the probable and incurred credit loss recognition threshold in current GAAP and, instead, reflect an entity’s current estimate of all expected credit losses. The amendments in ASU 2016-13 broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The use of forecasted information incorporates more timely information in the estimate of expected credit loss. This standard is effective for interim and annual reporting beginning after December 15, 2019, with early adoption permitted for interim and annual reporting beginning after December 15, 2018. While the Company is currently evaluating the impact that ASU 2016-13 will have on its consolidated financial statements, the adoption is not expected to result in a material increase in the amount of allowance for loan losses based on the short maturity of loans in the Company’s portfolio. However, if the Company makes longer term loans, the impact may be greater.

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’s effective date was deferred one year by ASU 2015-14, and it is now effective for the first interim or annual period beginning after December 15, 2017, and is to be applied retrospectively to all periods presented or retrospectively with the cumulative effect recognized at the date of the initial application. The Company plans to adopt the standard using the modified retrospective method. The Company expects that the majority of its revenue will not be impacted by the adoption of this accounting standard since the standard will not change its accounting policy for the recognition of interest income. The Company does not anticipate its revenue from real estate properties and related disclosures will be significantly impacted by this standard, as rental income from leasing arrangements is specifically excluded from ASU 2014-09, and will be evaluated with the adoption of the lease accounting standard, ASU 2016-02, discussed below.

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

The Company anticipates the primary effects of the new standard will be associated with the Company's non-lease revenue streams, which represented less than 4% of consolidated total revenues in 2017. In addition, under ASU 2014-09, gain or loss on the sale of real estate when such sale is financed by the Company will be impacted for future transactions entered into and management expects that the Company will need to reevaluate four past real estate sales transactions and retroactively apply the provisions of ASU 2014-09 as of January 1, 2018, which is not likely to result in a material change to the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)" or ASU 2016-02, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., lessees and lessors). ASU 2016-02 amends existing guidance related to leases, primarily by requiring the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under the current accounting guidance. This standard is effective for interim and annual reporting beginning after December 15, 2018, with early adoption permitted. The Company does not currently have any lease obligations. The Company expects that its operating leases where it is the lessor will be accounted for on its balance sheet similar to its current accounting with the underlying leased asset recognized as real estate. The Company expects that executory costs and certain other non-lease components will need to be accounted for separately from the lease component of the lease with the lease component continuing to be recognized on a straight-line basis over the lease term and the executory costs and certain other non-lease components being accounted for under the new revenue recognition guidance in ASU 2014-09. The Company does not believe that adoption of ASU 2016-02 will have a material impact on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments- Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities", or ASU 2016-01. ASU 2016-01 enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information. This Update contains several provisions, including but not limited to 1) requiring equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income; 2) simplifying the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) eliminating the requirement to disclose the method(s) and significant assumptions used to estimate fair value; and 4) requiring separate presentation of financial assets and liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements. ASU 2016-01 also changes certain financial statement disclosure requirements, including requiring disclosures of the fair value of financial instruments be made on the basis of exit price. ASU 2016-01 is effective for public entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Management does not expect adoption of this accounting standard will have a significant impact on the Company's consolidated financial statements, however management expects the requirement to use an exit price methodology could impact the disclosures the Company makes related to fair value of its financial instruments. Disclosure of the fair value of the Company's loans is likely to be impacted the most by this change.

#### **Cash and Cash Equivalents**

Cash and cash equivalents include funds on deposit with financial institutions.

#### **Restricted Cash**

Restricted cash includes contingency reserves required pursuant to the Company's charter and non-interest bearing deposits required pursuant to the Company's lines of credit (see Note 7).

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

#### **Concentration of Credit Risk**

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and loans. The Company places its cash and cash equivalents with financial institutions and, at times, cash held may exceed the Federal Deposit Insurance Corporation, or “FDIC”, insured limit. The Company has exposure to credit risk on its loans and other investments. The Company’s Manager, OFG, will seek to manage credit risk by performing analysis of underlying collateral assets.

#### **Loans and Allowance for Loan Losses**

Loans are generally stated at the principal amount outstanding. Advances under the terms of a loan to pay property taxes, insurance, legal and other costs are generally capitalized and reported as interest and other receivables. The Company’s portfolio consists primarily of real estate loans generally collateralized by first, second and third deeds of trust. Interest income on loans is accrued using the simple interest method. Loans are generally placed on nonaccrual status when the borrowers are past due greater than ninety days or when full payment of principal and interest is not expected. When a loan is classified as nonaccrual, interest accruals discontinue and all past due interest is included in the recorded investment in the impaired loan that is measured as described below. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest. Cash receipts on nonaccrual loans are used to reduce any outstanding accrued interest, and then are recorded as interest income, except when such payments are specifically designated as principal reduction or when management does not believe the Company’s investment in the loan is fully recoverable. The Company does not incur origination costs and does not earn or collect origination fees from borrowers as OFG is entitled to all such fees (see Note 12).

Loans and the related accrued interest and advances are analyzed by management on a periodic basis for ultimate recovery. The allowance for loan losses is management’s estimate of probable credit losses inherent in the Company’s loan portfolio that have been incurred as of the balance sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components: specific reserves related to impaired loans that are individually evaluated for impairment and general reserves for inherent losses related to loans that are not considered impaired and are collectively evaluated for impairment.

Regardless of the loan type, a loan is considered impaired when, based on current information and events, management believes it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. All loans determined to be impaired are individually evaluated for impairment. When a loan is considered impaired, management estimates impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, management may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. These valuations are generally updated during the fourth quarter but may be updated during interim periods if deemed appropriate by management.

A restructuring of a debt constitutes a troubled debt restructuring (“TDR”) if the Company for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDR’s are considered impaired and measured for impairment as described above.

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

The determination of the general reserve for loans that are not considered impaired and are collectively evaluated for impairment is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable incurred losses inherent in the portfolio taken as a whole.

The Company maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial real estate, residential real estate and land loans. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans that are individually evaluated for impairment and loans that are not considered impaired and are collectively evaluated for impairment, is combined to determine the Company's overall allowance, which is included on the consolidated balance sheet. The allowance for loans that are not considered impaired consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses, and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

**Land Loans** – These loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified costs and time lines. Trends in the construction industry significantly impact the credit quality of these loans as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

**Commercial and Residential Real Estate Loans** – Adverse economic developments or an overbuilt market impact commercial and residential real estate projects and may result in troubled loans. Trends in vacancy rates of properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Management monitors the credit quality of the Company's loan portfolio on an ongoing basis using certain credit quality indicators including a loan's delinquency status and internal asset classification. A loan is considered classified when it meets the definition of impaired as described above.

#### **Other Assets**

Other assets primarily include deferred rent, capitalized lease commissions, prepaid expenses, deposits and inventory. Amortization of lease commissions is provided on the straight-line method over the lives of the related leases.

#### **Deferred Financing Costs**

Issuance and other costs related to the Company's lines of credit and certain notes payable are capitalized and amortized to interest expense under either the straight-line or effective interest methods over the terms of the respective debt instruments. Deferred financing costs related to the construction loan in Zalanta Resort at the Village, LLC were amortized to the construction project under the straight-line method over the term of construction/renovation.

#### **Rental Income**

The Company leases multifamily rental units under operating leases with terms of generally one year or less. Rental revenue is recognized, net of rental concessions, on a straight-line method over the related lease term. Rental income on commercial property is recognized on a straight-line basis over the term of each operating lease.

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

#### **Real Estate Held for Sale**

Real estate held for sale includes real estate acquired in full or partial settlement of loan obligations, generally through foreclosure, that is being marketed for sale. Real estate held for sale is recorded at acquisition at the property's estimated fair value less estimated costs to sell. Any excess of the recorded investment in the loan over the net realizable value is charged against the allowance for loan losses. Any excess of the net realizable value over the recorded investment in the loan is credited first to the allowance for loan losses as a recovery to the extent charge-offs had been recorded previously and, then to earnings as gain on foreclosure of loan.

After acquisition, costs incurred relating to the development and improvement of property are capitalized to the extent they do not cause the recorded value to exceed the net realizable value, whereas costs relating to holding and disposition of the property are expensed as incurred. After acquisition, real estate held for sale is analyzed periodically for changes in fair values and any subsequent write down is charged to impairment losses on real estate properties. Any recovery in the fair value subsequent to such a write down is recorded (not to exceed the net realizable value at acquisition) as an offset to impairment losses on real estate properties.

Gains on the sale of real estate are recorded using the full accrual method whereby the amount by which the net sale proceeds exceeds the property's carrying amount is recorded as gain in full on the date of sale if the following criteria are met:

- The gain is determinable, that is, the collectability of the sales price is reasonably assured or the amount that will not be collectible can be estimated.
- The earnings process is virtually complete, that is, the Company is not obliged to perform significant activities after the sale in order to earn the gain.

Sales of real estate properties that do not meet the criteria for the full accrual method are accounted for as follows:

- Deposit method – If it is determined a sale has not consummated, the Company does not derecognize its recorded investment in the property and the transaction is accounted for under the deposit method whereby any initial investment from the buyer is accounted for as a deposit liability.
- Cost recovery method – If recovery of the cost of the property is not reasonably assured if the buyer defaults or if cost has already been recovered and collection of additional amounts is uncertain, the cost recovery method is used whereby no gain is recognized until cash payments from the buyer exceed the Company's recorded investment in the property sold.
- Installment method – If the buyer's initial investment is inadequate, as measured by its composition and its size compared with the sales value of the property, and if recovery of the carrying amount of the property is reasonably assured if the buyer defaults, the transaction is accounted for under the installment method whereby each cash receipt and principal payment by the buyer on debt assumed is allocated between cost recovered and gain. This allocation is in the same ratio as total cost and total gain bear to the sales value.
- Reduced profit method – If the buyer's initial investment is adequate but the buyer's continuing investment is inadequate, as measured by the annual payments required by the buyer compared to a 20-year fully-amortizing payment if the sold property is land and the a fully-amortizing payment at a customary amortization term of a first mortgage loan by an independent established lending institution if the sold property is other real estate, the gain is recognized using the reduced profit method whereby gain is determined by discounting the receivable from the buyer to the present value of the lowest level of annual payments required by the sales contract over a maximum period (20 years for land and customary underwriting terms for other real estate) and excluding requirements to pay lump sums. The present value is calculated using an appropriate interest rate, but not less than the rate stated in the sales contract. In order for the reduced profit method to be



## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

used, payments by the buyer each year must at least cover a) the interest and principal amortization on the maximum first mortgage loan that could be obtained on the property, and b) interest, at an appropriate rate, on the excess of the aggregate actual debt on the property over such a maximum first mortgage loan. If such criteria are not met, the Company may recognize gain on the sale using the installment method or cost recovery method.

#### **Real Estate Held for Investment**

Real estate held for investment includes real estate acquired in full or partial settlement of loan obligations, generally through foreclosure, that is not being marketed for sale and is either being operated, such as rental properties; is being managed through the development process, including obtaining appropriate and necessary entitlements, permits and construction; or are idle properties awaiting more favorable market conditions or properties the Company cannot sell without placing the Company's REIT status at risk or becoming subject to prohibited transactions penalty tax. Real estate held for investment is recorded at acquisition at the property's estimated fair value, less estimated costs to sell.

After acquisition, costs incurred relating to the development and improvement of the property are capitalized, whereas costs relating to operating or holding the property are expensed. Subsequent to acquisition, management periodically compares the carrying value of real estate to expected undiscounted future cash flows 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 estimated fair value through an impairment loss charged to earnings. Subsequent increases in the fair value of such properties are not recorded unless they are realized.

Depreciation of real estate properties held for investment is provided on the straight-line method over the estimated remaining useful lives of buildings and improvements (5-39 years). Depreciation of tenant improvements is provided on the straight-line method over the shorter of their estimated useful lives or the lease terms.

The Company reclassifies real estate properties from held for investment to held for sale in the period in which all of the following criteria are met: 1) Management commits to a plan to sell the property; 2) The property is available for immediate sale in its present condition; 3) An active program to locate a buyer has been initiated; 4) The sale of the property is probable and the transfer of the property is expected to qualify for recognition as a completed sale, within one year; and 5) Actions required to complete the plan indicate it is unlikely that significant changes to the plan will be made or the plan will be withdrawn. Such real estate properties are recorded at the time of reclassification at their carrying amounts prior to reclassification or fair value, whichever is lower. This establishes the initial basis at which the properties are accounted for as held for sale, as described above.

If circumstances arise that previously were considered unlikely, and, as a result, the Company decides not to sell a real estate property classified as held for sale, the property is reclassified to held for investment. The property is then measured individually at the lower of its carrying amount, adjusted for depreciation or amortization expense that would have been recognized had the property been continuously classified as held for investment, or its fair value at the date of the subsequent decision not to sell.

#### **Earnings per Common Share**

The Company calculates basic earnings per common share by dividing net income attributable to common stockholders for the period by the weighted-average shares of Common Stock outstanding for that period. Diluted earnings per common share take into effect any dilutive instruments, unless if when doing so such effect would be anti-dilutive. At the present time, the Company has not issued any restricted stock or restricted stock units and has no other dilutive instruments.

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

#### Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities, if any. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount that is “more likely than not” to be realized.

The Company has elected to be taxed as a REIT. As a result of the Company’s REIT qualification and its distribution policy, the Company does not generally expect to pay U.S. federal corporate level income taxes. Many of the REIT requirements, however, are highly technical and complex. To qualify as a REIT, the Company must meet a number of organizational and operational requirements, including a requirement that the Company distribute annually at least 90% of the Company’s REIT taxable income, determined without regard to net capital gains, to the Company’s stockholders. If the Company has previously qualified as a REIT and fails to qualify as a REIT in any subsequent taxable year and does not qualify for certain statutory relief provisions, the Company will be subject to U.S. federal income taxes at regular corporate rates (including any applicable alternative minimum tax) and may be precluded from qualifying as a REIT for the Company’s four subsequent taxable years. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain U.S. federal, state, local and foreign taxes on the Company’s income and property and to U.S. federal income and excise taxes on the Company’s undistributed REIT taxable income.

The Company has elected or may elect to treat certain of its existing or newly created corporate subsidiaries as taxable REIT subsidiaries (each a “TRS”). In general, a TRS of a REIT may hold assets that the REIT cannot hold directly and, subject to certain exceptions related to hotels and healthcare properties, may engage in any real estate or non-real estate related business. A TRS is treated as a regular corporation and is subject to federal, state, local and foreign taxes on its income and property.

Gains on sales of certain properties may be taxable to the Company if such properties were held primarily for sale to customers in the ordinary course of business, as contemplated by Internal Revenue Code Section 1221(a)(1), or were identified as foreclosure property under the related REIT taxation rules.

The accounting guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. A tax position is recognized as a benefit only if it is “more likely than not” that the position would be sustained in a tax examination, with a tax examination being presumed to occur. The Company has analyzed its various federal and state filing positions and believes that its income tax filing positions and deductions are well documented and supported. There was no reserve for uncertain tax positions recorded as of December 31, 2017 and 2016. Interest and penalties related to income tax matters, if any, are recorded as part of income tax expense in the consolidated statement of income.

Certain entities included in the Company’s consolidated financial statements are subject to certain state and local taxes. These taxes are recorded as general and administrative expenses in the accompanying consolidated financial statements.

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

**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 years ended December 31, 2017, 2016 and 2015 and the allocation of the allowance for loan losses and loans as of December 31, 2017 and 2016 by portfolio segment and by impairment methodology:

<u>2017</u>	<u>Commercial</u>	<u>Residential</u>	<u>Land</u>	<u>Total</u>
<b>Allowance for loan losses:</b>				
Beginning balance	\$ 864,971	\$ 1,331,318	\$ 510,533	\$ 2,706,822
Charge-offs	—	(546,004)	—	(546,004)
Recoveries	27,000	—	—	27,000
Provision (Reversal)	<u>177,487</u>	<u>(333,777)</u>	<u>(203,722)</u>	<u>(360,012)</u>
Ending balance	<u>\$ 1,069,458</u>	<u>\$ 451,537</u>	<u>\$ 306,811</u>	<u>\$ 1,827,806</u>
Ending balance: individually evaluated for impairment	<u>\$ —</u>	<u>\$ 186,708</u>	<u>\$ —</u>	<u>\$ 186,708</u>
Ending balance: collectively evaluated for impairment	<u>\$ 1,069,458</u>	<u>\$ 264,829</u>	<u>\$ 306,811</u>	<u>\$ 1,641,098</u>
Ending balance	<u>\$ 1,069,458</u>	<u>\$ 451,537</u>	<u>\$ 306,811</u>	<u>\$ 1,827,806</u>
<b>Loans:</b>				
Ending balance	<u>\$ 127,873,281</u>	<u>\$ 13,170,795</u>	<u>\$ 5,127,574</u>	<u>\$ 146,171,650</u>
Ending balance: individually evaluated for impairment	<u>\$ 1,212,851</u>	<u>\$ 7,321,359</u>	<u>\$ —</u>	<u>\$ 8,534,210</u>
Ending balance: collectively evaluated for impairment	<u>\$ 126,660,430</u>	<u>\$ 5,849,436</u>	<u>\$ 5,127,574</u>	<u>\$ 137,637,440</u>

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

<b><u>2016</u></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>				
Beginning balance	\$ 1,140,530	\$ 455,587	\$ 246,329	\$ 1,842,446
Charge-offs	(447,520)	—	—	(447,520)
Recoveries	27,000	—	—	27,000
Provision	<u>144,961</u>	<u>875,731</u>	<u>264,204</u>	<u>1,284,896</u>
Ending balance	<u>\$ 864,971</u>	<u>\$ 1,331,318</u>	<u>\$ 510,533</u>	<u>\$ 2,706,822</u>
Ending balance: individually evaluated for impairment	<u>\$ —</u>	<u>\$ 732,712</u>	<u>\$ —</u>	<u>\$ 732,712</u>
Ending balance: collectively evaluated for impairment	<u>\$ 864,971</u>	<u>\$ 598,606</u>	<u>\$ 510,533</u>	<u>\$ 1,974,110</u>
Ending balance	<u>\$ 864,971</u>	<u>\$ 1,331,318</u>	<u>\$ 510,533</u>	<u>\$ 2,706,822</u>
<b>Loans:</b>				
Ending balance	<u>\$ 102,442,111</u>	<u>\$ 19,001,677</u>	<u>\$ 8,238,523</u>	<u>\$ 129,682,311</u>
Ending balance: individually evaluated for impairment	<u>\$ —</u>	<u>\$ 4,883,866</u>	<u>\$ —</u>	<u>\$ 4,883,866</u>
Ending balance: collectively evaluated for impairment	<u>\$ 102,442,111</u>	<u>\$ 14,117,811</u>	<u>\$ 8,238,523</u>	<u>\$ 124,798,445</u>
<b><u>2015</u></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>				
Beginning balance	\$ 888,260	\$ 1,975,112	\$ 5,983	\$ 2,869,355
Charge-offs	—	—	—	—
Provision (Reversal)	<u>252,270</u>	<u>(1,519,525)</u>	<u>240,346</u>	<u>(1,026,909)</u>
Ending balance	<u>\$ 1,140,530</u>	<u>\$ 455,587</u>	<u>\$ 246,329</u>	<u>\$ 1,842,446</u>

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

The following tables show an aging analysis of the loan portfolio by the time monthly payments are past due at December 31, 2017 and 2016. All of the loans that were 90 days or more past due in payments as listed below were on non-accrual status as of December 31, 2017 and 2016.

<u>December 31, 2017</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	\$ 1,212,851	\$ —	\$ —	\$ 1,212,851	\$ 126,660,430	\$ 127,873,281
Residential	—	4,676,433	2,644,926	7,321,359	5,849,436	13,170,795
Land	—	—	—	—	5,127,574	5,127,574
	<u>\$ 1,212,851</u>	<u>\$ 4,676,433</u>	<u>\$ 2,644,926</u>	<u>\$ 8,534,210</u>	<u>\$ 137,637,440</u>	<u>\$ 146,171,650</u>

The above table as of December 31, 2017 includes seven past maturity loans in the Current Loan category of approximately \$7,585,000 (\$4,585,000 Commercial of which \$3,000,000 was 30-59 days past maturity and \$1,585,000 was greater than 90 days past maturity and \$3,000,000 Residential of which all was less than 30 days past maturity). These loans were current in making monthly interest payments and in the process of being extended, paid off or refinanced. In addition, of the delinquent loans above, \$7,107,000 of Residential loans were past maturity.

<u>December 31, 2016</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	\$ —	\$ —	\$ —	\$ —	\$ 102,442,111	\$ 102,442,111
Residential	1,983,247	—	4,883,866	6,867,113	12,134,564	19,001,677
Land	<u>1,080,000</u>	—	—	<u>1,080,000</u>	<u>7,158,523</u>	<u>8,238,523</u>
	<u>\$ 3,063,247</u>	<u>\$ —</u>	<u>\$ 4,883,863</u>	<u>\$ 7,947,113</u>	<u>\$ 121,735,198</u>	<u>\$ 129,682,311</u>

The above table as of December 31, 2016 includes past maturity loans of approximately \$8,686,000 in the Current Loan category (\$3,675,000 Commercial of which \$2,500,000 is less than 30 days and \$1,175,000 is 30-59 days past maturity and \$5,011,000 Residential all of which is greater than 90 days past maturity). These loans were current in making monthly interest payments and in the process of being extended, paid off or refinanced.

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

The following tables show information related to impaired loans as of and for the years ended December 31, 2017, 2016 and 2015:

	As of December 31, 2017			Year Ended December 31, 2017	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<i>With no related allowance recorded:</i>					
Commercial	\$ 1,222,499	\$ 1,212,851	\$ —	\$ 101,875	\$ 19,189
Residential	6,610,216	6,505,469	—	753,711	50,369
Land	—	—	—	—	—
	\$ 7,832,715	\$ 7,718,320	\$ —	\$ 855,586	\$ 69,559
<i>With an allowance recorded:</i>					
Commercial	\$ —	\$ —	\$ —	\$ —	\$ —
Residential	1,302,707	815,890	186,708	3,188,101	—
Land	—	—	—	—	—
	\$ 1,302,707	815,890	\$ 186,708	\$ 3,188,101	\$ —
<i>Total:</i>					
Commercial	\$ 1,222,499	\$ 1,212,851	\$ —	\$ 101,875	\$ 19,189
Residential	7,912,923	7,321,359	186,708	3,941,813	50,369
Land	—	—	—	—	—
	\$ 9,135,422	\$ 8,534,210	\$ 186,708	\$ 4,043,688	\$ 69,559

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

	As of December 31, 2016			Year Ended December 31, 2016	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<i>With no related allowance recorded:</i>					
Commercial	\$ —	\$ —	\$ —	\$ 1,684,877	\$ 38,187
Residential	228,349	228,349	—	236,042	20,598
Land	—	—	—	—	—
	<u>\$ 228,349</u>	<u>\$ 228,349</u>	<u>\$ —</u>	<u>\$ 1,920,919</u>	<u>\$ 58,785</u>
<i>With an allowance recorded:</i>					
Commercial	\$ —	\$ —	\$ —	\$ 865,285	\$ —
Residential	5,145,712	4,655,517	732,712	6,209,540	—
Land	—	—	—	—	—
	<u>\$ 5,145,712</u>	<u>\$ 4,655,517</u>	<u>\$ 732,712</u>	<u>\$ 7,074,825</u>	<u>\$ —</u>
<i>Total:</i>					
Commercial	\$ —	\$ —	\$ —	\$ 2,550,162	\$ 38,187
Residential	5,374,061	4,883,866	732,712	6,445,582	20,598
Land	—	—	—	—	—
	<u>\$ 5,374,061</u>	<u>\$ 4,883,866</u>	<u>\$ 732,712</u>	<u>\$ 8,995,744</u>	<u>\$ 58,785</u>

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

	<b>Year Ended December 31, 2015</b>	
	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
<i>With no related allowance recorded:</i>		
Commercial	\$ 2,300,846	\$ 639,935
Residential	8,217,114	192,491
Land	310,011	216,904
	\$ 10,827,971	\$ 1,049,330
<i>With an allowance recorded:</i>		
Commercial	\$ 1,119,594	\$ 49,442
Residential	—	—
Land	—	—
	\$ 1,119,594	\$ 49,442
<i>Total:</i>		
Commercial	\$ 3,420,440	\$ 689,377
Residential	8,217,114	192,491
Land	310,011	216,904
	\$ 11,947,565	\$ 1,098,772

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. The average recorded investment and interest income recognized on impaired loans for which no related allowance was recorded presented in the above tables are disclosed as such, even if these impaired loans may have had an allowance recorded at some point during the year. In addition, the calculations of average recorded investment and interest income recognized in the above tables include loans that had been outstanding for some period of time during the year, but for which there was no recorded investment at the end of the year.

***Troubled Debt Restructurings***

The Company had recorded specific loan loss allowances of approximately \$187,000 and \$733,000 on loans totaling \$2,739,000 and \$5,374,000 (recorded investments before allowance) to borrowers whose loan terms had been modified in troubled debt restructurings as of December 31, 2017 and 2016, respectively. The Company has not committed to lend additional amounts to any of these borrowers, other than discussed below.

During the year ended December 31, 2017, the terms of one impaired loan with a principal balance of \$1,145,000 were modified as a troubled debt restructuring. The maturity date was extended by one year and the Company agreed to advance another \$165,000 (of which \$68,000 was advanced at the time of modification) to the borrower to cover past due and future interest payments. All other terms of the loan remained the same. The loan and related collateral were analyzed and it was determined that no specific loan loss allowance was required as of December 31, 2017.



## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

There were no loans modified as troubled debt restructurings during the years ended December 31, 2016 and 2015.

The following table shows information related to the loan modification made by the Company during the year ended December 31, 2017 that constituted a troubled debt restructuring:

	<b>Modifications</b>		
	<b>During the Year Ended December 31, 2017</b>		
	<b>Number of</b>	<b>Pre-Modification</b>	<b>Post-Modification</b>
	<b>Contracts</b>	<b>Outstanding</b>	<b>Outstanding</b>
		<b>Recorded Investment</b>	<b>Recorded Investment</b>
<b><i>Troubled Debt Restructurings That Occurred During the Year</i></b>			
Commercial	1	\$ 1,173,625	\$ 1,212,851

There were no loans modified as troubled debt restructurings during the previous twelve months that defaulted during the years ended December 31, 2017, 2016 and 2015. Generally, the Company considers a loan as having defaulted if its payments are delinquent 90 days or more.

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

During 2008, the Company entered into an 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. 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, which are wholly owned by 1850. The Company and Nanook are the Members of 1850 and NV Manager, LLC is the Manager.

During the years ended December 31, 2017, 2016 and 2015, the Company received capital distributions from 1850 in the total amount of \$185,000, \$180,000 and \$177,000, respectively. The net income to the Company from its investment in 1850 De La Cruz was approximately \$185,000, \$179,000 and \$175,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

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

Real estate properties held for sale as of December 31, 2017 and 2016 consisted of properties acquired through foreclosure classified by property type as follows:

	<u>December,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
Residential	\$ 24,627,710	\$ —
Land (including land under development)	14,389,620	73,140,659
Retail	7,632,893	—
Golf course	1,999,449	1,970,437
Marina	2,207,675	—
Assisted care	5,253,125	—
Office	—	732,539
	<u>\$ 56,110,472</u>	<u>\$ 75,843,635</u>

Note: The ZRV mixed-use residential/retail project was completed during 2017. Thus, the related book value included in Land as of December 31, 2016 was transferred to the Residential and Retail categories as of December 31, 2017 in the table above.

#### ***Transfers***

During the year ended December 31, 2017, the Company transferred seven properties with carrying amounts totaling approximately \$13,423,000 (four land, two marina and one assisted care) from “Held for Investment” to “Held for Sale” as the properties were listed for sale and sales were expected within a one year period. In addition, during the year ended December 31, 2017, the Company transferred one land property of approximately \$1,915,000 from “Held for Sale” to “Held for Investment” as it was not expected to be sold within one year. Impairment losses totaling \$1,423,000 were recorded on four properties during 2017 (two marina, one land and one assisted care) as a result of the transfers or subsequent to the transfers.

During the year ended December 31, 2016, the Company transferred four properties with carrying amounts totaling approximately \$10,052,000 (one land, one office unit, one golf course and one condominium) from “Held for Investment” to “Held for Sale” as the properties were listed for sale and sales were expected within a one year period.

During the year ended December 31, 2015, the Company transferred one property (golf course) with a carrying amount of approximately \$1,954,000 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. In addition, during the year ended December 31, 2015, the Company transferred seven properties (two industrial, two residential, one land, one storage and one marina) with carrying amounts totaling approximately \$64,628,000 from “Held for investment” to “Held for sale” as the properties were listed for sale and sales were expected within the next year.

No losses were recorded as a result of transfers between “Held for sale” and “Held for investment” categories for the years ended December 31, 2017, 2016 and 2015, however, an impairment loss of \$146,000 was recorded on the land property mentioned above prior to its transfer from “Held for sale” to “Held for investment”.

#### ***Impairment Losses***

During the year ended December 31, 2017, the Company recorded impairment losses totaling \$1,423,000 on the marina located in Bethel Island, California (\$495,000), the marina located in Isleton, California (\$315,000), the undeveloped land located in San Jose, California (\$146,000) and the assisted

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

care property located in Bensalem, Pennsylvania (\$467,000) due to new appraisals obtained, reductions in the fair market value estimated by management and/or related to agreements signed by the Company to sell the properties at prices that were lower than the book values of the properties. See “Sales” below.

During the year ended December 31, 2016, the Company recorded impairment losses totaling \$3,228,000 on the unimproved residential and commercial land located in Gypsum, Colorado (\$2,110,000), the medical office condominium property located in Gilbert, Arizona (\$1,094,000) and the office condominium complex located in Oakdale, California (\$24,000) due to reductions in the fair market value estimated by management and/or related to agreements signed by the Company to sell the properties at prices that were lower than the book values of the properties. See “Sales” below.

During the year ended December 31, 2015, the Company recorded impairment losses totaling approximately \$1,589,000 on the unimproved residential and commercial land located in Gypsum, Colorado due to a new appraisal obtained as of December 31, 2015 and a decrease in the listing price of the property.

#### **Sales**

During the year ended December 31, 2017, the Company sold eight real estate properties (four land, one partial residential, two partial office and one marina) for aggregate net sales proceeds of approximately \$55,879,000 and carryback notes totaling \$450,000, resulting in net gain on sales of real estate totaling approximately \$14,729,000. All but one of the gains from 2017 sales were accounted for using the full accrual method. One sale resulted in the recording of deferred gain of approximately \$93,000.

During the year ended December 31, 2016, the Company sold seven real estate properties (two office, one industrial, two residential and two land) for aggregate net sales proceeds of approximately \$89,402,000 and a carryback note in the amount of \$1,595,000, resulting in net gain on sales of real estate totaling approximately \$24,498,000 (\$20,782,000 to the Company after \$3,716,000 gain attributable to non-controlling interest). All of the gains from 2016 sales were accounted for using the full accrual method.

During the year ended December 31, 2015, the Company sold eight real estate properties (three retail, one residential, one storage, one industrial, one land and one marina) for aggregate net sales proceeds of approximately \$48,602,000 and a carryback note in the amount of \$4,650,000, resulting in gain on sales of real estate totaling approximately \$21,666,000 (\$19,187,000 to the Company after \$2,479,000 gain attributable to non-controlling interest). All of the gains from 2015 sales were accounted for using the full accrual method. In addition, the Company recognized gain of approximately \$153,000 during the year ended December 31, 2015 that had previously been deferred related to the sale of a real estate property in 2012. The gain on the sale of that property was being accounted for under the installment method.

#### **Foreclosures**

There were no foreclosures during the years ended December 31, 2017 and 2015.

During the year ended December 31, 2016, the Company foreclosed on one loan secured by an office property located in Oakdale, California with a principal balance of approximately \$1,079,000 and obtained the property via the trustee’s sale. In addition, accrued interest and advances made on the loan (for items such as legal fees and delinquent property taxes) in the total amount of approximately \$70,000 were capitalized to the basis of the property. It was determined that the fair value of the property was lower than the Company’s investment in the loan and a specific loan allowance was previously established of approximately \$495,000. This amount was then recorded as a charge-off against the allowance for loan losses at the time of foreclosure, after a reduction of the previously established allowance in the amount of approximately \$47,000 as a result of an updated appraisal obtained (net charge-off of \$448,000). The property, along with a unit in the building purchased by the Company in 2015, was contributed into a new taxable REIT subsidiary, East G, LLC, in June 2016. The property was sold during 2017.

**OWENS REALTY MORTGAGE, INC.**

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

Real estate held for investment as of December 31, 2017 and 2016 consisted of properties acquired through foreclosure classified by property type as follows:

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
Retail	\$ 16,623,238	\$ 16,829,995
Land	2,018,068	4,234,806
Residential	2,356,995	2,405,439
Assisted care	—	5,820,709
Office	3,357,352	3,962,869
Marina	—	4,025,945
	<u>\$ 24,355,653</u>	<u>\$ 37,279,763</u>

The balances of land and the major classes of depreciable property for real estate held for investment as of December 31, 2017 and 2016 are as follows:

	<u>December 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
Land and land improvements	\$ 5,112,063	\$ 11,520,339
Buildings and improvements	<u>22,560,343</u>	<u>28,910,851</u>
	27,672,406	40,431,190
Less: Accumulated depreciation and amortization	<u>(3,316,753)</u>	<u>(3,151,427)</u>
	<u>\$ 24,355,653</u>	<u>\$ 37,279,763</u>

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

Depreciation expense was approximately \$1,080,000, \$1,186,000 and \$1,971,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

***Foreclosures***

There was no real estate held for investment acquired through foreclosure during the years ended December 31, 2017, 2016 and 2015.

**NOTE 7 – LINE OF CREDIT PAYABLE**

The Company borrows funds under the California Bank & Trust ("CB&T") Line of Credit and, until its termination in 2016, a line of credit that was in place with Opus Bank ("Opus"). As of December 31, 2017 and 2016, the outstanding balances and total commitments under the CB&T Line of Credit consisted of the following:

	<u>December 31, 2017</u>		<u>December 31, 2016</u>	
	<u>Outstanding Balance</u>	<u>Total Commitment</u>	<u>Outstanding Balance</u>	<u>Total Commitment</u>
CB&T Line of Credit	\$ <u>1,555,000</u>	\$ <u>27,259,000</u>	\$ <u>4,976,000</u>	\$ <u>22,625,000</u>

***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"). The agreements were

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### Notes to Consolidated Financial Statements

amended and restated in April 2015, March 2016 and June 2017 to add First Bank and Umpqua Bank as additional lenders and to increase the maximum borrowings available (total commitment) under the facility to the lesser of a \$75,000,000 maximum or the amount determined pursuant to a borrowing base calculation described in the Advance Formula Agreement (the “Total Current Commitment”). Borrowings under the CB&T Credit Facility now mature on June 1, 2018, and advances can be made up to that date, pursuant to the parties’ agreement to extend the maturity date entered effective February 28, 2018 (see Note 16). The Company is required to keep \$3,500,000 in a non-interest bearing account with CB&T that is reported as restricted cash in the accompanying consolidated balance sheets.

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 (4.75% at December 31, 2017). Upon a default such interest rate increases by 2.00%. The original 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 were being amortized to interest expense using the straight-line method through the maturity date of the CB&T Credit Facility (fully amortized as of December 31, 2017). The First Amendment required the payment of an origination fee and other costs totaling \$255,000 that were capitalized to deferred financing costs and were being amortized to interest expense using the straight-line method through the new maturity date. The Company is also subject to certain ongoing administrative fees and expenses.

Interest expense on the CB&T Credit Facility was approximately \$312,000, \$881,000 and \$431,000 during the years ended December 31, 2017, 2016 and 2015, respectively (including \$158,000, \$131,000 and \$126,000, respectively, in amortization of deferred financing costs).

Borrowings under the CB&T Credit Facility are secured by certain assets of the Company. These collateral assets 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 specified 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 December 31, 2017, the carrying amount and classification of loans securing the CB&T Credit Facility were as follows:

	<b>December 31,</b>
<b>Loans:</b>	<b>2017</b>
Commercial	\$ 40,829,143
Residential	1,653,107
Total	<u>\$ 42,482,250</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 December 31, 2017.

#### ***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 Company repaid the Opus Credit Facility in full in September 2016 and the facility has terminated.

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 were being amortized to interest expense using the straight-line method through the maturity date. The Company was also subject to certain ongoing administrative fees and expenses. Interest expense on the Opus Credit Facility was approximately \$364,000 and \$126,000 during the years ended December 31, 2016 and 2015, respectively

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(including \$103,000 and \$77,000, respectively, in amortization of deferred financing costs). The amount of unamortized deferred financing costs expensed immediately on termination of the Opus Credit Facility was approximately \$45,000 during the year ended December 31, 2016.

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

The Company had the following notes and loans payable outstanding as of December 31, 2017 and 2016:

	<u>December 31,</u> <u>2017</u>	<u>Interest</u> <u>Rate</u>	<u>December 31,</u> <u>2016</u>	<u>Interest</u> <u>Rate</u>	<u>Payment</u> <u>Terms/Frequency</u>	<u>Maturity Date</u>
Tahoe Stateline Venture, LLC Loan Payable	\$ 13,242,514	4.22%	\$ 13,634,889	3.47%	Amortizing Monthly	January 2021
Zalanta Construction Loan Payable	<u>17,176,288</u>	6.00%	<u>20,213,560</u>	5.25%	Interest Monthly Principal Quarterly	August 2018
Principal amount	\$ 30,418,802		\$ 33,848,449			
Less unamortized deferred financing costs	<u>(226,369)</u>		<u>(462,515)</u>			
Notes and loans payable, net	<u>\$ 30,192,433</u>		<u>\$ 33,385,934</u>			

The following table shows maturities by year on these notes and loans payable as of December 31, 2017:

Years ending December 31:	
2018	\$ 17,546,247
2019	387,135
2020	403,792
2021	12,081,628
2022	—
Thereafter	—
	<u>\$ 30,418,802</u>

***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”), and on January 1, 2018 the Long Term Adjustable Rate was 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 (4.22%). 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

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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 years ended December 31, 2017, 2016 and 2015, approximately \$502,000, \$515,000 and \$427,000, respectively, of interest expense was incurred (including approximately \$36,000, \$36,000 and \$36,000, respectively, of deferred financing costs amortized to interest expense).

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 December 31, 2017.

#### *Zalanta Construction Loan Payable*

In August 2016, Zalanta Resort at the Village, LLC (“ZRV”) and Zalanta Resort at the Village - Phase II, LLC (“ZRV II” and, together with ZRV, the “Borrowers”) entered into a Construction Loan Agreement (the “Loan Agreement”) and related documents with Western Alliance Bank as the lender (“Lender”) providing the Borrowers with a loan (the “ZRV Loan”) of up to \$31,000,000, subject to the terms and conditions of the ZRV Loan documents, for the purpose of financing the construction of a new mixed-use retail and residential condominium building (the “Project”) on land (the “Premises”) owned by ZRV in South Lake Tahoe.

Borrowings under the ZRV Loan documents are only for payment or reimbursement of approved Project costs and such borrowings are subject to customary conditions for loans of this type. The borrowings under the ZRV Loan may not exceed the lesser of (i) 60% of the value of the Project, determined on an “as is” basis; or (ii) 65% of the Borrowers’ total costs of the Project, to be calculated in accordance with the Loan Agreement. All outstanding borrowings under the ZRV Loan will bear interest at the Wall Street Journal Prime Rate plus 1.50% (calculated on a floating daily basis) (the “Note Rate”), but in no event will the Note Rate be lower than the floor rate of five percent (5.0%) per annum. The Note Rate as of December 31, 2017 was 6.00%. Upon a default under the Loan Agreement, the Note Rate increases by an additional five percent (5.0%) per annum.

Interest only payments are payable monthly from an established interest reserve. In addition, commencing on August 18, 2017 and continuing on the last day of each quarter thereafter during the term of the ZRV Loan, Borrowers are required to make a quarterly repayment of \$6 million of principal (the “Curtailed Requirement”). Any repayments in excess of \$6 million during one quarter can be applied to the Curtailed Requirement in the succeeding quarter(s). The balance of the ZRV Loan is due on August 3, 2018.

Borrowings are secured by: (i) a first mortgage lien on the Premises and certain additional property (the “Additional Premises”) held by ZRV II and all improvements, amenities and appurtenances to the Premises and the Additional Premises, (ii) an assignment of all personal property, sales contracts, rents, leases, and ground leases associated with the Premises, and (iii) all design, development, service, management, leasing and construction contracts associated with the Premises. In addition, ZRV established a deposit account with Lender of \$3,000,000 to be held as additional collateral for the ZRV Loan that was reported as restricted cash in the accompanying consolidated balance sheets. The deposit was released during 2017 and the \$3,000,000 applied as a repayment of the loan payable.

The ZRV Loan documents contain provisions that allow for the sale of individual condominiums in the Project during the term of the ZRV Loan, and the removal of those units from the collateral base, in exchange for payment of proceeds of the sales to Lender. Any such payment of sales proceeds to Lender will be applied to reduce the principal balance of the ZRV Loan and will reduce the quarterly Curtailed

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Requirement. Principal payments totaling approximately \$13,580,000 were made during the year ended December 31, 2017 from the sale of seven condominium units and from the released deposit account.

The Loan Agreement required the payment of an origination fee of \$310,000 and other issuance costs totaling approximately \$400,000. The majority of these costs were paid out of the loan proceeds and capitalized to deferred financing costs and are being amortized to the Project using the straight-line method through the maturity date. During the years ended December 31, 2017 and 2016, approximately \$76,000 and \$83,000, respectively, of deferred financing costs was amortized to the Project. During the years ended December 31, 2017 and 2016, approximately \$472,000 and \$272,000, respectively, of interest was incurred which was capitalized to the Project. During the year ended December 31, 2017, approximately \$774,000 of interest was expensed (including approximately \$124,000 of deferred financing costs amortized to interest expense).

The ZRV 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 December 31, 2017.

#### **NOTE 9 – STOCKHOLDERS’ EQUITY**

##### *Dividends*

The following table presents the tax treatment for dividends paid by the Company on its Common Stock for the years ended December 31, 2017, 2016 and 2015:

Year	Total Dividends Paid(4)	Dividends Paid Per Share	Dividends Classified as Ordinary Income			Capital Gain Distribution		Dividends Classified as Return of Capital		
			Percent	Dividends Paid Per Share	Qualified Dividend Income(5)	Percent	Dividend Paid Per Share	Percent	Dividends Paid Per Share	
<b>Common Stock:</b>										
2017 (1)	\$ 3,789,108	\$ 0.380	87.67%	\$ 0.333	—	12.33%	\$ 0.047	—%	\$ 0.000	
2016 (2)	\$ 3,279,193	\$ 0.320	15.05%	\$ 0.048	—	84.95%	\$ 0.272	—%	\$ 0.000	
2015 (3)	\$ 4,347,331	\$ 0.410	100.00%	\$ 0.410	—	—%	\$ —	—%	\$ 0.000	

1) Dividends declared and paid in 2017 per above do not include \$640,267 which represented capital gains tax on 2017 undistributed capital gains paid on behalf of shareholders to the U.S. Treasury in January 2018 (and recorded as dividends paid and payable in the consolidated financial statements).

(2) Dividends declared and paid in 2016 per above do not include \$582,698 which represented capital gains tax on 2016 undistributed capital gains paid on behalf of shareholders to the U.S. Treasury in January 2017 (and recorded as dividends paid and payable in the consolidated financial statements).

(3) Dividends declared and paid in 2015 per above do not include \$1,313,657 which represented capital gains tax on 2015 undistributed capital gains paid on behalf of shareholders to the U.S. Treasury in January 2016 (and recorded as dividends paid and payable in the consolidated financial statements) and exclude the \$1,292,160 dividend discussed in (3) below.

(4) Includes \$14,438 and \$2,914 for 2017 and 2015, respectively, of dividends on shares repurchased under the stock repurchase plans discussed below that were in transit with respect to the deposit/withdrawal at custodian process and therefore not yet held as treasury shares on the record date of the dividends. When such funds were subsequently received by the Company they were posted to retained earnings such that dividends reflected on the consolidated statement of stockholders’ equity are net of these amounts.

(5) Qualified dividend income is eligible for reduced dividend rates.

##### *Stock Repurchases and Repurchase Programs*

On May 27, 2015, the Board of Directors authorized a Rule 10b5-1 stock repurchase plan (the “2015 Repurchase Plan”) which authorized the Company to purchase up to \$7.5 million of its Common Stock subject to certain price, volume and timing constraints specified in the brokerage agreement. During the



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year ended December 31, 2015, the Company repurchased 520,524 shares of its Common Stock under this plan for a total cost of approximately \$7,503,000 (including commissions) and an average cost of \$14.41 per share and the repurchased shares were returned to the status of authorized but unissued shares of Common Stock. The authorized funding for the 2015 Repurchase Plan was exhausted in 2015.

On December 11, 2015, the Board of Directors authorized a new Rule 10b5-1 stock repurchase plan (the "2016 Repurchase Plan") which authorized the Company to purchase up to \$7.5 million of its Common Stock, subject to certain price, volume and timing constraints specified in the brokerage agreement. No shares were repurchased under the 2016 Repurchase Plan and it expired on March 31, 2017.

On June 9, 2017, the Board of Directors authorized a Rule 10b5-1 stock repurchase plan (the "2017 Repurchase Plan") which authorized the Company to purchase up to \$10 million of its Common Stock. Under the 2017 Repurchase Plan, repurchases were to be funded from available working capital, and the repurchased shares return to the status of authorized but unissued shares of Common Stock. The 2017 Repurchase Plan provided for stock repurchases to commence on July 13, 2017 and was subject to certain price, volume and timing constraints specified in the brokerage agreement. During the year ended December 31, 2017, the Company repurchased 341,086 shares of its Common Stock under the 2017 Repurchase Plan for a total cost of approximately \$5,820,000 (including commissions) and an average cost of \$17.06 per share and repurchased another 4,000 shares in January 2018 (subsequent to year end) for a total cost of approximately \$65,000 (including commissions) and an average cost of \$16.18 per share. The 2017 Repurchase Plan was terminated effective December 29, 2017.

On December 29, 2017, the Company entered into a settlement agreement (the "Settlement Agreement") with Freestone Capital Management, LLC and certain of its affiliates (collectively, "Freestone"), pursuant to which the Company purchased the 669,058 shares of Common Stock held by Freestone (the "Freestone Shares") in December 2017 and another 141,879 in January 2018 (for a total of 810,937 shares) in a privately negotiated transaction for \$19.25 per share, resulting in an aggregate purchase price of approximately \$15.6 million. Approximately \$4.1 million of the purchase price paid for the Freestone Shares was made with the remaining balance of the Company's 2017 Repurchase Plan following its termination. Pursuant to the terms of the Settlement Agreement, for a period of five years following the date of the Settlement Agreement, Freestone agreed to customary standstill restrictions relating to share purchases, support of proxy contests and other activist campaigns, calling of special meetings, and related matters. For a period of two years following the date of the Settlement Agreement, the Company and Freestone also agreed to abide by customary covenants not to sue and non-disparagement provisions. In addition, the Company and Freestone each released the other from all claims that the releasing party has, had or may have against the released party that relate to the investment by Freestone in the Company. The Company recorded as treasury stock the purchase of 810,937 Freestone Shares at the December 29, 2017 market price of \$16.01 per share (approximately \$12,983,000 total) and recorded as settlement expense the premium paid over the market price for those shares of \$3.24 per share (approximately \$2,627,000 total) in the accompanying consolidated financial statements. The purchase of 141,879 of the Freestone Shares settled in January 2018, and the Company recorded a forward contract liability for those repurchased shares of \$2,731,000 as of December 31, 2017.

#### **NOTE 10 – CONTINGENCY RESERVES**

In accordance with its charter, the Company is required to maintain cash, cash equivalents and marketable securities as contingency reserves in an aggregate amount of 1.50% 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 December 31, 2017 and 2016 were approximately \$3,464,000 and \$3,738,000 and are reported as restricted cash and/or cash and cash

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equivalents in the accompanying consolidated balance sheets.

#### **NOTE 11 - INCOME TAXES**

The Company operates in such a manner as to qualify as a REIT, under the provisions of the Internal Revenue Code of 1986, as amended (the "Code"); therefore, applicable REIT taxable income is included in the taxable income of its shareholders, to the extent distributed by the Company. To maintain REIT status for federal income tax purposes, the Company is generally required to distribute at least 90% of its REIT taxable income to its shareholders as well as comply, generally, with certain other qualification requirements as defined under the Code. As a REIT, the Company is not subject to federal corporate income tax to the extent that it distributes 100% of its REIT taxable income each year. During 2017, 2016 and 2015, the Company distributed at or in excess of 100% of its REIT taxable income to its stockholders. During 2017, 2016 and 2015, the Company had net capital gains from the sales of real estate properties totaling approximately \$2,297,000, \$4,451,000 and \$3,753,000, respectively. Management decided to retain all or a portion of capital gains in 2017, 2016 and 2015 within the Company and not distribute them as is permitted for REITs. However, the retention of capital gains required the Company to make a payment to the U.S. Treasury Department on behalf of shareholders at the highest corporate tax rate (35%) in the total amount of approximately \$640,000, \$583,000 and \$1,314,000 in January 2018, 2017 and 2016, respectively. This tax payment was accrued as dividends payable in the Company's financial statements as of December 31, 2017, 2016 and 2015. Shareholders' pro-rata portion of the amount paid is to be reflected as tax payments on the individual shareholders' tax returns.

Taxable income from non-REIT activities managed through the Company's taxable REIT subsidiaries ("TRS") (Lone Star Golf, Inc., Zalanta Resort at the Village, LLC and East G, LLC) is subject to federal, state and local income taxes. The Company did not record a provision for current income taxes related to Lone Star for the years ended December 31, 2017, 2016 and 2015 as it was in a net loss position. In addition, deferred taxes related to temporary differences in book and taxable income as well as net operating losses ("NOLs") of Lone Star would likely not be realizable due to Lone Star's loss history (full amount of deferred tax assets offset by a valuation allowance). The NOLs totaled approximately \$785,000 for Federal and California as of December 31, 2017 and expire between 2033 and 2037.

During 2016, the Company established a new entity, East G, LLC ("East G") and contributed an office property that was obtained via foreclosure of a loan in 2016 into this new entity along with a unit in the same building that had been purchased in 2015. The Company then converted East G into a TRS. No taxes have been recorded. Deferred taxes related to temporary differences in book and taxable income were not significant and tax loss carryforwards are not significant and the deferred taxes will not be realized. The Company sold the East G property during 2017 and dissolved the LLC.

During 2016, the Company converted ZRV into a TRS and contributed two additional real estate assets into ZRV. These properties included 75 improved, residential lots previously held within Baldwin Ranch Subdivision, LLC and a medical office condominium complex previously held within AMFU, LLC. The conversion of ZRV into a TRS and contribution of the additional real estate assets resulted in the Company recording a deferred tax asset and income tax benefit in the amount of approximately \$7,249,000 primarily due to a \$15,450,000 aggregate remaining difference between the book and tax basis of the subject real estate assets as of December 31, 2016. During 2017, ZRV recorded income tax expense of \$4,041,655 that was primarily the result of an increase in the valuation allowance recorded against deferred tax assets as a result of higher construction costs and lower expected gains from the sales of ZRV assets in the future and due to a decrease in the Federal corporate tax rate from 34% to 21% in 2018 and beyond as a result of the Tax Cuts and Jobs Act signed into law by President Trump on December 22, 2017, which required ZRV to remeasure its net deferred tax asset at the lower rate.

During the year ended December 31, 2015, the Company had a \$267,000 taxable gain on sale of a real estate property. The gain was taxable because the subject property was designated as foreclosure property

## OWENS REALTY MORTGAGE, INC.

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pursuant to the related REIT taxation rules. As a result, the Company recorded income tax expense of approximately \$93,000 for the year ended December 31, 2015.

As of December 31, 2017 and 2016, the Company has not recorded a reserve for any uncertain income tax positions. There has been no interest or penalties incurred to date.

As of December 31, 2017, income tax returns for the calendar years ended 2013 through 2017 remain subject to examination by IRS and/or any state or local taxing jurisdiction. Additionally, certain state tax returns from the predecessor entity (OMIF) remain open for the short year ended May 19, 2013.

The components of the income tax expense (benefit) as it relates to the Company's taxable income (loss) from domestic TRSs during the years ended December 31, 2017 and 2016 were as follows:

	Year Ended December 31, 2017		
	Federal	State and Local	Total
Change in valuation allowance	\$ 2,602,441	\$ 418,020	\$ 3,020,461
Reduction in Federal corporate tax rate	1,358,272	—	1,358,272
Other	(293,814)	(43,264)	(337,078)
Income tax expense (benefit)	\$ 3,666,899	\$ 374,756	\$ 4,041,655

	Year Ended December 31, 2016		
	Federal	State and Local	Total
Deferred expense (benefit)	\$ (6,655,774)	\$ (1,387,947)	\$ (8,043,721)
Change in valuation allowance	794,744	—	794,744
Income tax expense (benefit)	\$ (5,861,030)	\$ (1,387,947)	\$ (7,248,977)

A reconciliation of the income tax provision (benefit) based upon the statutory tax rates to the effective rates of our taxable REIT subsidiaries is as follows for the year ended December 31, 2017 and 2016:

	Year Ended December 31, 2017	Year Ended December 31, 2016
Tax (benefit) expense at Federal statutory rate	\$ (149,766)	\$ (423,847)
State income tax expense (benefit), net of Federal effect	250,193	(916,045)
Real estate basis differences at TRS conversion	—	(6,753,272)
Other	(19,485)	49,443
Change in Federal valuation allowance	2,602,441	794,744
Reduction in Federal corporate tax rate	1,358,272	—
Income tax expense (benefit)	\$ 4,041,655	\$ (7,248,977)

Significant components of the Company's deferred tax assets (liabilities) for its TRS entities are as follows as of December 31, 2017 and 2016:

	December 31, 2017	December 31, 2016
<b>Deferred tax assets (liabilities):</b>		
Real estate basis differences	\$ 4,255,681	6,154,411
Net operating losses	1,380,138	1,889,310
Total deferred tax assets	5,635,819	8,043,721
Valuation allowance	(2,428,497)	(794,744)
Net deferred tax assets	\$ 3,207,322	7,248,977

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts for income tax purposes, as well as operating loss and tax credit carryforwards. The Company evaluates the realizability of its deferred tax assets and recognizes a valuation allowance if, based on the available evidence, both positive and negative, it is more likely than not that some portion or all of its deferred tax assets will not be realized. When evaluating the realizability of its deferred tax assets, the Company considers, among other matters, estimates of expected future taxable income, nature of current and cumulative losses and tax planning strategies available.

Management has estimated future taxable gains and losses on sale of ZRV real estate assets to determine how much of the deferred tax assets are realizable. This realizability analysis is inherently subjective and actual results could differ from these estimates. Based on an assessment of all factors, it was determined that a valuation allowance of \$2,428,000 and \$795,000 related to Federal and State NOLs and differences in the book and tax basis of assets in ZRV was required as of December 31, 2017 and 2016, respectively, as management does not expect that ZRV will generate enough taxable income in the future to realize all of the NOL and basis benefits. The Company's Federal and California NOLs within ZRV totaled \$6,245,000 and \$982,000, respectively, as of December 31, 2017. ZRV has Arizona NOLs of \$3,511,000 as of December 31, 2017; however, ZRV did not record a deferred tax asset related to the Arizona NOLs as it does not expect to file another Arizona tax return, and thus, the NOLs will not be used. All of the NOLs expire in 2036 and 2037.

#### **NOTE 12 - TRANSACTIONS WITH AFFILIATES**

OFG is entitled to receive from the Company a management fee of up to 2.75% per annum of the average unpaid balance of the Company's loans at the end of the twelve months in the calendar year for services rendered as Manager of the Company (the "Existing Management Fee").

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 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 Existing Management Fee 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 \$3,546,000, \$3,286,000 and \$2,051,000 for the years ended December 31, 2017, 2016 and 2015, respectively, and are included in the accompanying consolidated statements of income. Servicing fees amounted to approximately \$362,000, \$299,000 and \$186,000 for the years ended December 31, 2017, 2016 and 2015, respectively, and are included in the accompanying consolidated statements of income. As of December 31, 2017 and 2016, the Company owed management and servicing fees to OFG in the amount of approximately \$245,000 and \$324,000, respectively.

During the first six months of the year ended December 31, 2017 and for the years ended December 31, 2016 and 2015, OFG elected to take the maximum compensation that it is able to take pursuant to the Company's charter. However, in August 2017, the Manager agreed to take less than the maximum compensation and instead compute the management fee based on a percentage of stockholders' equity for periods beginning on July 1, 2017 and ending on the final day of the month in which the Company's next stockholders' meeting is held.

Pursuant to the charter, OFG receives all late payment charges from borrowers on loans owned by the Company, with the exception of those loans participated with outside entities. The amounts paid to or collected by OFG for such charges on Company loans totaled approximately \$83,000, \$83,000 and \$30,000 for the years ended December 31, 2017, 2016 and 2015, respectively. In addition, the Company remits

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

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). Such fees remitted to OFG totaled approximately \$23,000, \$20,000 and \$7,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

OFG originates all loans the Company invests in and receives loan origination fees from borrowers. Such fees earned by OFG amounted to approximately \$2,492,000, \$2,514,000 and \$1,956,000 on loans originated, rewritten or extended of approximately \$122,240,000, \$101,594,000 and \$80,448,000 for the years ended December 31, 2017, 2016 and 2015, respectively. Such fees as a percentage of loans originated, rewritten or extended by the Company were 2.0%, 2.5% and 2.4% for the years ended December 31, 2017, 2016 and 2015, respectively.

OFG is reimbursed by the Company for the actual cost of goods, services and materials used for or by the Company and obtained from unaffiliated entities 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). The amounts reimbursed to OFG by the Company were \$381,000, \$440,000 and \$590,000 during the years ended December 31, 2017, 2016 and 2015, respectively. As of December 31, 2016 and 2015, there was approximately \$32,000 and \$36,000, respectively, payable to OFG for reimbursable expenses and other fees owed. The Company also reimbursed certain of OFG's officers for allowed expenses in the total amount of \$2,000, \$0 and \$1,000 during the years ended December 31, 2017, 2016 and 2015, respectively.

The Company paid Investor's Yield, Inc. (a wholly owned subsidiary of OFG) approximately \$1,000, \$9,000 and \$10,000 in trustee's fees related to certain foreclosure proceedings and other miscellaneous fees on Company loans during the years ended December 31, 2017, 2016 and 2015, respectively.

During 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 13 - RENTAL INCOME**

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 ten 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 December 31, 2017, and thereafter is as follows:

Year ending December 31:	
2018	\$ 2,130,167
2019	1,606,224
2020	806,807
2021	760,279
2022	544,115
Thereafter (through 2027)	<u>1,096,713</u>
Total	<u>\$ 6,944,305</u>

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

#### **NOTE 14 - FAIR VALUE**

The Company measures 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. The Company's assessment of the significance of a particular input requires judgment and considers factors specific to the asset or liability being measured.

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 recurring and nonrecurring 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 an 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. Impairment is estimated by either the present value of expected cash flows discounted at the note rate or, as a practical expedient, the loan's 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, broker price opinions, comparable property sales 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 December 31, 2017 and 2016, 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

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

### **Notes to Consolidated Financial Statements**

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. When the fair value of the collateral is based on an observable market price or is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser using observable market data, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available, when an appraisal includes significant unobservable inputs and assumptions or when management determines an adjustment to the appraised value is necessary in order to reflect management's estimate of the fair value of the collateral, 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 properties held for sale 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. As fair value is generally based upon an appraisal that may include observable data, unobservable data, or a combination thereof, the Company records these assets as nonrecurring Level 2 or Level 3 based on the same factors discussed in the impaired loans section above.

There were no assets or liabilities measured at fair value on a recurring basis, nor were there any liabilities measured at fair value on a nonrecurring bases at December 31, 2017 and 2016.

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

The following table presents information about the Company's assets measured at fair value on a nonrecurring basis as of December 31, 2017 and 2016:

	<b>Fair Value Measurements Using</b>			
	<b>Carrying Value</b>	<b>Quoted Prices In Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
<b>2017</b>				
<u>Nonrecurring:</u>				
Impaired loans:				
Residential	\$ 1,115,999	\$ —	\$ —	\$ 1,115,999
Total	\$ 1,115,999	\$ —	\$ —	\$ 1,115,999
Real estate properties:				
Commercial	\$ 7,460,800	\$ —	\$ —	\$ 7,460,800
Land	1,914,870			1,914,870
Total	\$ 9,375,670	\$ —	\$ —	\$ 9,375,670
<b>2016</b>				
<u>Nonrecurring:</u>				
Impaired loans:				
Residential	\$ 4,413,000	\$ —	\$ —	\$ 4,413,000
Total	\$ 4,413,000	\$ —	\$ —	\$ 4,413,000
Real estate properties:				
Land	\$ 139,498	\$ —	\$ —	\$ 139,498
Commercial	732,539			732,539
Total	\$ 872,037	\$ —	\$ —	\$ 872,037

The provision for loan losses (net) based on the fair value of loan collateral less estimated selling costs for the impaired loans above totaled approximately \$0 and \$733,000 during the years ended December 31, 2017 and 2016, respectively. There were charge-offs against the loan loss allowance totaling \$546,000 during 2017 for the impaired loan above. Impairment losses of approximately \$1,423,000 and \$3,228,000 were recorded on real estate properties during the years ended December 31, 2017 and 2016, respectively. The impairment losses recorded for the years ended December 31, 2017 and 2016 included \$145,000 and \$2,110,000, respectively, in the Land class and \$1,278,000 and \$1,118,000, respectively, in the Commercial class.

During the years ended December 31, 2017 and 2016, there were no transfers into or out of Levels 1 and 2.



**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

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 December 31, 2017 and 2016:

December 31, 2017:

<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>					
Residential	\$ 1,115,999	Comparable Sales	Comparable Sales Adjustment	(4.6)% to 4.2%	N/A
<b>Real Estate Properties:</b>					
Commercial	\$ 7,460,800	Appraisal	Comparable Sales Adjustment	(23.7)% to (11.6)%	(13.5)%
Land	1,914,870	Appraisal	Comparable Sales Adjustment Estimate of Future Improvements	(50.8)% to 21.9% 32.5%	N/A N/A

December 31, 2016:

<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>					
Residential	\$ 4,413,000	Comparable Sales	Comparable Sales Adjustment	(4.6)% to 4.2%	N/A
<b>Real Estate Properties:</b>					
Land	\$ 139,498	Appraisal	Comparable Sales Adjustment	(33.7)%	N/A
Commercial	732,539	Appraisal	Comparable Sales Adjustment Capitalization Rate	(5.0)% to 5.0% 7.3%	N/A 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 were multiple impaired loans or real estate properties within that class measured at fair value on a nonrecurring basis.

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

The approximate carrying amounts and estimated fair values of financial instruments at December 31, 2017 and 2016 are as follows:

		<b>Fair Value Measurements at December 31, 2017</b>				
		<b>Carrying Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Financial assets						
Cash and cash equivalents	\$	2,171,000	\$ 2,171,000	\$ —	\$ —	\$ 2,171,000
Restricted cash		3,500,000	3,500,000	—	—	3,500,000
Loans, net		144,344,000	—	—	144,255,000	144,255,000
Investment in limited liability company		2,141,000	—	—	4,819,000	4,819,000
Accrued interest and advances receivable		1,459,000	—	—	1,459,000	1,459,000
Financial liabilities						
Accrued interest payable	\$	115,000	—	77,000	38,000	\$ 115,000
Lines of credit payable		1,555,000	—	1,555,000	—	1,555,000
Notes payable		30,419,000	—	17,176,000	13,233,000	30,409,000

		<b>Fair Value Measurements at December 31, 2016</b>				
		<b>Carrying Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Financial assets						
Cash and cash equivalents	\$	434,000	\$ 434,000	\$ —	\$ —	\$ 434,000
Restricted cash		6,500,000	6,500,000	—	—	6,500,000
Loans, net		126,975,000	—	—	126,652,000	126,652,000
Investment in limited liability company		2,140,000	—	—	2,650,000	2,650,000
Accrued interest and advances receivable		1,328,000	—	—	1,328,000	1,328,000
Financial liabilities						
Accrued interest payable	\$	137,000	—	97,000	40,000	\$ 137,000
Lines of credit payable		4,976,000	—	4,976,000	—	4,976,000
Notes payable		33,386,000	—	20,213,000	13,499,000	33,712,000

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 values of cash and cash equivalents and restricted cash approximate the fair values because of the relatively short maturity and/or liquid nature of these instruments and are classified as Level 1.

**Loans, net:** Except as it relates to impaired loans measured at fair value on a nonrecurring basis discussed previously, the fair value of loans is estimated using discounted cash flow methodology, using

## OWENS REALTY MORTGAGE, INC.

### Notes to Consolidated Financial Statements

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 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 and is classified as Level 3 because the appraisal itself and/or adjustments thereto include unobservable data similar to the unobservable data discussed in the disclosures related to assets measured at fair value on a nonrecurring basis.

**Lines of credit payable:** The fair value of the Company's lines of credit payable is estimated based upon a discounted cash flow model using 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 is 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 a discounted cash flow model using 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 notes and loans payable with maturities of one year or less or that have been entered into in relatively close proximity to the balance sheet date and Level 3 inputs are used for other notes and loans payable. Accrued interest payable associated with the notes and loans payable is also classified as either Level 2 or Level 3.

#### **NOTE 15 - COMMITMENTS AND CONTINGENCIES**

##### **Contractual Obligations**

As of December 31, 2017, the Company has commitments to advance additional funds to borrowers of construction, rehabilitation and other loans in the total amount of approximately \$30,495,000 (including approximately \$3,883,000 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.

#### **NOTE 16 – SUBSEQUENT EVENTS**

As described above in Note 9, the Company purchased, pursuant to the Settlement Agreement between the Company and Freestone, 141,879 of the Freestone Shares in January 2018 at a total cost of approximately \$2,731,000 (\$2,271,000 treasury stock and \$460,000 settlement expense). This amount was recorded as forward contract liability for shares repurchased in the accompanying consolidated balance sheets as of December 31, 2017.

The Company sold three condominium units at ZRV in January and February 2018 for net sales proceeds totaling approximately \$3,725,000 (all proceeds used to repay the construction loan) and gains totaling approximately \$539,000.

Effective February 28, 2018, the Company entered into First Note Revision Agreements with CB&T, First Bank and Umpqua Bank to extend the maturity date of the CB&T Credit Facility from March 1, 2018

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

to June 1, 2018, and to permit advances under the facility until that date. All other terms and conditions in the Credit Agreement and related agreements remained the same.

On March 12, 2018, the Board approved a quarterly dividend of \$0.16 per share of Common Stock for the quarter ending March 31, 2018. The dividend will be paid on April 13, 2018 to stockholders of record at the close of business on March 31, 2018.

**NOTE 17 – SUMMARY QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (UNAUDITED)**

The following tables represent unaudited summarized quarterly financial data of the Company for the years ended December 31, 2017, 2016 and 2015 which, in the opinion of management, reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company's results of operations.

	<b>Three Months Ended</b>			
	<b>December 31, 2017</b>	<b>September 30, 2017</b>	<b>June 30, 2017</b>	<b>March 31, 2017</b>
Total revenues	\$ 3,850,940	\$ 4,277,493	\$ 3,867,290	3,537,405
Total expenses	<u>3,964,664</u>	<u>3,427,969</u>	<u>4,164,895</u>	<u>3,355,582</u>
Operating (loss) income	(113,724)	849,524	(297,605)	181,823
Gain (loss) on sale of real estate, net	268,891	582,496	13,877,715	(181)
Settlement expense	<u>(2,627,436)</u>	—	—	—
Net (loss) income before income taxes	(2,472,269)	1,432,020	13,580,110	181,642
Income tax (expense) benefit	<u>(1,951,828)</u>	<u>(1,275,700)</u>	<u>(824,163)</u>	<u>10,036</u>
Net (loss) income attributable to common stockholders	<u>\$ (4,424,097)</u>	<u>\$ 156,320</u>	<u>\$ 12,755,947</u>	<u>\$ 191,678</u>
(Loss) earnings per common share (basic and diluted)	<u>\$ (0.44)</u>	<u>\$ 0.02</u>	<u>\$ 1.24</u>	<u>\$ 0.02</u>
Weighted average number of common shares outstanding (basic and diluted)	<u>9,984,352</u>	<u>10,173,448</u>	<u>10,247,477</u>	<u>10,247,477</u>
Dividends declared per share of Common Stock	<u>\$ 0.10</u>	<u>\$ 0.10</u>	<u>\$ 0.10</u>	<u>\$ 0.08</u>

**OWENS REALTY MORTGAGE, INC.**

**Notes to Consolidated Financial Statements**

	<b>Three Months Ended</b>			
	<b>December 31, 2016</b>	<b>September 30, 2016</b>	<b>June 30, 2016</b>	<b>March 31, 2016</b>
Total revenues	\$ 3,667,283	\$ 4,493,977	\$ 4,692,114	4,225,617
Total expenses	<u>3,942,004</u>	<u>5,587,213</u>	<u>6,999,063</u>	<u>4,316,678</u>
Operating loss	(274,721)	(1,093,236)	(2,306,949)	(91,061)
(Loss) gain on sale of real estate, net	<u>(536,419)</u>	<u>20,195,367</u>	<u>—</u>	<u>4,838,815</u>
Net (loss) income before income taxes	(811,140)	19,102,131	(2,306,949)	4,747,754
Income tax (expense) benefit	<u>(380,706)</u>	<u>260,848</u>	<u>7,368,835</u>	<u>—</u>
Net (loss) income	(1,191,846)	19,362,979	5,061,886	4,747,754
Less: Net loss (income) attributable to non-controlling interests	<u>15,960</u>	<u>(3,630,318)</u>	<u>56,847</u>	<u>(13,492)</u>
Net (loss) income attributable to common stockholders	<u>\$ (1,175,886)</u>	<u>\$ 15,732,661</u>	<u>\$ 5,118,733</u>	<u>\$ 4,734,262</u>
(Loss) earnings per common share (basic and diluted)	<u>\$ (0.11)</u>	<u>\$ 1.54</u>	<u>\$ 0.50</u>	<u>\$ 0.46</u>
Weighted average number of common shares outstanding (basic and diluted)	<u>10,247,477</u>	<u>10,247,477</u>	<u>10,247,477</u>	<u>10,247,477</u>
Dividends declared per share of Common Stock	<u>\$ 0.08</u>	<u>\$ 0.08</u>	<u>\$ 0.08</u>	<u>\$ 0.08</u>

	<b>Three Months Ended</b>			
	<b>December 31, 2015</b>	<b>September 30, 2015</b>	<b>June 30, 2015</b>	<b>March 31, 2015</b>
Total revenues	\$ 4,432,455	\$ 4,414,217	\$ 5,987,048	6,409,831
Total expenses	<u>2,817,184</u>	<u>3,998,225</u>	<u>4,463,246</u>	<u>5,453,674</u>
Operating income	<u>1,615,271</u>	<u>415,992</u>	<u>1,523,802</u>	<u>956,157</u>
Gain on sale of real estate, net	6,787,254	—	14,825,858	205,441
Gain on foreclosure of loans	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income before income tax expense	8,402,525	415,992	16,349,660	1,161,598
Income tax expense	<u>93,335</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income	8,309,190	415,992	16,349,660	1,161,598
Less: Net income attributable to non-controlling interests	<u>(36,891)</u>	<u>(31,671)</u>	<u>(2,588,884)</u>	<u>(9,878)</u>
Net income attributable to common stockholders	<u>\$ 8,272,299</u>	<u>\$ 384,321</u>	<u>\$ 13,760,776</u>	<u>\$ 1,151,720</u>
Earnings per common share (basic and diluted)	<u>\$ 0.80</u>	<u>\$ 0.04</u>	<u>\$ 1.28</u>	<u>\$ 0.11</u>
Weighted average number of common shares outstanding (basic and diluted)	<u>10,310,149</u>	<u>10,538,735</u>	<u>10,768,001</u>	<u>10,768,001</u>
Dividends declared per share of Common Stock	<u>\$ 0.08</u>	<u>\$ 0.08</u>	<u>\$ 0.18</u>	<u>\$ 0.07</u>

**OWENS REALTY MORTGAGE, INC.**  
**FINANCIAL STATEMENT SECHEDULE III - REAL ESTATE AND ACCUMULATED DEPRECIATION**  
**DECEMBER 31, 2017**

Description	Encumbrances	Initial Cost	Capitalized Costs	Sales	Impairment Write-downs	Accumulated Depreciation	Carrying Value	Date Acquired	Depreciable Lives
Retail Complex (TSV), South Lake Tahoe, California	\$13,242,514 Note Payable	6,409,617	12,292,082	\$ (41,667)	—	\$(2,036,794)	\$16,623,238	Various	5-39 Years
Retail Complex and 23 Residential Condominium Units (ZRV), South Lake Tahoe, California	\$17,176,288 Construction Loan Payable	5,016,443	36,825,438	(9,581,278)	—	—	Note 4 32,260,603	Various	N/A
Residential Land (ZRV II), South Lake Tahoe, California	None	2,032,963	4,528,060	—	—	—	Note 4 6,561,023	Various	N/A
Assisted Living Facility, Bensalem, Pennsylvania	None	4,454,867	1,265,436	—	(467,178)	—	Note 5 5,253,125	12/12/2014	N/A
Office Condominium Complex (13 units), Roseville, California	None	8,569,286	321,923	(1,632,971)	(3,712,707)	(680,529)	Note 6 2,865,002	9/26/2008	2-39 Years
73 Residential Lots, Auburn, California	None	13,746,625	376,746	(96,678)	(9,904,826)	—	Note 7 4,121,867	9/27/2007	N/A
12 Condominium & 3 Commercial Units, Tacoma, Washington	None	2,486,400	84,909	—	—	(307,961)	2,263,348	7/8/2011	27.5-39 Years
Marina & Boat Club with 179 Boat Slips, Isleton, California	None	1,809,663	713,318	—	(315,306)	—	Note 8 2,207,675	1/29/2013	N/A
Undeveloped, Industrial Land, San Jose, California	None	3,025,992	102,046	—	(1,213,168)	—	Note 9 1,914,870	12/27/2002	N/A
Golf Course, Auburn, California	None	1,796,254	203,195	—	—	—	Note 10 1,999,449	6/20/2009	N/A
Unimproved residential and commercial land, Bethel Island, California	None	2,336,640	3,460	(1,867)	—	—	2,338,233	3/11/2014	N/A
Miscellaneous Real Estate	None					(291,469)	2,057,692	Various	Various
<b>TOTALS</b>						<u>\$(3,316,753)</u>	<u>\$80,466,125</u>		

NOTE 1: All real estate listed above was acquired through foreclosure or deed in lieu of foreclosure other than certain parcels of the commercial and residential land under development located in South Lake Tahoe, California that were purchased in 2012 and 2014 and one office condominium unit purchased in 2015.

NOTE 2: Changes in real estate held for sale and investment were as follows:

Balance at beginning of period (1/1/15)	\$ 163,016,805
Additions during period:	
Acquisitions through foreclosure	—
Investments in real estate properties	25,274,125
Amortization of deferred financing costs capitalized to construction project	207,347
Subtotal	<u>188,498,277</u>

Deductions during period:	
Cost of real estate properties sold	31,099,086
Impairment losses on real estate properties	1,589,434
Depreciation of properties held for investment	1,971,345
Balance at end of period (12/31/15)	\$ <u>153,838,412</u>

Balance at beginning of period (1/1/16)	\$ 153,838,412
Additions during period:	
Acquisitions through foreclosure	700,800
Investments in real estate properties	29,061,735
Amortization of deferred financing costs capitalized to construction project	119,471
Subtotal	<u>183,720,418</u>
Deductions during period:	
Cost of real estate properties sold	66,183,589
Impairment losses on real estate properties	3,227,807
Depreciation of properties held for investment	1,185,624
Balance at end of period (12/31/16)	\$ <u>113,123,398</u>

Balance at beginning of period (1/1/17)	113,123,398
Additions during period:	
Acquisitions through foreclosure	—
Investments in real estate properties	11,274,904
Amortization of deferred financing costs capitalized to construction project	76,260
Subtotal	<u>124,474,562</u>
Deductions during period:	
Cost of real estate properties sold	41,505,148
Impairment losses on real estate properties	1,423,286
Depreciation of properties held for investment	1,080,003
Balance at end of period (12/31/17)	\$ <u>80,466,125</u>

NOTE 3: Changes in accumulated depreciation were as follows:

Balance at beginning of period (1/1/15)	\$ 6,075,287
Additions during period:	
Depreciation expense	1,971,345
Subtotal	<u>8,046,632</u>
Deductions during period:	
Accumulated depreciation on real estate moved to held for sale	5,131,036
Balance at end of period (12/31/15)	\$ <u>2,915,596</u>

Balance at beginning of period (1/1/16)	\$ 2,915,596
Additions during period:	
Depreciation expense	1,185,624
Subtotal	<u>4,101,220</u>
Deductions during period:	
Accumulated depreciation on real estate moved to held for sale	949,793
Balance at end of period (12/31/16)	\$ <u>3,151,427</u>

Balance at beginning of period (1/1/17)	3,151,427
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Additions during period:	
Depreciation expense	1,080,003
Subtotal	<u>4,231,430</u>
Deductions during period:	
Accumulated depreciation on real estate moved to held for sale	914,677
Balance at end of period (12/31/17)	<u>\$ 3,316,753</u>

NOTE 4: During the year ended December 31, 2017 \$518,960 book value of land and \$2,571,536 of construction and related costs related to common areas in the ZRV project were transferred from ZRV to ZRV II pursuant to a cost sharing agreement between the two entities (reflected in capitalized costs column).

NOTE 5: Write-down of \$467,178 recorded on this property during 2017 based on pending sale contract. Property was moved to Held for Sale during 2017 and accumulated depreciation up to that time of \$563,299 is shown net with the Initial Cost above.

NOTE 6: Write-downs totaling \$3,712,707 were recorded on this property during 2010 and 2011 based on third party appraisals and comparable sales.

NOTE 7: Write-downs totaling \$9,904,826 were recorded on this property during 2009 through 2012 based on broker's opinions of value and third party appraisals.

NOTE 8: Write-downs totaling \$315,306 were recorded on this property in 2017 based on management's estimate of value and third party appraisal. Property was moved to Held for Sale during 2017 and accumulated depreciation up to that time of \$192,862 is shown net with the Initial Cost above.

NOTE 9: Write-downs totaling \$1,213,168 were recorded on this property in 2010 through 2012 and 2017 based on third party appraisals and other valuation information.

NOTE 10: Property was moved to Held for Sale during 2016 and accumulated depreciation up to that time of \$267,716 is shown net with the Initial Cost above.

NOTE 11: The aggregate cost of the above real estate properties for Federal income tax purposes is approximately \$105,382,000.



**OWENS REALTY MORTGAGE, INC.**  
**FINANCIAL STATEMENT SCHEDULE IV - MORTGAGE LOANS ON REAL ESTATE**  
**DECEMBER 31, 2017**

Description	Interest Rate	Final Maturity date	Carrying Amount of Mortgages	Principal Amount of Loans Subject to Delinquent Principal	Principal Amount of Loans Subject to Delinquent Payments
<b>TYPE OF PROPERTY</b>					
Commercial	6.99-10.00%	Current to November 2020	\$ 127,873,281	\$ 4,585,000	\$ 1,212,851
Residential	7.75-11.00%	Current to March 2028	13,170,795	10,107,398	7,321,359
Land	4.00-9.82%	October 2018 to October 2020	5,127,574	—	—
TOTAL			<u>\$ 146,171,650</u>	<u>\$ 14,692,398</u>	<u>\$ 8,534,210</u>
<b>AMOUNT OF LOAN</b>					
\$0-500,000	6.00-10.00%	Current to March 2028	\$ 2,631,611	\$ 1,039,157	\$ 771,057
\$500,001-1,000,000	7.75-11.00%	Current to January 2020	3,736,554	2,146,369	1,577,452
\$1,000,001-5,000,000	4.00-10.00%	Current to November 2020	75,562,318	11,506,872	6,185,701
Over \$5,000,000	6.99-8.00%	January 2018 to November 2019	64,241,167	—	—
TOTAL			<u>\$ 146,171,650</u>	<u>\$ 14,692,398</u>	<u>\$ 8,534,210</u>
<b>POSITION OF LOAN</b>					
First	4.00-11.00%	Current to March 2028	\$ 142,782,492	\$ 13,803,241	\$ 8,045,052
Second	8.00-9.82%	Current to October 2018	3,389,158	889,157	489,158
TOTAL			<u>\$ 146,171,650</u>	<u>\$ 14,692,398</u>	<u>\$ 8,534,210</u>

NOTE 1: All loans are arranged by or acquired from an affiliate of the Company, namely Owens Financial Group, Inc., the Manager.

NOTE 2:

Balance at beginning of period (1/1/15)	\$ 68,033,511
Additions during period:	
New loans	73,389,645
Advances moved to principal of loans	536,816
Subtotal	<u>141,959,972</u>
Deductions during period:	
Collection of principal	35,216,165
Foreclosures	—
Balance at end of period (12/31/15)	<u>\$ 106,743,807</u>
Balance at beginning of period (1/1/16)	\$ 106,743,807
Additions during period:	
New loans, including from sale of real estate property	79,867,140
Discount accretion	—
Subtotal	<u>186,610,947</u>
Deductions during period:	
Collection of principal	55,849,884
Foreclosures	1,078,752
Balance at end of period (12/31/16)	<u>\$ 129,682,311</u>
Balance at beginning of period (1/1/17)	\$ 129,682,311
Additions during period:	
New loans, including from sale of real estate property	86,274,680
Subtotal	<u>215,956,991</u>
Deductions during period:	
Collection of principal	69,785,341
Foreclosures	—
Balance at end of period (12/31/17)	<u>\$ 146,171,650</u>

NOTE 3: Included in the above loans are the following loans which exceed 3% of the total loans as of December 31, 2017:

<u>Description</u>	<u>Interest Rate</u>	<u>Final Maturity Date</u>	<u>Periodic Payment Terms</u>	<u>Prior Liens</u>	<u>Face Amount of Mortgages</u>	<u>Carrying Amount of Mortgages</u>	<u>Principal Amount of Loans Subject to Delinquent Principal or Interest</u>
Apartment Building Oxnard, California	7.25%	4/1/18	Interest only, balance due at maturity	0	14,900,000	13,272,146	0
Hotel Novi, Michigan	7.75%	12/31/18	Interest only, balance due at maturity	0	8,835,000	8,467,892	0
Shopping Center Ontario, California	6.99%	1/1/18	Interest only, balance due at maturity	0	10,000,000	8,400,000	0
Office Building Pleasanton, California	7.50%	11/1/19	Interest only, balance due at maturity	0	8,250,000	8,000,000	0
Office Building Pleasanton, California	7.50%	11/1/19	Interest only, balance due at maturity	0	8,250,000	6,757,044	0
Retail Building Antioch, California	8.00%	10/15/18	Interest only, balance due at maturity	0	7,000,000	6,741,605	0
Storage Facility Benbrook, Texas	7.75%	5/15/18	Interest only, balance due at maturity	0	6,625,000	6,625,000	0
Retail Building Folsom, California	7.75%	1/15/19	Interest only, balance due at maturity	0	8,006,000	5,977,480	0
Office Building Chula Vista, California	8.00%	11/1/18	Interest only, Balance due at maturity	0	5,600,000	4,760,059	0
<b>TOTALS</b>				<u>\$ 0</u>	<u>\$ 77,466,000</u>	<u>\$ 69,001,226</u>	<u>\$ 0</u>

NOTE 4: The aggregate cost of the Company's loans for Federal income tax purposes is approximately \$146,718,000 as of December 31, 2017.

## **Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

### **Item 9A. CONTROLS AND PROCEDURES**

#### ***Evaluation of Disclosure Controls and Procedures***

Management of the Company carried out an evaluation, under the supervision and 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 Rule 13a-15(e) under the Exchange Act. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of December 31, 2017.

#### ***Changes in Internal Control over Financial Reporting***

There have been no changes in the Company's internal control over financial reporting, as that term is defined in Rule 13a-15(f) under the Exchange Act, in the fiscal quarter ending December 31, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

#### ***Management's Report on Internal Control over Financial Reporting***

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as that term is defined in Rule 13a-15(f) under the Exchange Act, for the Company. Under the supervision and with the participation of our principal executive officer and principal financial officer, an evaluation of the effectiveness of the internal control over financial reporting was conducted based on the framework established in the 2013 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). There are inherent limitations in any internal control system over financial reporting, which may not prevent or detect misstatements. The Company's internal control system over financial reporting is a process designed to provide reasonable assurance of achieving its objectives and management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2017.

#### ***Attestation Report of Independent Registered Public Accounting Firm***

Crowe Horwath LLP, our independent registered public accounting firm, has audited our financial statements included in this Annual Report and has issued an attestation report on the effectiveness of our internal control over financial reporting, which is included in Item 8 of this Annual Report.

### **Item 9B. OTHER INFORMATION**

There is no information required to be disclosed in a report on Form 8-K during the fourth quarter of the year ended December 31, 2017 that has not been so reported.

## **PART III**

### **Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

#### **Directors of the Company.**

Our Board of Directors is comprised of five members divided into three classes serving staggered terms of three-years each, with a term of office of only one of these three classes of directors expiring each year. Gary C. Wallace is the Class I director, Bryan H. Draper and James M. Kessler are the Class II directors, and William C. Owens and Dennis G. Schmal are the Class III directors. Set forth below is certain information about each director of the Company as of the date of this Annual Report. The business address of each of the directors is c/o Owens Realty Mortgage, Inc., 2221 Olympic Boulevard, Walnut Creek, California 94595.

***Class I Director (Term expires at the 2020 Annual Meeting):***

**Gary C. Wallace** – Mr. Wallace, age 63, has been a member of our Board since July 22, 2016. Mr. Wallace has provided consulting services to various banks, private equity firms, venture capital firms and the Public Company Accounting Oversight Board since his retirement from KPMG in 2005. He has also served as a member of the Board and Chairman of the Audit Committee of Plaza Bancorp and Plaza Bank from June 26, 2015 until November 2017. From February 2014 until February 2017, Mr. Wallace served as a member of the Board and Chairman of the Audit Committee of Orient Bancorp and Bank of the Orient. From 2012 until June 26, 2015, Mr. Wallace served as a Director of Manhattan Bancorp and Bank of Manhattan, N.A. Mr. Wallace joined KPMG in 1975 and retired as a KPMG Audit Partner Specialist in Banking and Investment Services in 2005, having served as head of the Northern California Financial Institutions Practice. As a KPMG Audit Partner, Mr. Wallace served as engagement partner and associate SEC reviewing partner for banks, real estate, venture capital, private equity, hedge fund and investment companies ranging in size from startups to entities with over fifty billion dollars in assets. Mr. Wallace received a Bachelor of Science degree in Business Administration, Summa Cum Laude, from California State University – East Bay in 1975.

Mr. Wallace’s extensive experience in audit, accounting and other financial matters, as well as deep familiarity with the financial services industry and corporate governance issues, make him well qualified to serve as a director of the Company and strengthens our Board’s collective qualifications, skills, experience and viewpoints.

***Class II Directors (Terms expire at the 2018 Annual Meeting):***

**Bryan H. Draper** – Mr. Draper, age 60, has served as our President and CEO since January 2016 and as a member of our Board since the consummation of the Merger on May 20, 2013. Mr. Draper served as the Secretary and Treasurer of the Company from its inception in 2012 until January 2016, and as our Chief Financial Officer from January 2013 to January 2016. He has also been Chief Financial Officer and Corporate Secretary of our Manager since December 1987 and a member of the Board of Directors of the Manager since January 1997. Mr. Draper is also currently the Chief Financial Officer of Investors Yield, Inc. (a California Trust Company) which is owned 100% by the Manager. Mr. Draper is expected to continue as a director and Corporate Secretary and Chief Financial Officer of the Manager until he resigns or is replaced by a vote of the Manager’s stockholders and board of directors, respectively. Mr. Draper is a certified public accountant and is responsible for all accounting, finance, and tax matters for the Manager. Mr. Draper received a Master’s degree in business administration from the University of Southern California in 1981.

Mr. Draper’s extensive experience in the mortgage financing and real estate industries, his deep knowledge of our business as our Chief Executive Officer, as our former Chief Financial Officer and as the Chief Financial Officer of our Manager, as well as his expertise in accounting and financial matters make him well qualified to serve a director of the Company and strengthens our Board’s collective qualifications, skills, experience and viewpoints.

**James M. Kessler** – Mr. Kessler, age 65, has been a member of our Board since the consummation of the Merger on May 20, 2013. He has been the President of Stonehenge Property Group, a private real estate development and advisory services company, since its inception in August 2005. Mr. Kessler founded Stonehenge Property Group and is responsible for all of its operations including budgets, business plans, property acquisition and development, financing and leasing. From January 2004 to July 2005, he was the founder and principal of Highland Development Company, a retail acquisition and development company that was part of the Marcus & Millichap group of companies. From April 2002 to October 2003, Mr. Kessler served as the Chief Operating Officer of ScanlanKemperBard Companies, a private real estate investment firm. From July 1999 to February 2002, he served as the Chief Development Officer of Federal Realty Investment Trust, a publicly traded REIT. While at Federal Realty Investment Trust, Mr. Kessler was responsible for establishing and managing regional and satellite offices, development, redevelopment, construction, operations, asset management and leasing. From December 1989 to July 1999, Mr. Kessler was the Chief Development Officer of Burnham Pacific Properties/The Martin Group, a publically traded REIT. From 1985 to December 1989, he served as the Director of Marketing of Transpacific Development, a private real estate development and management company. Mr. Kessler received his bachelor’s degree in business administration and management from Golden Gate University in 1981.

Mr. Kessler’s extensive experience in the real estate investment, development and management industries and his senior management positions in two publically traded REITs make him well qualified to serve as a director of the Company and strengthens our Board’s collective qualifications, skills, experience and viewpoints.

***Class III Directors (Terms Expire at the 2019 Annual Meeting):***

***William C. Owens*** – Mr. Owens, age 67, has been our executive Chairman of the Board since ORM's inception in 2012. Mr. Owens also served as our President from our inception in 2012 until January 2016, and as our Chief Executive Officer from January 2013 until January 2016. He has been President of our Manager since April 1996, and is a member of the Board of Directors and the Loan Committee of the Manager and its Chief Executive Officer. Mr. Owens is expected to continue as a director and President and Chief Executive Officer of the Manager until he resigns or is replaced by a vote of the Manager's stockholders and board of directors, respectively. From 1979 until April 1996, he served as a Senior Vice President of the Manager. Mr. Owens is also currently the President of Investors Yield, Inc. (a California Trust Company) which is owned 100% by the Manager. Mr. Owens has been active in real estate construction, development, and mortgage financing since 1973. Prior to joining Owens Mortgage Company in 1979, Mr. Owens was involved in mortgage banking, property management and real estate development. As President of the Manager, Mr. Owens is responsible for the overall activities and operations of the Manager, including corporate investment, operating policy and planning. In addition, he is responsible for loan production, including the underwriting and review of potential loan investments. Mr. Owens graduated from Westmont College in 1973 and is a licensed real estate broker.

Mr. Owens' extensive experience in the mortgage financing and real estate industries, his deep knowledge of our business as our executive Chairman of the Board, as our former Chief Executive Officer and as the Chief Executive Officer of our Manager, and his prior leadership experience make him well qualified to serve as Chairman of our Board and strengthens our Board's collective qualifications, skills, experience and viewpoints.

***Dennis G. Schmal*** – Mr. Schmal, age 71, has been a member of our Board since the consummation of the Merger on May 20, 2013. In May of 2015, Mr. Schmal began service as a director and as chair of the audit committee of a public technology company, Blue Calypso, Inc., which deregistered and became a private company in March 2017. Mr. Schmal currently serves as a director of Blue Calypso, Inc., however, he no longer serves on the audit committee. Mr. Schmal also serves as a director of the public investment funds overseen by the following three asset management complexes: the AssetMark GuideMark/GuidePath Funds, where he has served as a director since 2006 and is chairman of the audit committee; the Wells Fargo GAI Hedge Funds where he has served as a director since 2008 and is a member of the audit committee; and the Cambria ETF Series where he has served as a director since 2013 and is chairman of the audit committee. Mr. Schmal served as a director and a member of the audit (chairman), nominating, and compensation committees of Merriman Holdings, Inc., a securities and investment banking firm from August 2003 until July 2016. From May 2005 until July 2014, Mr. Schmal served as chairman of the board of directors of Pacific Metrics Corporation, a private company in the educational assessment/software field. Mr. Schmal served as chairman of the board of directors of a technology industry startup, Sitoa Global Inc., from January 2012 until April 2013. From August 2004 to November 2011, he served as a member of the board of directors, audit committee (chairman) and compensation committee of Varian Semiconductor, a semiconductor equipment manufacturer. From October 2008 to May 2011, he served as a director and chairman of the audit committee of Grail Advisors EFT Trust, an exchange traded fund complex. From September 2006 to May 2008, Mr. Schmal served as a director and chairman of the audit committee of North Bay Bancorp, a bank holding company. From February 1972 to April 1999, Mr. Schmal was employed by Arthur Andersen LLP, primarily as a partner overseeing the delivery of accounting and audit services. During his career with Arthur Andersen LLP, Mr. Schmal specialized in working with companies in the financial services sector, including the commercial banking, securities/investment banking and asset management industries. Mr. Schmal received a Bachelor of Science in Business Administration – Finance and Accounting Option from California State University, Fresno in 1972 and holds a CPA certificate (retired).

Mr. Schmal's extensive experience serving on boards and the audit and other key committees of multiple private and public companies, as well as his extensive expertise in accounting and financial matters, make him well qualified to serve as a director of the Company and strengthens our Board's collective qualifications, skills, experience and viewpoints.

**Executive Officers of the Company that are not Directors.**

Set forth below is certain information about each executive officer that is not also a director of the Company as of the date of this Annual Report. The business address of each executive officer is c/o Owens Realty Mortgage, Inc., 2221 Olympic Blvd., Walnut Creek, CA 94595.

<u>Name</u>	<u>Age</u>	<u>Information about Executive Officers</u>
<i>William E. Dutra</i>	55	Mr. Dutra has served as an Executive Vice President of the Manager since March 2014 and member of the Board of Directors and the Loan Committee of the Manager since January 1997. Mr. Dutra previously served as a Senior Vice President of the Manager and has been one of its employees since February 1986. Mr. Dutra has responsibility for loan committee review, loan underwriting and loan production.
<i>Melina A. Platt</i>	51	Ms. Platt was appointed as the Company's Chief Financial Officer and Treasurer in January 2016 and has been the Controller of the Manager since May 1998. Ms. Platt is a certified public accountant and is responsible for all accounting, finance, and regulatory agency filings of the Company. Ms. Platt was previously a Senior Manager with KPMG LLP.
<i>Daniel J. Worley</i>	46	Mr. Worley has served as a Senior Vice President of the Manager since June 2013 and is responsible for capital markets, investor relations, regulatory compliance, and governance. Mr. Worley has served as Secretary of the Company since January 2016, and was Assistant Secretary of the Company from June 2013 until January 2016. In addition, he is a member of the senior management team and participates in executive management and strategy. Prior to joining the Company, from July 2012 to June 2013, he served as a consultant to OMIF. From July 2010 to October 2011, he was the Chief Strategy Officer at Mason-McDuffie Real Estate where his responsibilities included executive management, strategy, corporate development, governance, and legal matters. From May 2001 to October 2010, he co-founded and served as the Chief Operating Officer of NorthPoint Financial Group/SmartZip Analytics where his responsibilities included executive management, strategy and governance. From January 1998 to May 2001, he was the Managing Director of the Berkeley Center for Advanced Technology where his responsibilities included venture fund management, investment due diligence, investment oversight and investor relations.
<i>Brian M. Haines</i>	40	Mr. Haines has served as a Senior Vice President of the Manager since January 2014 and as a Loan Officer of the Manager since 2007. Mr. Haines' focus is on originating and structuring debt investments, developing and fostering broker relationships and asset management oversight. Prior to joining the Manager, Mr. Haines co-owned and operated a private lending firm headquartered in Northern California. He is a director of the Bay Area Mortgage Association (BAMA) and an active member of the Urban Land Institute (ULI) and California Mortgage Association (CMA).

#### **Audit Committee**

Our Board of Directors has a standing Audit Committee, established in accordance with the requirements of the SEC and NYSE American rules. The Audit Committee's purpose and responsibilities are more fully set forth in the committee's charter, which was adopted by our Board of Directors on May 20, 2013, and is available on our web site at [www.owensmortgage.com](http://www.owensmortgage.com).

The members of the Audit Committee are the independent directors, Messrs. Wallace, Kessler and Schmal. Our Board of Directors has determined that Mr. Wallace (the Chairman of the Audit Committee) qualifies as an "audit committee financial expert" for purposes of, and as defined by, applicable SEC rules and has the requisite accounting or related financial management expertise required by the NYSE American rules. In addition, our Board has determined that all of the members of the Audit Committee are financially literate as required by the NYSE American rules.

#### **Code of Business Conduct and Ethics**

We have adopted a Code of Business Conduct and Ethics, which requires our directors, employees (if any), officers (including our Chief Executive Officer and Chief Financial Officer), and the personnel of our Manager, to abide by high standards of business conduct and ethics. The Code of Business Conduct and Ethics covers a variety of topics, including those required by the SEC and the NYSE American rules. Topics covered include, but are not limited to, conflicts of interest,

confidentiality of information, and compliance with laws and regulations. The Code of Business Conduct and Ethics is available for viewing on our web site at [www.owensmortgage.com](http://www.owensmortgage.com), and a copy may also be obtained by stockholders, free of charge, by writing to us at Owens Realty Mortgage, Inc., 2221 Olympic Boulevard, Walnut Creek, CA 94595, Attention: Daniel Worley, Secretary. The Code of Business Conduct and Ethics was adopted by our Board of Directors on May 20, 2013 and amended and restated on February 3, 2016.

### **Procedures for Recommending Director Nominees**

There have been no material changes to the procedures described in the Company's proxy statement relating to the 2017 Annual Meeting of Stockholders by which stockholders may recommend director nominees to the Company.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the Exchange Act requires our directors, executive officers and holders of more than 10% of the outstanding shares of Common Stock ("10% Holders") to file with the SEC and the NYSE initial reports of ownership and reports of changes in ownership of Common Stock and other equity securities of ORM. Directors, executive officers and 10% Holders are required by the SEC's regulations to furnish us with copies of all Section 16(a) forms and amendments thereto filed during any given year.

Based on the review of copies of the Section 16(a) reports and amendments thereto furnished to us and/or written representations from our directors, executive officers and 10% Holders, we believe that for the year ended December 31, 2017 our directors, executive officers and 10% Holders complied with all Section 16(a) filing requirements applicable to them.

## **Item 11. EXECUTIVE COMPENSATION**

### **Compensation Committee Interlocks and Insider Participation**

Our Compensation Committee members are Messrs. Wallace, Schmal and Kessler and each of them served as members of the Compensation Committee throughout 2017, None of the foregoing persons served as an officer, former officer or employee of ours or had a relationship disclosable under Item 404 of Regulation SK. Further, during 2017, none of our executive officers served as a member of the board of directors or compensation committee (or equivalent) of any other entity, one of whose executive officers served as one of our directors or on our Compensation Committee.

### **Compensation Discussion and Analysis**

We are managed by our Manager pursuant to the terms of our charter and the Management Agreement between the Company and our Manager. In August 2017, the Board and the Manager agreed to adjust the Existing Management Fee paid to the Manager pursuant to the charter on an interim basis to the Interim Management Fee, which is a monthly management fee that equals 1/12<sup>th</sup> of 1.50% of the Company's Stockholders' Equity, subject to the additional details of the calculation as described in "Related Party Transactions – Management Fees and Expenses – *Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*" in Item 13 of this Annual Report. The Interim Management Fee is payable during the Interim Adjustment Period, which is the period commencing July 1, 2017 and ending on March 31, 2018. Effective April 1, 2018, the Interim Management Fee adjustment will become permanent along with an additional adjustment such that the monthly management fee payable will equal (i) one-twelfth (1/12) multiplied by (ii) (a) 1.50% of the first \$300,000,000 of the Company's Stockholders' Equity and (b) 1.25% of the Company's Stockholders' Equity that is greater than \$300,000,000. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Significant Developments During 2017 and Subsequent Events" in Item 7 of this Annual Report and "Related Party Transactions – Management Fees and Expenses" in Item 13 of this Annual Report for additional details of the revised management fee calculation and for a description of certain relevant terms of the charter and the Management Agreement, including a description of certain additional proposed changes to the fees and expenses payable to our Manager.

We have no employees other than two full-time and one part-time employee(s) (none of whom is an officer) that work for one of our subsidiaries. We do not have agreements with any of our executive officers or any employees of our Manager with respect to their compensation. Our executive officers are employees of our Manager and do not receive cash, equity or other compensation from us for serving as our executive officers. We did not pay any compensation to our executive officers nor did we make any grants of equity or other plan-based awards of any kind to them during 2017 or through the date of this

Annual Report. None of our executive officers received any options or stock directly from us prior to the date of this Annual Report. We do not provide any of our executive officers with pension benefits or nonqualified deferred compensation plans. We do not have any employment agreements with any persons and are not obligated to make any payments to any of our executive officers upon termination of employment or a change in control of us.

We estimate that the median annual compensation for our two full-time and one part-time employees was \$27,000 for 2017. The Company does not, however, pay salary, bonus or other compensation to its principal executive officer (or any of its officers) and the pay ratio required by Item 402(u) of Regulation SK is not calculable without salary and bonus information for our principal executive officer, which information will not become available unless we elect in the future to pay salary, bonus and/or other compensation to our principal executive officer.

### Compensation Committee Report

Our Compensation Committee reviewed and discussed with our management the “Compensation Discussion and Analysis” contained in this Annual Report. Based on that review and discussions, our Compensation Committee recommends to our Board of Directors that the “Compensation Discussion and Analysis” be included in this Annual Report.

*By the Compensation Committee:*  
Dennis George Schmal, Chair  
James Matthew Kessler  
Gary C. Wallace

*The foregoing Compensation Committee Report shall not be deemed under the Securities Act or the Exchange Act to be (i) “soliciting material” or “filed” or (ii) incorporated by reference by any general statement into any filing made by us with the SEC, except to the extent that we specifically incorporate such report by reference.*

### Compensation of Independent Directors

Our independent directors are Messrs. Kessler, Schmal and Wallace and each of them serves as a member of our Audit, Nomination and Corporate Governance and Compensation committees. Mr. Schmal is our Lead Director and the Chairman of the Nomination and Corporate Governance and Compensation Committees and Mr. Wallace serves as Chairman of our Audit Committee.

From January 1 through June 30, 2017, each independent director was paid a cash retainer at an annual rate of \$35,000 and, commencing July 1, 2017, the cash retainer paid to the independent directors was increased to an annual rate of \$50,000, payable quarterly in advance. In addition, during 2017 the chair of our Audit Committee (Mr. Wallace) was paid a retainer at an annual rate of \$7,500, the chair of our Compensation Committee (Mr. Schmal) was paid a retainer at an annual rate of \$7,500, the chair of our Nominating and Corporate Governance Committee (Mr. Schmal) was paid a retainer at an annual rate of \$5,000, and our lead independent director (Mr. Schmal) was paid a retainer at an annual rate of \$2,500, each payable quarterly in advance.

We also reimburse all members of our Board for their travel expenses incurred in connection with their attendance at our Board, committee and stockholder meetings. We pay directors’ fees only to those directors who are independent under the NYSE American rules.

The following table summarizes the compensation received by our independent directors for the fiscal year ended December 31, 2017.

<u>Name</u>	<u>Fees Earned or Paid in Cash(\$)</u>
James M. Kessler	\$42,500
Dennis G. Schmal	\$57,500
Gary C. Wallace	\$50,000



**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The following table sets forth certain information regarding the beneficial ownership of the Common Stock as of March 9, 2018 (unless otherwise indicated), of each current director and director nominee, each of our executive officers, our executive officers and directors as a group and each stockholder known to management to own beneficially more than 5% of the outstanding shares of our Common Stock. Unless otherwise indicated, we believe that the beneficial owner set forth in the table has sole voting and investment power.

<b>Name and Address of Beneficial Owner<sup>(1)</sup></b>	<b>Number of Shares Beneficially Owned</b>	<b>Percentage of Common Stock Beneficially Owned<sup>(2)</sup></b>
<b>Beneficial owners of more than 5%:</b>		
Nantahala Capital Management, LLC <sup>(3)</sup> 19 Old Kings Highway South, Suite 200 Darien, CT 06820	628,697	6.92%
BlackRock, Inc. <sup>(4)</sup> 55 East 52 <sup>nd</sup> Street New York, NY 10055	497,967	5.48%
<b>Executive officers and directors:</b>		
William C. Owens <sup>(5)(6)</sup>	185,985	2.05%
Bryan H. Draper <sup>(7)</sup>	93,017	*
James M. Kessler <sup>(8)</sup>	29,074	*
Dennis G. Schmal	3,000	*
Gary C. Wallace	1,500	*
Daniel J. Worley	2,325	*
William E. Dutra <sup>(9)</sup>	25,589	*
Melina A. Platt	3,910	*
Brian M. Haines <sup>(10)</sup>	7,908	*
<b>All executive officers and directors as a group (9 persons)</b>	<b>352,308</b>	<b>3.88%</b>

\* Less than one percent.

- (1) The address of each of the executive officers and directors listed above is c/o Owens Realty Mortgage, Inc., 2221 Olymptic Boulevard, Walnut Creek, California 94595.
- (2) The percentage reported in this column has been calculated based upon 9,091,454 shares of Common Stock outstanding on March 9, 2018.
- (3) This information, other than the percentage ownership calculation which was calculated based upon 9,091,454 shares of Common Stock outstanding on March 9, 2018, is based on a Schedule 13G/A filed with the SEC on February 14, 2018, by Nantahala Capital Management, LLC, a Massachusetts limited liability company (“Nantahala”), Wilmot Harkey and Daniel Mack (collectively the “Reporting Persons”). The Reporting Persons report that Nantahala may be deemed to be beneficial owner of 628,697 shares of Common Stock held by funds and separately managed accounts under its control that, each of Messrs. Harkey and Mack may also be deemed the beneficial owner of those shares and that each of the Reporting Persons has shared voting and dispositive power over all 628,697 shares.
- (4) This information, other than the percentage ownership calculation which was calculated based upon 9,091,454 shares of Common Stock outstanding on March 9, 2018, is based on a Schedule 13G/A filed with the SEC on February 9, 2018, by BlackRock, Inc., a Delaware corporation (“BlackRock”). BlackRock discloses that it may be deemed to be beneficial owner of 497,967 shares of Common Stock held by certain of its subsidiaries and affiliates that constitute a group, that it has sole voting power over 492,095 of the shares and sole dispositive power over all 497,967 shares .
- (5) Mr. Owens owns 62.5% of Owens Financial Group, Inc., our Manager and shares voting power at the Manager with Mr. Draper, Mr. Dutra and Mr. Haines, each of whom owns the following percentage of the Manager: Draper – 16.305%; Dutra – 16.305%; and Haines – 4.89%. Mr. Owens’ is reporting beneficial ownership of 83,049 shares of Common Stock held by the Manager directly and 13,736 shares of Common Stock held by Investors Yield. Inc. (a wholly-owned

subsidiary of the Manager), with respect to which he has shared voting and investment power. Mr. Owens disclaims beneficial ownership of these securities except to the extent of his pecuniary interest therein.

- (6) Includes 360 shares of Common Stock held by Owens Trust dated February 24, 1998, the trustee of which is Mr. Owens. Also includes 4,637 shares of Common Stock held by Belmar, a California limited partnership of which Mr. Owens owns 49.22%. Mr. Owens disclaims beneficial ownership of these securities except to the extent of his pecuniary interest therein. Also includes: (i) 6,361 shares of Common Stock held indirectly by Mr. Owens spouse; (ii) 11,572 shares of Common Stock held in an Individual Retirement Account of which Mr. Owens is sole beneficiary; and (iii) 63,460 shares of Common Stock owned indirectly through the Owens Financial Group 401(k) Plan.
- (7) Includes 4,543 shares of Common Stock held by Draper Family Partnership of which Mr. Draper is a 50% owner. Mr. Draper disclaims beneficial ownership of these securities except to the extent of his pecuniary interest therein. Also includes: (i) 32,713 shares of Common Stock held by Draper Family Trust dated May 16, 2000 of which Mr. Draper is co-trustee; (ii) 3,275 shares of Common Stock indirectly by Mr. Draper's spouse; (iii) 52,186 shares of Common Stock held in Individual Retirement Accounts of which Mr. Draper is sole beneficiary; and (iv) 300 shares of Common Stock owned by Mr. Draper's child. Does not include 83,049 shares of Common Stock held by the Manager directly and 13,736 shares of Common Stock held by Investors Yield, Inc.
- (8) Mr. Kessler owns 29,074 shares of Common Stock through two trusts. Mr. Kessler has sole voting and investment power over 17,836 shares of Common Stock held in one of those trusts and shared voting and investment power over shares of Common Stock held in the other trust.
- (9) Includes 2,689 shares of Common Stock held by The Dutra Trust of which Mr. Dutra is a co-trustee and 22,900 shares of Common Stock owned indirectly through the Owens Financial Group 401(k) Plan. Does not include 83,049 shares of Common Stock held by the Manager directly and 13,736 shares of Common Stock held by Investors Yield, Inc.
- (10) Includes 1,248 shares of Common Stock held in an Individual Retirement Account and 3,973 shares of Common Stock owned indirectly through the Owens Financial Group 401(k) Plan. Does not include 83,049 shares of Common Stock held by the Manager directly and 13,736 shares of Common Stock held by Investors Yield, Inc.

### **Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

#### **Related Party Transaction Policy and Procedures**

The Company has adopted a written policy for approval of transactions and arrangements between the Company and the Company's current and recent former directors, director nominees, current and recent former executive officers, greater than five percent stockholders and their immediate family members, and entities where any of the foregoing persons is employed or serves as a general partner, principal or in a similar position (each, a "Related Party").

The policy provides that the Audit Committee reviews certain transactions subject to the policy and determines whether or not to approve or ratify those transactions. In doing so, the Audit Committee takes into account, among other things, whether the transaction is on terms comparable to those that could be obtained in arm's length dealings with an unrelated third party under similar circumstances, the extent of the Related Party's interest in the transaction, and the conflicts of interest provisions and corporate opportunity provisions of the Company's Code of Business Conduct and Ethics. The Related Party transaction must be approved or ratified by the Audit Committee in accordance with the provisions of the policy and in accordance with relevant provisions of the Company's charter, bylaws and applicable provisions of the MGCL.

The Audit Committee has considered and adopted standing pre-approvals under the policy for certain limited transactions with Related Parties that meet specific criteria. Information on transactions subject to pre-approval is to be provided to the Audit Committee at its next regularly scheduled meeting. Pre-approved transactions are limited to:

- compensation to an executive officer or director of the Company if (a) the related compensation is required to be reported in the Company's proxy statement under the SEC's compensation disclosure requirements or (b) the executive officer is not an immediate family member of another executive officer or director of the Company, the related compensation would be reported in the Company's proxy statement under the SEC's compensation disclosure requirements if the executive officer was a "named executive officer," and the Compensation Committee approved (or recommended that our Board approve and the Board has approved) such compensation;

- certain transactions in the Company's ordinary course of business where the Related Party's interest arises only from: (a) the Related Party's position as a director of another entity that is a party to the transaction; (b) from direct or indirect ownership by such Related Party and all other Related Parties, in the aggregate, of less than a 5% equity interest in another person (other than a partnership) that is a party to the transaction; (c) from both such position described in (a) and ownership described in (b); or (d) from the Related Party's position as a limited partner in a partnership in which all Related Parties in the aggregate have an interest of less than 5% and the Related Party is not a general partner of and does not have another position in such partnership;
- certain transactions in the Company's ordinary course of business where the Related Party's interest arises solely from the ownership of the Company's Common Stock and holders of the Company's Common Stock received the same benefit on a pro rata basis; and
- certain transactions involving a Related Party where the rates or charges involved are determined by competitive bids, or transactions involving the rendering of services as a common or contract carrier, or as a public utility, at rates or charges fixed in conformity with law or a governmental authority.

## **Related Party Transactions**

### **Ownership of the Manager**

The voting common stock of our Manager, Owens Financial Group, Inc., is owned as follows: 62.5% by William C. Owens, 16.305% by Bryan H. Draper, 16.305% by William E. Dutra and 4.89% by Brian M. Haines.

### **Management Fees and Expenses**

We have entered into a Management Agreement with our Manager, Owens Financial Group, Inc., which describes the services to be provided by our Manager. The compensation payable to the Manager for those services and certain other important provisions relating to the Manager are described in our charter, provided, however that the Board and Manager have agreed to adjust the Existing Management Fee and pay the Interim Management Fee during the Interim Adjustment Period and to make certain permanent changes to reduce the management fee payable as described below in "*Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*". The Manager manages our day-to-day operations and business, subject to the supervision and oversight of our Board of Directors. The Manager is required to act in accordance with policies and restrictions contained in the Company's charter and such additional investment policies as may be adopted by our Board of Directors.

The Management Agreement continues in effect for the duration of the existence of the Company, unless earlier terminated by the affirmative vote of the holders of a majority of the outstanding shares of Common Stock, by the Manager in response to an amendment to its compensation that it does not consent to, automatically in certain circumstances relating to the assignment of the Management Agreement, or by either party for cause as defined therein.

The Management Agreement provides that the fees payable to the Manager as described in the charter may not be changed without the approval of the Board (including a majority of the independent members of the Board), the holders of a majority of the outstanding shares of Common Stock and the Manager; provided that stockholder approval is not required to adjust the Manager's compensation so long as such adjustment will not have a significant adverse impact on the stockholders of the Company. The charter provides for the payment of the following fees by the Company and by borrowers:

***Fees paid by the Company.*** The Manager is entitled to receive the following fees from the Company:

- ***Management Fee.*** Up until July 1, 2017, the Existing Management Fee has been paid by the Company to the Manager monthly not to exceed 2.75% annually of the average unpaid balance of our loans at the end of each of the 12 months in the calendar year. Since this fee was paid monthly, it could exceed 2.75% in one or more months, but the total fee in any one year was limited to a maximum of 2.75%, and any amount paid above this had to be repaid by the Manager to the Company. The Manager was entitled to receive a management fee on all loans, including those that were delinquent. In August 2017, the Board and the Manager agreed to adjust the Existing Management Fee on an interim basis to the Interim Management Fee which is a monthly management fee that equals 1/12<sup>th</sup> of

1.50% of the Company's Stockholders' Equity, subject to the additional details of the calculation as described below in "*Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*".

The Interim Management Fee is payable during the Interim Adjustment Period commencing July 1, 2017 and ending on March 31, 2018, and is intended to reduce the management fees that would otherwise be payable by the Company. Effective April 1, 2018, the Interim Management Fee adjustment will become permanent along with an additional adjustment such that the monthly management fee payable will equal (i) one-twelfth (1/12) multiplied by (ii) (a) 1.50% of the first \$300,000,000 of the Company's Stockholders' Equity and (b) 1.25% of the Company's Stockholders' Equity that is greater than \$300,000,000. See "*Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses*" below for additional details of the revised management fee calculation, and for a description of certain additional proposed changes to the fees and expenses payable to our Manager. Management fees amounted to approximately \$3,546,000 and \$3,286,000 for the years ended December 31, 2017 and 2016, respectively.

- ***Loan Servicing Fee.*** The Manager may act as servicing agent with respect to the Company's mortgage loans, in consideration for which it will be entitled to receive from ORM 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 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 year of the unpaid balance of ORM's mortgage loans at the end of each month. Servicing fees amounted to approximately \$362,000 and \$299,000 for the years ended December 31, 2017 and 2016, respectively.

***Fees paid by borrowers.*** The Manager is entitled to receive directly from borrowers the following fees:

- ***Acquisition and Origination Fees.*** The Manager or its affiliates is entitled to receive and retain all fees and commissions paid or payable to it by any party other than ORM and any subsidiary in connection with ORM making or investing in mortgage loans. Included in the computation of such fees or commission is any selection fee, mortgage placement fee, nonrecurring management fee and any origination fee, loan fee or points paid by borrowers to the Manager or any fee of a similar nature, however designated. Such fees earned by the Manager amounted to approximately \$2,492,000 and \$2,514,000 on loans originated or extended of approximately \$122,240,000 and \$101,594,000 for the years ended December 31, 2017 and 2016, respectively.
- ***Late Payment Charges.*** The Manager is entitled to receive and retain all additional charges paid by borrowers on delinquent loans and loans past maturity held by ORM, including additional interest and late payment fees. The amounts paid to or collected by the Manager for late payment charges totaled approximately \$83,000 and \$83,000 for the years ended December 31, 2017 and 2016, respectively.
- ***Other Miscellaneous Fees.*** ORM remits other miscellaneous fees to the Manager, which are collected from loan payments, loan payoffs or advances from loan principal (i.e. funding, demand and partial release fees). Such fees remitted to the Manager totaled approximately \$23,000 and \$20,000 for the years ended December 31, 2017 and 2016, respectively.

The Manager is entitled to be reimbursed by ORM for any expenses (subject to certain exceptions outlined in the charter and the Management Agreement) paid by the Manager, including, without limitation, legal and accounting expenses, filing fees, printing costs, and goods, services and materials used by or for ORM. Additionally, the Manager is entitled to reimbursements for salaries for non-management and non-supervisory services. For the years ended December 31, 2017 and 2016, ORM recorded expenses totaling approximately \$381,000 and \$440,000, respectively, related to expense reimbursements to the Manager. ORM also reimbursed certain of the Manager's officers for allowed expenses in the total amount of \$2,000 and \$0 during the years ended December 31, 2017 and 2016, respectively.

ORM paid Investor's Yield, Inc. (a wholly owned subsidiary of the Manager) approximately \$1,000 and \$9,000 in trustee's fees related to certain foreclosure proceedings on ORM loans during the years ended December 31, 2017 and 2016, respectively.

### ***Interim Fee Reduction and Amendment Proposal to Permanently Reduce Management Fees and Expenses***

***Interim Management Fee Reduction.*** In August 2017 the Manager and the Board agreed that, commencing July 1, 2017, the Existing Management Fee to be paid monthly is to be reduced (but not increased) during the Interim Adjustment Period to

the amount of the “Interim Management Fee” calculated as follows:

1. The “Interim Management Fee” is equal to (i) one-twelfth (1/12) multiplied by (ii) 1.50% of the “Opening Stockholders’ Equity Balance” (defined below), with such Opening Stockholders’ Equity Balance to be adjusted by the Manager in the following manner:

(A) at the end of a calendar month to reflect any changes that result from any of the events specified in clause (A) in the definition of “Stockholders’ Equity” (defined below) during such calendar month from the Opening Stockholders’ Equity Balance; and

(B) at the end of a calendar quarter to reflect any changes that result from the components specified in clauses (B), (C) or (D) in the definition of “Stockholders’ Equity” (defined below) for such calendar quarter from the Opening Stockholders’ Equity Balance.

Since the Management Fee is to be paid monthly during the Interim Adjustment Period, and the components of Stockholders’ Equity specified in clauses (B), (C) and (D) in the definition of “Stockholders’ Equity” will not be known until the end of the quarter in question, the Manager shall use the prior quarter’s value as an estimate for each monthly payment and will effect a reconciliation at the end of the quarter, so that the actual aggregate Management Fee paid for each quarter will be based on the values of the components specified in clauses (B), (C) and (D) in the definition of “Stockholders’ Equity” at the end of that particular quarter as if the components specified in clauses (B), (C) and (D) were known at each month end.

2. As used in the calculation of the Interim Management Fee, “Stockholders’ Equity” means:

(A) the sum of the net proceeds from any issuances of the Company’s equity securities since inception (including the book value of the Company’s Common Stock and Additional Paid-in Capital at inception of the Company) less any amount that the Company pays for repurchases of its equity securities (determined as of the most recent month end), plus

(B) the Company’s consolidated retained earnings at the end of the most recently completed calendar quarter (without taking into account any non-cash equity compensation expense incurred in current or prior periods), less

(C) any unrealized gains, losses or other items that do not affect realized net income as of the most recently completed calendar quarter as adjusted to exclude

(D) one-time events pursuant to changes in GAAP and certain other non-cash charges after discussions between the Manager and the Company’s Independent Directors and after approval by a majority of the Company’s Independent Directors.

3. As used in the calculation of the Interim Management Fee, “Opening Stockholders’ Equity Balance” means Stockholders’ Equity at the end of the most recently completed calendar quarter. “Independent Directors” means the members of the Company’s Board of Directors who are not officers, employees or directors of the Manager or any person directly or indirectly controlling or controlled by the Manager, and who are otherwise “independent” in accordance with the applicable rules of the NYSE American.
4. The Manager shall compute each installment of the Interim Management Fee reasonably promptly at the end of each calendar month during the Interim Adjustment Period. A copy of the computations, including a comparison of the Interim Management Fee to the Existing Management Fee, made by the Manager to calculate such installment shall thereafter promptly be delivered to the Board of Directors.
5. The agreement of the parties in August 2017 did not include any change to the loan servicing fees or expense reimbursements payable by the Company to the Manager, and the Manager would also continue to receive the fees paid by our borrowers to the Manager.

This adjustment resulted in a reduced management fee of approximately \$440,000 during the last six months of 2017.

Amendment Proposal to Permanently Reduce Management Fees and Expenses. On March 13, 2018, we announced that our Board and the Manager have reached a non-binding agreement in with respect to certain changes to be made to the Manager's compensation structure. The non-binding agreement contemplates that the Management Agreement will be amended (the "Amendment Proposal") as follows:

- *Reduced Management Fee:* The Amendment Proposal will reduce the management fee by making permanent the recent "Interim Management Fee" adjustment described above along with an additional adjustment such that the "Management Fee" will equal (i) one-twelfth (1/12) multiplied by (ii) (a) 1.50% of the first \$300,000,000 of Opening Stockholders' Equity Balance (as defined above), and (b) 1.25% of the Opening Stockholders' Equity Balance that is greater than \$300,000,000, subject to certain monthly and quarterly adjustments.
- *Company to Receive 30% of All Loan Fees:* The Company will become entitled to receive thirty-percent (30%) of all fees and commissions paid to the Manager in connection with the Company making or investing in mortgage loans, including thirty-percent (30%) of all gross fees paid in connection with the extension or modification of any loans, with the remaining seventy-percent (70%) to be paid to the Manager.
- *Company to Receive 30% of All Late Payment Charges:* The Company will become entitled to receive thirty-percent (30%) of all late payment charges from borrowers on loans owned by the Company, with the remaining seventy-percent (70%) to be paid to the Manager.
- *Elimination of Service Fees:* The Company will no longer pay the Manager any servicing fees for the Manager's services as servicing agent with respect to any mortgage loans.
- *Elimination of Certain Expense Reimbursements:* The Company will no longer reimburse the Manager for certain expenses, including the salary and related salary expense of the Manager's non-management and non-supervisory personnel.

No binding or definitive agreement has been entered into with respect to the Amendment Proposal. Any such definitive agreement to amend the Management Agreement must be reviewed and approved by the compensation committee of the Company before the Company could enter into such agreement. While the Company and the Manager caution that no assurances can be made regarding the timing or certainty of entering a definitive agreement, the Company and the Manager will work expeditiously to finalize and execute the Amendment Proposal. In the event the Amendment Proposal is not executed by March 31, 2018, the Manager has agreed that the Company will only be obligated to pay, and the Manager will only be entitled to receive, the reduced management fee contemplated under the Amendment Proposal from and after April 1, 2018.

### **Repurchase of Freestone Shares**

On December 29, 2017, the Company entered into the Settlement Agreement with Freestone Capital Management, LLC and certain of its affiliates (collectively, "Freestone"), a shareholder group that beneficially owned more than 5% of our outstanding Common Stock, pursuant to which the Company agreed to purchase the 810,937 shares of Common Stock held by Freestone in a privately negotiated transaction for \$19.25 per share, resulting in an aggregate purchase price of approximately \$15.6 million. Pursuant to the terms of the Settlement Agreement, for a period of five years following the date of the Settlement Agreement, Freestone agreed to customary standstill restrictions relating to share purchases, support of proxy contests and other activist campaigns, calling of special meetings, and related matters. For a period of two years following the date of the Agreement, the Company and Freestone also agreed to abide by customary covenants not to sue and non-disparagement provisions. In addition, the Company and Freestone each released the other from all claims that the releasing party has, had or may have against the released party that relate to the investment by Freestone in the Company.

### **Office Lease**

ORM does not have any separate offices. The Manager operates from its executive offices at 2221 Olympic Boulevard, Walnut Creek, California 94595, or the Executive Office. The lessor of the Executive Office is Olympic Blvd. Partners, a California General Partnership ("OBP"), of which the Manager is a 50% general partner. The Executive Office is the sole asset of OBP. The lease agreement, or the Office Lease, between OBP and the Manager for the Executive Office has a term

extending until December 31, 2019. The Manager pays rent in the amount of \$15,975 per month to OBP under the Office Lease. For each of the years ended December 31, 2017 and 2016, Owens Financial Group paid \$191,700 to OBP for use of the Executive Office. The Executive Office is subject to a deed of trust in the amount of \$616,780 as of December 31, 2017 with monthly payments of interest and principal of \$3,988 and the remaining principal balance of \$583,332 due on December 31, 2019.

### ***Director Independence***

The Company's corporate governance guidelines provide that a majority of the directors serving on our Board must be "independent" as defined by the NYSE American rules. Based upon its review of all relevant facts and circumstances, our Board has affirmatively determined that three of our five current directors, Gary C. Wallace, Dennis G. Schmal and James M. Kessler qualify as independent directors under applicable SEC and NYSE American rules. In addition, our Board's three standing committees, the Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee, are each composed entirely of independent directors as required by the charters of those committees.

### **Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The following table summarizes the aggregate fees (including related expenses) billed to us for professional services provided by Crowe Horwath LLP for the fiscal years ended December 31, 2017 and 2016:

	<b><u>Fiscal Year Ended December 31, 2017</u></b>	<b><u>Fiscal Year Ended December 31, 2016</u></b>
Audit Fees	\$ 255,000	\$ 229,000
Audit-Related Fees	1,200	13,200
Tax Fees	107,068	119,483
All Other Fees	<u>17,780</u>	<u>2,696</u>
<b>Total</b>	<b><u>\$ 381,048</u></b>	<b><u>\$ 364,379</u></b>

***Audit Fees.*** Audit fees consist of fees and expenses billed by Crowe Horwath LLP related to the audit of our consolidated financial statements included in Form 10-K, the audit of our internal control over financial reporting and the reviews of the interim consolidated financial statements included in the Form 10-Q's, including services normally provided by an accountant in connection with statutory and regulatory filings or engagements.

***Audit Related Fees.*** Audit-related fees are fees and expenses billed for assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements and are not reported under "Audit Fees."

***Tax Fees.*** Tax fees billed to us by Crowe Horwath LLP are for tax compliance and consulting fees, which typically consist of fees billed for professional services for tax return preparation and other tax compliance.

***All Other Fees.*** All other fees consist of fees for products and services other than the services reported above, including consulting fees paid for a cost segregation study and accounting guidance subscriptions paid.

All services rendered by Crowe Horwath LLP were pre-approved by the Audit Committee for 2017 in accordance with its pre-approval policy, and the Audit Committee concluded that the provision of such services by Crowe Horwath LLP was compatible with the maintenance of that firm's independence in the conduct of its audit functions. The Audit Committee charter requires that the committee review and pre-approve each audit or permissible non-audit engagement or accounting project involving the independent public accountant, and the related fees or ranges of fees, prior to commencement of the engagement or project subject to certain exceptions if the services meet pre-approval policies that may be established under the charter. The Audit Committee may delegate its pre-approval authority to one or more of its members and, if such delegation occurs, then such member(s) are required to report any pre-approval decisions to the Audit Committee at its next-scheduled meeting.

## PART IV

### Item 15. EXHIBITS, CONSOLIDATED FINANCIAL STATEMENT SCHEDULES

(a)		
(1)	<u>List of Financial Statements filed as part of Item 8 in this Annual Report:</u>	
	Report of Independent Registered Public Accounting Firm	66
	Consolidated Balance Sheets - December 31, 2017 and 2016	68
	Consolidated Statements of Income - December 31, 2017, 2016 and 2015	69
	Consolidated Statements of Stockholders' Equity - December 31, 2017, 2016 and 2015	70
	Consolidated Statements of Cash Flows - December 31, 2017, 2016 and 2015	71
	Notes to Consolidated Financial Statements	73
(2)	<u>List of Financial Statement Schedules filed as part of Item 8 in this Annual Report:</u>	
	Schedule III - Real Estate and Accumulated Depreciation – December 31, 2017	108
	Schedule IV - Mortgage Loans on Real Estate – December 31, 2017	111
(3)	<u>List of Exhibits:</u>	
* 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 by reference to exhibit 3.1 of the Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on March 16, 2015	
* 3.2	Bylaws of Owens Realty Mortgage, Inc., incorporated herein by reference to Annex C to the Proxy Statement/Prospectus on Form S-4 filed with the SEC on February 13, 2013	
* 3.3	Amendment No. 1 to the Bylaws of Owens Realty Mortgage, Inc., dated December 29, 2017, incorporated by reference to exhibit 3.1 of the current report on Form 8-K/A filed with the SEC on January 4, 2018	
* 3.4	Articles Supplementary, dated November 12, 2013, 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 by reference to exhibit 4.1 to the Proxy Statement/Prospectus on Form S-4 filed with the SEC on January 25, 2013	
* 10.1	Form of Management Agreement, dated May 20, 2013, by and between Owens Financial Group, Inc. and Owens Realty Mortgage, Inc., incorporated by reference to exhibit 10.1 of the current report on Form 8-K filed with the SEC on May 20, 2013	
* 10.2	Credit Agreement, dated as of December 15, 2014, between Tahoe Stateline Venture, LLC and RaboBank, N.A., together with related Real Estate Term Loan Note, Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing, Environmental Certificate and Indemnity Agreement, and Guaranty, incorporated by reference to exhibits 10.1 through 10.5 of the current report on Form 8-K filed with the SEC on December 30, 2014 and amended on Form 8-K/A filed with the SEC on January 8, 2015	
* 10.3	Amended and Restated Credit Agreement, dated as of April 16, 2015, by and among California Bank & Trust as Administrative Agent and a Lender, First Bank as a Lender and Owens Realty Mortgage, Inc. as Borrower, together with related Master Revolving Notes, Amended and Restated Advance Formula Agreement, Security Agreement, and Addendum to Credit Agreement (Agency Provisions) incorporated by reference to exhibits 10.1 through 10.6, respectively, to the current report on Form 8-K filed with the SEC on April 24, 2015	
* 10.4	First Amendment to Amended and Restated Credit Agreement and Loan Documents, dated as of March 1, 2016, by and among California Bank & Trust, a division of ZB, N.A., as Administrative Agent and a Lender, First Bank as a Lender and Owens Realty Mortgage, Inc. as Borrower., together with the related Master Revolving Notes, incorporated by reference to exhibits 10.1 through 10.3, respectively, to the current report on Form 8-K filed with the SEC on March 7, 2016	
* 10.5	Seventh Amendment to Amended and Restated Credit Agreement, dated as of June 5, 2017, by and among ZB, N.A. dba California Bank & Trust, as Administrative Agent and a Lender, First	



Bank as a Lender, Umpqua Bank as a Lender, and Owens Realty Mortgage, Inc. as Borrower, together with the related Sixth Amendment to Addendum to Credit Agreement, dated as of June 5, 2017 and Master Notes, incorporated by reference to exhibits 10.1 through 10.5, respectively, to the current report on Form 8-K filed with the SEC on June 9, 2017

- \* 10.6 Construction Loan Agreement and Exhibits, dated as of August 3, 2016, between Zalanta Resort at the Village, LLC, Zalanta Resort at the Village – Phase II, LLC and Western Alliance Bank, together with related Secured Promissory Note, Construction Deed of Trust, Deed of Trust, Security Agreement, Omnibus Assignment of Agreements, Environmental Indemnity, Completion Guaranty and Repayment Guaranty, incorporated by reference to exhibits 10.1 through 10.9 of the current report on Form 8-K filed with the SEC on August 8, 2016
- \* 10.7 Settlement Agreement, dated December 29, 2017, by and among Owens Realty Mortgage, Inc., Freestone Opportunity Partners LP, Freestone Opportunity Qualified Partners LP, Freestone Investments LLC, Freestone Capital Management, LLC, Freestone Capital Holdings, LLC, Erik Morgan and Gary I. Furukawa, incorporated by reference to exhibit 10.1 of the current report on Form 8-K/A filed with the SEC on January 4, 2018
- \*\* 21.1 List of Subsidiaries of the Registrant
- \*\* 23.1 Consent of Crowe Horwath LLP
- \*\* 24.1 Power of Attorney
- \*\* 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
- \*\* 32.1 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.

#### **Item 16. FORM 10-K SUMMARY**

Not applicable.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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: March 13, 2018                      By: /s/ Bryan H. Draper  
Bryan H. Draper, Chief Executive Officer and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Dated: March 13, 2018                      By: /s/ William C. Owens  
William C. Owens, Director and Chairman of the Board

Dated: March 13, 2018                      By: /s/ Bryan H. Draper  
Bryan H. Draper, Director, Chief Executive Officer and  
President (Principal Executive Officer)

Dated: March 13, 2018                      By: /s/ Melina A. Platt  
Melina A. Platt, Chief Financial Officer and Treasurer  
(Principal Financial and Accounting Officer)

Dated: March 13, 2018                      By: \* Dennis G. Schmal  
Dennis G. Schmal, Director

Dated: March 13, 2018                      By: \* Gary C. Wallace  
Gary C. Wallace, Director

Dated: March 13, 2018                      By: \* James M. Kessler  
James M. Kessler, Director

\*By: /s/ Bryan H. Draper  
**Bryan H. Draper, Attorney-in-fact**



