

Regency Affiliates, Inc. and Subsidiaries
Unaudited Consolidated Financial Statements
March 31, 2017 and 2016

Regency Affiliates, Inc. and Subsidiaries
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INDEPENDENT AUDITOR'S REVIEW REPORT

Board of Directors and Stockholders of
Regency Affiliates, Inc. and Subsidiaries

We have reviewed the accompanying interim consolidated financial statements of Regency Affiliates, Inc. and Subsidiaries, which comprise the interim consolidated balance sheet as of March 31, 2017, and the related interim consolidated statements of income, changes in equity, and cash flows for the nine months ended March 31, 2017 and 2016, and the related notes to the interim consolidated financial statements.

Management's Responsibility for the Financial Information

Management is responsible for the preparation and fair presentation of the interim consolidated financial information in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal sufficient to provide a reasonable basis for the preparation and fair presentation of interim consolidated financial information in accordance with accounting principles generally accepted in the United States of America.

Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim consolidated financial information. A review of interim consolidated financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the consolidated financial information as a whole. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim consolidated financial information for it to be in accordance with accounting principles generally accepted in the United States of America.

Rosenberg Rich Baker Berman & Company

Somerset, New Jersey
January 22, 2018

Regency Affiliates, Inc. and Subsidiaries
Consolidated Balance Sheets

	March 31, 2017	December 31, 2016
Assets	(unaudited)	
Current Assets:		
Cash and cash equivalents	\$ 5,171,170	\$ 5,044,512
Restricted cash	232,871	289,469
Prepaid expenses	385,320	386,640
Prepaid insurance	97,850	105,100
Prepaid income taxes	303,160	67,392
Rent receivable	4,456	4,119
Inventory	9,777	5,741
Total current assets	6,204,604	5,902,973
Real Estate		
Self-storage properties	35,078,359	35,078,359
Less accumulated depreciation	(742,636)	(548,565)
Property, plant and equipment, net	21,956	22,933
Investment in partnerships/LLC	36,954,420	36,689,891
Prepaid insurance, net of current portion	445,150	467,800
Other assets	204,360	204,360
Total assets	\$ 78,166,213	\$ 77,817,751
Liabilities and Shareholders' Equity		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 329,025	\$ 199,061
Deferred revenue	143,243	142,285
Deferred rent	80,577	79,192
Income tax payable	47,162	12,000
Dividends payable	291,467	291,467
Tenant security deposits	9,296	9,296
Total current liabilities	900,770	733,301
Non-current Liabilities:		
Mortgage note payable, net	25,135,323	25,132,167
Total liabilities	26,036,093	25,865,468
Commitments and contingencies		
Shareholders' Equity		
Serial preferred stock, par value \$0.10;		
2,000,000 shares authorized; no shares issued and outstanding	-	-
Common stock, par value \$0.01; 8,000,000		
shares authorized; 4,778,144 shares issued and outstanding, as of March 31, 2017 and December 31, 2016	47,781	47,781
Additional paid-in capital	13,991,566	13,978,408
Retained earnings	38,059,449	37,839,563
Total shareholders' equity	52,098,796	51,865,752
Noncontrolling interest	31,324	86,531
Total equity	52,130,120	51,952,283
Total liabilities and shareholders' equity	\$ 78,166,213	\$ 77,817,751

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

Regency Affiliates, Inc. and Subsidiaries
Consolidated Statements of Income
(unaudited)

	<u>Three Months Ended March 31,</u>	
	<u>2017</u>	<u>2016</u>
Revenue		
Rental	\$ 610,266	\$ 1,500
Insurance, late fees and other income	49,526	-
Retail	1,515	-
Total revenue	<u>661,307</u>	<u>1,500</u>
Operating expenses:		
Self-storage cost of operations	362,853	-
Self-storage depreciation expense	194,071	-
General and administrative expenses	533,014	711,070
Total operating expenses	<u>1,089,938</u>	<u>711,070</u>
Loss from operations	<u>(428,631)</u>	<u>(709,570)</u>
Other (income) expense:		
Income from equity investment in partnerships/LLC	(1,259,934)	(1,178,478)
License agreement income	(35,332)	
Interest income	(5,589)	(2,384)
Interest expense	312,470	-
Amortization of debt discount	3,156	-
Total other income	<u>(985,229)</u>	<u>(1,180,862)</u>
Net income before income taxes	556,598	471,292
Income tax expense (benefit)	<u>87,489</u>	<u>(39,817)</u>
Net income	469,109	511,109
Net loss attributable to noncontrolling interest	<u>(42,244)</u>	<u>-</u>
Net income allocated to shareholders	<u>\$ 511,353</u>	<u>\$ 511,109</u>

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

Regency Affiliates, Inc. and Subsidiaries
Condensed Consolidated Statements of Changes in Equity
For the Three Months Ended March 31, 2017
(unaudited)

	Preferred Stock		Common Stock		Additional Paid-In Capital	Retained Earnings	Shareholders' Equity	Noncontrolling Interest	Total Equity
	Shares	Amount	Shares	Amount					
Balance at December 31, 2016	-	\$ -	4,778,144	\$47,781	\$ 13,978,408	\$ 37,839,563	\$ 51,865,752	\$ 86,531	\$ 51,952,283
Stock options compensation expense	-	-	-	-	13,158	-	13,158	-	13,158
Dividend paid to noncontrolling interest	-	-	-	-	-	-	-	(12,963)	(12,963)
Cash dividends declared	-	-	-	-	-	(291,467)	(291,467)	-	(291,467)
Net income (loss)	-	-	-	-	-	511,353	511,353	(42,244)	469,109
Balance at March 31, 2017	-	\$ -	4,778,144	\$47,781	\$ 13,991,566	\$ 38,059,449	\$ 52,098,796	\$ 31,324	\$ 52,130,120

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

Regency Affiliates, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(unaudited)

	<u>For Three Months Ended March 31,</u>	
	<u>2017</u>	<u>2016</u>
Cash Flows From Operating Activities		
Net Income	\$ 469,109	\$ 511,109
Adjustments to reconcile net income to net cash used in operating activities:		
Non-cash expenses		
Depreciation and amortization	195,048	-
Income from equity investment in partnerships/LLCs	(1,259,934)	(1,178,478)
Stock based compensation	13,158	-
Amortization of debt discount	3,156	-
Bad debt expense	-	21,000
Changes in operating assets and liabilities		
Prepaid expenses	1,320	(194,526)
Prepaid insurance	29,900	(626,350)
Prepaid income taxes	(235,768)	(210,571)
Rent receivable	(337)	(1,500)
Inventory	(4,036)	-
Other assets	-	(201,329)
Accounts payable and accrued expenses	129,964	142,247
Deferred revenue	958	-
Deferred rent	1,385	-
Income tax payable	35,162	19,912
Total adjustments	<u>(1,090,024)</u>	<u>(2,229,595)</u>
Net cash used in operating activities	<u>(620,915)</u>	<u>(1,718,486)</u>
Cash Flows From Investing Activities		
Distributions of earnings from partnerships	995,405	800,000
Reduction in restricted cash	56,598	-
Net cash provided by investing activities	<u>1,052,003</u>	<u>800,000</u>
Cash Flows From Financing Activities		
Dividends paid to common shareholders	(291,467)	(216,115)
Dividends paid to noncontrolling shareholder	(12,963)	-
Net cash used in financing activities	<u>(304,430)</u>	<u>(216,115)</u>
Net increase (decrease) in cash and cash equivalents	126,658	(1,134,601)
Cash and cash equivalents - beginning	<u>5,044,512</u>	<u>8,287,331</u>
Cash and cash equivalents - ending	<u>\$ 5,171,170</u>	<u>\$ 7,152,730</u>
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for:		
Interest	<u>\$ 309,814</u>	<u>\$ -</u>
Income taxes	<u>\$ 1,045,288</u>	<u>\$ 169,342</u>
Non-cash investing and financing activities:		
Common stock dividend declared	<u>\$ 291,467</u>	<u>\$ 217,346</u>
Cashless exercise of common stock	<u>\$ -</u>	<u>\$ 209</u>

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

Regency Affiliates, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The financial statements are presented on an accrual basis in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) as defined in the Financial Accounting Standards Board Accounting Standards Codification (the “Codification”).

Nature of Operations

Regency Affiliates, Inc. (“Regency” or “the Company”) invests in assets that generate attractive, predictable and sustainable returns on capital. The Company’s objective is to generate long term value for its shareholders. Management seeks sound investment opportunities to meet its business characteristics and valuation criteria.

The Company holds a limited partnership interest in Security Land and Development Company Limited Partnership (“Security Land”), which owns and operates 34.3 acres of land and rental property of approximately 717,000 square feet in Woodlawn, Maryland, which is occupied by the United States Social Security Administration’s Office of Disability and International Operations. In November 2000, the Company acquired a 5% limited partnership interest in 1500 Woodlawn Limited Partnership, the general partner of Security Land. See Note 2, “Investment in Security Land and Development Company Limited Partnership.”

In addition, Regency Power Corporation (“Regency Power”, 100% owned subsidiary of the Company) owns a 50% interest in MESC Capital, LLC, a Delaware limited liability company (“MESC Capital”). MESC Capital owns a 100% interest in Mobile Energy Services Company, LLC, an Alabama limited liability company (“Mobile Energy”), which owns an on-site energy facility that supplies steam and electricity to a Kimberly-Clark tissue mill in Mobile, Alabama. See Note 3, “Investment in MESC Capital LLC.”

In April 2016, Regency formed a new, wholly owned subsidiary, RSS Investments LLC (“RSS”). RSS entered into a joint-venture, acquiring a majority ownership (80%) of SSCP Harrisburg Holdings, LLC, a Delaware limited liability company (“Harrisburg Holdings”). Harrisburg Holdings is the sole member of SSCP Harrisburg Intermediate Holdings, LLC, a Delaware limited liability company (“Intermediate Holdings”). Simultaneously with RSS’s investment in Harrisburg Holdings, Harrisburg Intermediate Holdings acquired a portfolio of five self-storage facilities in Harrisburg, Pennsylvania. Through our controlling interest of SSCP Harrisburg Holdings, LLC, we are focused on the ownership, operation, and acquisition of self-storage properties located within the Harrisburg, Pennsylvania area.

Principles of Consolidation

These unaudited consolidated financial statements include the accounts of the Company, and its wholly owned subsidiaries, Regency Power and RSS. All significant intercompany balances and transactions have been eliminated in consolidation.

Regency Affiliates, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

Note. 1. Summary of Significant Accounting Policies (continued)

Noncontrolling Interest

The Company consolidates its 80% equity interest in Harrisburg Holdings and reports the remaining 20% interest by the third party, SSCP Management LLC, as a noncontrolling interest on the condensed consolidated balance sheet. At March 31, 2017 and December 31, 2016, the noncontrolling equity interest was \$31,324 and \$86,531, respectively. The net income or net loss of Harrisburg Holdings is allocated based on the ownership percentages on the condensed consolidated statements of income. For the three months ended March 31, 2017 and 2016, Harrisburg Holdings had net losses of \$211,220 and \$0, respectively, resulting in net loss attributable to the noncontrolling interest for the three months ended March 31, 2017 and 2016 of \$42,244 and \$0, respectively.

Cash and Cash Equivalents

Cash and cash equivalents represent cash and short-term highly liquid investments with original maturities of three months or less. The Company places its cash and cash equivalents with high credit quality financial institutions that may exceed federally insured amounts at times. As of March 31, 2017 and December 31, 2016, the Company's cash equivalents were \$4,143,900 and \$4,144,490, respectively.

Restricted Cash

The self-storage facilities hold escrow funds in money market trust accounts for real estate taxes, insurance and replacement reserves disbursements to be paid when due, pursuant to the terms of the bank financing agreement.

Inventory

Inventory consists of purchased finished goods held by RSS and is valued at the lower of cost or market value using the first-in, first out (FIFO) valuation method.

Self-Storage Properties

Self-storage properties are carried at historical cost less accumulated depreciation and any impairment losses. Major replacements and betterments, which improve or extend the life of an asset, are capitalized. Expenditures for ordinary repairs and maintenance are expensed as incurred and are included in self-storage cost of operation. Estimated depreciable lives of self-storage properties are determined by considering the age and other indicators about the condition of the assets at their respective dates of acquisition, resulting in an estimated useful life for assets within each category. All self-storage property assets are depreciated using the straight-line method. Buildings and improvements are depreciated over estimated useful lives of 39 years.

When a self-storage property is acquired in a business combination, the purchase price of the acquired self-storage property is allocated to land, buildings and improvements, furniture and equipment, customer in-place leases, assumed real estate leasehold interests, other assets acquired and liabilities assumed, based on the estimated fair value of each component. When a portfolio of self-storage properties is acquired, the purchase price is allocated to the individual self-storage properties based on the fair value determined using an income approach with appropriate risk-adjusted capitalization rates, which take into account the relative size, age and location of the individual self-storage properties.

Regency Affiliates, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Self-Storage Properties (continued)

These items consist of the following at:

	March 31, 2017	December 31, 2016
Land	\$ 4,870,000	\$ 4,870,000
Building and improvements	30,193,771	30,193,771
Furniture and equipment	14,588	14,588
	<u>35,078,359</u>	<u>35,078,359</u>
Less: Accumulated Depreciation	(742,636)	(548,565)
	<u>\$ 34,335,723</u>	<u>\$ 34,529,794</u>

Depreciation expense was \$194,071 and \$0 for the three months ended March 31, 2017 and 2016, respectively.

Customer In-place Leases

In allocating the purchase price for an acquisition accounted for as a business combination, the Company determines whether the acquisition includes intangible assets. The Company allocates a portion of the purchase price to an intangible asset attributed to the value of customer in-place leases. This intangible asset is amortized to expense using the straight-line method over 12 months, the estimated average rental period for our customers. Substantially all of the leases in place at acquired properties are at market rates, as the leases are month-to-month contracts.

Acquisition Costs, Organizational and Offering Expenses

The Company incurred title, legal and consulting fees, and other costs associated with the completion of self-storage property acquisitions. Such costs are included in acquisition costs in the accompanying statements of income in the period in which they are incurred. The Company also incurred legal fees and filing fees in connection with the organization of the Company and its subsidiaries, which are charged to expense in the period incurred.

Commissions, legal fees and other costs that are directly associated with equity offerings are capitalized as deferred offering costs, pending a determination of the success of the offering. Deferred offering costs related to successful offerings are charged to equity in the period it is determined that the offering was successful. Deferred offering costs related to unsuccessful offerings are recorded as expense in the period when it is determined that the offering is unsuccessful. Other costs related to equity offerings, such as audit fees associated with the operations of our self-storage properties for periods preceding the related contribution and formation transactions, are charged to expense in the period incurred.

Regency Affiliates, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Property, Plant and Equipment

Property, plant and equipment is carried at cost. Depreciation is provided over the estimated useful lives of the assets using the straight-line method as follows: buildings and improvements 39 years; machinery and equipment 7 years. Repairs and maintenance costs are expensed as incurred.

These items consist of the following at:

	March 31, 2017	December 31, 2016
Machinery and equipment	\$ 37,291	\$ 37,291
Less: Accumulated depreciation	(15,335)	(14,358)
	\$ 21,956	\$ 22,933

Depreciation expense was \$977 and \$0 for the three months ended March 31, 2017 and 2016, respectively.

Investments in Partnerships / LLC

The Company uses the equity method of accounting for investments in equity securities in which it has more than a 20% interest, but does not have a controlling interest and is not the primary beneficiary. The Company uses the cost method of accounting for investments in equity securities in which it has a less than 20% equity interest and virtually no influence over the investee's operations. Investments owned over 50% with a controlling interest are consolidated within these financial statements.

Evaluation of Long Lived Assets

Long-lived assets are assessed for recoverability on an ongoing basis. In evaluating the fair value and future benefits of long-lived assets, their carrying value would be reduced by the excess, if any, of the long-lived assets' carrying value over management's estimate of the anticipated undiscounted future net cash flows of the related long-lived assets.

Fair Value of Financial Instruments

The fair values of cash and cash equivalents, other current assets, and accounts payable and accrued expenses approximate their carrying values because of the short maturity of these financial instruments.

Revenue and Expense Recognition

Management has determined that all of our leases are operating leases. Substantially all leases may be terminated on a month-to-month basis and rental income is recognized ratably over the lease term using the straight-line method. Rents received in advance are deferred and recognized on a straight-line basis over the related lease term associated with the prepayment. Promotional discounts and other incentives are recognized as a reduction to rental income over the applicable lease term. Other property-related revenue consists of ancillary revenues such as tenant access fees for insurance and commissions and sales of storage supplies which are recognized in the period earned.

Property tax expense is based on actual amounts billed, or estimates of anticipated bills or assessments that have not yet been received from the taxing authorities. Cost of operations, general and administrative expense, interest expense, and advertising expenditures are expensed as incurred.

Regency Affiliates, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Stock-Based Compensation

The Company accounts for stock and stock options issued for services and compensation to employees under the fair value method. For non-employees, the fair market value of the Company's stock is measured on the date of stock issuance or the date an option/warrant is granted. The Company determines the fair market value of the options issued under the Black-Scholes Pricing Model. The Company follows the requirements of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 718-10, "Compensation – Stock Compensation," which establishes accounting for equity instruments exchanged for employee services. Under the provisions of FASB ASC 718-10, share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the requisite service period (generally the vesting period of the equity grant).

Income Taxes

The Company utilizes FASB ASC 740-10, "Income Taxes", which requires an asset and liability approach to financial accounting and reporting for income taxes. The difference between the financial statement and tax basis of assets and liabilities is determined annually. Deferred income tax assets and liabilities are computed for those temporary differences that have future tax consequences using the current enacted tax laws and rates that apply to the periods in which they are expected to affect taxable income. In some situations, FASB ASC 740-10 permits the recognition of expected benefits of utilizing net operating loss and tax credit carryforwards. Valuation allowances are established based upon management's estimate, if necessary. Income tax expense (benefit) is the current tax payable or refund for the period plus or minus the net change in the deferred tax assets and liabilities.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements, and also affect the amounts of revenues and expenses reported for each period. Actual results could differ from those which result from using such estimates. Management utilizes various other estimates, including but not limited to, assessing the collectability of accounts receivable, the valuation of inventory, determining the estimated lives of long-lived assets, determining the potential impairment of intangibles, the fair value of stock options, the recognition of revenue, and other legal claims and contingencies. The results of any changes in accounting estimates are reflected in the financial statements in the period in which the changes become evident. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the period that they are determined to be necessary.

Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial statements. These estimates are subjective in nature, involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Subsequent Events Evaluation

The Company has evaluated subsequent events through January 22, 2018, which is the date these financial statements were available to be issued.

Regency Affiliates, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

Note 2. Investment in Security Land and Development Company Limited Partnership

The Company owns a limited partnership interest in Security Land, which owns and operates an office complex. The Company has limited voting rights and is entitled to certain allocations of the profit and loss of Security Land and operating cash flow distributions.

Summarized Balance Sheet information for Security Land is as follows:

	March 31, 2017	December 31, 2016
Balance Sheet Data		
Cash and cash equivalents	\$ 149,604	\$ 150,680
Restricted cash	2,612,006	2,372,915
Real estate, net	6,875,409	7,551,756
Deferred charges, net	800,645	984,996
Receivables and other assets	1,143,956	1,143,956
Leasing cost, net of accumulated amortization	742,277	538,734
Total Assets	<u>\$ 12,323,897</u>	<u>\$ 12,743,037</u>
Accounts payable and accrued expenses	\$ 313,278	\$ 359,817
Project note payable	22,845,199	24,321,658
Accrued interest payable	47,051	50,852
Due to Affiliate	(114,190)	-
Total Liabilities	<u>\$ 23,091,338</u>	<u>\$ 24,732,327</u>
Partners' capital (deficit):		
Total Partners' Capital (Deficit)	<u>(10,767,441)</u>	<u>(11,989,290)</u>
Total Liabilities and Partner's Capital (Deficit)	<u>\$ 12,323,897</u>	<u>\$ 12,743,037</u>

Summarized Statements of Income information for Security Land is as follows:

	For the Three Months Ended March 31,	
	2017	2016
Revenues	\$ 3,505,149	\$ 3,482,162
Expenses	2,283,301	1,645,747
Net income from operations	1,221,848	1,836,415
Other expenses	-	(846,791)
Net income	<u>\$ 1,221,848</u>	<u>\$ 989,624</u>

For the three months ended March 31, 2017 and 2016, the Company's income from its equity investment in Security Land was \$1,160,756 and \$940,143, respectively.

The Company also owns a 5% limited partnership interest in 1500 Woodlawn Limited Partnership, the general partner of Security Land. The Company recognized income of \$3,055 and \$2,474 for the three months ended March 31, 2017 and 2016, respectively, from this investment.

Regency Affiliates, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

Note 3. Investment in MESC Capital LLC

The Company owns a 50% membership interest in MESC Capital, which, through its subsidiary, owns an on-site energy facility that supplies steam and electricity to a Kimberly-Clark tissue mill in Mobile, Alabama pursuant to an Amended and Restated Tissue Mill and Energy Services and Site Coordination Agreement that expires on or about April 30, 2019.

The Company accounts for the Investment in Partnerships using the equity method, whereby the carrying value of these investments are increased or decreased by the Company's allocable share of book income or loss. The Company recognized income of \$96,123 and \$235,861 for the three months ended March 31, 2017 and 2016, respectively, from this investment.

On April 24, 2017, Kimberly-Clark notified MESC Capital of its intention to not renew the lease upon its expiration on April 30, 2019.

Summarized Balance Sheet information for MESC Capital LLC is as follows:

	<u>March 31,</u> <u>2017</u>	<u>December 31,</u> <u>2016</u>
Balance Sheet Data		
Cash and cash equivalents	\$ 2,950,433	\$ 1,143,816
Restricted cash	6,705,112	6,751,878
Trade receivable	1,519,451	3,453,963
Current portion of net investment in direct financing lease	2,726,039	460,402
Inventory	3,910,907	2,673,876
Prepaid expenses and other current assets	66,416	168,488
Total current assets	<u>17,878,358</u>	<u>14,652,423</u>
Debt issuance costs, net	57,583	-
General plant, net	11,288	12,256
Investment in direct financing lease, net of current portion	3,197,876	3,883,733
Other assets- Inventory, net of current portion	-	3,637,632
Total assets	<u>\$ 21,145,105</u>	<u>\$ 22,186,044</u>
Accounts payable	\$ 1,578,083	\$ 266,705
Accounts payable to related parties	576,532	550,280
Accrued liabilities	94,640	2,881,350
Current portion of long-term debt	2,964,000	58,603
Total current liabilities	<u>5,213,255</u>	<u>3,756,938</u>
Long-term debt, net of current portion	<u>4,705,000</u>	<u>5,403,688</u>
Total liabilities	<u>9,918,255</u>	<u>9,160,626</u>
Members' equity	<u>11,226,850</u>	<u>13,025,418</u>
Total liabilities and members' equity	<u>\$ 21,145,105</u>	<u>\$ 22,186,044</u>

Regency Affiliates, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

Note 3. Investment in MESC Capital LLC

Summarized Income Statement information for MESC Capital LLC is as follows:

	For the Three Months Ended March 31,	
	2017	2016
Revenues	\$ 3,916,386	\$ 3,950,676
Expenses	3,724,141	3,478,954
Income from operations	192,245	471,722
Other income (expense)	-	-
Net income	\$ 192,245	\$ 471,722

Note 4. Stock Based Compensation

2003 Incentive Stock Plan

Effective as of March 17, 2003, the Company's Board of Directors and Stockholders approved and adopted the 2003 Stock Incentive Plan (the "2003 Plan"). The 2003 Plan allows the Administrator (as defined in the 2003 Plan), currently the Compensation Committee, to determine the issuance of incentive stock options, non-qualified stock options and restricted stock to eligible employees and outside directors and consultants of the Company. The Company has reserved 500,000 shares of common stock for issuance under the 2003 Plan. The exercise price of any option granted under the 2003 Plan is determined by the Administrator, and no option or award exercise date can exceed ten years from the grant date. On August 13, 2008, the Company's Board of Directors approved an amendment to the 2003 Plan that increased the total number of authorized shares available from 500,000 to 750,000. All other terms of the Plan remain in full force and effect.

Total stock-based compensation expense recorded within General and Administrative Expenses in the Condensed Consolidated Statements of Income was \$13,158 and \$0 during the three months ended March 31, 2017 and 2016, respectively. These amounts recognize the vested portion of the requisite grant terms. Unamortized stock-based compensation for these option awards as of March 31, 2017 was \$70,108 and will be amortized over a remaining period of 4.25 years.

As of March 31, 2017, 75,000 shares remain available for issuance under the 2003 Plan.

Regency Affiliates, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

Note 4. Stock Based Compensation, continued

The following is a summary of the status of the Company's options for the three months ended March 31, 2017:

	Exercise Price Range	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Outstanding at January 1, 2017	\$ 2.60 - 9.50	190,000	\$ 5.98	3.93
Outstanding at March 31, 2017	\$ 2.60 - 9.50	190,000	5.98	3.68
Exercisable at March 31, 2017	\$ 2.60 - 6.50	155,000	\$ 5.18	2.45

Note 5. Income Taxes

As referred to in Note 1, the Company accounts for income taxes under FASB ASC 740-10, "Income Taxes". The deferred taxes are the result of temporary differences between financial reporting and tax reporting for depreciation, earnings from the Company's partnership investment in Security Land and the recognition of income tax carry-forward items.

The Company files consolidated income tax returns with its wholly owned subsidiaries. As of December 31, 2013, for regular federal and state income tax purposes, the Company has utilized all of its net operating loss carryforwards (NOLs). The Company believes it is no longer subject to income tax examinations for years prior to 2013 by the respective taxing authorities.

The Company and the general partner of Security Land are in disagreement as to the manner in which taxable income of Security Land is to be allocated pursuant to the partnership agreement and applicable law, and for years 2004 through 2015, the Company has reported taxable income (loss) from Security Land in a manner it believes is proper, but which was different than the manner reported by Security Land. An investigation or other action by the applicable tax authorities to resolve this difference could have an adverse impact on the Company's operations and financial results.

The Company's 2014 and 2015 tax returns have recently been selected for examination by the Internal Revenue Service ("IRS").

To safeguard itself from any possible negative impact, in February 2016, the Company purchased an insurance policy and binder to insure against the negative tax consequences should any arise from the disagreement with Security Land regarding reported taxable income allocations (See Notes 2 and 7). The Company paid \$633,900 for the policy and binder which provide coverage of up to \$10 million over the next seven years in the event the IRS or a state taxing authority were to investigate and reject the Company's tax positions taken. The policy is subject to certain limitations, exclusions and retentions.

Regency Affiliates, Inc. and Subsidiaries
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Note 5. Income Taxes, continued

For the three months ended March 31, 2017 and 2016, the Company has recorded tax expense (benefit) of \$87,489 and \$(39,817), respectively, including expense of \$11,115 and \$26,000, respectively, for state income taxes. The Company's applicable statutory tax rates are 34% and 5.5% for federal and state tax purposes. The reconciliation of the Company's income tax expense (benefit) for the three months ended March 31, 2017 and 2016 is as follows:

	For the Three Months Ended March 31,	
	2017	2016
Income tax at federal statutory rate	\$ 165,200	\$ 160,000
State taxes, net of federal benefit	11,115	26,000
Permanent differences	(88,826)	(251,000)
True up of prior year tax expense	-	25,183
Total income tax expense (benefit)	\$ 87,489	\$ (39,817)

Note 6. Related Party Transactions

Effective June 1, 2012, the Board of Directors authorized the Company to compensate each Board director an annual fee of \$20,000, payable \$5,000 quarterly, in arrears, for each fiscal quarter served. Subsequent annual 3% increases have been approved through May 31, 2017.

During the three months ended March 31, 2017 and 2016, the Company incurred directors' fees of \$11,252 and \$10,924, respectively. As of March 31, 2017 and 2016, directors' fees of \$0 and \$0, respectively, were outstanding.

In May 2016, the Company entered into a consulting agreement with a non-independent member of its Board of Directors, to provide consulting, financial analyses, and due diligence services for any new potential investment available to the Company, and ongoing financial monitoring of existing investments. Terms of the agreement include an initial fee of \$7,500 and a fee of \$7,200 each month thereafter. In addition, the agreement called for a 25,000 non-qualified common stock option award, exercisable at \$9.50 per share with a term of 10 years and a vesting term of 5,000 options per year over a 5-year period. The Company may terminate the agreement at any time for cause; the consultant may terminate the agreement at will. The fair value of the options granted was \$83,400. During the three months ended March 31, 2017, the Company recorded stock-based compensation expense of \$9,400 related to this stock option. In addition, \$21,600 was paid to the consultant under the terms of the agreement during the three months ended March 31, 2017.

Pursuant to a property management agreement entered into with the SSCP, SSCP must pay 5% of the monthly gross receipts as a management fee to an entity wholly-owned by the noncontrolling equity interest. The expense was \$33,066 during the three months ended March 31, 2017. Of this amount, \$0 is included in accounts payable and accrued expenses as of March 31, 2017. On July 31, 2017 this property management agreement was terminated and the Company entered into an agreement with an unrelated third party to provide these services.

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Note 7. Contingencies, Risks, and Uncertainties

The Company is subject to numerous contingencies, risks and uncertainties including, but not limited to, the following that could have a severe impact on the Company:

- (i) A default in the Lease or sudden catastrophe to the Security West Building from uninsured acts of God or war could have a materially adverse impact upon the Company's investment in Security Land and Development Company Limited Partnership and, therefore, its financial position and results of operations (See Note 2).
- (ii) Royalty, an affiliate of the company's management, beneficially owns approximately 60% of the Company's common stock. As a result, Royalty has the ability to control the outcome of all matters requiring shareholder approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of the Company's assets.
- (iii) There are many public and private companies that are also searching for operating businesses and other business opportunities as potential acquisition or merger candidates. The Company will be in direct competition with these other companies in its search for business opportunities. Many of these entities have significantly greater financial and personnel resources than the Company.
- (iv) The Company and the general partner of Security Land are in disagreement as to the manner in which taxable income of Security Land is to be allocated pursuant to the partnership agreement and applicable law, and for years 2004 through 2015, the Company reported taxable income (loss) from Security Land in a manner the Company believes is proper, but which was different than the manner reported by Security Land (See Note 5). This may result in an investigation or other action by the applicable tax authorities and any action taken by tax authorities to resolve this difference could have an adverse impact on the Company's operations and financial results. In February 2016, the Company obtained an insurance policy to protect against such losses, however, it may not be sufficient under all circumstances to cover all potential losses to the Company in the event of any such adverse determinations.
- (v) In September 2016, the Company received an Internal Revenue Service letter indicating its 2014 Federal Form 1120 was selected for examination. Management has recently submitted the initial documentation requested.
- (vi) On April 24, 2017, Kimberly-Clark notified MESC Capital of its intention to not renew its lease.

Regency Affiliates, Inc. and Subsidiaries
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Note 8. Lease Commitments

In January 2016, Regency paid a \$201,329 security deposit and entered into a new, seven-year office lease agreement, for a 4,081 square foot space for its New York City location. Base rental payments under this agreement are \$74 per square foot per year, with a 1.75% fixed annual escalation. In addition, the Company is responsible to pay the tenant's share of real estate tax increases above the 2016/2017 base year and electricity usage. A rent concession has been granted to waive the first three months' rent. On the third anniversary of rent commencement, and provided the Company is not in default of any rental obligations, the landlord agrees to reduce the security deposit to six months' base rent, or approximately \$151,000. The lease also contains an early termination clause which is effective after five years, with proper notice and payment of an early termination fee. The office relocated in May 2016, the first month of the lease term. Rent expense for this location for the three months ended March 31, 2017 and 2016 was \$75,499 and \$0, respectively.

As of March 31, 2017, future minimum payments under this operating lease are as follows:

For the Years Ended December 31:	
2017 (remainder of year)	\$ 229,138
2018	310,864
2019	316,304
2020	321,839
2021	327,471
Thereafter	444,911
Total	\$ <u>1,950,527</u>

Note 9. License Agreement

In May 2016, a new License Agreement commenced with an unrelated entity which provides the use of leased space within the Company's New York City office, for \$8,833 per month, plus monthly office service fees, through June 2018. Annual one-year renewal periods are available, with license and service fee increases of 2.25% and 2.5%, respectively, until the expiration of the office Lease.

License fee income and related service fees for the three months ended March 31, 2017 was \$35,332.

Note 10. Simplified Employee Pension- Individual Retirement Account (SEP-IRA)

The Company adopted a SEP-IRA Plan in 2004. During the three months ended March 31, 2017 and 2016, the Company expensed contributions of \$117,325 and \$97,558, respectively, to the SEP-IRA Plan. The SEP-IRA Plan covers all employees who receive compensation from the Company during the year. Employer contributions are discretionary and determined annually. In addition, the SEP-IRA Plan allows participants to make elective deferral contributions through payroll deductions.

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Note 11. Dividends

The Board of Directors has a dividend policy whereby the Board expects to declare a total annual dividend to common shareholders of \$0.244 per share, to be paid in equal, quarterly installments of \$0.061 per share, provided that the determination to pay any cash dividends for any quarterly period will be made at the applicable time by the Board, in the Board's sole discretion, in compliance with the requirements of applicable law, and with consideration of the Company's future earnings and financial condition and other factors as may be deemed appropriate for consideration by the Board. The Dividend Policy will remain in effect until the Board determines, in its sole discretion, that it is in the best interests of the Company and its common shareholders to terminate the Dividend Policy.

In March 2017, the Board of Directors declared a quarterly cash dividend \$0.061 per share of issued and outstanding common stock to holders of record as of the close of trading on March 31, 2017, totaling \$291,467, payable on April 6, 2017. The dividend was paid on April 7, 2017. Of this amount, \$291,467 was included in dividends payable as of March 31, 2016 and was paid on April 7, 2017.

Note 12. Mortgage Note Payable

On April 18, 2016, the Company, through its subsidiary SSCP, obtained a \$25,250,000 bank note to fund the acquisition of SSCP. The note is a non-recourse debt financing with a ten-year term, 4.95% fixed interest rate, and has a maturity date of May 6, 2026. The note is guaranteed by the owners of SSCP Management LLC, and is secured by all assets of Harrisburg Holdings. The net book value of these assets at March 31, 2017 was \$35,071,072

The Company paid underwriting fees of \$126,250 in conjunction with the issuance of the note. The fees were recorded as a debt discount and are amortized over the life of the agreement. Amortization of debt discount was \$3,156 for the three months ended March 31, 2017. The only amount due during the first four years of the note is interest.

Under the terms of this agreement Harrisburg Holdings is required to meet and maintain certain financial covenants. The covenant for the three months ended March 31, 2017 is:

Minimum Debt Service Coverage Ratio	1.45 to
1.00 Actual Debt Service Coverage Ratio	1.52 to
1.00	

As of March 31, 2017, future payments due under the note are as follows:

For the Years Ended December 31:	
2017 (remainder of year)	\$ -
2018	-
2019	-
2020	248,531
2021	388,486
Thereafter	<u>24,612,983</u>
Total	<u>\$ 25,250,000</u>

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Note 13. Subsequent Events

In June 2017, the Board of Directors declared a quarterly cash dividend of \$0.061 per share of issued and outstanding common stock to holders of record as of the close of trading on June 30, 2017, totaling \$291,467, payable on July 6, 2017. The dividend was paid on July 7, 2017.

In September 2017, the Board of Directors declared a quarterly cash dividend of \$0.0625 per share of issued and outstanding common stock to holders of record as of the close of trading on September 30, 2017, totaling \$299,457, payable on October 6, 2017. The dividend was paid on October 6, 2017.

Subsequent to March 31, 2017 through the date of this report, the Company received \$2,900,000 in distributions from its investment in MESC.

On April 24, 2017, Kimberly-Clark, the lessee of a power plant that the Company holds a 50% interest in, announced that upon the termination of their lease on April 30, 2019, they would not be renewing their contract. The Company is currently in the process of finding other potential lessees for the power facility.

In December 2017, the Board of Directors declared a quarterly cash dividend of \$0.0625 per share of issued and outstanding common stock to holders of record as of the close of trading on December 29, 2017, totaling \$299,457, payable on January 5, 2018. The dividend was paid on January 5, 2018.