Regency Affiliates, Inc. and Subsidiaries

Condensed Consolidated Financial Statements

March 31, 2018

Regency Affiliates, Inc. and Subsidiaries
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Regency Affiliates, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets

	March 31, 2018 (unaudited)	December 31, 2017
Assets		
Current Assets:		
Cash and cash equivalents	$ 5,663,505	$ 5,255,732
Restricted cash	444,787	339,002
Prepaid expenses	387,962	421,693
Prepaid insurance	115,690	90,600
Prepaid income taxes	357,547	231,409
Rent receivable	18,416	20,700
Total current assets	6,987,907	6,359,136
Real Estate		
Self-storage properties	35,087,907	35,087,576
Less accumulated depreciation	(1,519,577)	(1,325,507)
Property, plant and equipment, net	23,898	25,127
Investment in partnerships/LLC	40,217,231	39,723,401
Prepaid insurance, net of current portion	354,550	377,200
Other assets	204,360	204,360
Total assets	$ 81,356,276	$ 80,451,293
Liabilities and Shareholders' Equity		
Current Liabilities:		
Accounts payable and accrued expenses	$ 424,430	$ 321,283
Deferred revenue	170,581	145,683
Deferred rent	81,081	81,081
Income tax payable	401,180	233,722
Dividends payable	299,457	299,457
Tenant security deposits	8,159	8,244
Total current liabilities	1,384,888	1,089,470
Non-current Liabilities:		
Mortgage note payable, net	25,147,882	25,144,791
Total liabilities	26,532,770	26,234,261
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; 4,791,308 and 4,791,308 shares issued and outstanding, as of March 31, 2018 and December 31, 2017, respectively	47,913	47,913
Additional paid-in capital	14,024,312	14,016,916
Retained earnings	40,728,637	40,113,418
Total shareholders' equity	54,800,862	54,178,247
Noncontrolling interest	22,644	38,785
Total equity	54,823,506	54,217,032
Total liabilities and shareholders' equity	$ 81,356,276	$ 80,451,293

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

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

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017
Revenue		
Rental	$ 830,176	$ 610,266
Insurance, late fees and other income	24,911	49,526
Retail	5,856	1,515
Total revenue	860,943	661,307
Operating expenses:		
Self-storage cost of operations	396,346	362,853
Self-storage depreciation expense	194,070	194,071
General and administrative expenses	541,440	533,014
Total operating expenses	1,131,856	1,089,938
Loss from operations	(270,913)	(428,631)
Other (income) expense:		
Income from equity investment in partnerships/LLC	(1,645,454)	(1,259,934)
License agreement income	(36,127)	(35,332)
Interest income	(45,864)	(5,589)
Interest expense	312,469	312,470
Amortization of debt discount	3,091	3,156
Total other income	(1,411,885)	(985,229)
Net income before income taxes	1,140,972	556,598
Income tax expense	235,303	87,489
Net income	905,669	469,109
Net loss attributable to noncontrolling interest	(9,007)	(42,244)
Net income allocated to shareholders	$ 914,676	$ 511,353

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

Regency Affiliates, Inc. and Subsidiaries
Condensed Consolidated Statements of Changes in Equity
For the Three Months Ended March 31, 2018

	Preferred Stock		Common Stock		Additional Paid-In Capital	Retained Earnings	Shareholders' Equity	Noncontrolling Interest	Total Equity
	Shares	Amount	Shares	Amount					
Balance at January 1, 2018	-	$ -	4,791,308	$ 47,913	$ 14,016,916	$ 40,113,418	$ 54,178,247	$ 38,785	$ 54,217,032
Stock options compensation expense	-	-	-	-	7,396	-	7,396	-	7,396
Dividend paid to noncontrolling interest	-	-	-	-	-	-	-	(7,134)	(7,134)
Dividends declared	-	-	-	-	-	(299,457)	(299,457)	-	(299,457)
Net Income	-	-	-	-	-	914,676	914,676	(9,007)	905,669
Balance at March 31, 2018 (unaudited)	-	$ -	4,791,308	$ 47,913	$ 14,024,312	$ 40,728,637	$ 54,800,862	$ 22,644	$ 54,823,506

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

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

	Three Months Ended March 31, 2018	2017
Cash Flows From Operating Activities		
Net Income	$ 905,669	$ 469,109
Adjustments to reconcile net income to net cash used in operating activities:		
Non-cash expenses		
Depreciation and amortization	195,299	195,048
Income from equity investment in partnerships/LLCs	(1,645,454)	(1,259,934)
Stock based compensation	7,396	13,158
Amortization of debt discount	3,091	3,156
Changes in operating assets and liabilities		
Prepaid expenses	33,731	1,320
Prepaid insurance	(2,440)	29,900
Prepaid income taxes	(126,138)	(235,768)
Rent receivable	2,284	(337)
Inventory	-	(4,036)
Accounts payable and accrued expenses	103,147	129,964
Deferred revenue	24,898	958
Deferred rent	-	1,385
Income tax payable	167,458	35,162
Tenant security deposits	(85)	-
Total adjustments	(1,236,813)	(1,090,024)
Net cash used in operating activities	(331,144)	(620,915)
Cash Flows From Investing Activities		
Distributions of earnings from partnerships	1,151,624	995,405
Purchase of Property and Equipment	(331)	56,598
Investment in restricted cash	(105,785)	-
Net cash provided by investing activities	1,045,508	1,052,003
Cash Flows From Financing Activities		
Dividends paid to common shareholders	(299,457)	(291,467)
Dividends paid to noncontrolling shareholder	(7,134)	(12,963)
Net cash used in financing activities	(306,591)	(304,430)
Net increase in cash and cash equivalents	407,773	126,658
Cash and cash equivalents - beginning	5,255,732	5,044,512
Cash and cash equivalents - ending	$ 5,663,505	$ 5,171,170
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for:		
Interest	$ 312,469	$ 309,814
Income taxes	$ 297,648	$ 1,045,288
Non-cash investing and financing activities:		
Common stock dividends declared	$ 299,457	$ 291,467

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

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying 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") for interim financial information. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America. However, in the opinion of the management of the Company, all adjustments necessary for a fair presentation of the financial position and operating results have been included in these statements. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report for the fiscal year ended December 31, 2017, as posted with OTC Markets on July 24, 2018. Operating results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for any subsequent quarters or for the year ending December 31, 2018.

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 condensed 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.

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 balance sheet. At March 31, 2018 and December 31, 2017, the noncontrolling equity interest was $22,644 and $38,785, respectively. The net income or net loss of Harrisburg Holdings is allocated based on the ownership percentages on the condensed statements of income. For the three months ended March 31, 2018 and 2017, Harrisburg Holdings had net losses of $31,928 and $211,220, respectively, resulting in net losses attributable to the noncontrolling interest for the three months ended March 31, 2018 and 2017 of $9,007 and $42,244, 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, 2018 and December 31, 2017, the Company's cash equivalents were $4,462,382 and $4,488,345, respectively.

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.

Note 1. Summary of Significant Accounting Policies (continued)

Self-Storage Properties (continued)

These items consist of the following at:

	March 31, 2018	December 31, 2017
Land	$ 4,870,000	$ 4,870,000
Building and improvements	30,193,771	30,193,771
Furniture and equipment	24,136	23,805
	35,087,907	35,087,576
Less: Accumulated Depreciation	(1,519,577)	(1,325,507)
	$ 33,568,330	$ 33,762,069

Depreciation expense on these properties was $194,070 and $194,071 for the three months ended March 31, 2018 and 2017, respectively.

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, 2018	December 31, 2017
Machinery and equipment	$ 43,822	$ 43,822
Less: Accumulated depreciation	(19,925)	(18,695)
	$ 23,898	$ 25,127

Depreciation expense was $1,229 and $977 for the three months ended March 31, 2018 and 2017, respectively.

Note 1. Summary of Significant Accounting Policies (continued)

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.

The Tax Cuts and Jobs Act (the "Tax Act") was enacted on December 22, 2017. The Tax Act reduces the U.S. federal corporate tax rate from 35% to 21%. As of the completion of these condensed financial statements and related disclosures, the Company has made a reasonable estimate of the effects of the Tax Act. This estimate incorporates assumptions made based upon the Company's current interpretation of the Tax Act, and may change as the Company may receive additional clarification and implementation guidance and as the interpretation of the Tax Act evolves. In accordance with SEC Staff Accounting Bulletin No. 118, the Company will finalize the accounting for the effects of the Tax Act no later than the fourth quarter of 2018. Future adjustments made to the provisional effects will be reported as a component of income tax expense in the reporting period in which any such adjustments are determined.

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.

Note 1. Summary of Significant Accounting Policies (continued)

Revenue and Expense Recognition

Management has determined that all of its 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 insurance related access fees and commissions and sales of storage supplies with 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.

Fair Value Measurements

The carrying amounts of cash, restricted cash, prepaid expenses, accounts payable, accrued liabilities, deferred revenue, and other liabilities approximate their fair value due to the short-term nature of these instruments. Cash equivalents, consisting of U.S. Treasury Bills, are adjusted to fair value at each balance sheet date based on quoted prices which are considered level 1 inputs.

ASC 820 “Fair Value Measurements and Disclosures” provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

Fair value is defined as an exit price, representing the amount that would be received upon the sale of an asset or payment to transfer a liability in an orderly transaction between market participants. Fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or liability. A three-tier fair value hierarchy is used to prioritize the inputs in measuring fair value as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable, either directly or indirectly.
- Level 3 Significant unobservable inputs that cannot be corroborated by market data.

Note 1. Summary of Significant Accounting Policies (continued)

Fair Value Measurements, continued

The fair value of the Company's financial instruments are as follows:

	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Quoted Prices for Similar Assets or Liabilities in Active Markets (Level 2)	Significant Unobservable Inputs (Level 3)	Total
U.S. Treasury Bills as of March 31, 2018	$ 4,462,382	$ -	$ -	$ 4,462,382
U.S. Treasury Bills as of December 31, 2017	$ 4,488,345	$ -	$ -	$ 4,488,345

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 October 2, 2018, which is the date these financial statements were available to be issued.

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 and operating cash flow distributions of Security Land.

For the three months ended March 31, 2018 and 2017, the Company's income from its equity investment in Security Land was $1,110,841 and $1,160,756, 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 $2,923 and $3,055 for the three months ended March 31, 2018 and 2017, respectively, from this investment.

Summarized Balance Sheet information for Security Land is as follows:

	March 31, 2018	December 31, 2017
Balance Sheet Data		
Cash and cash equivalents	$ 78,037	$ 85,245
Restricted cash	3,608,029	3,425,360
Real estate, net	4,185,385	4,865,934
Deferred charges, net	254,482	349,333
Receivables and other assets	1,151,095	1,151,095
Due from affiliate	30,797	-
Leasing cost, net of accumulated amortization	184,204	269,755
Total Assets	$ 9,492,029	$ 10,146,722
Accounts payable and accrued expenses	$ 324,041	$ 361,558
Project note payable	15,257,669	17,040,169
Accrued interest payable	131,809	135,790
Total Liabilities	$ 15,713,519	$ 17,537,517
Partners' capital (deficit):		
Total Partners' Capital (Deficit)	(6,221,490)	(7,390,795)
Total Liabilities and Partner's Capital (Deficit)	$ 9,492,029	$ 10,146,722

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

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

	For the Three Months Ended March 31,	
	2018	2017
Revenues	$ 3,495,286	$ 3,505,149
Expenses	2,325,980	2,283,301
Net income	$ 1,169,306	$ 1,221,848

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 $531,690 and $96,123 for the three months ended March 31, 2018 and 2017, 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.

Note 3. Investment in MESC Capital LLC

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

	March 31, 2018	December 31, 2017
Balance Sheet Data		
Cash and cash equivalents	$ 1,973,904	$ 2,050,457
Restricted cash	7,672,106	8,097,742
Trade receivable	1,555,975	1,782,114
Current portion of net investment in direct financing lease	3,197,876	2,893,980
Inventory	3,902,189	138,850
Prepaid expenses and other current assets	51,226	143,841
Total current assets	18,353,276	15,106,984
General plant, net	7,418	8,386
Investment in direct financing lease, net of current portion	17,426	239,753
Other assets- Inventory, net of current portion	-	1,236,509
Total assets	$ 18,378,120	$ 16,591,632
Accounts payable	$ 548,499	$ 243,418
Accounts payable to related parties	544,569	510,050
Accrued liabilities	97,222	56,437
Current portion of long-term debt	3,705,000	3,434,250
Total current liabilities	4,895,290	4,244,155
Long-term debt, net of current portion	1,000,000	2,014,776
Total liabilities	5,895,290	6,258,931
Members' equity	12,482,830	10,332,701
Total liabilities and members' equity	$ 18,378,120	$ 16,591,632

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,	
	2018	2017
Revenues	$ 3,948,648	$ 3,916,386
Expenses	2,885,270	3,724,141
Net income	$ 1,063,378	$ 192,245

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 Statements of Income was $7,396 and $13,158 during the three months ended March 31, 2018 and 2017, respectively. These amounts recognize the vested portion of the requisite grant terms. Unamortized stock-based compensation for these option awards as of March 31, 2018 was $37,230 and will be amortized over a remaining period of 3.25 years.

As of March 31, 2018, 75,000 shares remain available for issuance under the 2003 Plan.

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, 2018:

	Exercise Price Range	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Outstanding at January 1, 2018	$ 2.60-9.50	140,000	$ 6.29	4.11
Issued		-		
Exercised		-		
Outstanding at March 31, 2018	$ 2.60-9.50	140,000	$ 6.29	3.86
Exercisable at March 31, 2018	$ 2.60-9.50	112,000	$ 5.49	2.80

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 condensed 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 are under 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.

Note 5. Income Taxes, continued

For the three months ended March 31, 2018 and 2017, the Company has recorded tax expense (benefit) of $235,303 and $87,489, respectively, including expense of $48,735 and $11,115, respectively, for state income taxes. The Company's applicable statutory tax rates are 21% and 5.5% for federal and state tax purposes, respectively, for the three months ended March 31, 2018. The Company's applicable statutory tax rates are 34% and 5.5% for federal and state tax purposes, respectively, for the three months ended March 31, 2017. The reconciliation of the Company's income tax expense for the three months ended March 31, 2018 and 2017 is as follows:

	For the Three Months Ended March 31,	
	2018	2017
Income tax at federal statutory rate	$ 237,828	$ 165,200
State taxes, net of federal benefit	58,335	11,115
Permanent differences	(60,860)	(88,826)
Total income tax expense (benefit)	$ 235,303	$ 87,489

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, 2018 and 2017, the Company incurred directors' fees of $11,252 and $11,252, respectively. As of March 31, 2018 and December 31, 2017, 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 vesting 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, 2018 and 2017, the Company recorded stock-based compensation expense of $5,283 and $9,400, respectively, related to this stock option. In addition, under the terms of the agreement, the Company paid $21,600 and $21,600 to the consultant during the three months ended March 31, 2018 and 2017, respectively.

Pursuant to a property management agreement entered into with SSCP Property Management, LLC, an affiliate of SSCP, SSCP must pay 5% of the monthly gross receipts as a management fee to an entity wholly-owned by the noncontrolling equity interest. 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. The expense incurred was $0 and $33,066 during the three months ended March 31, 2018 and 2017, respectively. No amounts were owed to this party as of March 31, 2018.

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:

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).

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.

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.

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 2017, 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.

In September 2016, the Company received an Internal Revenue Service letter indicating its 2014 Federal Form 1120 was selected for examination. In September 2017, the Company received an Internal Revenue Service letter indicating its 2015 Federal Form 1120 was selected for examination. Management has submitted the initial documentation requested.

On April 24, 2017, Kimberly-Clark notified MESC Capital of its intention to not renew its lease.

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 the three months ended March 31, 2018 and 2017 was $76,912 and $75,499, respectively.

As of March 31, 2018, future minimum payments under this operating lease are as follows:

For the Years Ended December 31:	Amount
2018 (remainder of the year)	$ 234,045
2019	316,304
2020	321,839
2021	327,471
2022	333,202
Thereafter	111,709
Total	$ 1,644,570

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, 2018 and 2017 was $36,127 and $35,332, respectively.

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, 2018 and 2017, the Company expensed contributions of $117,080 and $117,325, 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.

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 $0.25 per share, to be paid in equal, quarterly installments of $0.0625 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 2018, 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 March 30, 2018, totaling $299,457, payable on April 6, 2018. The dividend was paid on April 6, 2018.

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, 2018 was $34,372,440.

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, using the straight-line method which approximates the effective interest method. Amortization of debt discount was $3,091 and $3,156 for the three months ended March 31, 2018 and 2017, respectively. 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, 2018 is:

Minimum Debt Service Coverage Ratio	1.45 to 1.00
Actual Debt Service Coverage Ratio	1.71 to 1.00

As of March 31, 2018, future minimum principal payments due under the note are as follows:

For the Years Ended December 31:	Amount
2018 (remainder of the year)	$ -
2019	-
2020	248,531
2021	388,486
2022	408,158
Thereafter	24,204,825
Total	$ 25,250,000

Note 13. Subsequent Events

Subsequent to March 31, 2018, through the date of this report, the Company received $2,200,000 in distributions from its investment in MESC.

In June 2018, 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 June 29, 2018, totaling $299,457, payable on July 6, 2018. The dividend was paid on July 6, 2018.

In September 2018, the Board of Directors increased its quarterly dividend policy to $0.0640 per share of issued and outstanding common stock.

In September 2018, the Board of Directors declared a quarterly cash dividend of $0.0640 per share of issued and outstanding common stock to holders of record as of the close of trading on September 28, 2018, totaling $308,164, payable on October 6, 2018.