

Regency Affiliates, Inc. and Subsidiary
Consolidated Financial Statements
December 31, 2015 and 2014

**Regency Affiliates, Inc. and Subsidiary
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Independent Auditor's Report

To the Board of Directors and Shareholders of
Regency Affiliates, Inc. and Subsidiary

Report on the Consolidated Financial Statements

We have audited the accompanying financial statements of Regency Affiliates, Inc. and Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2015 and 2014 and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our audit opinion.



ROSENBERG RICH BAKER BERMAN & COMPANY

To the Board of Directors and Shareholders of
Regency Affiliates, Inc. and Subsidiary

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Regency Affiliates, Inc. and Subsidiary as of December 31, 2015 and 2014, and the results of its consolidated operations, changes in shareholders' equity and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Rosenberg Rich Baker Berman & Company

Somerset, New Jersey
June 30, 2016

Regency Affiliates, Inc. and Subsidiary
Consolidated Balance Sheets

	December 31,	
	2015	2014
Assets		
Current Assets		
Cash and cash equivalents	\$ 8,287,331	\$ 8,217,616
Prepaid expenses	109,404	273,827
Prepaid income taxes	199,569	219,179
Rent receivable	19,500	13,500
Total Current Assets	8,615,804	8,724,122
Machinery and equipment, net	-	2,067
Investments in partnerships / LLC	32,450,544	28,830,436
Other assets	21,629	3,031
Total Assets	41,087,977	37,559,656
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable and accrued expenses	131,353	67,720
Income taxes payable	65,021	185,146
Dividends payable	216,115	199,571
Preferred Series D redemptions payable	-	25,510
Total Current Liabilities	412,489	477,947
Total Liabilities	412,489	477,947
Commitments and contingencies		
Shareholders' Equity		
Serial preferred stock, par value \$0.10; 2,000,000 shares authorized; -0- shares issued and outstanding	-	-
Common stock, par value \$0.01; 8,000,000 shares authorized; 3,678,559 shares in 2015 and 3,628,559 shares in 2014, issued and outstanding	36,786	36,286
Additional paid in capital	5,057,196	4,912,696
Retained earnings	35,581,506	32,132,727
Total Shareholders' Equity	40,675,488	37,081,709
Total Liabilities and Shareholders' Equity	\$ 41,087,977	\$ 37,559,656

See notes to the consolidated financial statements.

Regency Affiliates, Inc. and Subsidiary
Consolidated Statements of Income

	<u>Year Ended December 31,</u>	
	<u>2015</u>	<u>2014</u>
Net Sales	\$ <u>-</u>	\$ <u>-</u>
Costs and expenses		
General and administrative expenses	<u>(1,348,699)</u>	<u>(1,069,675)</u>
Loss from operations	<u>(1,348,699)</u>	<u>(1,069,675)</u>
Other income		
Income from equity investments in partnerships / LLC	6,550,839	6,749,812
Rental income	6,000	6,000
Interest and dividend income	<u>368</u>	<u>261</u>
Total other income	<u>6,557,207</u>	<u>6,756,073</u>
Net income before income taxes	5,208,508	5,686,398
Income tax expense	<u>925,607</u>	<u>1,274,984</u>
Net Income	\$ <u>4,282,901</u>	\$ <u>4,411,414</u>

See notes to the consolidated financial statements.

Regency Affiliates, Inc. and Subsidiary
Consolidated Statement of Changes in Shareholders' Equity
Years Ended December 31, 2015 and 2014

	Preferred Stock		Common Stock		Additional	Retained	Total
	Shares	Amount	Shares	Amount	Paid in Capital	Earnings	Shareholders' Equity
Balance – January 1, 2014	-	\$ -	3,528,559	\$ 35,286	\$ 4,712,696	\$ 28,483,311	\$ 33,231,293
Common stock options exercised	-	-	100,000	1,000	200,000	-	201,000
Cash dividends paid	-	-	-	-	-	(562,427)	(562,427)
Cash dividends declared	-	-	-	-	-	(199,571)	(199,571)
Net income	-	-	-	-	-	4,411,414	4,411,414
Balance - December 31, 2014	-	-	3,628,559	36,286	4,912,696	32,132,727	37,081,709
Common stock options exercised	-	-	50,000	500	144,500	-	145,000
Cash dividends paid	-	-	-	-	-	(618,007)	(618,007)
Cash dividends declared	-	-	-	-	-	(216,115)	(216,115)
Net income	-	-	-	-	-	4,282,901	4,282,901
Balance - December 31, 2015	-	\$ -	3,678,559	\$ 36,786	\$ 5,057,196	\$ 35,581,506	\$ 40,675,488

See notes to the consolidated financial statements.

Regency Affiliates, Inc. and Subsidiary
Consolidated Statements of Cash Flows

	Year Ended December 31,	
	2015	2014
Cash flows from operating activities		
Net income	\$ 4,282,901	\$ 4,411,414
Adjustments to reconcile net income to net cash used in operating activities		
Income from equity investment in partnerships / LLC	(6,550,839)	(6,749,812)
Depreciation and amortization	2,067	2,072
Changes in assets and liabilities		
(Increase) decrease in prepaid expenses	158,515	(42,589)
(Increase) decrease in prepaid income taxes	19,610	(150,396)
(Increase) in rent receivable	(6,000)	(6,000)
(Increase) in other assets	(18,598)	-
Increase (decrease) in accounts payable and accrued expenses	63,633	(8,741)
(Decrease) in income taxes payable	(120,125)	(221,164)
Increase (decrease) in deferred rent	5,908	(5,908)
Net cash used in operating activities	<u>(2,162,928)</u>	<u>(2,771,124)</u>
Cash flows from investing activities		
Distribution of earnings from partnership	<u>2,930,731</u>	<u>3,041,785</u>
Net cash provided by investing activities	<u>2,930,731</u>	<u>3,041,785</u>
Cash flows from financing activities		
Proceeds from exercise of common stock options	145,000	201,000
Payments for redemptions of preferred stock	(25,510)	(4,120)
Dividends paid to common shareholders	<u>(817,578)</u>	<u>(738,855)</u>
Net cash used in investing activities	<u>(698,088)</u>	<u>(541,975)</u>
Increase (decrease) in cash and cash equivalents	69,715	(271,314)
Cash and cash equivalents – beginning	<u>8,217,616</u>	<u>8,488,930</u>
Cash and cash equivalents – ending	\$ <u>8,287,331</u>	\$ <u>8,217,616</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	\$ <u>-</u>	\$ <u>-</u>
Income taxes	\$ <u>1,211,634</u>	\$ <u>1,931,044</u>

Schedule of Non-Cash Investing and Financing Activities:

In December 2015, a common stock dividend of \$216,115 was declared but not paid until January 2016.
In December 2014, a common stock dividend of \$199,571 was declared but not paid until January 2015.

See notes to the consolidated financial statements.

Regency Affiliates, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Nature of Operations – Regency 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. Also refer to Note 2, “Investment in Security Land and Development Company Limited Partnership,” for additional information.

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. Also refer to Note 3, “Investment in MESC Capital LLC,” for additional information.

Principles of Consolidation – These consolidated financial statements include the accounts of Regency Affiliates, Inc. (the “Company”), and its wholly owned subsidiary, Regency Power, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

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 employee's requisite service period (generally the vesting period of the equity grant).

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.

Regency Affiliates, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Machinery and Equipment – Machinery and equipment are carried at cost. Depreciation is provided over the estimated useful lives of the assets using the straight-line method.

These items consist of the following at December 31, 2015 and 2014:

	2015	2014
Machinery and equipment	\$ 11,752	\$ 11,752
Accumulated depreciation	11,752	9,685
	\$ -	\$ 2,067

Depreciation expense for the years ended December 31, 2015 and 2014 was \$2,067 and \$2,072, respectively.

Investments – 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.

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.

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 asset over management's estimate of the anticipated undiscounted future net cash flows of the related long-lived asset.

Use of Estimates – The preparation of financial statements in conformity with generally accepted accounting principles 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 period. Actual results could differ from those estimates.

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

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.

Regency Affiliates, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Subsequent Events Evaluation – The Company has evaluated subsequent events through June 30, 2016, which is the date these financial statements were available to be issued.

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

In November 1994, the Company purchased, for \$350,000, a limited partnership interest in Security Land, which owns and operates an office complex. The Company has limited voting rights and is entitled to allocations of the profit and loss of Security Land and operating cash flow distributions, as amended (see below).

Security Land was organized to own and operate two buildings containing approximately 717,000 net rentable square feet consisting of a two-story office building and a connected six-story office tower. The buildings were purchased by Security Land in 1986 and are located on approximately 34.3 acres of land which is also owned by Security Land. The buildings have been occupied by the United States Social Security Administration's Office of Disability and International Operations for approximately 30 years under leases between the United States of America, acting by and through the General Services Administration ("GSA"). Effective November 1, 1994, Security Land and the GSA entered into a nine-year lease for 100% of the building. In March 2003, the General Services Administration agreed to extend the terms of the lease through October 31, 2018. Security Land has received an opinion of the Assistant General Counsel to the GSA that lease payments are not subject to annual appropriation by the United States Congress and the obligations to make such payments are unconditional general obligations of the United States Government.

In April 2003, the Company entered into an amendment to the Security Land partnership agreement. The amendment provides for the distribution of the net proceeds of a loan to Security Land to the Company and the non-Company partners on a 50/50 basis, provided that such allocation would result in a minimum distribution to the Company of \$39,000,000 (a "qualified financing"). This qualified financing was obtained in June 2003 (see below). The amendment also provides that, following the qualified financing, the Company will be entitled to (i) 95% of Security Land's distributions of cash flow until it has received \$2,000,000 of such distributions, and thereafter 50% of such distributions, and (ii) once it has received \$2,000,000 of cash flow distributions, it will receive an \$180,000 annual management fee from Security Land. The foregoing percentages are inclusive of the Company's interest as a limited partner in 1500 Woodlawn Limited Partnership, the general partner of Security Land.

The refinancing of Security Land's property at 1500 Woodlawn Drive, Woodlawn, Maryland closed on June 24, 2003. US SSA LLC (a single purpose entity owned by Security Land) borrowed \$98,500,000 through a public debt issue underwritten by CTL Capital, LLC. Proceeds of the refinancing were used to repay the outstanding balance of Security Land's 1994 indebtedness, to establish reserves to make capital improvements to the property, to provide reserves required by the new debt, to pay costs and expenses related to issuing the debt, to pay fees related to the lease extension with the GSA and the financing, and to make a distribution to the partners of Security Land. The debt is for a term of 15.3 years maturing October 31, 2018 at which time the loan will have been paid down to a balance of \$10,000,000.

Security Land also obtained residual value insurance for approximately \$10,000,000. The interest cost of the financing is 4.63%. The financing is non-recourse to the Company.

Regency Affiliates, Inc. and Subsidiary
Notes to Consolidated Financial Statements

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

For the years ended December 31, 2015 and 2014, the Company's income from its equity investment in Security Land was \$3,990,867 and \$3,499,399, respectively. These funds, however, are principally committed to the amortization of the outstanding principal balance on Security Land's real estate mortgage. Security Land does not currently provide liquidity to the Company. However, in September 2015 and 2014, Security Land remitted \$18,343 and \$191,378, respectively, to the State of Maryland for Regency's allocable portion of non-resident partner withholding taxes, classified as a distribution from this investment to the Company.

Summarized financial information for Security Land is as follows as of December 31,:

	2015	2014
Balance Sheet Data		
Cash and cash equivalents	\$ 204,639	\$ 214,253
Restricted cash	3,025,444	2,648,952
Real estate, net	10,163,338	12,655,244
Deferred charges, net	1,461,057	2,076,295
Receivables and other assets	1,526,260	1,463,776
Total Assets	<u>16,380,738</u>	<u>19,058,520</u>
Accounts payable and accrued expenses	342,374	377,950
Project note payable	31,843,807	38,672,860
Accrued interest payable	65,584	79,649
Total Liabilities	<u>32,251,765</u>	<u>39,130,459</u>
Partners' capital (deficit):		
Regency Affiliates, Inc.	23,942,189	19,951,323
Other partners	(39,813,216)	(40,023,262)
Total Partners' Capital (Deficit)	<u>(15,871,027)</u>	<u>(20,071,939)</u>
Total Liabilities and Partner's Capital (Deficit)	<u>\$ 16,380,738</u>	<u>\$ 19,058,520</u>
Statement of Operations Data		
For the year ended December 31,:		
Revenues	\$ 13,902,370	\$ 13,812,952
Expenses	6,362,220	6,730,702
Net operating income	7,540,150	7,082,250
Other expenses	(3,339,238)	(3,398,673)
Net income	<u>\$ 4,200,912</u>	<u>\$ 3,683,577</u>

Effective November 30, 2000 the Company invested \$10,000 for a 5% limited partnership interest in 1500 Woodlawn Limited Partnership, the general partner of Security Land. The Company recognized income of \$10,502 in 2015 and \$9,209 in 2014 from this investment. In September 2015 and 2014, Security Land remitted \$12,388 and \$407, respectively, to the State of Maryland for Regency's allocable portion of non-resident partner withholding taxes, classified as a distribution from this investment to the Company.

Regency Affiliates, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 3. Investment in MESC Capital LLC

On April 30, 2004, the Company, through its newly-formed, wholly-owned subsidiary called Regency Power Corporation, a Delaware corporation, acquired a 50% membership interest in MESC Capital, a Delaware limited liability company, from DTE Mobile, LLC ("DTE Mobile"), pursuant to an Assignment and Assumption Agreement dated as of April 30, 2004. The purchase price for the 50% membership interest was \$3,000,000 and was funded from Regency's working capital. The terms of the Assignment and Assumption Agreement were negotiated on an arm's length basis between Regency and DTE Mobile. DTE Mobile, which is owned by an unregulated subsidiary of a large energy company that has significant experience in owning, managing and operating electric generation and on-site energy facilities, owns the other 50% membership interest in MESC Capital.

MESC Capital was formed to acquire all of the membership interests in Mobile Energy. Mobile Energy 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 acquisition of Mobile Energy was also consummated on April 30, 2004 pursuant to a Membership Interest Purchase Agreement, dated as of January 30, 2004, between MESC Capital and Mobile Energy Services Holdings, Inc. The purchase price under the Membership Interest Purchase Agreement, after certain pre-closing adjustments, was \$33,600,000, and is subject to certain post-closing adjustments. The purchase price and working capital reserves were funded by the issuance of \$28,500,000 of non-recourse debt, a total equity contribution by MESC Capital of \$8,600,290, \$4,300,145 of which was funded by Regency Power and \$4,300,145 of which was funded by DTE Mobile, and a credit of \$1,000,000 on account of existing and continuing tax-exempt indebtedness of Mobile Energy. The terms of the Membership Interest Purchase Agreement were negotiated on an arms'-length basis between MESC Capital and Mobile Energy. The Company did not participate in negotiations with respect to the Membership Interest Purchase Agreement.

The \$28,500,000 acquisition indebtedness was obtained from Allied Irish Banks, P.L.C., which may assign or participate the loan in accordance with the terms of the loan agreement. The loan will be amortized over the fifteen-year term, and is currently held by Bank of America. In connection with the acquisition of the 50% membership interest in MESC Capital, Regency Power and DTE Mobile entered into an Operating Agreement, dated April 30, 2004, which sets forth their respective rights and obligations as members of MESC Capital as well as the duties and authority of DTE Mobile as the managing member of MESC Capital. Under the Operating Agreement, Regency Power will receive 50% of all distributions. Neither Regency Power nor DTE Mobile is obligated to contribute additional capital, or loan or otherwise advance funds, to MESC Capital, and neither member can sell or transfer its interest in MESC Capital without the consent of the other and without first complying with a right of first offer in favor of the non-selling member.

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 \$2,549,470 in 2015 and \$3,241,204 in 2014 from this investment.

Regency Affiliates, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 3. Investment in MESC Capital LLC (continued)

Summarized financial information for MESC Capital LLC is as follows as of December 31,:

	2015	2014
Balance Sheet Data		
Cash and cash equivalents	\$ 698,659	\$ 1,493,120
Restricted cash	7,564,636	8,241,445
Trade receivable	2,532,225	1,844,931
Current portion of net investment in direct financing lease	2,470,511	2,282,614
Inventory	782,399	580,084
Prepaid expenses and other current assets	178,241	197,121
Total current assets	<u>14,226,671</u>	<u>14,639,315</u>
Debt issuance costs	135,667	218,646
Inventory, net of current portion	3,196,931	3,391,477
General plant, net	19,588	27,414
Investment in direct financing lease, net of current portion	6,557,609	9,028,120
Total assets	<u>24,136,466</u>	<u>27,304,972</u>
Accounts payable	248,071	226,332
Accounts payable to related parties	552,279	593,970
Accrued liabilities	62,292	58,786
Current portion of long-term debt	2,633,400	2,451,000
Total current liabilities	<u>3,496,042</u>	<u>3,330,088</u>
Long-term debt, net of current portion	8,355,850	10,989,250
Total liabilities	<u>11,851,892</u>	<u>14,319,338</u>
Members' equity	12,284,574	12,985,634
Total liabilities and members' equity	<u>\$24,136,466</u>	<u>\$ 27,304,972</u>
Statement of Operations Data		
For the year ended December 31,:		
Revenues	\$16,167,634	\$ 16,177,100
Expenses	10,802,057	9,213,273
Net operating income	5,365,577	6,963,827
Other expense	(266,637)	(481,418)
Net income	<u>\$ 5,098,940</u>	<u>\$ 6,482,409</u>

Regency Affiliates, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 4. Serial Preferred Stock

At December 31, 2015 and 2014, the Company had 2,000,000 authorized shares of \$.10 par value Series A preferred stock; none was issued or outstanding.

On October 19, 2009, the Company redeemed all outstanding shares of its 7% Cumulative Contingent Convertible, Junior Preferred Stock, \$10, Series D, \$.10 par value, issued in 1992, ("the Series D Preferred Stock") for \$10.00 per share (\$256,940 in the aggregate for the 25,694 shares of Series D Preferred Stock outstanding). The redemption price was payable upon presentation and surrender by Series D preferred stockholders of their Series D preferred stock certificates in the manner provided in the notice of redemption. From and after the redemption effective date in 2009, the Series D Preferred Stock is no longer deemed to be outstanding, and all rights of the holders thereof as stockholders of the Company ceased. As of December 31, 2015, the Company has paid out the full \$256,940 redemption proceeds.

Note 5. 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.

No options were issued during the years ended December 31, 2015 or 2014.

During 2015, the Company received \$145,000 from the exercise of 50,000 common stock options nearing expiration, at \$2.90, by an option holder.

During 2014, the Company received \$201,000 from the exercise of 100,000 common stock options nearing expiration, at \$2.01, by two option holders.

As of December 31, 2015, 110,000 shares remain available for issuance under the 2003 Plan.

Regency Affiliates, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 5. Stock-Based Compensation (continued)

The following is a summary of the activity and status of the Company's options for the years ended December 31, 2015 and 2014:

	Exercise Price Range	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Outstanding at 1/1/14	\$ 2.01 - 6.50	355,000	\$ 4.12	3.68
Issued	-	-	-	-
Exercised, forfeited or expired	2.01	100,000	2.01	-
Outstanding at 12/31/14	2.60 - 6.50	255,000	4.95	3.95
Issued	-	-	-	-
Exercised, forfeited or expired	2.90	50,000	2.90	-
Outstanding at 12/31/15	\$ 2.60 - 6.50	205,000	\$ 5.45	2.86
Vested and Exercisable at 12/31/15	\$ 2.60 - 6.50	205,000	\$ 5.45	2.86

Note 6. 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 long-term 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 carryforward items.

The Company files consolidated income tax returns with its wholly owned subsidiary. 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's tax returns have not recently been examined by the Internal Revenue Service ("Service") and there is no assurance that the Service would not attempt to limit the Company's use of its net operating loss carry forwards. The Company's 2012, 2013 and 2014 federal and state income tax returns remain subject to examination by the respective taxing authorities. In addition, net operating losses arising from prior years are also subject to examination at the time they are utilized in future years.

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. To safeguard itself from any possible negative impact, subsequent to the balance sheet date, 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 (See Note 13).

For the years ended December 31, 2015 and 2014, the Company has provided \$704,507 and \$1,001,654, respectively, for regular Federal income taxes, and \$221,100 and \$273,330, respectively, for state income taxes. The Company's applicable statutory tax rates are 34% and 5.5% for federal and state tax purposes.

Regency Affiliates, Inc. and Subsidiary
Notes to Consolidated Financial Statements

Note 7. Employment Agreements

During 2015 and 2014, the Company maintained an employment agreement with its Chief Executive Officer, Laurence S. Levy, the 100% owner of Royalty Management, Inc. (Royalty Management), the entity that controls the Company's majority shareholder, Royalty Holdings, LLC (Royalty). Mr. Levy earns a base annual salary, SEP IRA contributions and expense reimbursements. As detailed below, Mr. Levy's compensation has been subsequently adjusted. SEP IRA contributions of \$53,000 and \$52,000, respectively, for the benefit of Mr. Levy, are included in the 2015 and 2014 Consolidated Statements of Income. No amounts remain outstanding as of December 31, 2015 or 2014. The employment agreement with Mr. Levy has been continued subsequent to the balance sheet date.

The Company's Chief Financial Officer, Marc H. Baldinger, does not have an employment agreement with the Company. Mr. Baldinger earns a base salary, SEP IRA contributions and expense reimbursements. As detailed below, Mr. Baldinger's compensation has been subsequently adjusted. SEP IRA contributions of \$13,713 and \$12,930, respectively, for the benefit of Mr. Baldinger, are included in the 2015 and 2014 Consolidated Statements of Income. \$600 and \$-0- remain outstanding as of December 31, 2015 and 2014, respectively. Mr. Baldinger has resigned from this position subsequent to the balance sheet date.

Since 2013, the Board of Directors has approved annual 3% increases in base salaries for the Company's CEO and CFO. The CEO earned \$245,858 and \$238,696 in salary in 2015 and 2014, respectively. In addition, \$54,636 and \$53,045 in bonus awards were approved for the CEO for the years ended December 31, 2015 and 2014, respectively.

Note 8. Related Party Transactions

Pursuant to a License Agreement entered into in March 2003, Royalty Management, Inc., which is wholly-owned by Laurence Levy, the Company's CEO and President, provides New York City office space, office supplies and services to the Company for \$126,000 per year. This License Agreement was terminated effective September 30, 2015, at which time Regency began paying the monthly New York City office rent of \$11,158 directly to the landlord through the end of 2015. During the years ended December 31, 2015 and 2014, Regency expensed \$94,500 and \$126,000, respectively, for this related party License Agreement. As of December 31, 2015, Regency owed \$10,500 to the related party, included within Accounts Payable on the balance sheet. As of December 31, 2014, Regency had prepaid \$10,500 to the related party, included in Prepaid Expenses on the balance sheet.

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 in have been approved through 2015.

During the years ended December 31, 2015 and 2014, the Company incurred directors' fees of \$23,827 and \$41,200, respectively, for services rendered. As of December 31, 2015 and 2014, no director fees were outstanding.

During 2012, the Company entered into a month to month sub-lease rental agreement with an entity 100% owned by its CFO. Pursuant to the terms of the agreement, monthly sub-lease rental income to the Company will be \$500, effective January 1, 2012. Sub-lease rental income from this related party was \$6,000 for each of the years ended December 31, 2015 and 2014. During the years ended December 31, 2015 and 2014, zero was collected. As of December 31, 2015 and 2014, \$19,500 and \$13,500, respectively, was receivable from the related party.

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Note 9. 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) The Company had significant tax loss and credit carryforwards in past years and no assurance can be provided that the Internal Revenue Service would not attempt to limit or disallow altogether the Company's use, retroactively and/or prospectively, of such carryforwards, due to ownership changes or any other reason. The disallowance of the utilization of the Company's net operating losses would severely impact the Company's financial position and results of operations due to the significant amounts of taxable income (generated by the Company's investment in Security Land) that has in the past been offset by the Company's net operating loss carryforwards (See Note 6).
- (iii) 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.
- (iv) 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.
- (v) 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 6). 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. Subsequent to the balance sheet date, 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 (See Note 13).

Regency Affiliates, Inc. and Subsidiary
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Note 10. Lease Commitments

In January 2012, Regency's Florida office relocated and entered into a new, four-year lease agreement, for a 1,365 square foot space. Minimum lease payments under this agreement are \$26,754 per year. A rent concession has been granted to waive the first and last five months' rent, provided the lease terms have not been breached. As a result, minimum lease payments for each year 1 and 4 amount to \$15,607, and for years 2 and 3, \$26,754. In addition, the Company is responsible to pay the tenant's share of operating expenses that are estimated to be \$6.50 per square foot on an annualized basis.

In September 2015, the Florida office lease was extended for an additional five years. Per the terms of this First Lease Amendment, base rental payments of \$26,754, remain the same for 2016, until January 2017 through December 2020, at which time annual base rental payments will increase by the prior year's Consumer Price Index percentage adjustments (See Note 13).

Rent expense was \$22,451 for each of the years ended December 31, 2015 and 2014.

In addition, as discussed in Note 8, during 2012, the Company entered into a month to month sub-lease rental agreement with an entity 100% owned by its CFO. Pursuant to the terms of the agreement, monthly sub-lease rental income to the Company will be \$500, effective January 1, 2012. Sub-lease rental income from this related party was \$6,000 for each of the years ended December 31, 2015 and 2014. During the years ended December 31, 2015 and 2014, zero was collected. As of December 31, 2015 and 2014, \$19,500 and \$13,500, respectively, was receivable from the related party.

Note 11. Simplified Employee Pension – Individual Retirement Account (SEP-IRA)

The Company adopted a SEP-IRA Plan in 2004. During the years ended December 31, 2015 and 2014, the Company expensed contributions of \$73,317 and \$71,343, respectively, to the SEP-IRA Plan. The SEP-IRA Plan covers all employees who received 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 12. Dividends

In September 2013, the Board of Directors adopted a Dividend Policy whereby the Board expects to declare a total annual dividend to common shareholders of \$0.20 per share, to be paid in equal, quarterly installments of \$0.05 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. In September 2014, the Board amended the Policy and increased the total annual dividend to common shareholders to \$0.22 per share, to be paid in equal, quarterly installments of \$0.055 per share. In September 2015, the Board again amended the Policy and increased the total annual dividend to common shareholders to \$0.235 per share, to be paid in equal, quarterly installments of \$0.05875 per share. 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.

Dividends have been declared and paid quarterly pursuant to the above from September 2013 through April 2016. Total dividends paid in 2015 and 2014 were \$817,578 and \$738,855, respectively.

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Notes to Consolidated Financial Statements

Note 12. Dividends (continued)

In December 2015, the Board of Directors declared a quarterly \$0.05875 per share of issued and outstanding common stock cash dividend to holders of record as of the close of trading on December 30, 2015, payable on January 7, 2016. The total dividend of \$216,115 was paid from surplus earnings of the Company in January 2016.

In December 2014, the Board of Directors declared a quarterly \$0.055 per share of issued and outstanding common stock cash dividend to holders of record as of the close of trading on December 30, 2014, payable on January 7, 2015. The total dividend of \$199,571 was paid from surplus earnings of the Company in January 2015.

Note 13. Subsequent Events

Effective January 1, 2016, a 3% increase in base salaries for all employees was approved by the Board of Directors. In addition, a 3% increase in quarterly directors' fees was approved for 2016.

On January 7, 2016, the cash dividend declared in December 2015, of \$216,115, was paid.

In January 2016, Regency paid a \$201,329 security deposit for a new office lease for its New York City location.

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 3, 6 and 9). 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.

In March 2016, a corporate officer exercised 50,000 common stock options with a strike price of \$6.27 nearing expiration, on a cashless basis. Total common shares issued amounted to 20,952.

In March 2016, the Board of Directors declared a quarterly \$0.05875 per share of issued and outstanding common stock cash dividend to holders of record as of the close of trading on March 31, 2016, totaling \$217,346, payable on April 7, 2016. The dividend was paid in April 2016.

On March 16, 2016, the Company commenced a private stock offering of up to 1,212,121 shares of common stock at a purchase price of \$8.25 per share, to its shareholders of record as of January 22, 2016, who are accredited investors as defined in Rule 501 of Regulation D under the Securities Act of 1933. The offering, originally set to expire on April 7, 2016, was extended to May 12, 2016. At the close of the offering, 1,078,633 common shares were sold for total gross proceeds raised of \$8,898,722.

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Note 13. Subsequent Events (continued)

On April 6, 2016, the Company formed a wholly owned subsidiary, RSS Investments, LLC. On April 18, 2016, the Company, through its newly formed wholly owned subsidiary, entered into a majority owned joint-venture interest. Also on this date, the joint-venture interest completed its acquisition of a portfolio of five stand-alone self-storage facilities in the Harrisburg, Pennsylvania vicinity, for a total purchase price of \$35 million. The facilities comprise approximately 330,000 square feet of net rentable space consisting of in excess of 2,500 climate and non-climate controlled storage units. The purchase price and related transaction expenses were financed by an \$11,231,000 capital contribution by the Company to its joint-venture purchaser and a \$25,250,000 non-recourse debt financing with a ten year term, 4.95% fixed interest rate, and 30 year amortization commencing after a four year interest only period. The joint venture terms provide the Company with a 7.5% per annum preferred return on its \$11,231,000 capital contribution, and a 7.5% per annum preferred return to SSCP Management, LLC, the minority joint-venture partner, on its base contribution amount of \$350,000. After satisfaction of the preference amounts, 80% of surplus cash flow is allocated to the Company and 20% to SSCP Management, LLC. The facilities will be managed on a day-to-day basis by a newly-engaged third party property management company, who is an affiliate of SSCP Management, LLC.

In April 2016, the Board of Directors concluded it would be cost-effective to close the Florida office location and are currently in negotiations with the landlord for an early release of the office lease term.

In May 2016, the Company's New York City office relocated and entered into a new, seven-year lease agreement, for a 4,081 square foot space. 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.

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 2017. 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.

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, a 25,000 non-qualified common stock option award, exercisable at \$9.50 per share with a term of 10 years and vest and become exercisable over a 5 year period, and \$7,200 per month thereafter for the term of the agreement. The Company may terminate the agreement at any time for cause; the consultant may terminate the agreement at will.

In May 2016, the Compensation Committee authorized the issuance of 10,000 non-qualified common stock options, exercisable at \$9.50 per share, to its new Chief Financial Officer, under the 2003 Plan. The options granted have a term of 10 years and vest and become exercisable over a 5 year period.

Subsequent to December 31, 2015 through the date of this report, the Company received \$1,500,000 in distributions from its investment in MESC.