

Regency Affiliates, Inc. and Subsidiaries

Consolidated Financial Statements

December 31, 2016 and 2015

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

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

We have audited the accompanying consolidated financial statements of Regency Affiliates, Inc. and Subsidiaries (the "Company"), which comprise the consolidated balance sheet as of December 31, 2016 and 2015, and the related consolidated statements of income, changes in 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from 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 basis for our audit opinion.

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 Subsidiaries as of December 31, 2016 and 2015, and the consolidated results of its operations and its 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
October 23, 2017

Regency Affiliates, Inc. and Subsidiaries
Consolidated Balance Sheets

	As of December 31,	
	2016	2015
Assets		
Current Assets:		
Cash and cash equivalents	\$ 5,044,512	\$ 8,287,331
Restricted cash	289,469	-
Prepaid expenses	386,640	109,404
Prepaid insurance	105,100	-
Prepaid income taxes	67,392	199,569
Rent receivable	4,119	19,500
Inventory	5,741	-
Total current assets	5,902,973	8,615,804
Real Estate		
Self-storage properties	35,078,359	-
Less accumulated depreciation	(548,565)	-
Property, plant and equipment, net	22,933	-
Investment in partnerships/LLC	36,689,891	32,450,544
Prepaid insurance, net of current portion	467,800	-
Other assets	204,360	21,629
Total assets	\$ 77,817,751	\$ 41,087,977
Liabilities and Shareholders' Equity		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 199,061	\$ 131,353
Deferred revenue	142,285	-
Deferred rent	79,192	-
Income tax payable	12,000	65,021
Dividends payable	291,467	216,115
Tenant security deposits	9,296	-
Total current liabilities	733,301	412,489
Non-current Liabilities:		
Mortgage note payable, net	25,132,167	-
Total liabilities	25,865,468	412,489
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 and 3,678,559 shares issued and outstanding, as of December 31, 2016 and December 31, 2015, respectively	47,781	36,786
Additional paid-in capital	13,978,408	5,057,196
Retained earnings	37,839,563	35,581,506
Total shareholders' equity	51,865,752	40,675,488
Noncontrolling interest	86,531	-
Total equity	51,952,283	40,675,488
Total liabilities and shareholders' equity	\$ 77,817,751	\$ 41,087,977

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

Regency Affiliates, Inc. and Subsidiaries
Consolidated Statements of Income

	Years Ended Decemberr 31,	
	2016	2015
Revenue		
Rental	\$ 2,190,622	\$ -
Insurance, late fees and other income	146,332	-
Retail	4,770	-
Total revenue	<u>2,341,724</u>	<u>-</u>
Operating expenses:		
Self-storage cost of operations	864,232	-
Self-storage depreciation expense	548,565	-
General and administrative expenses	2,140,887	1,348,699
Total operating expenses	<u>3,553,684</u>	<u>1,348,699</u>
Loss from operations	<u>(1,211,960)</u>	<u>(1,348,699)</u>
Other (income) expense:		
Acquisition costs	1,298,494	-
Income from equity investment in partnerships/LLC	(7,289,347)	(6,550,839)
License agreement income	(54,522)	(6,000)
Interest income	(2,610)	(368)
Interest expense	880,049	-
Amortization of debt discount	8,417	-
Total other income	<u>(5,159,519)</u>	<u>(6,557,207)</u>
Net income before income taxes	3,947,559	5,208,508
Income tax expense	<u>860,090</u>	<u>925,607</u>
Net income	3,087,469	4,282,901
Net loss attributable to noncontrolling interest	<u>(251,584)</u>	<u>-</u>
Net income allocated to shareholders	<u>\$ 3,339,053</u>	<u>\$ 4,282,901</u>

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

Regency Affiliates, Inc. and Subsidiaries
Consolidated Statements of Changes in Equity
For the Years Ended December 31, 2016 and 2015

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Retained Earnings</u>	<u>Shareholders' Equity</u>	<u>Noncontrolling Interest</u>	<u>Total Equity</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>					
Balance at January 1, 2015	-	\$ -	3,628,559	\$ 36,286	\$ 4,912,696	\$ 32,132,727	\$ 37,081,709	\$ -	\$ 37,081,709
Cashless exercise of common stock options	-	-	50,000	500	144,500	-	145,000	-	145,000
Cash dividends paid	-	-	-	-	-	(618,007)	(618,007)	-	(618,007)
Cash dividends declared	-	-	-	-	-	(216,115)	(216,115)	-	(216,115)
Net income (loss)	-	-	-	-	-	4,282,901	4,282,901	-	4,282,901
Balance at December 31, 2015	-	\$ -	3,678,559	\$ 36,786	\$ 5,057,196	\$ 35,581,506	\$ 40,675,488	\$ -	\$ 40,675,488
Cashless exercise of common stock options	-	-	20,952	209	(209)	-	-	-	-
Common stock issued through private placement offering	-	-	1,078,633	10,786	8,887,936	-	8,898,722	-	8,898,722
Noncontrolling interest expense	-	-	-	-	-	-	-	350,000	350,000
Stock options compensation expense	-	-	-	-	33,485	-	33,485	-	33,485
Dividend paid to noncontrolling interest	-	-	-	-	-	-	-	(11,885)	(11,885)
Cash dividends paid	-	-	-	-	-	(789,529)	(789,529)	-	(789,529)
Cash dividends declared	-	-	-	-	-	(291,467)	(291,467)	-	(291,467)
Net income (loss)	-	-	-	-	-	3,339,053	3,339,053	(251,584)	3,087,469
Balance at December 31, 2016	-	\$ -	4,778,144	\$ 47,781	\$ 13,978,408	\$ 37,839,563	\$ 51,865,752	\$ 86,531	\$ 51,952,283

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

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

	Years Ended December 31,	
	2016	2015
Cash Flows From Operating Activities		
Net Income	\$ 3,087,469	\$ 4,282,901
Adjustments to reconcile net income to net cash used in operating activities:		
Non-cash expenses		
Depreciation and amortization	551,171	2,067
Income from equity investment in partnerships/LLCs	(7,289,347)	(6,550,839)
Stock based compensation	33,485	-
Amortization of debt discount	8,417	-
Bad debt expense	21,000	-
Changes in operating assets and liabilities		
Prepaid expenses	(307,906)	158,515
Prepaid insurance	(540,400)	-
Prepaid income taxes	132,177	19,610
Rent receivable	(5,619)	(6,000)
Inventory	(2,073)	-
Other assets	(182,731)	(18,598)
Accounts payable and accrued expenses	8,735	63,633
Deferred revenue	142,285	-
Deferred rent	79,192	5,908
Income tax payable	(53,021)	(120,125)
Tenant security deposits	(1,000)	-
Total adjustments	<u>(7,405,635)</u>	<u>(6,445,829)</u>
Net cash used in operating activities	<u>(4,318,166)</u>	<u>(2,162,928)</u>
Cash Flows From Investing Activities		
Acquisition of SSCP, net of cash acquired and acquisition expenses	(9,750,000)	-
Distributions of earnings from partnerships	3,050,000	2,930,731
Purchase of Property and Equipment	(40,127)	-
Investment in restricted cash	(289,469)	-
Net cash (used in) provided by investing activities	<u>(7,029,596)</u>	<u>2,930,731</u>
Cash Flows From Financing Activities		
Dividends paid to common shareholders	(1,005,644)	(817,578)
Proceeds from exercise of common stock options	-	145,000
Dividends paid to noncontrolling shareholder	(11,885)	-
Proceeds from comon stock private placement offering	8,898,722	-
Payments for redemptions of preferred stock	-	(25,510)
Cash paid for debt financing fee	(126,250)	-
Contribution from non-controlling interest	350,000	-
Net cash provided by (used in) financing activities	<u>8,104,943</u>	<u>(698,088)</u>
Net (decrease) increase in cash and cash equivalents	(3,242,819)	69,715
Cash and cash equivalents - beginning	<u>8,287,331</u>	<u>8,217,616</u>
Cash and cash equivalents - ending	<u>\$ 5,044,512</u>	<u>\$ 8,287,331</u>
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for:		
Interest	<u>\$ 777,320</u>	<u>\$ -</u>
Income taxes	<u>\$ 1,045,288</u>	<u>\$ 1,211,634</u>
Non-cash investing and financing activities:		
Common stock dividends declared	<u>\$ 291,467</u>	<u>\$ 216,115</u>
Cashless exercise of common stock	<u>\$ 209</u>	<u>\$ -</u>
Mortgage note payable to finance acquisition of Harrisburg Holdings investment	<u>\$ 25,250,000</u>	<u>\$ -</u>

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

Regency Affiliates, Inc. and Subsidiaries
Notes to 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”). Certain amounts previously reported in our 2015 financial statements have been reclassified to conform to the 2016 presentation.

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. See Note 4, “Acquisition of SSCP Harrisburg Holdings, LLC.” 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 consolidated financial statements include the accounts of Regency Affiliates, Inc. (the “Company”), and its wholly owned subsidiaries, Regency Power and RSS Investments LLC. All significant intercompany balances and transactions have been eliminated in consolidation.

Regency Affiliates, Inc. and Subsidiaries
Notes to 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 consolidated balance sheet. At December 31, 2016 and 2015, the noncontrolling equity interest was \$86,531 and \$0, respectively. The net income or net loss of Harrisburg Holdings is allocated based on the ownership percentages on the consolidated statements of income. For the years ended December 31, 2016 and 2015, Harrisburg Holdings had net losses of \$1,257,920 and \$0, respectively, resulting in net loss attributable to the noncontrolling interest for the years ended December 31, 2016 and 2015 of \$251,584 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 December 31, 2016 and 2015, the Company's cash equivalents were \$4,145,850 and \$0, 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 Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies (continued)

Self-Storage Properties (continued)

These items consist of the following at:

	December 31,	
	2016	2015
Land	\$ 4,870,000	\$ -
Building and improvements	30,193,771	-
Furniture and equipment	14,588	-
	35,078,359	-
Less: Accumulated Depreciation	(548,565)	-
	\$ 34,529,794	\$ -

Depreciation expense was \$548,565 and \$0 for the years ended December 31, 2016 and 2015, 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. The Company evaluated this in the current year acquisitions and determined this amount was immaterial.

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 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:

	December 31,	
	2016	2015
Machinery and equipment	\$ 37,291	\$ 11,752
Less: Accumulated depreciation	(14,358)	(11,752)
	\$ 22,933	\$ -

Depreciation expense was \$2,606 and \$2,067 for the years ended December 31, 2016 and 2015, 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 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 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 dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

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 23, 2017, which is the date these financial statements were available to be issued.

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

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.

For the years ended December 31, 2016 and 2015, the Company's income from its equity investment in Security Land was \$3,858,770 and \$3,990,867, 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, Security Land remitted \$18,343 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 Subsidiaries
Notes to Consolidated Financial Statements

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

Summarized Balance Sheet information for Security Land is as follows:

	As of December 31,	
	2016	2015
Balance Sheet Data		
Cash and cash equivalents	\$ 150,680	\$ 204,639
Restricted cash	2,372,915	3,025,444
Real estate, net	7,551,756	10,163,338
Deferred charges, net	984,996	1,461,057
Receivables and other assets	1,143,956	1,526,260
Leasing cost, net of accumulated amortization	538,734	-
Total Assets	<u>\$ 12,743,037</u>	<u>\$ 16,380,738</u>
Accounts payable and accrued expenses	\$ 359,817	\$ 342,374
Project note payable	24,321,658	31,843,807
Accrued interest payable	50,852	65,584
Total Liabilities	<u>\$ 24,732,327</u>	<u>\$ 32,251,765</u>
Partners' capital (deficit):		
Total Partners' Capital (Deficit)	(11,989,290)	(15,871,027)
Total Liabilities and Partner's Capital (Deficit)	<u>\$ 12,743,037</u>	<u>\$ 16,380,738</u>

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

	For the Years Ended December 31,	
	2016	2015
Revenues	\$ 13,803,667	\$ 13,902,370
Expenses	9,742,015	6,362,220
Net income from operations	4,061,652	7,540,150
Other expenses	-	(3,339,238)
Net income	<u>\$ 4,061,652</u>	<u>\$ 4,200,912</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

\$10,154 and \$10,502 for the years ended December 31, 2016 and 2015, respectively, from this investment. In September 2015, Security Land remitted \$12,388 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 Subsidiaries
Notes to Consolidated Financial Statements

Note 3. Investment in MESC Capital LLC

On April 30, 2004, the Company, through a 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 \$3,420,423 and \$2,549,470 for the years ended December 31, 2016 and 2015, respectively, from this investment.

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

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

Note 3. Investment in MESC Capital LLC (continued)

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

	As of December 31:	
	2016	2015
Balance Sheet Data		
Cash and cash equivalents	\$ 1,143,816	\$ 698,659
Restricted cash	6,751,878	7,564,636
Trade receivable	3,453,963	2,532,225
Current portion of net investment in direct financing lease	460,402	2,470,511
Inventory	2,673,876	782,399
Prepaid expenses and other current assets	168,488	178,241
Total current assets	14,652,423	14,226,671
Debt issuance cost	-	135,667
General plant, net	12,256	19,588
Investment in direct financing lease, net of current portion	3,883,733	6,557,609
Other assets- Inventory, net of current portion	3,637,632	3,196,931
Total assets	\$ 22,186,044	\$ 24,136,466
Accounts payable	\$ 266,705	\$ 248,071
Accounts payable to related parties	550,280	552,279
Accrued liabilities	2,881,350	62,292
Current portion of long-term debt	58,603	2,633,400
Total current liabilities	3,756,938	3,496,042
Long-term debt, net of current portion	5,403,688	8,355,850
Total liabilities	9,160,626	11,851,892
Members' equity	13,025,418	12,284,574
Total liabilities and members' equity	\$ 22,186,044	\$ 24,136,466

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

	For the Years Ended December 31,	
	2016	2015
Revenues	\$ 16,138,819	\$ 16,167,634
Expenses	8,990,418	10,719,078
Income from operations	7,148,401	5,448,556
Other income (expense)	(307,557)	(349,616)
Net income	\$ 6,840,844	\$ 5,098,940

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

Note 4. Self-Storage Property Acquisition and Dispositions

On April 6, 2016, the Company formed a new, wholly owned subsidiary called RSS Investments LLC (“RSS”), a Delaware limited liability company. On April 18, 2016, RSS entered into a joint-venture, acquiring 97% of the outstanding preferred shares and 80% of the outstanding common shares of SSCP Harrisburg Holdings, LLC (“Harrisburg Holdings”). Harrisburg Holdings is the sole member of SSCP Harrisburg Intermediate Holdings, LLC (“Intermediate Holdings”). Also on this date, Intermediate Holdings 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.

RSS funded the acquisition with proceeds from Regency’s private stock offering (See Note 13) and Regency’s working capital. The purchase price and related transaction expenses were financed with an \$11,230,744 acquisition cash capital contribution by RSS 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 initial 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.

Regency accounts for its Investment in Harrisburg Holdings on a consolidated basis, reflecting the minority joint-venture partner’s equity and share of net income or loss within the noncontrolling interest accounts. The fair value of the purchase price has been allocated to the assets acquired and liabilities assumed based on their estimated fair values. The following table summarizes the allocation of the fair value of identifiable assets acquired and liabilities assumed in the acquisition.

	Allocation of Fair Value
Land	\$ 4,870,000
Building and improvements	30,193,771
Property, plant and equipment, net	35,063,771
Inventory	3,668
Prepaid expenses and other current assets	1,830
Assets acquired	35,069,269
Accounts payable and accrued liabilities	(58,973)
Tenant security deposits	(10,296)
Liabilities acquired	(69,269)
Net assets acquired over liabilities acquired	35,000,000
Total purchase price	\$ 35,000,000

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

Note 5. Serial Preferred Stock

At December 31, 2016 and 2015, the Company had 2,000,000 authorized shares of \$0.10 par value Series A preferred stock; none were 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, \$0.10 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. During the years ended December 31, 2016 and 2015, the Company paid \$0 and \$256,940, respectively, to stockholders for the redemptions. All redemption proceeds were paid in full as of December 31, 2015.

Note 6. 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.

In May 2016, the Company issued a 25,000 non-qualified common stock option award, exercisable at \$9.50 per share with a term of 10 years and which vest and become exercisable over a 5-year period, to a non-independent member of its Board of Directors, in conjunction with a consulting agreement entered into with him. See Note 8, “Related Party Transactions” for additional information about this agreement.

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.

Total compensation expense recorded within General and Administrative Expenses in the Consolidated Statements of Income was \$33,485 and \$0 during the years ended December 31, 2016 and 2015, respectively. These amounts recognize the vested portion of the requisite grant terms. Future stock-based compensation for these option awards amount to \$83,268. The fair value of the stock options granted during 2016 is estimated as of the date of grant using a Black-Scholes option valuation model which requires highly subjective assumptions including the expected stock price volatility. The fair value of the Company’s stock options was estimated using the following assumptions: 2.45% annual rate of quarterly dividends, U.S. Treasury 10-year risk free rate of 1.75%, expected average life of 10 years, and an expected stock price volatility of 40.87%.

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

Note 6. Stock Based Compensation (continued)

2003 Incentive Stock Plan (continued)

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

As of December 31, 2016, 75,000 shares remain available for issuance under the 2003 Plan.

The following is a summary of the status of the Company's options for the years ended December 31, 2016:

	Exercise Price Range	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Outstanding at January 1, 2016	\$ 2.60 - 6.50	205,000	\$ 5.45	2.61
Issued	9.50	35,000	9.50	9.63
Exercised, forfeited or expired	6.27	(50,000)	6.27	-
Outstanding at December 31, 2016	<u>\$ 2.60 - 9.50</u>	<u>190,000</u>	<u>\$ 5.98</u>	<u>3.93</u>
Exercisable at December 31, 2016	<u>\$ 2.60 - 6.50</u>	<u>155,000</u>	<u>\$ 5.18</u>	<u>2.70</u>

Note 7. 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. In addition, net operating losses arising from prior years are also subject to examination at the time that 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.

The Company's 2014 tax return has recently been selected for examination by the Internal Revenue Service ("IRS").

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

Note 7. Income Taxes (continued)

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 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.

For the years ended December 31, 2016 and 2015, the Company has recorded tax expense of \$860,090 and \$925,607, respectively, including \$113,762 and \$109,560, 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 for the years ended December 31, 2016 and 2015 is as follows:

	For the years ended December 31,	
	2016	2015
Income tax at federal statutory rate	\$ 1,324,821	\$ 1,770,893
State taxes, net of federal benefit	113,762	109,560
Permanent differences	(521,647)	(954,846)
True up of prior year tax expense	(56,846)	-
Total income tax expense	\$ 860,090	\$ 925,607

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 directly to the landlord. During the year ended December 31, 2015, Regency expensed \$94,500 for this related party License Agreement.

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 2017.

During the years ended December 31, 2016 and 2015, the Company incurred directors' fees of \$43,697 and \$23,827, respectively, for services rendered. As of December 31, 2016 and 2015, directors' fees of \$0 and \$0, respectively, 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 was \$500, effective January 1, 2012. Sub-lease rental income from this related party was \$1,552 and \$6,000 for the years ended December 31, 2016 and 2015, respectively. In March 2016, the Company terminated the sub-lease rental agreement with the entity, at which time, management determined the \$21,000 outstanding receivable balance to be uncollectible and charged it to expense.

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

Note 8. Related Party Transactions (continued)

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. The options were valued using the Black Scholes pricing model (See Note 6). During the year ended December 31, 2016, the Company recorded stock based compensation expense of \$23,918 related to this stock option. In addition, \$47,100 was paid to the consultant under this terms of the agreement through December 31, 2016.

Pursuant to the Property Management Agreement entered into with the SSCP Acquisition, 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 \$109,370 during the year ended December 31, 2016. Of this amount, \$14,700 is included in accounts payable and accrued expenses as of December 31, 2016.

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 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 7).
- (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.

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

Note 9. Contingencies, Risks, and Uncertainties (continued)

(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 7). 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.

(vi) 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.

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

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 were \$26,754 per year. A rent concession had 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 amounted to \$15,607 and for years 2 and 3, \$26,754. In addition, the Company was 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, the Company paid annual base rent of \$26,754 from September 2015 until October 1, 2016, when the Company terminated this lease, as described below.

In April 2016, the Board of Directors concluded it would be cost-effective to close the Florida office location. Management began negotiations with the landlord for an early release of the office lease term. A settlement of \$7,716, plus loss of its \$2,500 security deposit held by the landlord, was entered into effective October 1, 2016, thereby releasing Regency from any remaining lease obligations or claims for the Florida location.

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 was \$500, effective January 1, 2012. Sub-lease rental income from this related party was \$1,500 and \$6,000 for the years ended December 31, 2016 and 2015. In March 2016, the Company terminated the sub-lease rental agreement with the entity, at which time, management determined the \$21,000 outstanding receivable balance to be uncollectible and charged it to expense.

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

Note 10. Lease Commitments (continued)

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 years ended December 31, 2016 and 2015 was \$205,022 and \$0, respectively.

As of December 31, 2016, future minimum payments under this operating lease are as follows:

<u>For the Years Ended</u>	
2017	\$ 305,517
2018	310,864
2019	316,304
2020	321,839
2021	327,471
Thereafter	<u>444,911</u>
Total	\$ <u>2,026,906</u>

Note 11. 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 year ended December 31, 2016 was \$54,522.

Note 12. Simplified Employee Pension- Individual Retirement Account (SEP-IRA)

The Company adopted a SEP-IRA Plan in 2004. During the years ended December 31, 2016 and 2015, the Company expensed contributions of \$113,883 and \$73,317, 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.

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

Note 13. Private Offering of Stock

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. These funds were used in the Harrisburg Holdings acquisition (See Note 4).

Note 14. 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 June 2016.

In September 2016, the Board of Directors amended its Dividend Policy to increase the total annual dividend to common shareholders by 3.8%, or \$0.244 per common share.

During the years ended December 31, 2016 and 2015, the Company declared total quarterly dividends of \$1,080,995 and \$834,122, respectively. Of this amount, \$291,467 is included in dividends payable as of December 31, 2016 and was paid on January 7, 2017.

Note 15. Mortgage Note Payable

As noted in Note 4, on April 18, 2016, the Company, through its five self-storage properties, 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 December 31, 2016 was \$35,392,894.

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 \$8,417 for the year ended December 31, 2016. The only amount due during the first four years of the note is interest.

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

Note 15. Mortgage Note Payable (continued)

Under the terms of this agreement Harrisburg Holdings is required to meet and maintain certain financial covenants. The covenant for the year ended December 31, 2016 is:

Minimum Debt Service Coverage Ratio	1.45 to 1.00
Actual Debt Service Coverage Ratio	1.68 to 1.00

Future payments due under the note are as follows for the years ended December 31:

2017	\$	-
2018		-
2019		-
2020		248,531
2021		388,486
Thereafter		<u>24,612,983</u>
Total	\$	<u><u>25,250,000</u></u>

Note 16. Subsequent Events

In March 2017, the Board of Directors declared a quarterly \$0.061 per share of issued and outstanding common stock cash dividend 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.

In June 2017, the Board of Directors declared a quarterly \$0.061 per share of issued and outstanding common stock cash dividend 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.

Subsequent to December 31, 2016 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.