

**Regency Affiliates, Inc. and Subsidiaries**  
**Condensed Consolidated Financial Statements**  
**June 30, 2018**

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

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

We have reviewed the accompanying interim condensed consolidated financial statements of Regency Affiliates, Inc. and Subsidiaries, which comprise the interim condensed consolidated balance sheet as of June 30, 2018, and the related interim condensed consolidated statements of income, changes in equity, and cash flows for the three and six months ended June 30, 2018 and 2017, and the related notes to the interim condensed consolidated financial statements.

### Management's Responsibility for the Financial Information

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

### Auditor's Responsibility

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

### Conclusion

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

*Rosenberg Rich Baker Berman & Company*

Somerset, New Jersey  
November 14, 2018

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

|  | June 30, 2018 | December 31, 2017 |
|--|---------------|-------------------|
|  | (unaudited)   |                   |
| <b>Assets</b>  |               |                   |
| Current Assets:  |               |                   |
| Cash and cash equivalents  | \$ 3,905,620  | \$ 5,255,732      |
| Restricted cash  | 527,827       | 339,002           |
| Prepaid expenses   | 390,182       | 421,693           |
| Prepaid insurance  | 107,327       | 90,600            |
| Prepaid income taxes   | -             | 231,409           |
| Rent receivable  | 24,125        | 20,700            |
| Total current assets   | 4,955,081     | 6,359,136         |
| Real Estate  |               |                   |
| Self-storage properties  | 35,089,264    | 35,087,576        |
| Less accumulated depreciation  | (1,714,308)   | (1,325,507)       |
| Property and equipment, net  | 22,669        | 25,127            |
| Investment in partnerships/LLC   | 41,434,005    | 39,723,401        |
| Prepaid insurance, net of current portion  | 331,900       | 377,200           |
| Other assets   | 204,360       | 204,360           |
| Total assets   | \$ 80,322,971 | \$ 80,451,293     |
| <b>Liabilities and Shareholders' Equity</b>  |               |                   |
| Current Liabilities:   |               |                   |
| Accounts payable and accrued expenses  | \$ 562,976    | \$ 321,283        |
| Deferred revenue   | 169,362       | 145,683           |
| Deferred rent  | 81,081        | 81,081            |
| Income tax payable   | 45,731        | 233,722           |
| Dividends payable  | 299,457       | 299,457           |
| Tenant security deposits   | 7,939         | 8,244             |
| Total current liabilities  | 1,166,546     | 1,089,470         |
| Non-current Liabilities:   |               |                   |
| Mortgage note payable, net   | 25,151,008    | 25,144,791        |
| Total liabilities  | 26,317,554    | 26,234,261        |
| Commitments and contingencies  |               |                   |
| Shareholders' Equity   |               |                   |
| Serial preferred stock, par value \$0.10;<br>2,000,000 shares authorized; no shares issued<br>and outstanding  | -             | -                 |
| Common stock, par value \$0.01; 8,000,000<br>shares authorized; 4,791,308 and 4,791,308<br>shares issued and outstanding, as of June 30,<br>2018 and December 31, 2017, respectively | 47,913        | 47,913            |
| Additional paid-in capital   | 14,030,318    | 14,016,916        |
| Retained earnings  | 39,901,768    | 40,113,418        |
| Total shareholders' equity   | 53,979,999    | 54,178,247        |
| Noncontrolling interest  | 25,418        | 38,785            |
| Total equity   | 54,005,417    | 54,217,032        |
| Total liabilities and shareholders' equity   | \$ 80,322,971 | \$ 80,451,293     |

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

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

|  | Three Months Ended June 30, |                     | Six Months Ended June 30, |                     |
|--|-----------------------------|---------------------|---------------------------|---------------------|
|  | 2018                        | 2017                | 2018                      | 2017                |
| Revenue  |                             |                     |                           |                     |
| Rental   | \$ 825,580                  | \$ 938,078          | \$ 1,611,016              | \$ 1,548,344        |
| Insurance, late fees and other income              | 72,750                      | 95,233              | 142,401                   | 144,759             |
| Retail   | 6,128                       | 5,252               | 11,984                    | 6,767               |
| Total revenue                                      | <u>904,458</u>              | <u>1,038,563</u>    | <u>1,765,401</u>          | <u>1,699,870</u>    |
| Operating expenses:                                |                             |                     |                           |                     |
| Self-storage cost of operations                    | 351,058                     | 262,343             | 747,404                   | 625,196             |
| Self-storage depreciation expense                  | 194,731                     | 194,071             | 388,801                   | 388,142             |
| General and administrative expenses                | 522,837                     | 462,238             | 1,064,277                 | 995,252             |
| Total operating expenses                           | <u>1,068,626</u>            | <u>918,652</u>      | <u>2,200,482</u>          | <u>2,008,590</u>    |
| (Loss) income from operations                      | <u>(164,168)</u>            | <u>119,911</u>      | <u>(435,081)</u>          | <u>(308,720)</u>    |
| Other (income) expense:                            |                             |                     |                           |                     |
| Income from equity investment in partnerships/LLC  | (2,166,774)                 | (2,050,701)         | (3,812,228)               | (3,310,635)         |
| License agreement income                           | (27,095)                    | (26,499)            | (63,222)                  | (61,831)            |
| Interest income                                    | (503)                       | (36)                | (46,367)                  | (5,625)             |
| Interest expense                                   | 319,411                     | 282,305             | 631,880                   | 594,775             |
| Amortization of debt discount                      | 3,126                       | 3,157               | 6,217                     | 6,313               |
| Total other (income) expense                       | <u>(1,871,835)</u>          | <u>(1,791,774)</u>  | <u>(3,283,720)</u>        | <u>(2,777,003)</u>  |
| Net income before income taxes                     | 1,707,667                   | 1,911,685           | 2,848,639                 | 2,468,283           |
| Income tax expense                                 | <u>2,225,742</u>            | <u>708,741</u>      | <u>2,461,045</u>          | <u>796,230</u>      |
| Net (loss) income                                  | (518,075)                   | 1,202,944           | 387,594                   | 1,672,053           |
| Net income attributable to noncontrolling interest | <u>9,337</u>                | <u>59,333</u>       | <u>330</u>                | <u>17,809</u>       |
| Net (loss) income allocated to shareholders        | <u>\$ (527,412)</u>         | <u>\$ 1,143,611</u> | <u>\$ 387,264</u>         | <u>\$ 1,654,244</u> |

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

**Regency Affiliates, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Changes in Equity**  
**For the Six Months Ended June 30, 2018**

|  | Preferred Stock |        | Common Stock |           | Additional Paid-<br>In Capital | Retained Earnings | Shareholders'<br>Equity | Noncontrolling<br>Interest | Total Equity  |
|--|-----------------|--------|--------------|-----------|--------------------------------|-------------------|-------------------------|----------------------------|---------------|
|  | Shares          | Amount | Shares       | Amount    |                                |                   |                         |                            |               |
| Balance at January 1, 2018               | -               | \$ -   | 4,791,308    | \$ 47,913 | \$ 14,016,916                  | \$ 40,113,418     | \$ 54,178,247           | \$ 38,785                  | \$ 54,217,032 |
| Stock options compensation expense       | -               | -      | -            | -         | 13,402                         | -                 | 13,402                  | -                          | 13,402        |
| Dividend paid to noncontrolling interest | -               | -      | -            | -         | -                              | -                 | -                       | (13,697)                   | (13,697)      |
| Dividends declared                       | -               | -      | -            | -         | -                              | (598,914)         | (598,914)               | -                          | (598,914)     |
| Net Income                               | -               | -      | -            | -         | -                              | 387,264           | 387,264                 | 330                        | 387,594       |
| Balance at June 30, 2018 (unaudited)     | -               | \$ -   | 4,791,308    | \$ 47,913 | \$ 14,030,318                  | \$ 39,901,768     | \$ 53,979,999           | \$ 25,418                  | \$ 54,005,417 |

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

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

|   | Six Months Ended June 30, |                     |
|---|---------------------------|---------------------|
|   | 2018                      | 2017                |
| <b>Cash Flows From Operating Activities</b>                                   |                           |                     |
| Net Income  | \$ 387,594                | \$ 1,672,053        |
| Adjustments to reconcile net income to net cash used in operating activities: |                           |                     |
| Non-cash expenses   |                           |                     |
| Depreciation  | 391,259                   | 390,096             |
| Income from equity investment in partnerships/LLCs                            | (3,812,228)               | (3,310,635)         |
| Stock based compensation  | 13,402                    | 23,519              |
| Amortization of debt discount   | 6,217                     | 6,313               |
| Changes in operating assets and liabilities                                   |                           |                     |
| Prepaid expenses  | 31,511                    | 11,801              |
| Prepaid insurance   | 28,573                    | 52,492              |
| Prepaid income taxes  | 231,409                   | (189,865)           |
| Rent receivable   | (3,425)                   | (25,846)            |
| Inventory   | -                         | (566)               |
| Accounts payable and accrued expenses   | 241,693                   | (87,373)            |
| Deferred revenue  | 23,679                    | (4,892)             |
| Deferred rent   | -                         | 1,889               |
| Income tax payable  | (187,991)                 | (12,000)            |
| Tenant security deposits  | (305)                     | 2,034               |
| Total adjustments   | <u>(3,036,206)</u>        | <u>(3,143,033)</u>  |
| Net cash used in operating activities   | <u>(2,648,612)</u>        | <u>(1,470,980)</u>  |
| <b>Cash Flows From Investing Activities</b>                                   |                           |                     |
| Distributions of earnings from partnerships                                   | 2,101,624                 | 1,495,405           |
| Purchase of self storage equipment  | (1,688)                   | -                   |
| Change in restricted cash   | (188,825)                 | (29,714)            |
| Net cash provided by investing activities                                     | <u>1,911,111</u>          | <u>1,465,691</u>    |
| <b>Cash Flows From Financing Activities</b>                                   |                           |                     |
| Dividends paid to common shareholders   | (598,914)                 | (582,934)           |
| Dividends paid to noncontrolling shareholder                                  | (13,697)                  | (25,926)            |
| Net cash used in financing activities   | <u>(612,611)</u>          | <u>(608,860)</u>    |
| Net decrease in cash and cash equivalents                                     | (1,350,112)               | (614,149)           |
| Cash and cash equivalents - beginning   | <u>5,255,732</u>          | <u>5,044,512</u>    |
| Cash and cash equivalents - ending  | <u>\$ 3,905,620</u>       | <u>\$ 4,430,363</u> |
| <b>Supplemental Disclosures of Cash Flow Information</b>                      |                           |                     |
| Cash paid during the period for:  |                           |                     |
| Interest  | \$ 631,881                | \$ 546,835          |
| Income taxes  | <u>\$ 2,417,627</u>       | <u>\$ 998,095</u>   |
| Non-cash investing and financing activities:                                  |                           |                     |
| Common stock dividends declared   | <u>\$ 299,457</u>         | <u>\$ 291,467</u>   |

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

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

**Note 1. Summary of Significant Accounting Policies**

*Basis of Presentation*

The accompanying financial statements are presented on an accrual basis in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) as defined in the Financial Accounting Standards Board Accounting Standards Codification (the “Codification”) for interim financial information. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America. However, in the opinion of the management of the Company, all adjustments necessary for a fair presentation of the financial position and operating results have been included in these statements. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report for the fiscal year ended December 31, 2017, as posted with OTC Markets on July 24, 2018. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for any subsequent quarters or for the year ending December 31, 2018.

*Nature of Operations*

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

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

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

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

*Principles of Consolidation*

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



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

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

*Noncontrolling Interest*

The Company consolidates its 80% equity interest in Harrisburg Holdings and reports the remaining 20% interest by the third party, SSCP Management LLC, as a noncontrolling interest on the condensed balance sheet. At June 30, 2018 and December 31, 2017, the noncontrolling equity interest was \$25,418 and \$38,785, respectively. The net income or net loss of Harrisburg Holdings is allocated based on the ownership percentages on the condensed statements of income. For the three months ended June 30, 2018 and 2017, Harrisburg Holdings had net income of \$33,578 and \$296,665, respectively, resulting in net income attributable to the noncontrolling interest for the three months ended June 30, 2018 and 2017 of \$9,337 and \$59,333, respectively. For the six months ended June 30, 2018 and 2017, Harrisburg Holdings had net income of \$1,650 and \$120,057, respectively, resulting in net income attributable to the noncontrolling interest for the six months ended June 30, 2018 and 2017 of \$330 and \$17,809, respectively.

*Reclassification*

Certain amounts in prior periods have been reclassified to conform to current period presentation. These reclassifications had no effect on the previously reported net income (loss).

*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 June 30, 2018 and December 31, 2017, the Company's cash equivalents were \$3,265,047 and \$4,488,345, respectively.

*Self-Storage Properties*

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

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

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

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

*Self-Storage Properties (continued)*

These items consist of the following at:

|                                | June 30, 2018        | December 31, 2017    |
|--------------------------------|----------------------|----------------------|
| Land                           | \$ 4,870,000         | \$ 4,870,000         |
| Building and improvements      | 30,193,771           | 30,193,771           |
| Furniture and equipment        | 25,493               | 23,805               |
|                                | <u>35,089,264</u>    | <u>35,087,576</u>    |
| Less: Accumulated Depreciation | (1,714,308)          | (1,325,507)          |
|                                | <u>\$ 33,374,956</u> | <u>\$ 33,762,069</u> |

Depreciation expense on these properties was \$194,731 and \$194,071 for the three months ended June 30, 2018 and 2017, respectively. Depreciation expense on these properties was \$388,801 and \$388,142 for the six months ended June 30, 2018 and 2017, respectively.

*Property and Equipment*

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

These items consist of the following at:

|                                | June 30, 2018    | December 31, 2017 |
|--------------------------------|------------------|-------------------|
| Machinery and equipment        | \$ 43,822        | \$ 43,822         |
| Less: Accumulated depreciation | (21,153)         | (18,695)          |
|                                | <u>\$ 22,669</u> | <u>\$ 25,127</u>  |

Depreciation expense was \$1,229 and \$977 for the three months ended June 30, 2018 and 2017, respectively. Depreciation expense was \$2,458 and \$2,132 for the six months ended June 30, 2018 and 2017, respectively.

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

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

*Income Taxes*

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

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

*Use of Estimates*

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

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

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

*Revenue and Expense Recognition*

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

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

*Fair Value Measurements*

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

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

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

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

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

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

*Fair Value Measurements, continued*

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

|  | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets or<br>Liabilities<br>(Level 1) | Quoted Prices<br>for Similar<br>Assets or<br>Liabilities in<br>Active Markets<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total        |
|--|--|--|--|--------------|
| U.S. Treasury Bills as of<br>June 30, 2018     | \$ 3,265,047   | \$ -   | \$ -   | \$ 3,265,047 |
| U.S. Treasury Bills as of<br>December 31, 2017 | \$ 4,488,345   | \$ -   | \$ -   | \$ 4,488,345 |

*Limitations*

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

*Subsequent Events Evaluation*

The Company has evaluated subsequent events through November 14, 2018, which is the date these financial statements were available to be issued.

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

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

For the three months ended June 30, 2018 and 2017, the Company's income from its equity investment in Security Land was \$1,098,140 and \$867,295, respectively.

For the six months ended June 30, 2018 and 2017, the Company's income from its equity investment in Security Land was \$2,208,981 and \$2,047,303, respectively.

The Company also owns a 5% limited partnership interest in 1500 Woodlawn Limited Partnership, the general partner of Security Land. The Company recognized income of \$2,923 and \$2,282 for the three months ended June 30, 2018 and 2017, respectively, from this investment. The Company recognized income of \$5,813 and \$5,337 for the six months ended June 30, 2018 and 2017, respectively, from this investment.

**Regency Affiliates, Inc. and Subsidiaries**  
**Notes to Condensed 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:

|   | June 30, 2018 | December 31, 2017 |
|---|---------------|-------------------|
| <b>Balance Sheet Data</b>                         |               |                   |
| Cash and cash equivalents                         | \$ 71,980     | \$ 85,245         |
| Restricted cash                                   | 3,772,438     | 3,245,360         |
| Real estate, net                                  | 3,507,315     | 4,865,934         |
| Deferred charges, net                             | 88,691        | 349,333           |
| Receivables and other assets                      | 1,151,095     | 1,151,095         |
| Due from affiliate                                | 37,986        | -                 |
| Prepaid expenses and other receivables            | 42,283        | -                 |
| Leasing cost, net of accumulated amortization     | -             | 269,755           |
| Total Assets                                      | \$ 8,671,788  | \$ 10,146,722     |
|   |               |                   |
| Accounts payable and accrued expenses             | \$ 305,592    | \$ 361,558        |
| Project note payable                              | 13,305,671    | 17,040,169        |
| Accrued interest payable                          | 126,076       | 135,790           |
| Total Liabilities                                 | \$ 13,737,339 | \$ 17,537,517     |
|   |               |                   |
| <b>Partners' capital (deficit):</b>               |               |                   |
| Total Partners' Capital (Deficit)                 | (5,065,551)   | (7,390,795)       |
| Total Liabilities and Partner's Capital (Deficit) | \$ 8,671,788  | \$ 10,146,722     |

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

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

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

|                            | For the Three Months Ended<br>June 30, |                   | For the Six Months Ended<br>June 30, |                     |
|----------------------------|--|-------------------|--------------------------------------|---------------------|
|                            | 2018                                   | 2017              | 2018                                 | 2017                |
| Revenues                   | \$ 3,516,972                           | \$ 3,493,917      | \$ 7,012,258                         | \$ 6,999,066        |
| Expenses                   | 1,514,244                              | 1,914,728         | 2,993,433                            | 3,743,057           |
| Net income from operations | 2,002,728                              | 1,579,189         | 4,018,825                            | 3,256,009           |
| Other expenses             | (846,791)                              | (666,246)         | (1,693,582)                          | (1,121,218)         |
| Net income                 | <u>\$ 1,155,937</u>                    | <u>\$ 912,943</u> | <u>\$ 2,325,243</u>                  | <u>\$ 2,134,791</u> |

**Note 3. Investment in MESC Capital LLC**

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

The Company accounts for the Investment in Partnerships using the equity method, whereby the carrying value of these investments are increased or decreased by the Company's allocable share of book income or loss. The Company recognized income of \$1,065,711 and \$1,181,124 for the three months ended June 30, 2018 and 2017, respectively, from this investment. The Company recognized income of \$1,597,400 and \$1,277,247 for the six months ended June 30, 2018 and 2017, respectively, from this investment.

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

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

**Note 3. Investment in MESC Capital LLC**

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

|  | <u>June 30, 2018</u> | <u>December 31, 2017</u> |
|--|----------------------|--------------------------|
| Balance Sheet Data   |                      |                          |
| Cash and cash equivalents                                    | \$ 1,487,712         | \$ 2,050,457             |
| Restricted cash  | 7,713,768            | 8,097,742                |
| Trade receivable   | 1,580,022            | 1,782,114                |
| Current portion of net investment in direct financing lease  | 1,724,381            | 2,893,980                |
| Inventory  | 1,228,042            | 138,850                  |
| Prepaid expenses and other current assets                    | 273,985              | 143,841                  |
| Total current assets   | <u>14,007,910</u>    | <u>15,106,984</u>        |
| General plant, net   | 6,451                | 12,256                   |
| Investment in direct financing lease, net of current portion | 10,763               | 239,753                  |
| Other assets- Inventory, net of current portion              | -                    | 1,236,509                |
| Total assets   | <u>\$ 14,025,124</u> | <u>\$ 16,591,632</u>     |
| Accounts payable   | \$ 148,690           | \$ 243,418               |
| Accounts payable to related parties                          | 524,093              | 510,050                  |
| Accrued liabilities  | 121,087              | 56,437                   |
| Current portion of long-term debt                            | 2,907,000            | 3,434,250                |
| Total current liabilities                                    | <u>3,700,870</u>     | <u>4,244,155</u>         |
| Long-term debt, net of current portion                       | <u>1,000,000</u>     | <u>2,014,776</u>         |
| Total liabilities  | <u>4,700,870</u>     | <u>6,258,931</u>         |
| Members' equity  | 9,324,254            | 10,332,701               |
| Total liabilities and members' equity                        | <u>\$ 14,025,124</u> | <u>\$ 16,591,632</u>     |



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

**Note 3. Investment in MESC Capital LLC**

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

|            | For the Three Months Ended |                  | For the Six Months Ended |                  |
|------------|----------------------------|------------------|--------------------------|------------------|
|            | June 30,                   |                  | June 30,                 |                  |
|            | 2018                       | 2017             | 2018                     | 2017             |
| Revenues   | \$ 3,925,835               | \$ 3,895,658     | \$ 7,874,483             | \$ 7,812,044     |
| Expenses   | 1,794,413                  | 1,533,411        | 4,679,683                | 5,257,552        |
| Net Income | <u>2,131,422</u>           | <u>2,362,247</u> | <u>3,194,800</u>         | <u>2,554,492</u> |

**Note 4. Stock Based Compensation**

*2003 Incentive Stock Plan*

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

Total stock-based compensation expense recorded within General and Administrative Expenses in the Condensed Statements of Income was \$6,006 and \$10,361 during the three months ended June 30, 2018 and 2017, respectively. Total stock-based compensation expense recorded within General and Administrative Expenses in the Consolidated Statements of Income was \$13,402 and \$23,519 during the six months ended June 30, 2018 and 2017, respectively. These amounts recognize the vested portion of the requisite grant terms. Unamortized stock-based compensation for these option awards as of June 30, 2018 was \$31,224 and will be amortized over a remaining period of 3 years.

As of June 30, 2018, 75,000 shares remain available for issuance under the 2003 Plan.

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

**Note 4. Stock Based Compensation, continued**

The following is a summary of the status of the Company's options for the six months ended June 30, 2018:

|                                | Exercise<br>Price<br>Range | Options | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life |
|--------------------------------|----------------------------|---------|--|---|
| Outstanding at January 1, 2018 | \$ 2.60-9.50               | 140,000 | \$ 6.29                                  | 4.11  |
| Issued                         |                            | -       |  |   |
| Exercised                      |                            | -       |  |   |
| Outstanding at June 30, 2018   | \$ 2.60-9.50               | 140,000 | \$ 6.29                                  | 3.62  |
| Exercisable at June 30, 2018   | \$ 2.60-9.50               | 119,000 | \$ 5.72                                  | 2.86  |

**Note 5. Income Taxes**

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

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

The Company and the general partner of Security Land are in disagreement as to the manner in which taxable income of Security Land is to be allocated pursuant to the partnership agreement and applicable law, and for years 2004 through 2017, the Company has reported taxable income and loss from Security Land in a manner it believes is proper, but which was different than the manner reported by Security Land. An investigation or other action by the applicable tax authorities to resolve this difference could have an adverse impact on the Company's operations and financial results.

The Company's 2014 and 2015 tax returns are under examination by the Internal Revenue Service ("IRS").

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

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

**Note 5. Income Taxes, continued**

For the three months ended June 30, 2018 and 2017, the Company has recorded tax expense of \$2,225,742 and \$708,741, respectively, including expense of \$151,950 and \$104,836, respectively, for state income taxes. For the six months ended June 30, 2018 and 2017, the Company has recorded tax expense of \$2,461,045 and \$796,230, respectively, including expense of \$210,285 and \$115,951, respectively, for state income taxes. The Company's applicable statutory tax rates are 21% and 5.5% for federal and state tax purposes, respectively, for the three and six months ended June 30, 2018. The Company's applicable statutory tax rates are 34% and 5.5% for federal and state tax purposes, respectively, for the three and six months ended June 30, 2017. The reconciliation of the Company's income tax expense for the three and six months ended June 30, 2018 and 2017 is as follows:

|                                      | For the Three Months Ended |                   | For the Six Months Ended |                   |
|--------------------------------------|----------------------------|-------------------|--------------------------|-------------------|
|                                      | June 30,                   |                   | June 30,                 |                   |
|                                      | 2018                       | 2017              | 2018                     | 2017              |
| Income tax at federal statutory rate | \$ 360,386                 | \$ 720,594        | \$ 598,214               | \$ 885,794        |
| State taxes, net of federal benefit  | 151,950                    | 104,836           | 210,285                  | 115,951           |
| Change in prior year tax estimate    | 2,020,046                  | -                 | 2,020,046                | -                 |
| Permanent differences                | (306,640)                  | (116,689)         | (367,500)                | (205,515)         |
| Total income tax expense (benefit)   | <u>\$ 2,225,742</u>        | <u>\$ 708,741</u> | <u>\$ 2,461,045</u>      | <u>\$ 796,230</u> |

**Note 6. Related Party Transactions**

In May 2016, the Company entered into a consulting agreement with a non-independent member of its Board of Directors, to provide consulting, financial analyses, and due diligence services for any new potential investment available to the Company, and ongoing financial monitoring of existing investments. Terms of the agreement include an initial fee of \$7,500 and a fee of \$7,200 each month thereafter. In addition, the agreement called for a 25,000 non-qualified common stock option award, exercisable at \$9.50 per share with a term of 10 years and vesting of 5,000 options per year over a 5-year period. The Company may terminate the agreement at any time for cause; the consultant may terminate the agreement at will. The fair value of the options granted was \$83,400. During the three months ended June 30, 2018 and 2017, the Company recorded stock-based compensation expense of \$4,290 and \$7,400, respectively, related to this stock option. During the six months ended June 30, 2018 and 2017, the Company recorded stock-based compensation expense of \$9,573 and \$16,800, respectively, related to this stock option. In addition, under the terms of the agreement, the Company paid \$21,600 and \$21,600 to the consultant during the three months ended June 30, 2018 and 2017, respectively. The Company paid \$43,200 and \$43,200 to the consultant under the terms of the agreement during the six months ended June 30, 2018 and 2017, respectively.

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

**Note 6. Related Party Transactions, continued**

Pursuant to a property management agreement entered into with SSCP Property Management, LLC, an affiliate of SSCP, SSCP must pay 5% of the monthly gross receipts as a management fee to an entity wholly-owned by the noncontrolling equity interest. On July 31, 2017 this property management agreement was terminated and the Company entered into an agreement with an unrelated third party to provide these services. The expense incurred was \$0 and \$33,066 during the three months ended June 30, 2018 and 2017, respectively. The expense incurred was \$0 and \$66,132 during the six months ended June 30, 2018 and 2017, respectively. No amounts were owed to this party as of June 30, 2018 or December 31, 2017.

**Note 7. Contingencies, Risks, and Uncertainties**

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

A default in the Lease or sudden catastrophe to the Security West Building from uninsured acts of God or war could have a materially adverse impact upon the Company's investment in Security Land and Development Company Limited Partnership and, therefore, its financial position and results of operations (See Note 2).

Royalty, an affiliate of the Company's management, beneficially owns approximately 60% of the Company's common stock. As a result, Royalty has the ability to control the outcome of all matters requiring shareholder approval, including the election and removal of directors and any merger, consolidation or sale of all or substantially all of the Company's assets.

There are many public and private companies that are also searching for operating businesses and other business opportunities as potential acquisition or merger candidates. The Company will be in direct competition with these other companies in its search for business opportunities. Many of these entities have significantly greater financial and personnel resources than the Company.

The Company and the general partner of Security Land are in disagreement as to the manner in which taxable income of Security Land is to be allocated pursuant to the partnership agreement and applicable law, and for years 2004 through 2016, the Company reported taxable income (loss) from Security Land in a manner the Company believes is proper, but which was different than the manner reported by Security Land (See Note 5). This may result in an investigation or other action by the applicable tax authorities and any action taken by tax authorities to resolve this difference could have an adverse impact on the Company's operations and financial results. In February 2016, the Company obtained an insurance policy to protect against such losses, however, it may not be sufficient under all circumstances to cover all potential losses to the Company in the event of any such adverse determinations.

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

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

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

**Note 8. Lease Commitments**

In January 2016, Regency paid a \$201,329 security deposit and entered into a new, seven-year office lease agreement, for a 4,081 square foot space for its New York City location. Base rental payments under this agreement are \$74 per square foot per year, with a 1.75% fixed annual escalation. In addition, the Company is responsible to pay the tenant's share of real estate tax increases above the 2016/2017 base year and electricity usage. A rent concession has been granted to waive the first three months' rent. On the third anniversary of rent commencement, and provided the Company is not in default of any rental obligations, the landlord agrees to reduce the security deposit to six months' base rent, or approximately \$151,000. The lease also contains an early termination clause which is effective after five years, with proper notice and payment of an early termination fee. The office relocated in May 2016, the first month of the lease term. Rent expense for the three months ended June 30, 2018 and 2017 was \$76,853 and \$78,266, respectively. Rent expense for the six months ended June 30, 2018 and 2017 was \$153,765 and \$153,765, respectively.

As of June 30, 2018, future minimum payments under this operating lease are as follows:

| For the Years Ended<br>December 31: |                     |
|-------------------------------------|---------------------|
| 2018 (remainder of the year)        | \$ 155,880          |
| 2019                                | 316,304             |
| 2020                                | 321,839             |
| 2021                                | 327,471             |
| 2022                                | 333,202             |
| Thereafter                          | 111,709             |
| Total                               | <u>\$ 1,566,405</u> |

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

**Note 9. License Agreement**

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

License fee income and related service fees for the three months ended June 30, 2018 and 2017 was \$27,095 and \$26,499, respectively. License fee income and related service fees for the six months ended June 30, 2018 and 2017 was \$63,222 and \$61,831, respectively.

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

The Company adopted a SEP-IRA Plan in 2004. During the three months ended June 30, 2018 and 2017, the Company expensed contributions of \$0 and \$0, respectively, to the SEP-IRA Plan. During the six months ended June 30, 2018 and 2017, the Company expensed contributions of \$117,080 and \$97,558, respectively, to the SEP-IRA Plan. The SEP-IRA Plan covers all employees who receive compensation from the Company during the year. Employer contributions are discretionary and determined annually. In addition, the SEP-IRA Plan allows participants to make elective deferral contributions through payroll deductions.

**Note 11. Dividends**

The Board of Directors has a dividend policy whereby the Board expects to declare a total annual dividend to common shareholders of \$0.25 per share, to be paid in equal, quarterly installments of \$0.0625 per share, provided that the determination to pay any cash dividends for any quarterly period will be made at the applicable time by the Board, in the Board's sole discretion, in compliance with the requirements of applicable law, and with consideration of the Company's future earnings and financial condition and other factors as may be deemed appropriate for consideration by the Board. The dividend policy will remain in effect until the Board determines, in its sole discretion, that it is in the best interests of the Company and its common shareholders to terminate the dividend policy.

In March 2018, the Board of Directors declared a quarterly cash dividend of \$0.0625 per share of issued and outstanding common stock to holders of record as of the close of trading on June 30, 2018, totaling \$299,457, payable on April 6, 2018. The dividend was paid on April 6, 2018.

In June 2018, the Board of Directors declared a quarterly cash dividend of \$0.0625 per share of issued and outstanding common stock to holders of record as of the close of trading on June 30, 2018, totaling \$299,457, payable on June 19, 2018. The dividend was paid on June 19, 2018.

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

**Note 12. Mortgage Note Payable**

On April 18, 2016, the Company, through its subsidiary SSCP, obtained a \$25,250,000 bank note to fund the acquisition of SSCP. The note is a non-recourse debt financing with a ten-year term, 4.95% fixed interest rate, and has a maturity date of May 6, 2026. The note is guaranteed by the owners of SSCP Management LLC, and is secured by all assets of Harrisburg Holdings. The net book value of these assets at June 30, 2018 was \$34,220,726.

The Company paid underwriting fees of \$126,250 in conjunction with the issuance of the note. The fees were recorded as a debt discount and are amortized over the life of the agreement, using the straight-line method which approximates the effective interest method. Amortization of debt discount was \$3,216 and \$0 for the three months ended June 30, 2018 and 2017, respectively. Amortization of debt discount was \$6,217 and \$3,156 for the six months ended June 30, 2018 and 2017, respectively. The only amount due during the first four years of the note is interest.

Under the terms of this agreement Harrisburg Holdings is required to meet and maintain certain financial covenants. The covenant for the six months ended June 30, 2018 is:

Minimum Debt Service Coverage Ratio 1.45 to 1.00  
 Actual Debt Service Coverage Ratio 1.55 to 1.00

As of June 30, 2018, future minimum principal payments due under the note are as follows:

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

**Note 13. Subsequent Events**

Subsequent to June 30, 2018, through the date of this report, the Company received \$2,250,000 in distributions from its investment in MESC.

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

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